Restructuring Reconsidered

Are industry setbacks a death knell for competitive electricity—or a call to action?

Can restructuring of electric markets bring the intended benefits for customers? That's the question experts are asking as customer choice and savings in Pennsylvania, long considered the U.S. model for successful restructuring, have all but disappeared. Plummeting stock valuations and public confidence levels resulting from a string of scandals have heightened concern that the national restructuring effort may be yet another casualty.

"IT'S STILL AN OPEN QUESTION as to whether electricity deregulation can work," says Frederic H. Murphy, Ph.D., an energy industry expert and professor at Temple University.

What's the Outlook for Electricity Competition?

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Murphy notes that electricity's price volatility makes it far riskier to market competitively than natural gas, for example. "I think that in design of the markets and understanding how the players behave, the designers really haven't taken into account the massive increase in risk in this business that has been induced by deregulation," says Murphy. "It's not clear to me that we couldn't have done better with other approaches—re-jiggering regulation rather than *de*regulation."

But advocates argue that it's too early to write off electric restructuring, because a strong model has yet to emerge in the United States. As Ken Malloy of the Center for the Advancement of Energy Markets likes to say, "In the land of the blind, the one-eyed man is king." According to the CEO of the Washington-based think tank, "Everyone else was so far off from having effective implementation of retail competition that Pennsylvania looked real good."

Malloy notes that Pennsylvania and Texas, the most advanced U.S. electric markets, scored 67 and 69 out of 100, respectively, in CAEM's 2002 Retail Energy Deregulation Index. The RED Index is a score for measuring progress in energy restructuring. He points to England, which scored 83 to rank No. 1 globally, as a more promising market.

According to Malloy, successful restructuring in the United States will depend on policy integration both vertically, between federal and state regulator, and horizontally, between each state within a given regional transmission organization (RTO). But that's not to say that the federal government must lead. Instead, Malloy says, the feds have two roles to play: creating a workable RTO structure, and facilitating the successful implementation of retail strategy by the states.

FOR THAT TO HAPPEN MAY DEPEND ON THE INDUSTRY taking another look at the intended benefits of electric competition. Murphy is doubtful that it can deliver the expected customer savings. "On average," he says, "electricity could just wind up more expensive everywhere with deregulation, just because the cost of capital has to reflect the risk, and the risks are high in this business."

But Malloy sees broader potential benefits. He foresees a market in which an aggregator of such services as electricity, natural gas, cable and even lawn services will become a services manager, selling for instance, "air conditioned to 72 degrees F," but providing that service through whatever appliances and commodities it deems optimal. Says Malloy, "We're fighting for a technological revolution and a service revolution; we're not fighting to save somebody $5 on their monthly electric bill."

Though prospects look grim, even in Pennsylvania, where most alternative suppliers have dropped out, Malloy remains optimistic. "Sometimes it takes a two-by-four to the head to make somebody recognize what needs to be done. I think we've been hit by 20 two-by-fours over the last two years," he says. "Out of crisis will come some deeper recognition that we need to do something."

—Regina R. Johnson