Monday, June 11, 2018

California Customer Choice Staff
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102
Via email: customerchoice@cpuc.ca.gov

RE: Informal comments and recommended solutions on the Green Book

Dear California Customer Choice Staff,

Infinite Energy, Inc. ("Infinite Energy") writes today to address one of the most important questions that California faces in its move toward allowing more choices for electric service customers. This question, posed by California Customer Choice Staff ("Staff") in its Request for Informal Comments and Recommended Solutions on the Draft Green Book, is as follows:

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?

As part of its eventual plan for competitive restructuring, California should remove the incumbent electric utilities from the commodity supply function. This is the single most important market design issue in any restructured electricity market, and the contrasting experiences of both New York and Texas on this point over the last two decades represent a critical lesson that California can learn from in restructuring its own electricity market.

New York's clean energy incentives and decarbonization programs, embodied in its "Reforming the Energy Vision" proceeding, are worth serious consideration, as are its programs to help promote energy affordability for low-income customers. However, New York's retail competition program, which should have been a natural complement to cleaner and cheaper energy, has instead suffered from a fatal design problem from the beginning: New York allows electric utilities to compete with other market participants.

True competition between incumbent electric utilities and competitive retail energy providers (REPs) is not practical, and the question at issue hints as to why – the utilities' platform is essential for all other electricity suppliers, and so REPs will need to routinely work with the utilities as partners, rather than as competitors, in providing electric service. At the same time, the utilities' incumbency gives them artificial competitive advantages over REPs as well, which distort markets at customers' expense. There are three key issues to consider in understanding the removal of incumbent electric utilities from commodity supply:

1. Removing the utilities from the commodity supply function is critical to ensuring that subsidized utility commodity costs do not ultimately hinder overall market development.

In its last filing with Staff on November 13, 2017, Infinite Energy pointed out that when utilities provide commodity supply, it is invariably subsidized in one or more ways. New York provides two examples of how these subsidies work in practice, each of which revolves around the incomplete separation of commodity costs and delivery costs that results when utilities remain in commodity supply:

- **Commodity cost adjustments.** New York, like other states, has processes in place to deal with overestimated utility commodity supply rates, both for electricity and natural gas. If a utility overestimates their commodity supply rates, they must eventually distribute a credit to their customers that will go into those customers' supply charges.

  However, a customer who paid overestimated utility commodity supply rates and then switched to an REP does not see any credit for these prior-period overpayments for as long as they receive REP service. The customers who remain on utility service see an incremental reduction in their rates, but those customers who chose to shop will see no recourse at all.

- **Retailing costs, such as call centers and collections teams.** Utilities in New York still have a statutory obligation to serve, and therefore remain tied to the commodity supply function. Because of this, the New York Public Service Commission (NYPSC) concluded that by law, some of the utilities' commodity supply costs must be borne by every customer in the market.[1] These costs include basic components of the service provided by REPs, such as call centers and collections costs. As the NYPSC noted in its original 2004 decision on these costs:

[1] Page 3 of the NYPSC's Statement of Policy on Unbundling and Order Directing Tariff Filings in Case 00-M-0504 on August 25, 2004. "The purpose of the two-part mechanism is to recognize that some of the utilities' competitive service costs are unavoidable due to the statutory obligation to serve. All customers benefit from and all customers should therefore contribute to the recovery of those costs."

> “[T]he costs we are allocating will form the basis for competitive utility rates, and, if those rates do not fairly reflect the allocation of supporting costs to each distinct service, the utility competitive rate could be set at a subsidized level, perhaps placing competitors at a distinct disadvantage and impeding market development.”[2]

Despite this understanding, impeded market development is precisely what came to pass as a result of the utilities never leaving the commodity supply function in New York. Today, an REP customer in New York pays not only for their REP’s own retailing costs, but also for a large share of the utilities’ retailing costs as well, while a utility customer pays these costs only once.

These costs, like all other costs in a competitive marketplace, can be somewhat alleviated with proper planning and utility price transparency, but this itself is an ongoing challenge because of the unavoidable complexity of the continuing commodity rate case proceedings that are required when the utilities remain as commodity service providers. The end result of these and other subsidies is that in states like New York, utility ratepayers do not see a fair return on their investment, except on a kind of statistical basis.

At the same time, these problems do not exist in Texas because its electric utilities do not provide any commodity service. REPs there compete with one another on price, and that has resulted in the highly competitive, cost-driven marketplace that Staff referenced in the Green Book. Even so, New York’s experience demonstrates that keeping the utilities in the commodity supply function leads to a variety of subsidies that result from trying to mesh incumbent utilities into what should be a competitive system. The only way to eliminate these problems altogether, and to therefore ensure that California customers pay the lowest price possible for their electricity, is to remove utilities from the commodity supply function.

2. Separating the utilities from the commodity supply function is essential to ensuring complete customer participation in competitive electricity markets and full REP market development.

Subsidized utility commodity prices drive down customer shopping activity, and the advantage in name recognition held by long-established incumbent utilities makes it hard for REPs to establish themselves in competitive markets. As a result, in states like New York that retain utilities as commodity suppliers, customer participation in competitive markets is typically uneven and incomplete. For example, in New York, after two decades of customer choice, only 20% of residential customers are served by REPs.

By comparison, in Texas, nearly every customer is actively engaged in the competitive electricity market, and fully 92% of them have exercised their ability to switch REPs since the opening of the market in 2002.

---

[2] Page 21 of the NYPSC’s Statement of Policy on Unbundling and Order Directing Tariff Filings in Case 00-M-0504 on August 25, 2004.

This has led to a much more competitive marketplace where REPs, having successfully driven down the cost of commodity service across the board, now compete in offering value-added services and clean energy products as well. According to the Public Utility Commission of Texas, at the start of 2017, 109 REPs offered 440 total unique products across Texas, and a full 97 of these were based on electricity that was generated from 100% renewable sources.[3]

Beyond customer engagement, removing the utilities from the commodity supply function ensures that REPs are also free to handle other functions that are properly competitive, but which are nevertheless left to utilities and paid for by all ratepayers in states where the utilities persist in providing commodity supply:

- **REPs as providers of last resort.** Removing the utilities from the commodity supply function does not put customers at risk in the event that an REP exits the market. This is because the role of serving as provider of last resort (POLR) is another competitive function that can and should be provided exclusively by REPs. For example, in Texas, the POLR role is objectively assigned to the largest REPs (by market segment) in each utility service area, although other qualifying suppliers may opt-in ahead of the objectively assigned POLR. A large POLR is also well-situated to handle large-scale transitions, such as an REP's sudden exit from the market, which should generally be rare in a properly-functioning market but which may sometimes occur in the early years of market development after full restructuring.

- **Consolidated billing by REPs.** Additionally, removing the utilities from the commodity supply function does not require an extra decision from customers who prefer a simple and reliable bundled service. As in Texas, every REP should be required to purchase all of the utility's receivables – the transmission and distribution charges that customers would otherwise pay for directly – for each of its customers. Then, the REP should provide a consolidated monthly bill containing all of these fully unbundled charges to the customer, who can see the cost benefits of full unbundling without losing the simplicity of receiving one bill from one company. This has the added benefit of placing the full risk of credit and collections on the REP, rather than leaving any of it with the utility, which would eventually have to pass these costs onto its ratepayers.

3. Legislative engagement is critical to the process of refocusing utilities away from commodity supply and toward transmission and distribution in California.

Finally, to reiterate what CPUC President Michael Picker noted in his opening letter, there is no substitute for leadership from the legislature. New York is the only state that tried to implement restructuring without

[3] Pages 2 and 3 of the PUCT's Report to the 85th Texas Legislature on the Scope of Competition in Electric Markets in Texas, published in January of 2017.

this vital leadership, and many of its market design problems have ultimately resulted from this decision because it prevented the utilities from leaving the commodity supply function.

For example, in the early days of New York's electricity and natural gas restructuring program, many utilities were actively interested in leaving the commodity supply function altogether – or were at least indifferent to their removal from it. Unfortunately, because existing law placed a clear obligation to serve on New York's utilities, none of them could leave the commodity supply function. Even those utilities that were actively interested in focusing on transmission and delivery alone eventually had to argue against any administrative abrogation of their obligation to serve because of their fear that someday, a court might order them back into the commodity supply function. Since that time, New York's utilities have largely lost interest in the prospect, and the state's originally promising restructuring program has languished, with its once-collaborative processes gradually becoming adversarial as a result.[4]

By contrast, Texas, along with nearly every other jurisdiction that has implemented competitive electricity restructuring, moved forward using comprehensive legislation that outlined the responsibilities of each participant in the market, and in the process resolved questions similar to those raised in the Green Book. Legislation must also ensure that the energy research, efficiency upgrades, and environmental mandates that are core, continuing elements of California's electric system are all fully provided for.

Legislative certainty is the foundation upon which the CPUC can build an effective electricity marketplace that allows utilities to focus on transmission and delivery, and suppliers to focus on clean, affordable energy choices. If the utilities are removed from the commodity supply function through legislation, the CPUC can then use its clear, statutory authority to actively oversee the market for all of its participants, including REPs, utilities, generators, brokers and aggregators, and individual customers.

Conclusion

The experiences of New York and Texas show the importance of strong market design to the future success of California's plan to build a competitive electricity market. By committing to removing the utilities from the commodity supply function as a part of its overall plan for electricity restructuring, California can focus on creating a competitive market that also provides for robust clean energy incentives and energy assistance guarantees for low-income customers. Focusing the utilities on providing a platform for REPs with the support of a firm legislative foundation will ensure that competitive

[4] For example, without legislation affirming that it was no longer obligated to supply electricity, one New York utility that wanted to leave the commodity supply function in 2001 still resolved to sue New York regulators if they ordered it out of the commodity supply function without express legislative authority, since the utility specifically feared it might later be ordered back in by a judge's strict application of existing law. Case 00-M-0504, page 22, note 7, April 13, 2001.

markets are not affected by harmful artificial subsidies, that customer engagement is successful and comprehensive, and that REPs are able to provide the highest quality products and service possible.

Infinite Energy greatly appreciates the opportunity to contribute to this process, and we hope to participate further as it continues to develop. Please feel free to contact us about any questions you may have, and thank you for your time.

Sincerely,

Warren L. Rhea
Corporate Counsel | Infinite Energy, Inc.
(352) 231-2579 | wlrhea@infiniteenergy.com