

Via E-Mail

June 11, 2018

California Customer Choice Team
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: Shell Energy North America (US), L.P. Informal Comments
on Customer Choice Issues and Draft Green Book

To: California Customer Choice Team:

Consistent with the amended schedule announced on May 21, 2018, Shell Energy North America (US), L.P. (“Shell Energy”) submits its informal comments on Customer Choice questions posed in the draft revised “Green Book” that was posted on May 17, 2018.

A. General Comments

The authors of the draft Green Book express no urgency to embrace a fully competitive retail electricity market in California. The authors appear unconvinced that a competitive market can achieve the State’s adopted “decarbonization” goals. For example, the authors mistakenly assume that vertically integrated IOUs have been singularly responsible for accelerated procurement of RPS energy and rapid deployment of demand response, energy storage and other “green product” programs.

Burdened with this IOU-centered perspective, it is no wonder that the authors appear reluctant to adopt a competitive electric market structure. The authors’ questions reflect a concern that if the IOUs’ role is limited to performing “monopoly” functions, the Commission will not be able to control the means by which the State’s decarbonization goals are achieved.

The authors’ bias in favor of an IOU-centered structure is misplaced. The IOUs are not uniquely qualified to undertake investment in and development of “green energy” programs to achieve the State’s policy objectives. Through a competitive market structure, multiple LSEs (and other third party service providers) can achieve the State’s decarbonization goals, and in a manner that allows greater flexibility, greater innovation, and more competitive prices than can be achieved by the IOUs.

In this connection, the authors highlight the growth of CCAs (and associated departing customer load) as an unanticipated phenomenon in the California market. Yet CCA is the logical -- and inevitable -- result of two intersecting State policies: first, the State's increased focus on decarbonization, which has been embraced (and must be implemented in part) by local municipalities; and second, the artificial limit (cap) on direct access.

Because most residences and businesses are foreclosed from the competitive retail options (including enhanced RPS procurement) offered through direct access, these customers have shifted their attention to local governments to offer green -- and greener -- alternatives to the retail products and services provided by the IOUs. CCA is a natural response to the limits imposed on direct access. Rapid growth of the CCA program provides compelling evidence that California ratepayers seek competitive energy alternatives.

The Commission should welcome, rather than resist the growth of competitive retail choice in California. The Commission should advocate, before the Legislature, elimination of the cap on direct access. The Commission should explore options for an alternative "provider of last resort" structure. Non-IOU LSEs can and will work with their customers, suppliers and third party developers to meet the State's decarbonization goals. Through this Customer Choice initiative, the Commission must send a signal that it is prepared to allow the competitive market, rather than a few IOUs, to be the engine driving the State to increased "affordability," "decarbonization," and "reliability."

B. Responses to Green Book Questions

Shell Energy responds to the questions presented at pages five to seven of the May 17, 2018 revised Green Book:

Question: How does California continue its course as a global leader in achieving deep decarbonization as regulated utilities provide electricity to fewer Californians?

Response: The Legislature and the Commission should establish LSE targets (e.g., RPS, GHG emission reduction, demand response and energy storage targets) and then allow LSEs to meet these targets in the manner each LSE chooses. The Commission should not be overly prescriptive. The Commission should establish goals and remove roadblocks that inhibit third parties from participating in innovative product and service markets. The Commission should allow LSEs to develop the means by which to achieve the State's green energy and reliability goals. The Commission should allow the competitive market to work.

Question: Does there need to be a single entity for policy target setting, implementation, oversight and enforcement?

Response: The Legislature will continue to establish the overall decarbonization program targets for all LSEs. The Commission and other agencies should work collaboratively to establish monitoring, reporting and penalty mechanisms to ensure compliance. The Commission and other agencies will provide oversight. The Commission and other agencies should not, however, limit or foreclose LSEs from developing unique and creative means by which to meet their targets while serving their customer needs.

The Commission and other agencies also must not impose burdensome and costly regulatory requirements that detract from LSEs' ability to offer creative products and services. The Commission and other regulatory agencies should eliminate overlapping and cumbersome reporting requirements. Efficient regulation will lead to reduced costs for ratepayers.

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

Response: The IOUs are not uniquely qualified to provide financing for large scale deployment of innovative products and services, such as transportation electrification. Once "decarbonization" targets are set, the market will respond and invest in the technologies, resources and other means by which to satisfy these targets. When and if the market is truly opened to competition (see below), competitors will innovate and devote resources to meet customer demand while complying with legislative mandates. Third party suppliers and developers seek regulatory certainty to ensure that investments in innovative resources and infrastructure are not stranded as a result of legislative and/or regulatory "flip-flops."

Question: What is needed [to] reduce the use of fossil fuels such as natural gas, which is used not just for electric power, but also for industry and in homes and buildings?

Response: As RPS, demand response, energy efficiency and energy storage targets are increased, natural gas-fired generation will be squeezed out of the California electricity market. Through the adoption of proper price signals, transportation electrification will substantially reduce fossil fuel usage in light, medium and heavy duty vehicles. With reduced use of fossil fuels in the areas of electric generation and transportation, electrification of other commercial, industrial and residential uses of natural gas can be targeted and achieved, as well.

Question: How are the utilities compensated for providing the essential infrastructure to achieve these policies?

Response: The draft Green Book authors recognize that the IOUs will continue to play a critical role in providing “essential infrastructure” to facilitate development of a competitive retail market. The draft Green Book states: “Every outcome contemplated and analyzed by this assessment relies on the basic proposition that the [IOUs] will continue to provide the fundamental backbone services of electric delivery to customers along with ensuring the safety and reliability of that delivery.” Draft Green Book at p. 25. The IOUs will serve in the role of a “common carrier.”

The IOUs will continue to provide monopoly services. The IOUs will continue to own and operate the gas pipelines, electric transmission lines and electric distribution lines that deliver energy from the source to the ultimate consumer. The IOUs also will facilitate the “smart grid” through the installation of state-of-the-art wires-related technology to ensure that the grid operates efficiently. The IOUs will continue to earn a healthy, regulated return on their investment in this “essential infrastructure.”

The IOUs should not be allowed to continue to participate, however, in areas (and investments) in which a monopoly provider is not required. If a private entity can provide a product or service under a competitive model, the IOUs should not be allowed to compete in the space. In order to encourage competition, the IOUs must be excluded from competitive product and service markets.

Question: **What are the essential grid operations to make sure California’s lights stay on?**

Response: The IOUs’ “essential grid operations” include transmission and distribution. These functions represent the IOUs’ core business. Energy production and procurement, and behind the meter activities, including energy storage, rooftop solar, and EV charging, are activities that can be provided on a competitive basis, and thus are outside the scope of a “public utility” service.

Question: **Who has the requirement to perform the necessary functions?**

Response: “Essential grid operations,” including transmission and distribution, are properly performed by the IOUs. Not all “necessary” functions, however, must be provided by the IOUs. For example, energy storage and demand response can and should be provided by the market. Energy and capacity, including RPS resources, can and should be provided by the market.

Question: **Who establishes the rules and has enforcement authority?**

Response: This Commission and the CAISO share responsibility for ensuring that there is adequate transmission and distribution infrastructure to provide essential grid operations, and to facilitate interconnections with generation and behind-the-meter resources.

Question: What does it cost and who pays?

Response: All customers connected to the grid should pay for essential transmission and distribution infrastructure that is used for the benefit of all customers. Customers that permanently and completely detach from the distribution/transmission grid (e.g., microgrids) should not be required to continue to pay for the distribution/transmission grid, unless they continue to receive “standby service.” Standby charges must be reasonable and should not discourage customers from electing competitive behind-the-meter and/or bypass options.

By the same measure, a customer that chooses to depart bundled IOU sales service in favor of a competitive retail supplier should not be required to pay, for an indefinite period, IOU procurement costs undertaken when the customer was a bundled IOU customer. Mechanisms to reduce the IOUs’ “stranded” procurement costs, as well as measures to limit the IOUs’ procurement costs shifted to departing load customers, are being addressed in the PCIA proceeding (R.17-06-026). Limits on the PCIA are a vital element of the Commission’s movement to a fully competitive regulatory framework.

Question: 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?

Response: “Reliability” and “resilience” are two separate issues. The CAISO and this Commission have processes in place to ensure that all LSEs have sufficient assets to provide capacity reliability. Moreover, the IOUs are accountable to the CAISO and this Commission to ensure that their electric (and gas) transmission and distribution facilities are adequate to deliver gas and electricity from supply sources to end-use customers.

“Resilience” is a different matter. “Resilience” refers to whether the infrastructure in place, and the personnel and systems supporting this infrastructure, are capable of withstanding and responding to a disaster or other unexpected events. This Commission exercises its authority, in general rate cases and elsewhere, to ensure that IOU infrastructure is “resilient.” For assets not within the jurisdiction of the Commission, owners and operators are responsible for maintaining their facilities in a manner that is consistent with industry standards and municipal/state/federal regulations.

Question: 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: The CAISO performs this role, pursuant to its tariff and the authority granted (and overseen) by FERC. The CAISO depends, however, on the operation of the competitive market. This is an area where the Commission must step away from its preference for a centrally planned procurement structure. The Commission should encourage, rather than restrict, an open and competitive market structure with multiple suppliers and multiple buyers. Diversity in the universe of electric supply options will lead to lower consumer prices and greater innovation.

Question: 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: The CAISO has a comprehensive process in place to address shortages of capacity, including capacity shortages in local areas. In a well-functioning market, with proper price signals, existing generators and competing suppliers will be encouraged and incentivized to maintain and develop RA resources (system, flexible and local RA resources).

Unfortunately, as Shell Energy has discussed in the RA proceeding (R.17-09-020), the current “hybrid” RA capacity market is not working. The Commission has fostered a dual market in which very high prices have been approved for IOU procurement of new RA capacity (the costs of which are spread to all customers through the Cost Allocation Mechanism (“CAM”)), while much lower prices are obtained in the market for existing RA capacity. This price duality discourages owners of existing capacity from making investments to maintain and improve existing RA resources. The hybrid RA capacity market is an example of how Commission-directed centralized procurement leads to higher costs for ratepayers.

The Commission must address how the bilateral capacity market can be integrated, and the existing “hybrid” market eliminated, so that RA capacity can be bought and sold at transparent, market-based prices. This is a fundamental issue that the Commission cannot continue to ignore. Eliminating the hybrid RA capacity market will enable price transparency in the bilateral capacity market and ensure that local RA capacity is maintained and increased through the operation of competitive price signals. Eliminating the hybrid capacity market will also eliminate the need for CAM resources in local reliability areas.

The Commission can also adopt incentives for the development of preferred resources (and/or transmission), and/or for the extension of existing resources. For example, as Shell Energy proposed in the RA proceeding, local capacity shortages can be addressed by offering

Congestion Revenue Rights (“CRR”) for resources in constrained areas. CRRs are financial instruments that enable CRR holders to manage variability in congestion costs based on locational marginal pricing. By allocating CRRs to generation owners developing resources in capacity-constrained local areas, generation developers will be encouraged to maintain existing generation and/or pursue new generation in these areas. This approach is not unlike other incentive-based approaches the State has adopted to achieve GHG emission reductions.

Question: 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: As discussed above, the CAISO has a comprehensive process in place to address shortages of capacity, including capacity shortages in local areas. However, the Commission can ensure that local RA capacity is maintained and increased by adopting an integrated structure that responds to competitive price signals. The Commission should adopt incentives for the development of preferred resources (and/or transmission), and/or for the extension of existing resources in local reliability areas. Through the adoption of these incentives, the Commission should allow the market to respond to price signals that will encourage innovation and development of new, GHG-free resources.

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

Response: If a “catastrophic” or “emergency” event disables transmission or distribution facilities, responsibility for repair and/or replacement is with the IOU. Owners of generation and behind-the-meter resources will contribute to the response by bidding resources into the CAISO market to complement or replace, as necessary, disabled transmission/distribution infrastructure. Multiple State and local agencies, including this Commission, have coordinated plans to address such events.

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

Response: Yes. First, the Legislature and the Commission have adopted comprehensive consumer protection provisions that apply to ESPs serving residential and small commercial customers. The Commission can rely upon these established rules to protect the smallest customers who may be susceptible to abuse.

Commercial and industrial customers are sophisticated and should have the opportunity to manage their own energy costs. Currently, through the direct access program, many businesses and organizations such as universities, community colleges, K-12 schools, retail

companies, government facilities, fast-food chains, supermarkets, technology companies, food processors, and others have taken control of their electricity needs and associated costs. “Consumer protections” for these customers are available through existing statutes and regulations.

Second, under a market structure that fully embraces retail competition, universal access is maintained for all customers. Customers that do not elect customer choice (direct access) or who “opt out” of CCA will be provided retail procurement service from a Commission-approved provider of last resort (“POLR”). Currently, the POLR is the IOU. However, as the competitive retail market evolves, the IOUs should exit the generation/procurement market altogether. The IOUs should no longer serve as the POLR.

Instead, a process should be established to assign (or “auction”) the POLR obligation to one or more eligible (and financially secure) entities that seeks to provide POLR service in an IOU’s service area. A competitive process should be established to allow third parties to bid to become a POLR. The Commission should devote a new OIR proceeding to establishing the terms and conditions of POLR service.

In an IOU’s service territory, a POLR should be responsible for securing RA, RPS, energy storage and demand response on behalf of “default” customers. The POLR should be responsible for meeting the State’s decarbonization targets. Maintaining a POLR function ensures that all customers have a retail electric supplier. This model achieves “universal” electric service.

Question: 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: See response above.

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

Response: The POLR (currently the IOU) is required to accept customers that are, for whatever reason, turned back by an ESP or a CCA, or that do not select a competitive retail supplier. When a third party successfully bids to provide POLR service, that entity must agree to perform the POLR obligations currently undertaken by the IOU.

Question: 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: The POLR must adhere to terms and conditions of service established by this Commission. The Commission will set rules that protect “default” customers. A third party must agree to comply with these rules to be selected to provide POLR service. Violation of these rules will subject the POLR to penalties and may jeopardize the POLR’s status.

Question: **What is the role of the investor-owned utilities in the new regulatory construct?**

Response: In a fully competitive retail market, the “for-profit” IOU will continue to have a significant role as the owner and operator of the monopoly distribution and transmission systems. The IOU will provide a transparent platform to facilitate competitive alternatives, and will provide the infrastructure through which competitive solutions can be implemented by customers and their retail providers. The IOU will be compensated through the regulated process that is currently in place for an IOU’s monopoly assets and services.

The IOUs will not, however, compete for “customer share.” Rather, registered LSEs and other third parties will offer competitive options in energy, demand response, energy efficiency, and other supply and behind-the-meter services. Eventually, when POLR service is assigned to one or more third parties, the IOUs will be limited to providing “wires” service.

In order to implement this strategy, the IOU business model should be modified to draw a bright line between “utility” services that are provided on a monopoly basis, and other, competitive services that are provided by third parties, including but not limited to unregulated affiliates of the IOUs. Experience has shown that when the regulatory structure protects IOUs from new market entrants, the end result is less innovation, less creativity, and less adaptation to new technologies. Instead of relying on the IOUs to encourage customer participation in competitive markets, the Commission should grant third party providers the tools (and the opportunity) to expand participation in new markets. By allowing the market to operate efficiently, the Commission will avoid the not insignificant expenditure of ratepayer dollars to subsidize an IOU’s participation in the development of new programs.

Question: **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: The IOUs will continue to operate under the traditional “regulatory compact.” As a condition for maintaining monopoly status in a defined service area, the Commission imposes standards and obligations upon the monopoly provider. The IOU receives a healthy rate of return on its investment in the assets used to perform its monopoly function.

Question: How will these utilities be compensated for building the necessary infrastructure and operating the grid?

Response: An IOU is already entitled to earn an authorized rate of return on its investment in monopoly infrastructure that is approved by the Commission. Adoption of a competitive retail market structure will not interfere with an IOU's ability to earn a return on its investment in monopoly assets, and a competitive market structure will not interfere with the general rate case process.

The IOU is largely indifferent to cost because it is able to pass through its costs to ratepayers, as long as the costs are found to be "reasonably incurred." In a competitive market, non-IOU LSEs bear the risk of their investments. The market demands prudent management of an LSE's portfolio costs, which minimizes the costs imposed on customers.

Question: 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 the PCIA proceeding (R.17-06-026), a number of parties have advanced proposals to optimize the IOUs' portfolios and reduce the cost of "excess" IOU procurement. The Commission has an opportunity, in the PCIA proceeding, to address this "stranded cost" issue through the adoption of several complementary approaches that are designed to reduce the cost burden on all ratepayers.

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

Response: With the growth of the CCA market, CCAs are stepping in to make long-term commitments that support the construction of new RPS facilities. When the Legislature and the Commission fully embrace an open, competitive retail market, and the cap on direct access is eliminated, all non-IOU LSEs will make the long-term resource investments that are necessary to meet the needs of their customers, and satisfy the State's decarbonization and reliability targets.

Regulatory certainty -- including the assurance of an open market for competition -- is necessary for non-IOU LSEs to make long-term resource investments. As long as the future of direct access is uncertain, ESPs cannot make the long-term investments necessary to construct new generation facilities to meet future customer load. ESPs must have an assurance that they will be able to compete to serve all retail customer load without a "cap." For this reason, the Commission should actively engage with the Legislature to eliminate the cap on direct access participation.

Question: 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: No. The IOU business model should be modified to draw a bright line between “utility” services that are provided on a monopoly (for-profit) basis, and other, competitive services that are provided by third parties, including but not limited to unregulated affiliates of the IOUs. Today, the Commission permits -- indeed encourages -- the IOUs to participate in potentially competitive markets (DERs, demand response, electric vehicle charging) in order to jump-start these markets in the pursuit of State policy goals (e.g., GHG emission reductions). The IOUs take advantage of opportunities to participate in competitive markets by leveraging their existing customer relationships (and ratepayer dollars) to offer new products and services.

Allowing the IOUs to participate in competitive markets dampens participation by third parties and limits customers’ service options. Encouraging (or allowing) the IOUs to “jump-start” participation in competitive markets ignores historical evidence that openly competitive markets result in innovation and lower prices. Instead of relying on the IOUs to encourage customer participation in these competitive markets, the Commission should provide third parties with the tools (and the opportunity) to expand participation in new markets, without having to compete with the incumbent IOUs.

C. Conclusion

If the Commission is committed to embracing Customer Choice, the Commission must urge the Legislature to eliminate the cap on direct access. Competitive electricity suppliers can provide innovative energy solutions tailored to individual customers’ needs and circumstances. Until the direct access cap is removed, non-IOU LSEs will be limited in the customers they can serve and limited in the “green” options they can pursue and provide. Non-IOU LSEs will be reluctant to make investments in green resources and products (including behind the meter options) until the market is truly and fully opened to competition. This is not a matter that can be delayed any further.

Additionally, the Commission must, as a matter of high priority, eliminate the “hybrid” capacity market and avoid the temptation to authorize centralized procurement on behalf of all customers. The Commission must facilitate an integrated bilateral capacity market to ensure that there is a liquid, transparent market for all capacity. An integrated capacity market will provide proper price signals that encourage the development of resources (generation, transmission or behind-the-meter resources) to meet capacity needs, including capacity needs in local reliability areas. An integrated market structure for generation, energy storage and other competitive products will eliminate the need for CAM treatment and enable all LSEs to work with their customers to engage in tailored capacity procurement.

Thank you for the opportunity to provide these comments. Shell Energy looks forward to participating in the en banc meeting on June 22, 2018.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "John W. Leslie". The signature is fluid and cursive, with a long horizontal stroke at the end.

John W. Leslie
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Attorney for Shell Energy North America (US), L.P.

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