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

See Shell Energy's attached supplemental comments on the Draft Green Book submitted to the Customer Choice Team on June 11, 2018.

Additional submitted attachment is included below.

Via E-Mail

July 6, 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. Supplemental
Comments on Customer Choice Issues and Draft Green Book

To: California Customer Choice Team:

In response to the invitation extended at the en banc hearing on June 22, 2018, Shell Energy North America (US), L.P. (“Shell Energy”) submits supplemental comments on Customer Choice issues and the draft revised “Green Book.” In its supplemental comments, Shell Energy responds to some of the issues raised during the June 22 en banc hearing.

I.

INTRODUCTION

Former FERC Commissioner Pat Wood III hit the nail on the head when he said that competitive choice is not a problem to be solved; rather, it is an opportunity as the State seeks to achieve the stated goals of affordability, de-carbonization, and reliability of electric service. The State will achieve de-carbonization more quickly, with more diverse resources, at a lower cost, if the market is open to competition. Contrary to concerns raised by some Commissioners, electric service reliability can be maintained and enhanced through an open and competitive market structure.

Former Commissioner Wood also noted that the power grid of the future will be decentralized, and providers of energy products and services will be more dispersed. In view of the inevitability of energy choice at the customer level, the Commission should embrace competition at the retail level and work with stakeholders to develop structures to support competition and customer-based energy solutions. The IOUs do not have a monopoly on innovative energy ideas. Neither should the IOUs have a monopoly on the energy procurement structure.

II.

THE COMMISSION SHOULD EMBRACE A COMPETITIVE RETAIL ELECTRIC MARKET TO ENABLE CUSTOMER-FOCUSED ENERGY SOLUTIONS

Panelists at the June 22 hearing repeatedly noted that customers seek greater control of the sources and prices of energy used at their homes and businesses. This has been the driving force behind the CCA movement and the legislatively capped direct access program. This is also why there is a lengthy queue among agricultural, commercial and industrial customers to participate in direct access.

Customers do not want to be limited to the service options offered by the IOUs. This sentiment was expressed forcefully in the June 22 hearing and in the Commission's rate design workshop held in December 2017. Customers highlighted the difficulty of aligning utility rate structures with customers' desire to manage their own energy portfolios.

Rather than make it more burdensome for non-IOU LSEs to participate in the State's electric market, the Commission should make every effort to facilitate competition and encourage innovative energy solutions. The Commission should listen to the ideas advanced by customers and third-party suppliers. The Commission should not perpetuate a "command and control" structure that fundamentally stifles innovation. Limits on competitive choice discourage new businesses from entering the California economy.

III.

IN A TRANSITION TO AN ENERGY-ONLY MARKET, THE COMMISSION SHOULD TAKE STEPS TO FACILITATE A LIQUID AND TRANSPARENT CAPACITY MARKET

During the hearing, Commissioners asked why it appears that the IOUs have been the only LSEs that have purchased RA capacity on a long term basis. The answer is simple: The IOUs have guaranteed cost recovery for IOU-procured capacity, through the CAM, PCIA or otherwise. Guaranteed cost recovery makes the IOUs indifferent to the prices they pay for new RA (and RPS) resources. The IOUs currently have little, if any incentive to negotiate with a developer for the lowest possible price for new capacity, and the IOUs have little, if any incentive to limit their procurement based on a reasonable projection of future (and departing) load.

Furthermore, the IOUs have no incentive to reduce the costs of the assets in their supply portfolios or to assign or sell excess capacity. Regardless of whether or how the IOUs dispose of excess capacity, the IOUs recover the full cost of their excess resources: from their own procurement customers through the generation charge; and from departing load customers through the CAM and the PCIA. "Shortages" of local RA capacity in some cases may be the result of IOUs' withholding unused capacity.

The IOUs' guaranteed recovery of costs under Commission-approved procurement contracts has led to an excess of capacity and has created a dysfunctional hybrid (dual) capacity market. The Commission has approved extremely high prices for IOU procurement of new RA capacity (the costs of which are spread to all customers through the CAM), while much lower prices are obtained in the bilateral market for existing RA capacity. In some cases, the price of new capacity purchased by the IOUs exceeds the market price by a factor of four.

A hybrid RA capacity market cannot function properly. The current dual market structure discourages merchant generators by underfunding their facilities' fixed costs, resulting in less funding for maintenance unless the generator has a long-term contract. Merchant generators threaten to retire existing facilities in order to cause the CAISO to institute RMR contracts or trigger the Capacity Procurement Mechanism ("CPM"). The Commission must fix the current bilateral RA capacity market, starting with an examination of whether a capacity requirement is necessary at all. As proposed by former Commissioner Wood, the Commission should "bend the curve" to focus on a liquid and transparent energy market, thereby reducing the cost of capacity for all California ratepayers.

During the hearing, President Picker emphasized that in the past year, there have been eleven requests for waiver of the local RA obligation. It appears that President Picker raised the issue to suggest that the only way to ensure reliability in certain local sub-areas is to assign local RA procurement responsibility to a "central buyer."

Contrary to President Picker's suggestion, the requests for waiver of the local RA obligation were not made because resources are not available to serve the specific local reliability areas. Rather, the requests for waiver were made due to the absence of a liquid and transparent market for the purchase and sale of local RA capacity, exacerbated by last-minute CAISO changes to RA requirements after the Commission had issued its determination of annual LSE RA requirements. The IOUs are naturally reluctant to release RA capacity out of concern that they will be accused of not meeting RA capacity requirements. This results in the IOUs holding capacity that they do not need, thus creating an artificial shortage of capacity in constrained local areas. Only diligent auditing by this Commission can address this artificial market deficiency.

The remedy for constrained local RA capacity is not a "central buyer" of local RA capacity, but rather an open and transparent market, with multiple buyers and sellers. Even in local sub-areas, developers will build capacity if a transparent market produces proper price signals for new generation.

In instances where it is found that a shortage of local RA capacity does in fact exist, the Commission should work with the CAISO to determine if new transmission may be an alternative to new generation in the local reliability area. In many cases, new transmission will provide improved firm connectivity to existing generation outside the local sub-area and obviate the need for new generation.

The Commission also has the opportunity to explore market-based mechanisms to encourage new generation located in constrained areas. For example, long term Congestion Revenue Rights (“CRR”) to the “gen hub” can provide revenue assurance for a new generator that locates in a locally constrained area. When the generator’s bid to recover costs is mitigated to a value assigned by the CAISO, the CRR provides necessary compensation to cover costs at the hub price. This market-based solution can be compared to upgraded transmission costs and other renewable, energy efficiency and demand response alternatives to resolve local area shortages.

Developers are eager to provide market-based solutions to multiple LSEs in a transparent and open RA market, with RA needs, especially at the sub-lap level, known in advance. At a minimum, where the operation of a transparent and liquid RA market shows a need for additional resources in a local sub-area, the CAISO should study the potential for transmission to address the constraint.

IV.

ESPS AND CCAS WILL BE ENCOURAGED TO INVEST IN CAPACITY ON A LONG-TERM BASIS WHEN THERE IS GREATER CERTAINTY IN THE REGULATORY STRUCTURE

Non-IOU LSEs do not have guaranteed cost recovery for the procurement-related assets they purchase for their customers. If an ESP or a CCA loses load, it does not have a mechanism to shift the costs of excess resources to other LSE customers or to the IOUs. Non-IOU LSEs must recover the costs of RPS and RA assets from their own customers, or not at all. This structure provides natural accountability for an LSE’s actions.

During the hearing, Commissioners expressed concern that CCAs and ESPs do not invest long term in RA and RPS resources. Commissioners asked whether and when CCAs and ESPs will make the long-term financial commitments necessary to ensure the reliability of the grid.

CCA and ESP representatives noted that non-IOU LSEs will make long-term investments in fixed generation assets when they have greater certainty regarding the rules of the game. Currently, the direct access market is limited to a small slice of the non-residential market. Opening up the market for direct access will provide assurances that an ESP can compete with other ESPs, CCAs and IOUs for retail customers. An open, unrestricted direct access market is a logical step toward a more liquid bilateral RA capacity market. When ESPs are fully able to participate in the market for retail competition, ESPs will invest long term in the resources that are necessary to serve retail load.

Furthermore, a large portion of the RA and RPS resources in a non-IOU LSE's portfolio reflects IOU-procured resources, the costs of which are allocated to all customers through the CAM. An ESP or a CCA cannot make long term investments in new (or existing) resources when the IOUs continue to invest in new resources (including but not limited to local reliability resources) and pass the cost (and benefit) of these resources on to the customers of CCAs and ESPs. The Commission must eliminate the IOUs' ability to procure new resources and allocate the costs to direct access and CCA customers.

Similarly, ESPs and CCAs face uncertainty because the PCIA is in flux. Volatility in the PCIA from one year to the next makes it difficult for a non-IOU LSE to procure resources on a long term basis and offer a price that competes with the tariff price available from the IOU. A final decision on the PCIA calculation, as well as a final decision on the IOUs' obligation to optimize their supply portfolios, will provide greater certainty regarding the level of the PCIA, and greater certainty regarding the resources that can be acquired by non-IOU LSEs to serve their customers' load.

Finally, if the Commission is intent upon imposing a multi-year forward procurement obligation on LSEs that do not have guaranteed cost recovery (see D.18-06-030), the Commission must establish or facilitate a transparent bilateral capacity trading platform (electronic bulletin board and/or a centralized capacity market) to allow LSEs to purchase and sell capacity to meet the needs of shifting load. In its haste to approve a multi-year forward procurement obligation in the RA proceeding, the Commission neglected to address the means by which a non-IOU LSE may minimize stranded costs resulting from load migration.

V.

THE COMMISSION SHOULD ESTABLISH TARGETS, NOT MANDATES; PROVIDE LSEs WITH FLEXIBILITY TO MEET THE STATE'S PUBLIC POLICY GOALS

A common question during the hearing was how the Commission can ensure that public policy goals are met, except through a central procurement agent (IOU) that is regulated by the Commission. These public policy goals include energy storage procurement, demand response and energy efficiency programs, specific RPS resource procurement (e.g., generation fueled with biomass from high hazard zones), and local RA sub-area resources. The answer, provided by ESP, CCA and customer representatives during the hearing, is straightforward: The Commission should establish targets, and then get out of the way.

The Commission should allow retail suppliers to meet State-imposed targets in the manner they choose: an approach that is tailored to the needs of its customers and is market-based. The Commission should avoid the temptation to micro-manage energy storage, RPS, RA and demand response procurement decisions by non-IOU LSEs. Similarly, compliance mechanisms must be easily transferrable between LSEs to ensure economic efficiency and market liquidity.

If the Commission allows market participants, including customers, to devise innovative means to meet the State's public policy targets, the Commission will not have to direct specific procurement by the IOUs. Restrictive mandates that dictate the balance of resources, the source of resources, the length of contracts, and the terms of delivery are not the answer when the market is de-centralized. The Commission's role should be to establish the targets and monitor LSEs' progress toward achieving these targets. LSEs will find innovative and economic means to meet the targets, resulting in greater affordability and equally effective reliability. A competitive, customer-focused approach is likely to lead to greater and more accelerated de-carbonization, as well.

VI.

CONCLUSION

The Commission should embrace customer choice as the vehicle to achieve greater reliability, affordability and de-carbonization in the State's electricity market. Competitive electricity suppliers can provide innovative energy solutions tailored to individual customers' needs and circumstances.

In addition, the Commission must eliminate the "hybrid" capacity market and avoid the temptation to authorize centralized procurement by the IOUs 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 and/or behind-the-meter resources) to meet capacity needs, including capacity needs in local reliability areas.

Shell Energy appreciates the opportunity to provide these supplemental comments.

Respectfully submitted,



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