Alliance for Retail Energy Markets

INFORMAL COMMENTS OF THE ALLIANCE FOR RETAIL ENERGY MARKETS ON THE DRAFT GREEN BOOK

I. INTRODUCTION

The Alliance for Retail Energy Markets[1] ("AReM") is pleased to provide these informal comments on the draft paper issued by the California Customer Choice Project on May 3, 2018, as revised May 17, 2018, entitled *California Customer Choice: An Evaluation of Regulatory Framework Options for an Evolving Electricity Market*, and referred to as the "Green Book." To the extent that the Green Book spurs formal action by the California Public Utilities Commission (CPUC or Commission), the State Legislature, and other California energy agencies to address the barriers to customer choice and implement the market design changes necessary for it work effectively, it heralds a significant step forward for California. AReM stands ready to assist the Commission in its efforts to innovate clean energy options and implement the transition to full customer choice for all of California's consumers.

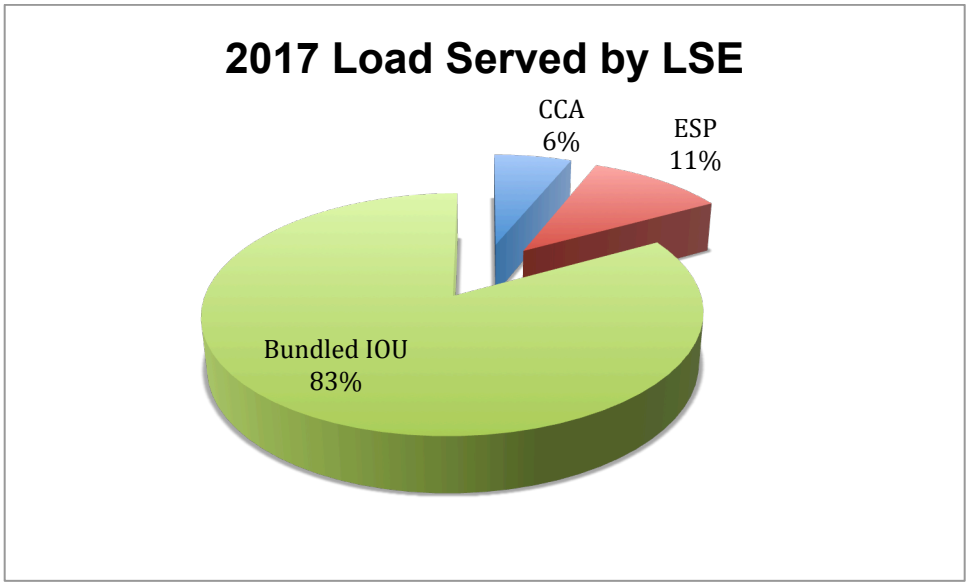
II. OVERVIEW OF THE GREEN BOOK

A. The Green Book Overlooks the History and Status of Direct Access.

While California is a global leader in clean energy, its efforts to encourage and facilitate customer choice have lagged. Direct Access ("DA") was implemented in California in 1998, then suspended in 2001for any new customers during the energy crisis as part of the actions to recover power supply costs incurred by the Department of Water Resources, and then re-opened via legislation (Senate Bill 695)[2] to a limited amount of new customer usage in 2009. Yet the Green Book includes virtually no discussion of DA and the economic benefits it has provided to California's electricity consumers for the past 20 years, nor is it even explicitly mentioned in the Green Book's Figure 1, "California's Energy Policy Timeline."[3]

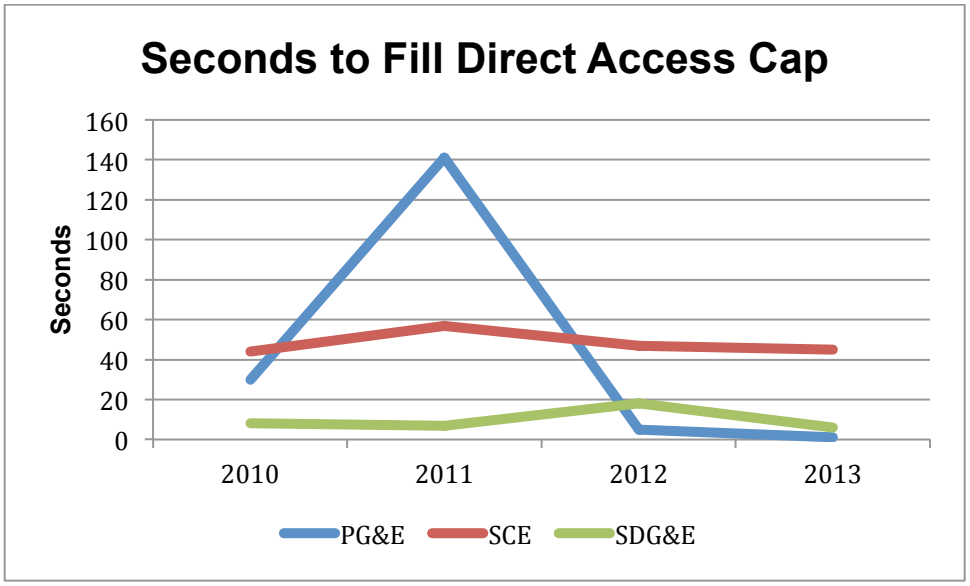
[1] AReM is a California non-profit mutual benefit corporation formed by electric service providers that are active in the California's direct access market. This filing represents the position of AReM, but not necessarily that of a particular member or any affiliates of its members with respect to the issues addressed herein.
[2] California Statutes 2009, Chapter 337.
[3] Green Book, p. 2.

Perhaps that omission is understandable given the attention being given to Community Choice Aggregation ("CCA"), which is not legislatively limited in its customer growth as is DA, and which is therefore rapidly adding customers as cities and towns exercise their option to take control of their energy supply and costs. Collectively, the IOUs, electric service providers ("ESPs"), and CCAs served or were expected to serve nearly 225,000 GWh of load by the end of 2017. Comparing the distribution of customer usage by these three types of load-serving entities ("LSE") reveals that ESPs represent 11% of this overall market as Figure 1 below illustrates.[4]



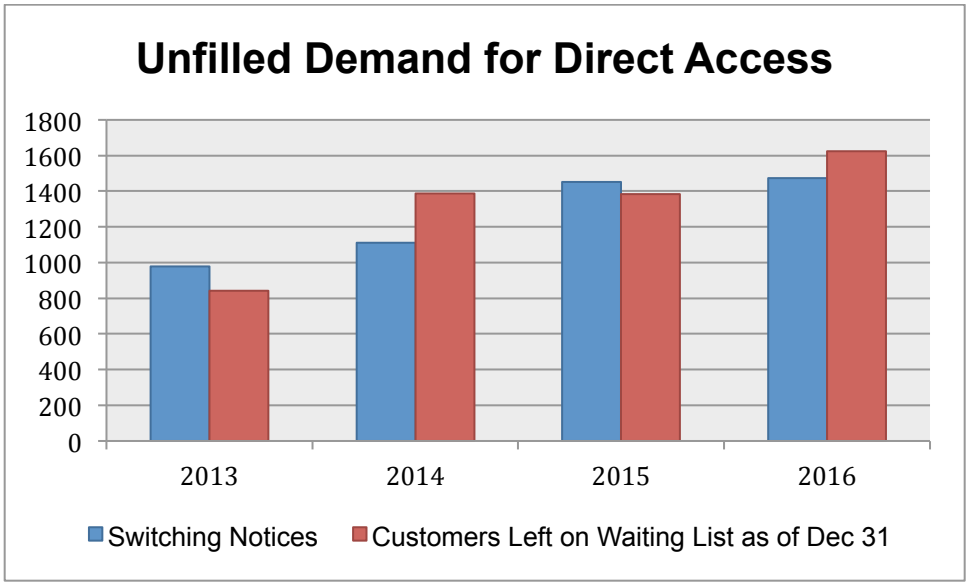
In fact, the Commission has recognized that customer demand for DA is significant. When Senate Bill ("SB") 695 re-opened DA to new customers, the Commission phased-in the increased participation levels from 2010 to 2013.[5] Each phase of the reopening was filled within seconds of the moment that submissions of requests to join DA were allowed, as shown in the following figure:[6]

[4] Data on direct access and utility load data obtained from the Direct Access Implementation Activities Report for December 31, 2017 and CCA data from slide 10 of the Commission's Staff presentation at the CCA *En Banc,* February 1, 2017, showing projected CCA load for 2017.
[5] D.10-03-022.
[6] Data obtained from Energy Division's annual direct access status reports dated August 2, 2010, July 15, 2011, and May 14, 2012.



The cap has remained fully subscribed in each IOU's territory since then. In its most recent annual report on DA, Energy Division reported that the "pent up demand for DA remains substantial and has increased in 2016,"[7] reflecting the fact that, each year, customers are allowed to sign-up to be on a waiting list to join DA if participation room opens under the cap – a waiting list that has grown longer each year. As shown in the figure below, more than 1,600 customers were in the queue in 2016 to receive direct access if the cap had been lifted that year.[8] Simply put, customer demand for DA continues to greatly exceed legislated availability.

[7] *Energy Division Direct Access Annual Status Report*, September 28, 2017, p. 3.
[8] Data obtained from Energy Division's annual direct access status reports dated May 26, 2014, July 17, 2015, October 7, 2016 and September 28, 2017. Complete data are only available in the published reports for years 2014 through 2015. The September 28, 2017 report for 2016 direct access service specified switching notices of 1,473 for 2017, but the number of customers remaining on the waiting list on December 31, 2016 will be provided in the 2017 report, which has not been published. However, Energy Division orally provided the number of customers remaining on the waiting list on December 31, 2016.



B. Other Comments on the Green Book.

Several additional aspects of the Green Book warrant correction and/or clarification:

- As concerns about the potential for another energy crisis serve as the underlying premise for the Green Book, AReM urges that the full scope of the causes of the energy crisis should be part of it, and therefore recommends the 2002 study prepared by Christopher Weare of the Public Policy Institute of California be included in it.[9]
- The assessments of select retail markets outside of California presented in the Green Book[10] provide useful information, but are incomplete, as they tend to underestimate customers' ability to embrace choice and overlook the significant benefits of competitive retail markets. In particular, the Green Book exhibited consistently low expectations about the ability of customers to engage in competitive markets and obtain benefits from that participation, such as proposing protections for customers who "unwittingly make the wrong choice"[11] or assuming some consumers would be "unwitting participants" in retail choice.[12] The Texas model of retail choice has clearly demonstrated that all types of

[9] *The California Energy Crisis: Causes and Policy Options*, Christopher Weare, Public Policy Institute of California, 2003.
[10] Green Book, pp. 28-55.
[11] Green Book, p. 6.
[12] Green Book, p. 60.

customers can and will engage and make innovative use of services offered by their competitive electricity suppliers. Moreover, a customer's decision to remain on utility service when alternatives are available is still a "choice" — and failing to choose does not mean the customer is an "unwitting participant" or "left behind."[13]

- Concerns outlined in the Green Book about the potential for California to "drift" into a second "Energy Crisis"[14] are misplaced as they do not take into account fact that this Commission, prior Commissions, and the California Independent System Operator (CAISO) have implemented program changes to improve the electric market design in ways that are intended to prevent wholesale market failures that could threaten grid reliability or allow market manipulation that led to the first energy crisis.. These protections include: System, Local and Flexible Resource Adequacy ("RA") Requirements, with Local RA expected to be extended to multi-year forward procurement requirements;[15] Integrated Resource Planning ("IRP");[16] long-term procurement requirements with respect to the Renewable Portfolio standard ("RPS") requirement; and extensive wholesale market reforms through the CAISO, including LMP pricing, market monitoring and capacity backstop procurement authority.
- The Green Book is notably remiss in providing any overview of the well-documented benefits of competitive retail electricity markets, such as: driving the utilities to compete to improve customer service levels; driving adoption of new technologies and services; competitive markets creating downward pressure on rates/prices; and expanding the choices of service plans for customers (*e.g.,* increased renewable energy adoption, fixed payment; controllable load, etc.). ESPs customize product and price offerings specific to the customer's interest and needs and these customer plans often provide overarching societal benefits, such as enhanced integration of renewable generation or reduction of greenhouse gas emissions. Studies have demonstrated that innovative, customer-oriented energy

[13] See, Green Book, pp. 6 and 60.
[14] Green Book, p. 5.
[15] See, Proposed Decision issued May 22, 2018 in R.17-09-020.
[16] R.16-02-007.

options thrive in states embracing competitive retail electricity markets.[17] Moreover, AReM and others have provided ample evidence of the benefits to consumers and society of retail choice in previous comments submitted to this Commission.[18] The Green Book is notably lacking in failing to reference or summarize any of this key information.

C. Market Design Considerations – Reforming Utility Procurement Practices.

1. The Hybrid Market Is Not Sustainable in A Competitive Retail Market.

California electricity policy has endorsed a paradigm referred to as the hybrid market – where the utilities continue to contract for or own and operate electricity resources via rate-regulation, rate of return and cost of service accounting – at the same time ESPs and merchant generators are expected to make investments in reliability and renewable assets to meet their share of compliance requirements or marketplace demand. The hybrid market is untenable in a broad retail choice market, a fact recognized by the Commission in Decision 07-12-052 where it said the "position that continued reliance on UOG (and ratepayer-backed PPAs) is incompatible with the development of a competitive market model that stimulates private investment is consistent with basic economic theory."[19] The much lower risk profile associated with rate-regulated (ratepayer funded) investments is simply too different from the risk profile and regulatory risk faced by owners and contractors of investments who do not have a captive customer base that also provides a guaranteed rate of return for competitive investments to "pencil out."

Despite the recognition that ratepayer funded investments are incompatible with competitive choices, non-bypassable charges, such as the cost allocation mechanism (CAM) and

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[17] See, for example, *Restructuring Recharged -- The Superior Performance of Competitive Electricity Markets 2008-2016,* by Dr. Philip R. O'Connor*,* April 2017.

[18] See, AReM Comments on Staff White Paper, June 16, 2017, which attached: "*Electricity & Natural Gas Customer Choice in Illinois—A Model for Effective Public Policy Solutions*;" and "Evolution of the Revolution: *The Sustained Success of Retail Electricity Competition*," by Philip R. O'Connor, Ph.D. and Erin M. O'Connell-Diaz, July 2015. Also see, the June 16, 2017 comments of the Retail Energy Supply Association, which attached: *Restructuring Recharged -- The Superior Performance of Competitive Electricity Markets 2008-2016,* by Dr. Philip R. O'Connor*,* April 2017; Comments of John Hanger to Governor Sandoval's Committee on Energy Choice, *May 10, 2017; Implementing Customer Choice in Nevada;* Pat Wood III, May 10, 2017*;* and *The Power of Choice: Consumer Preferences on Energy Choice in Florida and Ohio*, American Coalition of Competitive Energy Suppliers (ACCES), June 2017.

[19] D.07-12-052, p. 200.

its brethren, have proliferated for myriad policy reasons – replacement of SONGS, replacement of Diablo Canyon, help clearing the forests of dead trees, kick-starting energy storage technologies, impacts to reliability through the loss of gas storage capacity at Aliso Canyon. Even the IOUs' program costs for their demand response programs falls into this category, as these costs are primarily recovered through distribution rates. Put simply, the problem with the hybrid approach is that it destroys competitive neutrality since IOU programs are guaranteed cost recovery, which the competitive suppliers do not have.

This is why the transition to increasing levels of customer choice in California must focus on reforming utility procurement practices – and reduce and, for the most part, eliminate the hybrid market design. Just as DA suppliers and CCAs utilize the products and services offered by the wholesale markets to construct portfolios that meet their customers' portfolio preferences while at the same time meeting existing reliability and environmental requirements – so too should the utilities utilize wholesale markets to provide supply to retail load they continue to serve (if indeed that is their role in the future).

The time has come for the Commission to move beyond its current non-bypassable policies and practices and put the mechanisms in place that ensure genuine competitive neutrality between supply-side products and services offered by the utilities and those offered by the competitive markets.

2. The Path Forward.

First, there must be a fundamental decision whether the IOUs will retain any load-serving obligations at all as a provider of last resort. There are workable models for that (widespread throughout the PJM, New York, and New England states), and an approach in which the IOU has no supply obligations and functions solely as a wires-only company (Texas). Both models work.

Second, to avoid cost shifting, disposition of the utility ownership of supply-side assets must occur in a way that ensures the IOUs and their contractual counterparties are kept financially whole for the investments that they have made by implementing transparently calculated transition costs.

Third, if the IOUs retain a provider of last resort obligation, then there needs to be clear guidelines and protocols to govern their electricity purchases from the competitive wholesale

market. Again, there are several workable provider-of-last-resort models (also referred to as "default service") throughout the restructured states that the Commission can use as a model.

Fourth, if the IOUs decide that they want to provide supply and services to retail electricity customers other than as provider of last resort, they should only be allowed to do so through the vehicle of a separate competitive affiliate governed by strong, enforceable affiliate rules.

D. Market Design Considerations - Managing Reliability in Open Retail Choice Markets.

1. The Green Book concept of a "Central Buyer" is flawed.

The Green Book introduces the concept of the Central Buyer as a means to ensure reliability as the number of suppliers proliferate with customer choice.[20] This Central Buyer concept – also referred to as "on-behalf-of" procurement -- is the antithesis of customer choice, and in fact represents the status quo hybrid market procurement described above, in which the utilities, or some other preferred entity, procures resources and recovers their costs from all customers through non-bypassable charges. Customers want electricity supply choices so that they can actively manage their costs and procure electricity consistent with their risk, technology and sustainability preferences. Rate-regulated, cost of service central buyer procurement undercuts the value of retail choice and undermines the competitive market's ability to meet the customers' needs.

2. The central buyer approach described in the Green Book is different from a centralized clearing capacity market.

AReM notes that the Central Buyer concept described in the Green Book is a separate and distinct paradigm from a centralized capacity market. The RA proceeding will soon be tackling Central Buyer versus clearing markets and AReM will be active in proposing competitive and workable alternatives, such as a central capacity clearing mechanism that would provide price transparency, market signals, and an accounting mechanism to ensure all LSEs are able to meet their reliability requirements.

[20] Green Book, p. 57.

3. Backstop procurement authority will remain necessary.

AReM does not dispute that there needs to be a backstop procurement function that can step in if there is non-compliance by some LSEs with the reliability requirements, genuine exigent circumstances, or some form of market failure. The key in implementing such backstop mechanisms is to make sure that the circumstances that trigger the need for backstop procurement are clearly understood. In addition, if the backstop is triggered, there must be follow-up analysis to determine why backstop was needed in the first place so that changes to the overall reliability market design can be made, if they are indeed warranted and supported by the analysis.

III. RECOMMENDATIONS AND CALL TO ACTION

The Green Book states it serves as a "call to action."[21] Action is necessary because retail choice is happening, whether through CCA formation, technology adoption, expanded DA, or increased deployments of on-site generation. AReM's recommendations to ensure a smooth transition are as follows:

1. Establish a Commission proceeding to address the market structure details of a competitive retail market, including:
    a. What role the IOUs will have, if any, with respect to provider of last resort service, and how the IOUs will procure provider of last resort electricity and capacity supply to meet that load.
    b. The process by which the IOUs will divest their supply-side resources in way that assures full recovery of their investments they have made to date with required due diligence to reduce any over-supply.
    c. Customer-switching rules that govern customer migration among suppliers, including to and from provider of last resort service, to simplify and facilitate ease of customer movement among retail suppliers.
    d. Programs that support the vulnerable customer classes, such as the CARE program, continue to be adequately and effectively funded and that all customers, whether DA, CCA or POLR have equal access to programs and discounts.

[21] Green Book, p. 56.

2. Prohibit the IOUs from selling services to retail customers other than provider-of-last-resort service (if they are the entity that provides such service) except through corporate affiliates governed by strong, enforceable affiliate rules.

These fundamental retail market reforms are designed to permit a healthy, well-designed competitive retail market to expand and flourish, as well as to address the Commission's concerns set out in the Green Book on affordability, decarbonization, and reliability.[22]

- Affordability – The fact that direct access is and has been fully subscribed is a clear indicator of "affordability." Further, as noted above, AReM and others submitted a number of studies and papers describing the benefits to consumers and society from retail choice, including lower costs.[23] Additional work has been published on how choice contributes to affordability. A recent study by Rice University compared rates in the competitive versus non-competitive markets in Texas, demonstrating how much better the competitive portions of the state have done on price, all other aspects being held equal.[24] Similar outcomes were demonstrated in the 2017 report on Dr. Phil O'Connor's work on competitive electricity markets from 2008-2016, noted above.[25] That report clearly documents the cost savings and other benefits customers receive from access to restructured energy markets, including meeting renewable energy goals.
- Decarbonization – To AReM's knowledge, ESPs and CCAs are complying with all state mandates and requirements regarding resource adequacy, renewables and carbon emission reduction goals, and there is no reason to think that such compliance will falter. In fact, allowing competition can accelerate the achievement of the state's goals, as highlighted above. Many CCAs have reported that portions of their customer base have opted for high renewable portfolios, and direct access providers and direct access providers are positioned to provide any level of enhanced renewable energy that its customers want.

[22] Green Book, pp. 56-61.
[23] Submitted in 2017 and referenced in footnote 23 above.
[24] *Electricity Reform and Retail Pricing in Texas*, Dr. Peter R. Hartley, Dr. Kenneth B. Medlock III, and Olivera Jankovska, Rice University, Center for Energy Studies, Baker Institute, June 2017.
[25] O'Connor Report, *loc. cit.,* Appendices A-D.

- Reliability - As explained above, the Commission has put extensive rules in place since 2001 regarding resource adequacy and the CAISO has extensively reformed its market rules. All LSEs are required to comply with these rules to serve load in California. As such, there should be no diminution to reliability as we move forward with an expanded competitive retail market.

IV. RESPONSES TO FUNDAMENTAL QUESTIONS[26]

AReM has addressed many of these questions throughout its comments herein. The following are some additional responses, where necessary, and references to where responses have been provided herein.

- *How does California continue its course as a global leader in achieving deep decarbonization as regulated utilities provide electricity to fewer Californians?*
  - *Does there need to be a single entity for policy target setting, implementation, oversight and enforcement?*

  Response: No, the various California energy agencies each have separate responsibilities. There should be a continued focus on coordination and collaboration among them.

  - *How can California continue to support innovation and provide financing for scaling up new technologies?*

  Response: To the extent the legislature authorizes funding to support innovation or scaling of new technologies, an increasingly competitive market place should ensure that such funding is utilized effectively and efficiently.

  - *How are the utilities compensated for providing the essential infrastructure to achieve these policies?*

  Response: The utilities are adequately compensated for providing the wires infrastructure. That can continue assuming they do that job well. The current rate structure primarily compensates the utilities for steel in the ground — not how well they provide transmission and distribution services. The Commission should revise current utility compensation to tie rate of return and utility compensation to doing their wires job well — and for facilitating customer choice. Moreover, the Commission

[26] Green Book, pp. 5-7.

should be open to micro-grids and other similar innovative products and services offered by third parties.

- *What are the essential grid operations to make sure California's lights stay on?*
  - *Who has the requirement to perform the necessary functions?*

  Response: The CAISO has the primary responsibility to manage the electricity grid.

  - *Who establishes the rules and has enforcement authority?*

  Response: With respect to grid operations managed by the CAISO, the Federal Energy Regulatory ("FERC") has primary jurisdiction, along with the North American Electric Reliability Corporation ("NERC"), and the Western Electricity Coordinating Council ("WECC"). The CPUC has primary authority to establish resource adequacy obligations for the entities that it regulates.

- *Can California provide investment and operational certainty to address reliability and resiliency, especially in the face of catastrophic events that impact the electric sector, such as the 2017 wildfires?*
  - *With so many decision-makers entering into the market to provide electrical supply, how do we ensure coordination to provide all the energy needs for reliability purposes?*

  Response: Adequate Commission regulations are already in place to ensure such coordination. For example, LSEs currently comply with separate requirements regarding IRP, RPS (procurement and procurement plans), RA (system, local, flexible), and energy storage procurement. To streamline the compliance process with no impact in meeting state goals, consideration should be given to consolidating the IRP and RPS plans should be consolidated. In addition, adopting a centralized clearing market would greatly simplify compliance and administration for the current, complex RA requirements.

  - *Who will provide backstop procurement for resource adequacy if there are shortages of power needs identified in planning and a disaggregated set of electricity purchasers cannot fill the need?*

  Response: As discussed in Section II.D.4, there will continue to be a need for backstop procurement authority to address unanticipated reliability issues that arise. Evaluation and reform of the Reliability Must Run and Capacity Procurement Mechanisms are currently underway to address this very issue. This is yet another example of programs already in place to meet the range of concerns listed in the Green Book.

- *Who will coordinate supply and operations during local events where resources must come from outside the region? What is the responsibility of non-utility electricity suppliers to help meet unexpected contingencies?*

  Response: Please see the next response.

- *What role do non-utility providers play to ensure adequate responses to catastrophic and emergency events?*

  Response: If catastrophes or emergencies occur that resources simply cannot meet, it is entirely appropriate that regulators step in and mandate actions that are necessary to protect life and property, and non-utility providers will have to comply with such emergency direction. Moreover, The CAISO coordinates emergency response efforts working with other balancing authorities, generators and wires companies. These efforts and results will not change with expanded customer choice.

- *Are there adequate protections for all customers with the wider choices created by Direct Access, CCAs and behind-the-meter installations?*

Response: Yes. There are already adequate protections in place. As to DA service, the Commission has put in place strong registration requirements for ESPs, which include executing agreements with each IOU, payment of financial security and, if applicable, re-entry fees, providing proof of technical and operational ability, fingerprinting of principal officers, arranging for a Scheduling Coordinator at the CAISO, and complying with extensive metering and billing requirements at the CAISO and CPUC. The Commission has also promulgated additional requirements for ESPs serving residential and small commercial customers to ensure such customers are protected. Moreover, these protections are embodied in statute first initiated in 1996 and amended several times since.[27]

- *Should there be a state entity that provides basic customer protections to customers of services that are either behind the meter or served by entities not historically under the jurisdiction of the CPUC?*

  Response: Adequate customer protections are already in place, as noted above. There is no need for a "state entity" to perform this function.

- *Who will ensure that customers have access to power service if a lightly or unregulated electric power provider fails?*

[27] See, Public Utilities Code Sections 394 through 396.

Response: There are more than adequate rules already in place in the event that an ESP or CCA "fails" or leaves the market. As noted above, ESPs are subject to financial security and re-entry fees that are used to compensate customers as needed. In addition, current rules for switching customers accommodate moving customers to other ESPs or IOU bundled service in the event an ESP decides to leave the market or "fails" unexpectedly. In AReM's experience, ESPs have left the market over the years and the transition has been orderly and in compliance with the Commission's rules.

- *What protects customers who are not interested in choice, elect not to engage or unwittingly make the wrong decision or might otherwise be left behind?*

Response: This question assumes customers are unable to choose an electricity provider — a notion that has been completely disproven in Texas and other markets with greater choice than California. With liberal switching rules, no "protection" is needed — customers just switch to another provider. In addition, see the discussion in Section II.C above regarding provider of last resort service.

- *What is the role of the investor-owned utilities in the new regulatory construct?*
  - *Under all visions of the future, the IOUs continue to provide transmission, distribution and other grid services, what are the requirements to maintain these systems?*

Response: AReM sees no change to the manner in which the IOUs maintain their transmission systems as retail choice expands.

- *How will these utilities be compensated for building the necessary infrastructure and operating the grid?*

Response: AReM sees no change to the continuation of rate-regulated, cost of service transmission and distribution rates as retail choice expands to the extent the utilities continue to build and maintain such infrastructure..

- *Regulated utilities were required by laws, like the Renewables Portfolio Standard, to enter into long-term contracts. If customers increasingly buy electricity from non-utility sources, what happens to the contracts that the regulated entities executed?*

Response: In fact, all LSEs, not just the utilities, are required to enter into long-term contracts in accordance with RPS requirements. Any LSE in an over-supply situation due to decreases in the amount of load it serves must off-load those contracts or sell the associated energy, and indeed this divestiture will be an important part of a transition to retail choice as

outline in the Section III above. This situation is not unique to the utilities or to California. This is a common practice in any wholesale or retail power market.

- *Who will execute the long-term contracts that can be used to finance construction of new facilities going forward?*

Response: Competitive buyers and sellers will determine when new facilities are required, in order to meet established resource adequacy and/or environmental mandates. Market constructs such as a centralized capacity clearing market will facilitate such transactions.

- *Should the incumbent electric utilities be allowed to compete with other market participants, or should they be limited to offering a platform for other electricity suppliers?*

Response: Please see discussion in Section III. If the utilities are permitted to compete directly with others offering electricity and related services, transparent and enforceable affiliate and cost allocation rules must be in place that prohibit the IOUs' wires business from advantaging its competitive activities.

V. CONCLUSION

In summary, customers prefer to have choices and the Commission has a significant role to play in ensuring that California customers have electricity supply options. Customers should have the option of choosing among a host of electricity suppliers, including ESPs and CCAs, each entity offering innovative services to meet their customers' needs and desires. As California continues to strive to be the "global leader" in addressing climate change, embracing and promoting policies that facilitate customer choice will send a strong signal to other jurisdictions throughout the world that individuals working within a competitive framework guided by progressive environmental policy goals can achieve environmental goals more quickly and at a lower cost. The Commission can help achieve this reality by adopting policies that promote and expand competitive markets and customer choice.