Wholesale Electric Restructuring: Was 2004 the ''Tipping Point''?

Whatever happens, it is doubtful that we will ever return to the now almost touchingly naïve faith in open access transmission and competitive wholesale power markets that characterized the electric utility industry just a few years ago. Too much ratepayer blood and investor red ink has been spilled and too many expectations have been dashed. It may be time to ask whether we should continue down our current electricity policy path, or seek out a new direction.

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These three characteristics—one, contagiousness; two, the fact that little causes can have big effects; and three, that change happens not gradually but at one dramatic moment—are the same three principles that define how measles moves through a grade-school class room or the flu attacks every winter. Of the three, the third trait—the idea that epidemics can rise or fall in one dramatic moment—is the most important, because it is the principle that makes sense of the first two and that permits the greatest insight into why modern change happens the way it does. The name given to that one dramatic moment in an epidemic when everything can change all at once is the Tipping Point.

–Malcolm Gladwell,
The Tipping Point: How Little Things Can Make a Big Difference *(2000)*

I. Introduction

Looking back on 2004, it might well be the year the electric industry reached the ''tipping point'' on wholesale restructuring. In 2004, it became abundantly clear that the Federal

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Energy Regulatory Commission's Standard Market Design (SMD) rulemaking,[1] even after being repackaged by FERC as the Wholesale Market Platform (with the most unfortunate acronym of WMP),[2] was really dead, and no final rule would be forthcoming.[3] 2004 similarly saw the beginning of FERC's renewed interest in reviewing and enforcing its once-passé Order No. 888 Open Access Transmission Tariff (OATT).[4] It was the year that those polar opposite organizations, the American Public Power Association and the Cato Institute, actually appeared to agree that something had gone awry during the electric industry's wholesale restructuring, and that simply continuing down the current regulatory path would not be wise.[5] A new consensus appears to be developing—one that says the industry must step over the wreckage of SMD and FERC's failed efforts to form regional transmission organizations (RTOs) in those regions that do not have them (and likely will not soon) and must reexamine the efficacy of the RTOs in those regions that do have them—all with the goal of finally cutting the Gordian knot of regulatory uncertainty that has dogged the industry. How did this change happen, and why? This article will attempt to identify some of the economic, regulatory, and political forces that coalesced in 2004, and suggest how the industry might proceed from here.

II. Independent Merchant Generators Had a (Near) Death Experience

While the financial woes of the independent generator sector started prior to 2004, perhaps the most startling sight of last year was watching many independent (and even affiliated) generators leave the merchant generation sector stage left, with incumbent investor-owned utilities, lenders, hedge funds, and other financial institutions entering stage right. The plugs were pulled on planned and pending projects,[6] existing projects were sold to local incumbent utilities,[7] lenders stepped into the shoes of or propped up existing market players,[8] and merchant competitors vacated entire regions.[9] Certain of the merchant generators that have survived the turmoil now have a stronger focus on long-term bilateral power purchase contracts, and are pursuing very different business models than a few years ago.

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The testimony of a representative of CitiGroup at FERC's June 10, 2004, Technical Conference on solicitation processes for public utilities encapsulated the wreckage the merchant sector implosion has wrought: he recommended that FERC *not* bar incumbent investor-owned utilities from purchasing distressed generation projects (notwithstanding the increased regional generation sector consolidation such purchases would bring), because ''precluding utility purchases of merchant power assets will reduce the universe of potential investors in such assets, and thus competition will decrease for investors seeking to optimize recovery of their investment.''[10] When the ''competition'' in the generation sector that FERC is advised to foster is competition for purchases of foreclosed or distressed generation assets, something has gone badly wrong with FERC's wholesale competition vision.

The decimation of the merchant generator sector calls into question FERC's wholesale electric restructuring regime, because it was effectively built around and for merchant generators. FERC was correct in commencing in 2004 a ''bottom up'' review of all four prongs of its current market-based rate

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