Competition is Dead! Long Live Competition! (Part 2)

April 13, 2016

Missed Part 1? [View it here](#).

In my last column I looked backward and talked about past forays into competition within the electricity sector.

Now it is time for me to toss out my thoughts on where we are going from here.

Let's begin by imagining that you are the top person at a utility (let's assume for the moment that it is an investor-owned utility). Here are a couple of things that are on your mind.

First, you understand that climate change is going to change everything. Not only is it going to change the electricity demands on your system and the way that you and others meet that demand, but it is also going to provide challenges to the one business that would seemingly be yours for the foreseeable future - running a resilient, adaptive wires system in the face of increases in extreme weather events.

Second, you understand that the present transformation of the electricity sector is like nothing it has seen before. It is not like opening up competition among generators or the deregulation/restructuring that introduced retail competition. You realize that this is all about technology, and unlike those other changes that were exercises in policy and economics, the new technologies cannot be held back.

You are also trying to answer three questions:

1. How do I make sure that none of my present investment is stranded by the introduction of competition in a way that simply leaves that sunk costs to be eaten by my company?
2. How can I improve or at least preserve my primary, regulated business and prevent it from being diminished by the introduction of DER and other things that are starting to happen on the "other side" of the meter?
3. How do I improve the return on my shareholders' investments? Can I do so by getting performance-based regulation on my regulated business? Should I step outside of my regulated business and get in on the party that seems to be happening on that other side of the meter?

The first question is a matter of policy and fairness that I have discussed in past columns, but it is also an important matter when it comes to competition in DER and other related areas. If utilities and their customers have sunk costs that were approved by regulators, then those costs are on the face of it ones that need to be covered, and not stranded. This means that the present fleet of power plants can't necessarily go away overnight. The latest development on this front is the approvals in states in the Midwest of deals that provide a secure revenue stream to existing Duke power plants and keep those plants in operation.

But large power plants are not really in anyone's future and so going forward the stranded investment arguments will be about costs on the distribution system. The widespread debate and early policymaking on fixed charges and new non-variable elements of a customer's bill needs to continue and things need to get resolved. Utilities should not get a free pass in this debate by any means, but they should not get screwed either, no matter the temptation to foster "instant" competition by doing so.

The second question involves utilities being in a situation where they have to keep their present business going while also trying to pivot for the future. Keeping the present business humming along requires a lot of effort, which can distract from and make more challenging the introduction of new products and services. And the fact that policy is only just beginning to evolve does not make it any easier. Take the case in New York, which is moving under its REV proceeding to introduce distribution management platforms. The regulators there have made it clear that the utilities will not automatically be the ones to manage these platforms, and if they do get to do it there will be a lot of restrictions on them.

One logical response for utilities is to fight in the policy arena against anything that would threaten or diminish their existing business. The other, which I think is the winning course of action, would involve utilities embracing partners that will help them offer new things to their customers. This means utilizing their strengths in their core business while bringing into play the strengths of new players with new technologies, products and services - all of whom can compete for the chance to partner with the utilities.

But no matter what technologies and services they offer, a utility is going to have to compete to keep its core regulated business and its regulated customers and prevent them from becoming the equivalent of the "cord-cutters" in the world of telecom. While electricity customers will not literally go off the grid like folks are doing by tossing out their landline phone and cable service, they will look at the opportunities presented to them on the other side of the meter and compare them to what they are getting from the utility. And the comparison will not just be on price but also quality and other non-price aspects.

The third question is the most intriguing one. What kind of things should I as a utility take on that will make my company a viable, modern business that creates good returns for my shareholders?

We are already seeing moves being made in different states to look at PBR (that's Peformance-Based Ratemeking for those of you were suddenly thirsty for a tall-boy). We are also now seeing utilities moving to the outside. Southern Company has acquired a DER company. Edison International, the parent of Southern California Edison (SCE), just started up an unregulated consultancy to help large customers with energy management and other things.

Taking energy management consulting first, this would seem like a natural fit for utilities. But there are a lot of non-utility companies out there, particularly in the ESCO sector, who might say they are doing this already. These companies will want to make sure that that there will be a hard wall between the new affiliate and a utility doing this.

Moving to DER, this is where a lot of the action will be. Utilities have been quick to learn that there doesn't seem to be any technological reason they cannot do DER. Maybe they can do it as part of their regulated business as SDG&E did with its Borrego Springs microgrid project.

But it is more likely for DER as a business opportunity to be a non-regulated business, like what NextEra did with solar and Constellation did with retail marketing. Utilities will have to make a serious leap into these outside businesses. If they really want to do it they probably need to look at bringing new people in or partnering. But because others can supply DER, the business will have to be competitive.

The reasons not to let utilities into these non-regulated areas would be the usual (i.e., market power, use of existing assets, using data on customers, existing brand power, etc.) But those issues can all be solved by policy. Once they have, a utility DER company would be able to compete directly against other DER companies.

But things are not going to be as simple as dividing everything above into questions two (new things done by the regulated utility) and three (new un-regulated endeavors). It is going to get a little fuzzy when it comes to some types of DER. In the case of demand response, you have a DER that regulated utilities already provide and manage. While demand response in its supply form is a DER, it has the "duality" feature of also being something that can modify demand and optimize the way a system operates. When you look at this latter function, it is natural for utilities to do that.

In the case of microgrids, the question is embedded in that name and concept. A microgrid is really a mini-system, complete with a little bit of generation, a little bit of demand management and an ability to actively and optimally manage the system. That is what utilities do now on a system basis. But again, can the regulated utility provide microgrids to its customers as a supply option without non-utility entities having a chance to compete against it? Does the utility have to accept microgrids on its system like it had to accept PURPA supply projects? If so, can the utility be in an unregulated microgrid business and compete to provide the microgrid to its customers? I think the answer to all of these questions is yes, but the details and rules would of course be a challenge.

And the real tricky business may be "gardens", which are beginning to sprout across the country. The idea of solar or storage "gardens" is akin to what utilities have always done from the standpoint of system operations, i.e. look at communities as aggregations of customers to be served. But gardens and microgrids could be considered crossing the competitive line in that they are not just operating a mini-wires system but the generation sources on that system. In that vein, shouldn't others have a chance at providing generation for that community? This is why gardens may be the wild card as we move forward.

Whew...there is a lot to think about here, isn't there? I have a lot more I could say, including about competition between different types of DER and what kinds of businesses utilities should not get involved in. But having let this column get a little long, let me give my brain a rest. Stay tuned for more.