Power Sector Reform: Codes of Conduct for the Future

One model for the electric distribution utility of the future would allow it to compete in the market and provide energy services to supplement its revenues. To make competition fair, strict enforcement of codes of conduct and some form of separation are paramount. A well-written code will prevent discrimination in service provision, sharing of competitive information among affiliates, and cross-subsidization.

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I. Introduction

A power sector transformation is underway, driven by new opportunities for customers to provide resources for the grid, and new developers of these services. Key to this will be the role of the utility and protection of the competitive market. Historically, electric utilities had a monopoly over the generation, transmission, and distribution of electricity to customers. In exchange for this exclusive franchise, utilities were regulated by state commissions to ensure that the rates charged were fair, just, and reasonable, and that adequate service was being provided. The Public Utilities Regulatory Policies Act (PURPA) modified this monopoly by allowing a limited opening of the market to competitive generation. This permitted qualifying facilities (QFs) constructed by non-utility entities to sell their output to their local utility, which was obligated to purchase the

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power from QFs at its avoided cost. This was later expanded to create wholesale competition where independent power producers (IPPs) could sell power to utilities under long-term power purchase agreements and, later, into organized markets. Once the door opened to competitive wholesale generation, many states restructured their electricity industry to permit retail choice so that end users could select their supplier.

With the advent of retail competition and emerging new technologies, residential, commercial, and industrial customers are taking more control over their energy usage and exercising choice through energy efficiency, demand response, and distributed generation resources. New businesses providing equipment and service aggregation are developing to help either through the utility, or working with customers directly. Seventeen states and the District of Columbia, among others, have adopted retail choice (US Energy Information Administration, 2012). While this is good news for customer choice and from an environmental perspective, many in the utility industry are raising the concern of declining sales, which are the foundation of utility revenues. State utility regulators across the country, notably in New York, California, and the District of Columbia, among others, are exploring a variety of utility business models, rate designs, and other mechanisms to balance utilities' revenue requirements to maintain grid reliability with providing incentives for customers to engage in clean energy solutions, meeting public policy goals, including the Clean Power Plan and other environmental regulations, and ensuring equity among participants and non-participants in distributed energy resources (New York Department of Public Utilities, 2015; District of Columbia Public Service Commission; California Public Utilities Commission).

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While many models will emerge regarding the role of utilities in the future, two have taken center stage. In one model, the electric distribution utility (EDU) becomes strictly a wires company that manages the activities and services provided by other companies across its wires. In the other model, the EDU is permitted to compete in the market and provide energy services to customers to supplement its revenues. This not only may make utilities less reluctant to support power sector reform, but also recognizes the utilities position to provide economies of scope.

If utility participation in the competitive market is going to be part of the solution, however, policymakers should reflect on these two points:

- In order to create a fair and functioning market devoid of cross-subsidies from captive customers, some form of corporate separation and strict enforcement of codes of conduct are paramount;
- Allowing utilities to compete in the competitive market is not the panacea for solving the concern of reduced utility revenues due to customer choices/empowerment, unless the parent or holding company under corporate separation is willing to accept the reductions in revenue in exchange for opportunities in the competitive market. This is unlikely, as typically each business unit has to stand on its own merit. Failing to address EDU revenue shortfalls is not sustainable in the long run, as the EDU needs sufficient funds to operate and maintain a reliable grid. Other mechanisms will still be needed to address utility revenues, including new rate designs and more emphasis on cost-effective EDU operations and efficiency. Under functional separation, the concern shifts to the risk to core customers if the utility is relying on revenues from competitive services to maintain the core system.

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