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Via E-Mail

November 28, 2017

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

Re: Shell Energy North America (US), L.P. Responses to Post-Workshop Questions on Customer Choice

To: California Customer Choice Staff

In accordance with the revised schedule announced on November 8, 2017, Shell Energy North America (US), L.P. ("Shell Energy") provides its responses to the questions presented in connection with the "California Customer Choice Project." Shell Energy supports continued expansion of customer choice, both in front of and behind the meter.

I.

INTRODUCTION

The Commission (and the Legislature) should take necessary steps to facilitate customer choice for all customers of the investor-owned utilities ("IOU"), not just those customers that are located in municipalities that elect community choice aggregation ("CCA"). Customer choice should be encouraged for all customers, and on both sides of the meter. Customer choice drives innovation and contributes to achieving the State's greenhouse gas ("GHG") emission reduction goals.

Through direct access, customers are able to choose their supplier and the characteristics of their procurement service. Energy service providers ("ESP") offer unlimited service options, including an enhanced level of RPS procurement and/or local RPS investment. Direct access customers negotiate their retail electricity costs, pricing structure, and/or their mix of resources. Over the long term, the IOUs should be removed from the procurement function, and all customers should have access to competitive retail procurement.

Customers also should have "behind the meter" choice, including the ability to select the mix of resources (e.g., demand response, energy efficiency, behind the meter generation and storage) that meets their specific facility needs. To foster greater innovation and competition in the behind-the-meter services market, however, participation by the IOUs should be limited. Excessive IOU involvement in behind-the-meter services would discourage competition.

Contrary to the views of some advocates, enhanced customer choice will not jeopardize reliability or prevent achievement of the State's GHG emission reduction goals. Neither will enhanced customer choice increase the level of "stranded" IOU procurement costs. All LSEs have the same RPS procurement, RA capacity procurement, and GHG emission reduction goals. Customer choice provides an opportunity for each load serving entity ("LSE") to meet its statutory mandates in its own way, consistent with its customers' objectives. The overall procurement targets, however, remain the same for IOUs and non-IOUs alike.

Finally, the Commission has in place cost recovery structures to address IOU transition (stranded) costs. The Commission has experience in ensuring that the IOUs' stranded costs are not shifted to bundled IOU procurement customers. Nevertheless, the only way to eliminate stranded costs over time is to fully transition to customer choice, including ending IOU procurement and replacing it with a regulated provider of last resort ("POLR").

II.

RESPONSES TO SPECIFIC QUESTIONS

Shell Energy responds to the post-workshop questions as follows:

A. White Paper Scoping Questions

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):

- **Affordability**: Design Rates and Charges So That Bills Are Affordable
- **Decarbonization**: Meet California's Environmental and Climate Goals
- **Reliability**: Maintain Safety, Reliability, and Resiliency of Electricity Services

Response: One of the proposed principles is "affordability." It is not clear what the authors mean. When customers have choice (e.g., retail procurement choice), affordability is achieved through the competitive process. Retail suppliers compete for customers based on price, as well as the quality and variety of products and services they offer. "Affordability" for services and products offered through the customer choice program is achieved through competition.

The authors also could be referring to "affordability" as it relates to the monopoly services provided by the IOU. "Affordability" is achieved with respect to monopoly services in two ways: First, the Commission must be vigilant to ensure that the IOUs invest capital prudently, maintain a lean workforce, and eliminate excess expenditures. The IOUs should not be allowed to spend excessively on programs or projects. Moreover, the IOUs should not spend at all on programs or projects that do not serve a "utility" purpose.

Second, the Commission must exercise caution with respect to the adoption of IOU projects and programs that are not central to the utility function. The Commission should resist the temptation to require the IOUs to invest in ancillary programs that yield limited energy savings or limited GHG emission reductions. Before the Commission directs the IOUs to embark on a new program, the Commission should undertake a risk/benefit analysis to determine whether the cost is worth the expenditure.

The focus of the Commission's regulation must be to maintain safety and service reliability. To the extent that IOUs (and other LSEs) have statutory procurement mandates, the Commission should ensure that the IOUs comply with these statutory mandates in a manner that does not shift costs to customers of non-IOU LSEs.

The authors should include one more "principle" to the list: "**Innovation**." A key objective of customer choice is to promote innovation among competing retail suppliers. The IOUs do not have a "lock" on innovative ideas for energy efficiency, demand response, behind-the-meter generation, or integrated energy and storage development. Non-IOU LSEs and other unregulated businesses work with customers to come up with creative solutions that allow customers and their suppliers to meet and exceed the statutory minimums for RPS, RA, energy storage and GHG emission reduction targets. The Commission should provide the "baseline" requirements for the RPS, GHG emission reduction and RA goals that all retail providers must achieve. The competitive market will exceed these minimums through innovation in order to satisfy customer demand.

Key Questions in Considering Customer Choice

Question 1: How does this choice model ensure consumer protections?

Response: The Legislature and the Commission have adopted comprehensive consumer protection provisions that apply to ESPs serving residential and small commercial customers. While these rules can and should be adjusted periodically to address specific concerns, the Commission can rely upon these established rules to protect residential customers who may be susceptible to abuse by marketers. In this regard, the Commission should resist the temptation to impose draconian consumer protection rules that unduly burden retail suppliers. The

Commission can and should mete out appropriate penalties when a retail supplier abuses the rules or engages in misleading conduct. The Commission should not adopt overly burdensome rules for the entire retail program when the Commission can deal with specific retail customer concerns on an individual ESP basis.

Moreover, 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. The ability to choose direct access should be made available to all businesses and institutions, because they are vital contributors to California's economy.

<u>Question 2</u>: How does this choice model support development and incorporation of innovations driven by customer demand?

<u>Response</u>: An ESP works with each individual customer to develop an energy plan that includes a tailored portfolio of energy, storage, demand response and energy efficiency, all of which can be managed effectively to meet the customer's energy needs, as well as the State's energy policy goals. An energy resource program that is tailored for a retail customer may include behind-the-meter solutions, electric vehicle charging, and/or flexible price hedging to assist a customer in levelizing costs, reducing its load, extending de-carbonization to transportation service, and meeting the customer's "green portfolio" and/or sustainability goals.

<u>Question 3</u>: Does this choice model ensure universal electric service?

<u>Response</u>: Yes. Even with the adoption of a more comprehensive customer choice program, the IOUs will continue to provide monopoly services (e.g., distribution and transmission services) to all customers connected to the IOUs' systems. Customers that do not elect customer choice (direct access) or who "opt out" of CCA will be provided retail procurement service from the POLR.

Currently, the POLR is the IOU. However, as the competitive retail market evolves, the IOU 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. In an IOU's service territory, a POLR should be responsible for securing RA, RPS, energy storage and other products and services on behalf of "default" customers. Maintaining a POLR function ensures that all customers have a retail electric supplier. This model achieves "universal" electric service.

<u>Question 4</u>: How does the choice model leverage investment necessary to finance the evolution of the electric grid?

<u>Response</u>: Increased customer choice may reduce or mitigate the need to expand IOU transmission and distribution systems. Increased behind-the-meter generation (potentially combined with energy storage) could reduce the demand for extensions and expansions of the distribution grid.

In other respects, increased customer choice is likely to be neutral with respect to the investment necessary to finance the evolution of the grid. Extension of the transmission grid to reach new RPS resources, for example, may be necessary whether an IOU purchases the RPS resources or a non-IOU LSE purchases the RPS resources. Financial responsibility for the transmission line extension will be addressed through the same process, and the cost will be allocated to transmission customers or the generator, whether or not there is a robust customer choice program. The investment in new transmission likely will be driven by the statutory RPS procurement mandate.

<u>Question 5</u>: How does this choice model consider the transition of utility obligations?

<u>Response</u>: In an increasingly competitive retail market, the 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 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. The role of the regulated IOU will evolve in a competitive retail market.

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 these opportunities by leveraging their existing customer relationships (and ratepayer dollars) to offer new products and services. Instead of relying on the IOUs to encourage customer participation in these competitive markets, the Commission should provide third party providers with the tools (and the opportunity) to expand participation in new markets.

By allowing the market to operate efficiently, the Commission will avoid the expenditure of ratepayer dollars to subsidize an IOU's participation in the development of new programs.

Question 6: Does this choice model have competitively neutral rules among market participants?

Response: Yes. Competitive neutrality is a key feature of a successful customer choice program. No retail sales provider, no EV charging provider, no demand response provider, and no energy storage provider should have a competitive advantage in the solicitation of customers or access to IOU facilities, resources and information. The Commission should not put its thumb on the scale in favor of one supplier over another.

Creating a "level playing field" is a primary reason for removing the IOUs from the market for competitive services and products. The Commission's affiliate transaction rules are a good starting point for this effort. Neither the IOU nor its unregulated affiliate should receive any subsidy from the IOU's ratepayers for products or services that it wishes to provide on a competitive basis.

Question 7: Can customers determine their level of participation and are they informed to participate at their desired level?

Response: Customers should have flexibility to determine the number and types of programs in which they participate in a competitive retail market. For example, a customer will work with its retail supplier or a third party to determine whether it should install behind-the-meter generation or energy storage. All customers, through their LSE, must meet (and pay for) an LSE's minimum energy storage, RPS and RA requirements, but a customer will determine whether, and by how much, its own RPS procurement exceeds the minimum requirements established by the Legislature and the Commission.

Question 8: How does this choice model impact and benefit local communities?

Response: Local communities can benefit from an expanded competitive choice program either through the adoption of a CCA program, or through independent decisions by the municipality and/or its citizens and businesses to enroll in direct access. In either case, the local community will benefit because local businesses and citizens (or the municipality as whole) will make decisions about RPS procurement and behind-the-meter generation that have a direct impact on the local environment and local economy.

2) The California Customer Choice Project is reviewing several markets as key examples of how customer choice operates under different regulatory frameworks. These markets include:

- New York
- Texas
- Illinois
- United Kingdom

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?

Response: The Commission need not look further than its own direct access and CCA rules (on the electric side) and the gas industry restructuring rules for guidance on how an expanded customer choice program should operate. The Commission already has in place the customer enrollment and switching rules, stranded cost recovery (customer indifference) rules, and consumer protection rules that necessarily accompany an expansion of direct access and the CCA program.

The Commission (and the Legislature) must decide whether and when the cap on direct access can be lifted (or removed), and whether and when residential customers may participate in direct access once again. The Commission must adopt a transition structure for the IOUs as the POLR. Ultimately, the Commission must establish the rules to replace the IOUs with third party POLRs. These rules will include provisions that address whether, and to what extent, the POLR must enter into long term agreements to serve default customers.

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

Response: The Commission has considered, in previous decisions, all the issues that must be addressed in connection with expansion of the customer choice program. At this point, the Legislature and the Commission must decide when and how customer choice (including direct access) will be expanded.

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

Response: The relevant statutes include P.U. Code Section 365, 365.1, 365.2, 365.5, 366, 366.1, 366.2, 366.3, 366.5, 380, 394, 394.1, 394.2, 394.25, 394.27, 394.3, 394.4, 394.5, 394.6, 394.7, 394.8, 394.9, 395, 396, 396.5, 399.11, 399.12, 399.13, 399.15, 399.16, 399.21, 454.51, and 454.52.

B. 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?

Response: At the center of Texas' competitive choice program is a price incentive for customers to leave IOU procurement and select an alternative supplier. Under the Texas program, the incumbent IOU must establish a fixed procurement price for a two-year period. During that period, customers have the opportunity to choose an alternative retail supplier that offers a more competitive price. The IOU's fixed price is set at a level that encourages customers to shift to an alternative supplier. Rather than adopt programs and incentives that encourage customers to remain with the IOU, the Texas program encourages customers to seek out a more competitive supply arrangement. California should consider a similar approach that encourages customers to leave the IOU for another retail supplier.

Another example of successful competitive choice is California's gas industry restructuring program. This Commission successfully implemented gas industry restructuring rules beginning in the 1980s. These rules, which have functioned successfully for 30 years, provide that all large commercial and industrial (noncore) customers must purchase their gas supply from an entity other than the IOU. Over the past 30 years, the Commission has updated these rules and provided for small commercial and residential (core) customers to elect to purchase their gas supplies from a third party supplier, as well.

Through the gas industry restructuring program, the IOU remains the POLR for core customers that do not otherwise elect a third party supplier. The IOU continues to provide transmission and distribution service to all customers, and may provide billing service as well. Through its System Operator, the IOU manages customer "imbalances" on a daily and monthly basis (requiring customers' deliveries of gas into the system to match customer usage within a tolerance band) to maintain system reliability.

Through the gas restructuring program, the Commission has addressed customer enrollment and "switching" rules, stranded cost recovery rules, and consumer protection rules. Many of the rules adopted for the gas program have been embraced, in some form, for the electric market. The Commission's recent decision on "competitive neutrality" for third party demand response programs, for example (D.17-10-017, October 26, 2017), is a direct descendant of Commission decisions approving the "unbundling" of costs from noncore gas customer rates. In a series of decisions adopted by the Commission over more than two decades, the Commission decided that noncore customers may choose to obtain interstate pipeline capacity, storage, and/or backbone transmission capacity on their own. In each case, the IOU's embedded transportation and/or storage costs were removed from noncore customers' rates. See, e.g., D.11-04-032 (April 14, 2011).

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

Response: Potential "pitfalls" may arise if the Commission opens direct access to all residential customers at the same time, on an accelerated schedule. It makes sense to take a first step by opening direct access to all commercial, industrial and agricultural customers. Thereafter, the Commission can open direct access to residential customers on a phased basis.

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

Response: Customer choice is driven by retail customers that want to make their own procurement and customer service decisions. The IOUs provide a one-size-fits-all service, with the same combination of resources for every customer, regardless of the customer's needs. An ESP, by contrast, works with a customer to develop an energy plan that includes a tailored portfolio of energy, energy storage, behind-the-meter generation, demand response and energy efficiency, all of which can be managed efficiently to meet the customer's needs, and in conjunction with the State's policy goals.

An ESP's tailored energy resource program for a retail customer may include behind-the-meter generation combined with energy storage, electric vehicle charging, and/or flexible price hedging to assist a customer in levelizing costs, reducing its load, extending de-carbonization to transportation service, and meeting the customer's "green portfolio" and/or sustainability goals. A direct access customer may choose, for example, to purchase all of its RPS energy resources from facilities and resource types agreed upon by the customer and its ESP.

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?

Response: The "cap" on commercial, industrial and agricultural customer participation in direct access must be removed. In addition, the Commission must facilitate the development of a liquid market through which firm resources (RA capacity, RPS energy and capacity) can be purchased and sold between LSEs based on customer migration between bundled IOU sales service and direct access or CCA service.

Grid reliability resources should be purchased by the CAISO and the cost of the reliability resources should be allocated to all customers through the TAC. The utilities (or succeeding POLRs) should not engage in procurement on behalf of direct access and CCA customers. The CAM should be eliminated prospectively. Limits should be imposed on the duration and amount of the PCIA.

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?

Response: The "cap" on commercial, industrial and agricultural customer participation in direct access must be removed immediately. Removing the cap will require a modification to P.U. Code Section 365.1(b), and potentially other statutes. Once direct access is opened fully to nonresidential customers, the Legislature should look again at other statutory provisions to determine whether they are consistent with a structure in which a large portion of the market is served by entities other than the IOU.

III.

CONCLUSION

Shell Energy looks forward to participating actively in further discussions about the California Customer Choice Project.

Sincerely,

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Attorneys for Shell Energy North America (US), L.P.