



California Public Utilities Commission
505 Van Ness Ave
San Francisco, CA

November 28, 2017

Dear Commissioners,

Any retail choice market must be well-designed to bring looked-for benefits and must be designed to be compatible with the other regulatory efforts in California. In particular, retail competition must not undermine efforts to cost-effectively transition to renewables, including deploying Distributed Energy Resources, send perverse price signals that make the energy system more expensive, or allow market participants to distort the market.

Several key conclusions arise out of these principles:

- 1) A Distribution System Operator must coordinate distribution services and markets to ensure that the activities of no retail provider undermine reliability, and to act as a guarantor that customers have continued access to fundamental services whether or not retail entities perform or go out of business.
- 2) Delivery charges must be tied to the contributions to the drivers of delivery infrastructure costs, especially new transmission build. If charges do not reflect the proportional cost contribution of resources, the market will drive overuse and overinvestment in unpriced resources. Transmission charges unequivocally must be tied to the use of the transmission grid by charging for energy downflow at the Transmission-Distribution Interface. Flat fees are contrary to use reduction and efficiency incentives, and will incentivize inefficient or excessive use and necessitate overinvestment and associated ratepayer costs.
- 3) Retail markets must have a backstop entity to offer basic services to customers under regulated tariffs and to act as a backstop purchaser of energy and energy services for providers.

Retail Choice will be strengthened with a Distribution System Operator to coordinate distribution system management.

A Distribution System Operator (DSO) will be needed to ensure that the uncoordinated actions of a multiplicity of retail providers do not degrade reliability at the distribution level. Several speakers emphasized the risks that the grid would incur should multiple retail providers fail simultaneously or otherwise simultaneously respond to market signals in such a way that degrades reliability without accountability. A critical component of any retail choice market is to have entities in charge of both transmission and distribution management to ensure that critical functions are not abandoned. As several speakers emphasized, left to their own devices, retailers could cause market (or grid) instability if they were to fail as a group (for example in response to events in financial markets) or to abandon contracts in response to conditions. While the generating capacity procured would still exist, system operators may have to scramble to ensure grid operations in such an event. Implementing a DSO with authority to dispatch and manage resources at the distribution level can provide appropriate signals to optimize grid operations and reliability for all customers. Thus, there should be a DSO that is focused solely on distribution and retail level services, and there should be a provider of last resort to provide a floor for electricity services for all customers.

Delivery charges must correspond price signals proportional to factors driving demand for transmission resources.

Transmission and Distribution unequivocally must NOT be recovered by a flat fee, since this would send a perverse signal to increase unneeded investment in transmission infrastructure. Any resource that is not priced will be overconsumed because there is no cost to marginal use. Here, transmission charges must be assessed at the Transmission-Distribution Interface to ensure that resource procurement that uses the transmission grid and therefore drives the need for new investment bears the cost of that investment. Otherwise, there will be no price signal to avoid procurement that drives up transmission and investment for all ratepayers. Ultimately, the charges must follow cost causation, or

the rate design will not be fair, economically efficient, or comparable. Thus, the principles of rate design categorically mandate that transmission and distribution delivery charges be tied to usage of those facilities and not a flat fee divorced from usage. For greater detail, please see our filings in the CAISO stakeholder process.¹

We urge the CPUC in fact to take steps to encourage changes in how low voltage transmission fees are assessed to parallel the current efforts underway at CAISO to review the structure of the high voltage transmission charges to better correspond to a high DER future.² In particular, the CPUC should work to promote a structure that charges transmission charges based on transmission use for energy delivery and a cost recovery structure that ensures that the appropriate price signals are reflected in procurement decisions. These two changes can be implemented by recovering transmission charges on energy downflow from the transmission grid, and then ensuring that LSEs procuring energy from distributed resources receive credit for the avoided transmission use resulting from that procurement.

Backstop entity to allow for regulated tariffs as failsafe against market failure or manipulation.

Finally, CPUC should strongly consider incorporating a backstop entity operating default regulated tariffs with distribution management responsibilities to ensure that the grid continues to function even if retail entities do not. Several speakers have raised concerns that any retail choice reform ensure that the market manipulation and failure that has accompanied past reforms does not happen again. We recommend, for example, looking to the example of France where customers can choose between market offers and regulated tariffs to ensure something akin to a price cap exists for ratepayers.

¹ <http://www.caiso.com/Documents/CleanCoalitionComments-TransmissionAccessChargeWholesaleBillingDeterminant-IssuePaper.pdf>

² <http://www.caiso.com/informed/Pages/StakeholderProcesses/ReviewTransmissionAccessChargeStructure.aspx>

Such an entity would be in a position to manage the market and dispatch on the distribution grid and to levy penalties against retail entities that fail to perform as required at high enough a level that failures do not occur because of market calculations. Naturally, the backstop functions would need visibility and authority in the management of the grid to ensure that the energy grid is not manipulated into failure and second to have a set default price for providing energy should retail entities fail in their obligations or retail market failure drive up rate payer charges to unacceptable levels.

Ultimately, if the choice model is to rely on private retail companies to procure energy for customers, the downside risk of that retail model should be borne by the companies attempting to profit and not by ratepayers. By having a regulated backstop DSO, this would ensure that at worst the ratepayers would end up with regulated rates similar to what they currently pay.

1) The California Customer Choice project has three principles and eight key questions when considering customer choice (see below) in California and other markets. Are there any additional questions that the project should be considering? Why?

Principles (in alphabetical order):

The Customer Choice Project should also include a principle of **Market Robustness**. It is critical that any retail market have adequate safeguards built in to ensure that no market actor can manipulate the market to increase profits at the expense of ratepayers. For example, if retail competition enables retailers to set rates in order to be competitive, it is critical that this not include an ability to raise rates should competitors fail or be bought out. If rates include components tied to grid conditions (such as congestion charges), it is critical that retail entities are in no position to manipulate grid conditions. Thus, whatever structure is proposed, it must also be evaluated against a screen of market robustness to ensure that mechanisms exist to ensure that functioning markets behave as intended regardless of intentional manipulation or other market failure (e.g., loss of competition through failures of market players.).

Four additional questions to consider are

- a) How does the choice model affect or interact with other regulatory efforts?

The choice model and rate structures may interact with other regulatory efforts in unanticipated or detrimental ways. For example, imposition of a flat fee for delivery charges would undermine efforts to rationalize cost recovery for the transmission and delivery grid. In particular, developing market rules for retail choice could interact in complex ways with Distribution Investment Deferral Framework opportunities, Integrated Distributed Energy Resources planning, Multiple Use Applications rules and the like as new markets for energy services come online at the same time that retail entities are securing services from DER providers.

- b) How does the choice model alter the economics, development, and incorporation of services provided by DER and central resources that shape the efficiency of the electrical system?

If the main procurers of energy are retail entities, then the economics of DER in particular may be shaped by the rules governing the choice model. This may shape their ability to provide other services (e.g., if a DER is providing retail generation, when and how would it be able to provide frequency regulation or voltage support?) or the ability of transmission and distribution system operators to procure services for grid needs, if the choice model does not explicitly consider how this approach will affect the markets for needed grid services.

- c) What are the regulatory and infrastructure costs associated with implementing the customer choice model?

Any retail market will require monitoring, enforcement, and infrastructure investments to ensure the market can function. These costs should be transparent and reflected in any analysis of the implementation of a choice model.

- d) How will the choice model prevent cherry-picking of low-cost-of-service customers, leaving high cost customers with regulated utilities and/or substandard service?

One of the strongest incentives for retail companies will be to selectively target the most profitable customers, leaving the most expensive or difficult to serve customers with the utilities or other LSE. This will run the risk of undermining the viability of the energy industry or of shifting high costs to those least able to afford them.

2) Are there other markets, either domestic or international, that you think would be an important model for California to consider as a regulatory framework option? Why?

California should examine the markets of France and Germany to examine how retail operations interaction with independent transmission system operators and distribution system operators. Since these market structures incorporate different ownership structures, especially with dedicated distribution system operators, and retail market structures.

3) What published resources do you recommend the California Customer Choice team review in addressing key questions for evaluated markets?

No comment

4) What specific statutes should the California Customer Choice team review when considering customer choice as discussed during the workshop?

No comment

Panel Follow-up Questions

Market Perspectives

1) What are the most compelling examples of successful implementation of customer choice that you heard during the Market Perspectives panel?

2) Given some of the pitfalls illustrated by the panelists, how might California best avoid or mitigate these issues?

One of the key pitfalls that we see is the business model that continues to reward utilities for increasing energy usage by customers. If we retain a business model where profits are derived from kWh sales rather than from provision of electrical service in the most efficient and cost-effective mode possible, we will see market signals that drive inefficiencies. A business model that incentivizes greater use of resources will result in more investment and higher costs for customers, since the retail entities and utilities are incentivized to be wasteful. One example of such a perverse outcome are the Texas retail entities which attempt to promote energy use by customers in order to maximize energy sales. While this may maximize profits, it leaves ratepayers and the economy worse off overall. By conceptualizing energy as a good, rather than a service, regulators and utilities alike would run serious risks of creating perverse incentives that would make the grid more expensive over the medium term.

A better model would be to create a “pay for performance” model where retail or utility compensation is tied to meeting energy goals. For example, if customers were to pay a flat fee to retailers that reflects the existing cost of service, then the retailer or utility would derive new profits from driving costs down, rather than up. If the utility is inefficient, then a high proportion of customer revenues would go to providing energy service and profits would fall, while an efficient utility would be able to pocket the savings and increase its profits with better performance. Coupled with penalties or bonuses for reliability, power quality, etc., this kind of utility compensation model would align utility incentives with ratepayer and public interests, resulting in better outcomes for all.

Second, we should be clear eyed about the likely benefits of retail choice. While competition may drive costs down, the reality is that the impact of competition will be limited by limited customer engagement. If a high proportion of customers make no change, as has been the case in all or nearly all retail experiments, then the impacts of competition will be blunted. Any savings must be offset by the increased regulatory and maintenance costs for a system that enables a functioning market. For example, the wholesale generation market operates today in part thanks to a large and highly redundant

transmission system built less on engineering grounds and more to ensure market failures cannot result from manipulation of issues such as local congestion.

3) What are the motivations and entities driving customer choice in California? How are they similar or different from the other markets?

Shark Tank

1) After reviewing the “shark tank” presentations, what are the “must haves” as California considers regulatory framework options to manage the transition associated with customer choice? What is the most compelling vision of customer choice as presented in the shark tank?

2) As California considers potential updates to its regulatory framework on customer choice, it is possible that certain existing rules or statutes may need to be reconciled. Are there any “must change” and/or “must not change” statutes? What are these rules and statutes and why?

Probably the most compelling aspect of the presentations were the admonitions to avoid the dire errors of the last round of deregulation. Leaving opportunities for market manipulation and failing to incorporate robust mechanisms to act as failsafes against market failures resulted in serious economic damage to California and reputational damage to the CPUC and the energy industry. A repeat failure would greatly impede the other necessary regulatory innovations needed to transform our energy economy. Frankly, these are a higher priority than possible savings from a retail markets.

As mentioned, it is critical that the rate structure accurately reflect the relative costs of different energy sources and avoid market distortions that make meeting energy and carbon goals more expensive than they should be. One such area where change will be needed is in the transmission access charges for the low voltage transmission system which should be recovered based on the energy crossing that system. A second aspect is ensuring that price signals are reflected in the costs paid by decision-makers affecting



usage. For procurement, the costs of delivery must be incorporated in procurement, the costs of overall energy system use should be reflected in customer bills, and profits should reflect delivering services efficiently and effectively.

Finally, retail markets are unlikely to generate large savings. First, as noted above, competition is likely to be limited by customer behavior if retail companies are simply unable to shift customers based on better performance. Second, these savings will be offset by the necessary expenditures to operate a successful retail market. In principle, many of the innovations could be provided by a monopoly provider through regulatory oversight, especially if the incentives for innovation from relatively limited competition are weak.

We greatly appreciate the opportunity to comment on these important issues.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. Karpa", with a long horizontal stroke extending to the right.

Doug Karpa
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Clean Coalition