Energy Innovators: Ringing in an Age of Enlightenment

Six executives map out the technology, tools, theories and institutions that could change the face of electricity forever.

By Richard Stavros, Regina R. Johnson and Bruce W. Radford

"LIBERTY IS THE MOST IMPORTANT COMPONENT OF enlightenment. Once a person frees themselves ... they will not only be on their way to becoming a free thinker themselves, but they will also spread the word to others about the value of attaining enlightenment."

Though Immanuel Kant was writing in 1784 to define his own age of enlightenment, he just as well may have been describing the early results of electric deregulation and the liberty it is giving energy executives to enlighten the industry with new innovations.

Five years ago, the technologies, companies, markets and institutions being developed by the innovators profiled here did not exist and would not have existed had it not been for their determination and enlightened vision of the future of electric competition.

Many historians believe the ideas of the Enlightenment provoked both the American Revolution and the French Revolution. Will the innovators profiled here be the architects of a revolution yet unseen in the electric industry?

The *Fortnightly* spoke to some of the most innovative people we have come across in the areas of business, technology and policy. —R.S.

Ken Malloy—Policy Guru, No Strings Attached

First a professor, then lawyer, economist and consultant, this philosopher returns to his roots to guide regulators and legislators on energy restructuring.

"THOSE WHO KNOW ME WELL KNOW THE DEPTH OF FEELING I have for the energy industry," says Ken Malloy. "The day I start having to make compromises to kowtow to a funding source is the day I'll hang it up."

That's how a one-time federal policymaker found himself drawn this past summer to found the Center for Advancement of Energy Markets, a nonprofit think tank designed to be independent from industry stakeholders (www.energymarkets.org). With no excess baggage to carry, CAEM would pull no punches in advising state and federal regulators and legislators on how to foster competitive retail markets for gas and electricity.

"Industry restructuring at the retail level is phenomenally more difficult than anything we were dealing with at the wholesale level during my days in the federal government," Malloy explains.

"You've got three classes of customers—large industrial, medium commercial and mass market residential—each with very different needs. So you're going to need three different revolutions to prepare the retail market. Add to that the complexity of restructuring in 50 different states, and the tremendous influence that incumbent utilities can exert in state PUC proceedings, by contrast to cases before the Department of Energy or the Federal Energy Regulatory Commission.

"All of this led me to conclude that retail competition wasn't working the way I'd hoped, and was going to require a lot more work than we first thought."

At press time, Malloy was preparing the first set of initiatives at the newly formed CAEM, aimed in no small part at securing funding to allow him to offer services to public servants without regard to depth of pocket.

Can a think tank survive without tying itself to a group of stakeholders? Malloy believes that his Center can do just that. —B.W.R.

Your career track seems a bit unusual. How has it prepared you for your work at the Center?

My career path might seem chaotic, but it actually makes a certain amount of sense. The consistent theme has been a desire to understand the tension between government control and market behavior in network industries. How do you regulate network facilities and yet avoid distortion of markets? If someone could figure that out, they might deserve a Nobel Prize. Certainly for me it has been the most challenging intellectual problem—how to regulate the network and yet at the same time create competitive markets for the products and services that come out of those networks.

When did you start this quest?

I began as law professor in the late 1970s at Western New England School of Law, focusing on the economic regulation of industry.

That was good timing, don't you think?

Yes, it was a very fertile time. We had just passed the Natural Gas Policy Act and airline and trucking decontrol, and there was debate between Carter and Reagan on the role of government. I came out of that experience more convinced than ever on the efficacy of markets. I went from being a Ralph Nader liberal to a Milton Friedman conservative.

So when Reagan was elected I came to Washington in 1981, to the FERC, and got so enmeshed in energy deregulation [wellhead decontrol, plus the FERC's Order 436 on gas pipeline open access] that I've stayed in that field for going on 20 years now.

From there I went over to the Illinois Commerce Commission with the idea that action would move to the hinterlands. I didn't anticipate the 10-year lag before the things we were doing at the FERC would be ripe for decision by the states. So I returned to the DOE, working [again] on wellhead decontrol, oil pipeline deregulation, and the recommendations in the National Energy Strategy that would become FERC Order 636 [mandating open access for gas pipelines].

By 1992 I had started to work closely with NARUC (the National Association of Regulatory Utility Commissioners) in planning the five DOE-NARUC natural gas conferences to help open policy discussions on how far the states could go in allowing customers to select their own gas supplier. At the same time, Dave Meyer at DOE was putting together the DOE-NARUC electricity conferences. And now here we are, both David and myself, both working at the Center for Advancement of Energy Markets.

Didn't you put in time at private consulting?
Three years ago I left the DOE and moved to Hagler Bailly, continuing to work in the field of retail energy restructuring. But during that time I came to the very disappointing conclusion that retail restructuring was going to be phenomenally more difficult than anything we were dealing with at the wholesale level.

It sounds like you target regulators as your new clients.
My only quibble is with the word "clients." I see myself working a lot with state commissioners but I don't necessarily see them always paying for the work. We designed the Center as a 501(c)(3) nonprofit educational organization with the idea that we could go to foundations to seek funding for difficult challenges like retail energy restructuring.

Do you work with legislators, too, or just lobbyists?
No, we'll be working with legislators too, but the job is more difficult, since lawmakers are besieged by a large array of different stakeholder interests.

"We'll be an equal opportunity offender ... a promoter of markets."

How do you distinguish your Center from the National Regulatory Research Institute in Columbus, Ohio?
NRRI is the research arm of NARUC, and NARUC has to be viewed as having an interest in the outcome of the debate. I don't want to be too crass about it, but [their] jobs are on the line.

By contrast, we have a singularity of focus at the Center—a dedication to the truth. Our sole mission is to promote a competitive model. And that means that sometimes we will agree with the utilities—one example is social-benefit programs. You cannot continue to overlay these programs on the utilities and expect them to deal with competition.

And we may side with marketers sometimes—against the utilities and perhaps even against consumers. The same goes for conflicts between state and federal regulators. We'll be an equal opportunity offender—but always an unabashed promoter of markets.

Will you take positions or just lay out alternatives?
Absolutely we will take positions. Those that know me well know the depth of feeling I have for the energy industry. The day I start having to make compromises to kowtow to a funding source or the like is the day I'll hang it up.

What about financial incentives to jump-start markets?
You need to take very aggressive steps in the early stages to promote customer choice. You need to think about shopping credits that are higher than a cost-based threshold. Right now you have a classic David-and-Goliath problem where the new entrants have to attack markets all over the country, but the utility only has to defend its home market and can therefore spend enormous amounts of money in one place.

For example, I'm an unabashed advocate of what Georgia did for their gas market. They added a provision so that when a third of customers switch to a third-party supplier, then the remaining two-thirds get allocated among those suppliers in the same proportion as the first third. That attracted the marketers.

What about federal legislation? Will it do any good?
The current legislation on the Hill, as it relates to retail competition, with ideas like a date-certain coupled with an opt-out provision [let's ignore PURPA repeal or PUHCA reform for the moment], is worse than useless. It's designed to convince the lawmakers in Congress that they've done something when in reality they will have done nothing.

Frankly, in my judgment, Congress could do nothing better at this early stage in restructuring than to make sure that the DOE dedicates a significant amount of both leadership and resources to helping the states meet the challenge of gas and electric restructuring.

My biggest disappointment is that the DOE has not seen fit to help the states at this task, so the states don't have to re-invent the wheel 50 times. We got off to a good start with that, with the DOE-NARUC conferences, but as far as I can see, there has been very little true partnership between the states and the Department of Energy on retail competition.

Do you see Congress passing a bill? If not, where do we go from here?

Certainly nothing will happen this year of any consequence affecting retail competition. But the real question is how much do we need a federal presence?

I think we're at a stage now that it makes sense to give the states wide latitude to experiment and to let a thousand flowers bloom, as the saying goes. But that can only go on for a limited period of time. Ultimately we're trying to create national markets. Eventually we'll need a high degree of federal involvement.

Of course, there is a balance. You don't want to blunt innovation and creativity. We don't know where that dividing line is right now, but that is the dividing line we ought to be trying to find. F

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