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Re-Energizing Competition



By Ken Silverstein
Director, Energy Industry Analysis

Retail competition in the electricity industry has not failed but it has definitely "ground to a halt" in the last few years.

That's the word from the fourth edition of the Retail Energy Deregulation Index (RED Index), which shows that states have sidelined their plans to free up their electricity markets in response to the California and Enron debacles. The index, issued Tuesday by the Center for the Advancement of Energy Markets, says, however, that some states are permitting their regulated utilities to offer choices to consumers—a positive development that the center says will enlighten customers and prove the benefits of deregulation.

"We are still in the second or third inning," says Ken Malloy, CEO of the group. "Deregulation will either prove itself or not. Right now, the issue is largely theoretical. I am a great believer that markets work. And they can work for electricity. We just need to create an effective model."

Texas leads the way in the United States with a score of 69. It is followed by Pennsylvania, Maine, New York, the District of Columbia, Michigan, Maryland and New Jersey, all with a profile of 50 or greater. By comparison, England ranks first among all jurisdictions with a score of 88 while New Zealand posited a ranking of 75.

Alberta leads Canada with a 61 although its sister city, Ontario, scored a 33, which comes as a result of price caps it imposed on marketers in December 2002. Finally, Victoria leads Australia with score of 50. England did well, says Malloy, not only because it got started in the early 1990s and has had time to revise its model but also because it has eliminated price caps on all residential customers.

Virtual Choice

The RED Index is a reference tool that measures the progress states are making in moving from the monopoly model of public utility regulation to the competitive model. The index is based on 22 attributes that the center's advisory board—made up of utilities, marketers and scholars—has identified as the foundation for an effective transition to competition.

Once those parameters are set, its researchers work with each state public utility commission to gather the data. The national index that consist of all 50 states and the District of Columbia has risen from a score of "one" in 1997 to a score of 17 in 2002. It has remained flat for the last year. A score of zero means that states operate under a traditional set of utility policies whereas a ranking of 100 represents complete and effective implementation of policies necessary to achieve customer choice. The median score is four.

Obviously, states are seeing how deregulation plays out in other areas, like Texas—a better tack than "just saying no," says Malloy. "No one is disadvantaged by what a state may do in the future, but they are if a state says that it will not do anything." The nation will remain bifurcated "for quite some time," he adds, although "I don't think any of the states with a score above 50 will turn back."

Just what criteria are being used to come up with these scores? For example, the model attempts to look at just how comprehensive deregulation is as well as the percentage of customers who are eligible to switch versus those that have done so. It furthermore reviews the policies in place that ensure alternative providers are playing on a level playing field. Along those lines, the index examines the information systems in place to facilitate switching and the ways in which customer information is shared. Meanwhile, efforts to educate consumers are evaluated.

Current market conditions have caused some states to experiment with "virtual choice," which is allowing consumers to pick from a richer menu of options added to the distribution utility's traditional offerings. According to the RED Index, Oregon has taken the lead on virtual choice by giving customers the chance to use renewable energy plans that rely on existing geothermal and wind sources as well as providing time-of-use rates.

"If the alternative is to do nothing, then virtual choice makes sense," says Malloy. At one point he balked at the concept, saying that it stood in the way of all-out competition. But as states now take a wait-and-see attitude, Malloy says that it is a good interim step. "Customers can start to understand that there are many variables that can be applied to the decisions they make."

Better Values

To be sure, a lot of state regulators and consumer groups say that the push to deregulate the electric utility sector has destabilized markets and raised rates. The Consumer Federation of America says that market manipulation, inefficient transactions costs and a sharp increase in the cost of capital—all tied to deregulation—have swamped any benefits. Rather than "charge ahead," it says, policy makers should "step back" and examine the earliest experiments with deregulated electricity markets.

About 25 jurisdictions in the United States have deregulated. But a handful of states, including Arkansas, Montana, Nevada, New Mexico and Oklahoma, are considering delay, or have already done so. California has completely reversed itself. The central focus among all skeptics will be whether the new systems produce an overall benefit to consumers or whether deregulation and electricity are anathema to one other.

Proponents of deregulation would admit that some of the earliest trials have foundered or failed, particularly in California. An apt comparison, they say, is to England's model. Moreover, success is not necessarily measured by whether rates are lower than before deregulation but by whether they reflect true market conditions. The ultimate goal is whether consumers have ample choices to better suit their lifestyles, they add.

Take Centrica: Since its spin-off from British Gas and its subsequent formation in 1997, it has been on a quest to gain customers globally. Besides the 19 million customer accounts that it has in Great Britain, it has become active in six U.S. states as well as the provinces of Ontario and Alberta, Canada. Its business model is to offer top-rate customer service and to use its goodwill to sell such additional services as telecom and financial products.

"Price is an important driver, but it's not the only one," says Lois Hedgpeth, president of U.S. operations for Centrica North America. "Quality of service and flexibility are also key factors in the customer's choice to switch."

Despite the fact that deregulation has stalled, the Center for the Advancement of Energy Markets and others say that Centrica's message will eventually resonate and that customers will adapt to a new way of doing business. Free markets can work, they say, but past lessons have shown that it takes a commitment and well-established framework.

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