Deregulation in California, One Year Later:

LOCAL POWER NEWS

Without Community Choice, No Consumer Choice

by Paul Fenn

When California's electric deregulation bill, AB1890, was passed in September 1996, it was heralded as a national model for other states to imitate; it would deliver a "rate reduction," and put an end to monopoly. Proponents claimed it would foster Green Power development, and with it a competitive, consumer-responsive, and cleaner energy industry. Today, a year after AB1890 went into effect - and after many states did in fact imitate California - only 7/10 of one percent of Californians are participating at all in the deregulated market, leading many to call AB1890 a dismal failure in supply side economics.

There are two major contributing factors: the law's stranded costs bailout, and its prohibition of Community Choice.

First, California's $28.5 billion, 118% stranded cost bailout has attached a "Competition Transition Charge" (CTC) to all bills which amounts to nearly half of the bill - irrespective of who is buying or selling it - reducing the energy portion of monthly electric bills to such a small margin that energy companies cannot offer savings that exceed the transaction costs of serving residents and small businesses. In effect, no one can beat the "Power Exchange" price to which consumers are defaulted (through their old utilities) if they cannot find a provider. The stranded costs factor is temporary, however, lasting only as long as it takes to pay off the utilities.

The second major factor preventing competition in California's deregulated market is a permanent feature of the structure of the industry: its prohibition of Community Choice. Community Choice is the right of local governments, established in Massachusetts, to aggregate on behalf of their residents and businesses on an "opt-out" basis (consumers wishing to find their own supplier may opt-out of the municipal contract), forming in effect one large consumer which can wield market power in the electric industry, securing better prices for residents and businesses and enabling communities to make unprecedented, high-impact decisions regarding renewable energy and efficiency.

It should be emphasized that the rights of local governments to aggregate were restricted by statute in spite of franchising authorities established in California's constitution. Section 19 of the California constitution provides that "any municipal corporation may establish and operate public works for supplying its inhabitants with lights, water, power, heat, transportation, telephone service or other means of communication. Such works may be acquired by original construction or by the purchase of existing works, including their franchises, or both. **Persons or corporations may establish and operate works for supplying the inhabitants with such services and operate works for supplying the regulants with such services upon such conditions and under such regulations as the**

municipality may prescribe under its organic law, on condition that the municipal government shall have the right to regulate the charges thereof."

Indeed, early on in the debate, California's cities were vocal about their franchise authorities, and lobbied state legislators to respect those rights in any restructuring legislation. "Cities should continue to have the authority to issue franchises and any program should be at least revenue neutral relative to revenue currently received from franchises," announced the California League of Cites in June, 1995.

More than merely assert the right of Community Choice, or "opt-out" aggregation, the League asserted that their franchise rights gave local governments the **exclusive authority** over power providers within their jurisdictions. "Under any restructuring program, local government should have the authority to become an aggregator to negotiate the purchase of electricity with electricity suppliers for their customers. The decision of whether the individual customer within a local government jurisdiction should have the option to purchase power directly from an electricity supplier should be made by the local governing body, consistent with the principle of local control."

By September, 1996, however, it was clear that the legislature would not recognize these rights, and the League of Cities became strangely silent on the issue, meekly endorsing legislation which curtailed the franchise authorities of local governments by restricting their aggregation to an "opt-in" approach, and denying outright that the legislation was harmful to local governments.

There is in fact a prehistory of municipal activism in the electric industry which partly explains why Community Choice was prohibited in AB1890. Prior to its passage - indeed prior to the restructuring debate itself, the city of Palm Springs had been active for a number of years in an attempt to separate its community from Southern California Edison's system by means of a "Muni Lite" proposal presented to the Federal Energy Regulatory Commission (FERC). In it, Palm Springs claimed that sundry distribution facilities owned by the city qualified Palm Springs as a "municipal utility" with rights to buy and sell power as a wholesaler within its jurisdiction. The intention of "Muni-Lite" was to enable the city to open up competitive bidding among alternate power suppliers to serve the businesses and residents of Palm Springs.

With staunch opposition from Southern California Edison and Pacific Gas and Electric, the FERC eventually rejected Palm Springs' claim as a "sham wholesale transaction" in the months just prior to deregulation, mainly on the basis that it would interfere with the state legislature's efforts to negotiate a deregulation "stakeholder agreement."

AB1890, which was the result of those negotiations, severely restricted cities from getting very involved in the deregulated market. Proponents of the legislation said it was modeled on long distance telecommunications deregulation, under which individual consumers have enjoyed a significant choice of service providers seeking their business (many have since demonstrated that telecomm deregulation has also hurt small consumers). Under the telecomm model, the very act of allowing competition would **deliver** choice to consumers. Few questioned whether power suppliers would compete for any consumer's business.

Regarding Community Choice as a form of "slamming," the legislation treated municipal or county aggregation as no different from commercial aggregators, requiring that communities seeking to purchase power collectively sign up each consumer individually. This has come to be known as "opt-in" municipal aggregation. The logic of this provision was that because consumers would have choice, any municipal intermediary role would interfere with this choice.

It soon became clear, however, that residents and small businesses in California had been locked out of an uncompetitive market. Only months after California regulators claimed its market was "open to competition," and a despite spending $10 million in marketing and advertising in California, dereg champion Enron Corporation had signed up only 30,000 customers (a $333 per customer marketing cost), announced "it's virtually impossible to make money" on small customers, and scaled back its efforts to market power to residents and small businesses. San Francisco-based Working Assets, expected to play a significant role as a green power marketer, said it would not enter the California market. Since that time, virtually all "consumer choice" in the state has been restricted to large corporate consumers such as the California Manufacturers' Association, McDonald's, Jack in the Box, etc..

"Green Power," whose alleged promise was a selling point for deregulation itself, proved no less disappointing under "Consumer Choice" economics, which reduced it to a niche market for wealthy consumers. One-third (33%) of California's residential consumers would have to sign up for a 100% renewable energy product, just to subscribe what the state already has in place. Yet, ten months after the market opened and after tens of millions of dollars in advertising, less than 0.4% of residential consumers (about 25,000) have subscribed to green products that contain from 50-100% renewables.

The reason: transaction costs required to sign up green consumers render it uncompetitive. Green marketers have stated publicly that it costs $100 in advertising and marketing costs just to acquire a new green customer - over 15% of an average consumer's total annual electric bill.

Meanwhile, green marketing efforts are aimed at the residential sector, which comprises only a third of electricity sales. Of the other two thirds of electricity sold, few commercial and industrial customers will place themselves at a competitive disadvantage by paying for higher cost power when their competitors don't.

Community Choice advocates had predicted this outcome from the outset. By setting community standards for renewable energy and efficiency, Community Choice spreads the cost of green investment across all customer classes and bypasses prohibitive marketing costs. Green Citizens are the key to a renewable future: Green Consumers represent only the gentrification of renewable energy.

The state's anti-Community Choice provision has both discouraged cities from attempting to aggregate on behalf of their communities, and has crushed one determined city's efforts to aggregate under its "opt-in" requirement. The city of Santa Monica recently voted to power its city facilities with 100% renewable energy, but was prevented from including residents and businesses in the mix. After losing its "Muni-Lite" fight, Palm Springs remained determined to aggregate on behalf of its community, and signed an agreement with Enron to market "Palm Springs Energy Services" electricity to each individual resident and business on an "opt-in" basis. After an early mailing to Palm Springs' 29,000 residents and businesses, a strong 30% "interested" response (9000 consumers) boosted the city's confidence that it would be able to meet the 25% of market benchmark with Enron to lock in the contract. "But when we called them back, they didn't respond," said Art Lyons, who headed up the efforts. In the end, only 8.5% of Palm Springs' customers signed up with the city. "We tried a TV and radio blitz in September, and got a few more customers, but not enough." Enron has indicated it can "no longer afford to subsidize Palm Springs' rates," and may raise its prices to match the State's Power Exchange.

As California's deregulated market has proven itself a failure for 99.3 percent of Californians, and as obstacles facing Palm Springs' opt-in aggregation effort has proven insurmountable, a number of California cities are finally coming around to challenge the anti-Communty Choice provision. The city of Berkeley passed a resolution asking the legislature to pass a Community Choice amendment in 1998, and a number of other cities will likely follow suit in 1999.

While California's advocacy community has focused the greater part of its efforts on fighting the stranded costs bailout, some observers now feel that the anti-Community Choice provision will prove even more devastating in the long term. Whether one is concerned about consumer protection, market power, renewable energy, or energy efficiency, Community Choice, or "opt-out" municipal aggregation, is critical to the public interest in a deregulated electric industry.