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Response of the Alliance for Retail Energy Markets

Additional submitted attachment is included below.

BEFORE THE ENERGY COMMISSION
OF THE STATE OF CALIFORNIA

In the matter of, *2017 Integrated Energy Policy Report (2017 IEPR)*	Docket No. 17-IEPR-01 NOTICE OF REQUEST FOR PUBLIC COMMENTS RE: Joint En Banc on Changing Nature of Consumer and Retail Choice in California

RESPONSE OF THE ALLIANCE FOR RETAIL ENERGY MARKETS TO THE CALIFORNIA ENERGY COMMISSION REQUEST FOR PUBLIC COMMENTS ON THE JOINT *EN BANC* ON THE CHANGING NATURE OF CONSUMER AND RETAIL CHOICE IN CALIFORNIA

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Pursuant to a June 14, 2017, Notice of Request for Public Comments in Docket No. 17-IEPR-01, the California Energy Commission ("Energy Commission") sought comments on the May 19, 2017, Joint En Banc Hearing it held together with the California Public Utilities Commission ("CPUC") to discuss the changing state of retail electric choice in California. The Energy Commission has requested comments on these materials as they relate to the scope of the 2017 Integrated Energy Policy Report ("IEPR"). The Alliance for Retail Energy Markets[1] ("AReM") is pleased to offer these comments in response.

I. INTRODUCTION

In preparation for the En Banc Hearing, the CPUC issued a Staff document entitled-*Consumer and Retail Choice, the Role of the Utility and an Evolving Regulatory Framework Staff White Paper* ("White Paper") describing the changing electricity landscape and highlighting key framework policies. The White Paper stressed that the Energy Commission and CPUC "must now look at long held assumptions in their regulatory frameworks and examine the role of the electric utility at the center of this system, tasked with the primary responsibility for

[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.

providing power and other services to all consumers within a geographic service area."[2] It explained that the annual process for planning for energy needs, including natural gas, petroleum, electric generation and energy efficiency, starts with the Energy Commission's Integrated Energy Planning Report ("IEPR"), which establishes a ten-year needs projection.[3] The inclusion of these comments on the En Banc Hearing in the IEPR process is thus much appreciated by AReM, as the IEPR is foundational to California's energy future. Further, the White Paper states that the Energy Commission and CPUC, as sponsors of the En Banc, will prepare and publish a report from the hearing, summarizing the range of comments on these key questions, and summarizing the insights gleaned from comments such as these offered by AReM.

AReM appreciates the Energy Commission's focus on California's future. The future best able to meet California's climate change goals efficiently, effectively and innovatively is one with fully open retail choice available to all consumers and utilities operating as wires companies that *facilitate* energy choices by customers and third-party suppliers. Several key actions are required to make this future a reality: (1) transition of the "role of the utility" to a wires-only company; (2) lifting of the cap on the direct access market; (3) eliminating as much as possible any further "on-behalf-of procurement" by the investor-owned utilities ("IOUs"); and (4) ensuring clear, uniform rules for all market participants.

Obviously, an essential feature of a vibrant future energy landscape would be a transformation of California's IOUs into wires-only companies, which would require the following actions:

- Implementing a provider of last resort ("POLR") model that provides service to customers that do not choose an alternative supplier;
- Transitioning to "wires-only" that provides recovery of stranded costs and mechanisms that limit further utility procurement on behalf of non-bundled customers;

The White Paper explains that the Commission "must evaluate" whether a new POLR requirement should be put in place,[4] but argues that only Texas has jettisoned this "role" for the

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[2] White Paper, at p. 3
[3] Id, at p. 7
[4] Staff White Paper, p. 10.

utilities. That is accurate, but there are POLR models in other markets that do not involve the IOUs. AReM urges that all these options should be explored and evaluated as part of the deliberations on how to adapt the utility role in a retail choice environment.

The White Paper also notes the need to address the "legacy" costs of the IOUs during a "transition to retail choice."[5] Although the IOUs have already enjoyed a lengthy "transition to retail choice" that began in 1998 with the advent of direct access ("DA") and continued in 2002 with the implementation of community choice aggregation ("CCAs"), AReM understands and acknowledges that the CPUC has directed procurement by the IOUs for many different reasons, including procurement on behalf of non-bundled customers, and that fair recovery of those costs will be an important part of a transition to more fully competitive retail choice in California. The White Paper concludes that:

> Finally (and as a fundamental framing consideration), it is critical to recognize that whatever the specific outcomes of this proceeding, it is very difficult to conceive of a scenario where the CPUC and CEC will not find that significant changes to the regulatory model and the utility structure are required. Drivers of change to the California electric system are accelerating whether we want them to or not. Technology will continue to advance and as a result consumers will have more options to meet their energy needs. Customers will seek to use these new developments to further their own needs and interests. California leaders and citizens intend to continue moving forward to decarbonize our economy, and the will to forge ahead grows stronger every day.[6]

AReM concurs that significant changes are required and looks forward to working with the Energy Commission on its evaluation of how the competitive retail market can contribute meaningfully and positively to that process.

II. COMMENTS ON THE PANEL DISCUSSION ON WHAT CUSTOMERS WANT

As customers explore and select alternatives to traditional vertically integrated electricity supply through DA, CCA and distributed generation options, AReM foresees a transition during which the state's IOUs will be responsible for the construction, operation and maintenance of their existing and future transmission and distribution systems pursuant to the existing rate regulated cost-of-service framework. This is both a role for which they are well-equipped and

[5] Staff White Paper, p. 11.
[6] Id, at p. 14

one that will not harm their investors as it is the source of all their utility-based shareholder earnings. The IOUs should also the ability to recover all appropriate costs associated with previous and future supply-side purchase requirements. As a general principle, it has been observed that where retail choice is vibrant, IOUs are generally wires companies with the ability to support various customer and public policy demands. For example, this is the case throughout the Texas, New England, New York, and Mid-Atlantic organized markets.

Furthermore, increasing the ability for customers to choose their electric supplier need not come at the expense of achieving the state's environmental or reliability goals. Indeed, the markets that support broad retail choice have ample reserve margins and vibrant renewable portfolio standards and emission reduction goals. The same should be true in California; that increasing retail choice will facilitate achievement of the increasingly higher levels of renewable and emission free electricity supply that Californians desire.

Put simply, AReM believes that all consumers from the smallest residential to the largest industrial should have a multiplicity of choices and not be obligated solely to take "one size fits all" service, whether bundled service from an IOU, DA service from an ESP or service from CCA. We routinely accept choice as a matter of fact in almost all our daily activities. We choose where to shop, where to dine, what cable company to use, what gasoline retailer, what cellular carrier. Electricity should be no different. Choice by its very nature encourages more market participants and this multiplicity of suppliers and consumers facilitates innovation, competition and lower costs.

Consumer protections, especially for residential and small commercial load, must be maintained. However, AReM does not believe that there should be any dichotomy between the consumer protection requirements imposed on non-profit or for-profit suppliers. AReM is unaware of any significant or pervasive consumer protection issues that have occurred under existing regulations. Therefore, AReM would suggest that any changes to the current consumer protection requirements should target and address any area of the current regime that does not or is not expected to work well as retail choice increases.

AReM does not believe the utilities must necessarily continue to be saddled with the POLR obligation, although such a model is certainly workable in a retail choice market structure. There are several models in the existing retail choice markets that work well to ensure that customers who for whatever reason do not select a competitive supplier are provided with stable pricing and reliable supply, even while their right to select an alternative supplier is maintained.

Moreover, these models also provide for customers who elect alternative supply to return to the POLR service should that become necessary or desirable, and the construct of the POLR models is such that they present no financial risks to themselves, and limit any obligation for owning generation assets. AReM notes that the transition to an appropriate POLR model for California will likely be among the biggest challenges and most sweeping change that is necessary for retail choice to thrive. Therefore, AReM recommends that the Energy Commission give additional consideration to POLR procurement models, including determining the POLR preferences of the IOUs, to begin the assessment of what will work best in California.

III. COMMENTS ON THE PANEL DISCUSSION ON THE STATE OF CUSTOMER CHOICE IN CALIFORNIA

AReM is comprised of ESPs that serve a large portion of the state's DA load and participate in the CCA programs. DA service is popular not simply because it affords customers choice and the ability to actively manage their energy costs by selecting among a variety of pricing options. DA customers also can receive individually tailored, customer-specific services that monolithic IOUs are unable or unwilling to provide. If a customer wants 100% green power, an ESP can provide it. If it wants billing services to reflect and work with its own accounting systems and generates energy use reporting that helps manage energy use, an ESP can provide it. If it wants assistance with unique behind the meter storage or distributed energy resources, or with participation in demand response opportunities, an ESP can provide that as well, including financing of energy efficiency tools on their commodity bill. Put simply, ESPs are customer driven and efficiently and effectively meet individually designed and desired customer needs.

Furthermore, retail competition almost inevitably results in lower prices to consumers. In a recent study for the Retail Energy Supply Association ("RESA"), Dr. Philip O'Connor, former Chairman of the Illinois Commerce Commission, concluded that, "Prices in competitive states have trended downward while in monopoly states prices have been rising, producing a double-digit gap in average price changes when adjusted for inflation."[7] A February 2014, joint report

[7] Restructuring Recharged - *The Superior Performance of Competitive Electricity Markets 2008-2016*, April 2017.

prepared by the Illinois Chamber of Commerce, Manufacturers' Association, Retail Merchants Association and Business Roundtable reported to the Illinois General Assembly that:

> When the new law began implementation in mid-1998, Illinois had the 13th highest average electricity prices in the United States. In 2013, Illinois' average electricity prices were among the ten lowest in the country. Illinois electricity consumers—residential, business and government—have paid $37 billion less since 1998 than they would have if our state's average electricity rates had maintained their above average level in the decade prior to industry restructuring.[8]

As noted by Dr. O'Connor, "The central problem with the traditional model of monopoly electricity pricing in a future characterized by low growth is that it inevitably results in higher per unit prices on shrinking sales volumes in order to cover fixed generation costs. This is the conundrum at the heart of the much-discussed 'utility death spiral.'"[9]

This situation can be addressed by providing for fair recovery of any stranded costs and implementing procurement models, such as those used by POLR providers in other markets, that avoid the creation of new stranded costs. In short, the fundamental element of the transition is that the IOUs be allowed to stop or transition away from having to procure base load generation for load they do not serve or will not be serving. The Energy Commission should rigorously examine IOU load forecasting and procurement so that stranded costs burdens are curtailed. The existing cost allocation mechanism paradigm cannot be maintained in a market that is expected to facilitate retail choice

Certainly, AReM advocates for reopening of the DA market even as the CCA market continues to grow. The Energy Commission and CPUC simply cannot be serious about facilitating retail choice if only some versions of choice are permitted, although AReM recognizes that the authority for expansion of DA resides with the California legislature. Nevertheless, the question as to whether there needs to be an increased level of regulatory oversight on the procurement practices of competitive suppliers is one that should be addressed.

ESPs can procure long-term system and local capacity in a reopened and uncapped market. For ESPs to do so, however, there must be market based tools, such as a centralized capacity market or some form of fixed resource requirement structure to provide a way to

[8] "*Electricity & Natural Gas Customer Choice in Illinois—A Model for Effective Public Policy Solutions*."

[9] "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, at pp. 7-8 (copy attached).

manage capacity procurement risks that will occur, as ESPs contracts with its DA load may differ from the underlying RA compliance requirements. AReM believes that implementation of the market based tools to ensure reliability will be one of the key challenges of the transition to full retail choice but a further benefit of putting these changes in place is that the competitive development of new generation by ESPs and CCAs s will be far less likely to result in costly excess capacity. The market will deliver the investment mandated by environmental and reliability requirements so long as there are appropriate risk management tools and relief from the current stranded costs burden.

Reopening the competitive DA market and continued CCA expansion will ultimately benefit customers. A reopened DA market will encourage additional market entrants that are successful retail providers in states that are more receptive to competition than California. More suppliers will cause competition not only as to price, but also with respect to innovation and services. This will affect both ESPs and CCAs and drive them both in the direction of offering greater services, lower prices and more options. Consumers will benefit directly from this increased competition, as they should.

IV. COMMENTS ON THE PANEL DISCUSSION ON THE INVESTOR-OWNED UTILITY PERSPECTIVE ON CURRENT STATE OF RETAIL ELECTRICITY MARKET AND COMING CHANGES

A future retail electric system should ideally be one in which end-users are free to select the supplier of their choice and to work with suppliers to devise supply portfolios that meet their energy needs, consistent with established and clear reliability and environmental mandates. One way to accomplish that is to transition the utilities away from their role as a rate-regulated, vertically integrated supplier of energy to a wires company approach where their focus is on constructing, maintaining and operating their distribution systems.

This transition will require that the IOUs' existing supply portfolios be monetized, transitioning these supply resources to competitive ownership. Again, models for achieving this transition already exist in the retail choice markets, ranging from outright divestiture through sale of the resources to transfer of the assets to competitive affiliates. It is also important to continue to ensure that the selected POLR structure works well to provide POLR customers, including low-income or hard to serve customers, with reliable supply, and that customer switching among suppliers and to and from POLR service is well managed. AReM believes that programs benefitting low income and hard to serve customers are beneficial and should be maintained. If, however, there is a broad reopening of DA, participation in these programs should not compromise customers' right to choose.

AReM believes that ESPs and CCAs, which are far closer to their customers' needs and desires, should be free to make decisions that best meet the needs of those customers, consistent with the stated reliability and environmental mandates. An examination of how other states with open direct access markets have managed the transition from vertically integrated IRP procedures to retail choice should be helpful as these concepts are further explored.

It was notable at the *en banc* that the IOU representatives focused much of their presentations on their need to recover stranded costs and their portfolio allocation methodology ("PAM") proposed in the joint IOU application A.17-04-018. AReM has believed since the PAM application was filed that the evaluation of PAM should take place as an essential part of a new proceeding that should be opened to consider *en banc* issues. The CPUC has subsequently dismissed the IOUs' application without prejudice and directed that it will instead be considered as one of many alternatives to Power Charge Indifference Adjustment ("PCIA") reform in the new rulemaking approved at the CPUC's meeting held on June 29, 2017. AReM continues to believe that PAM should be considered in the context of the overall market structure transformation that is underway so that its evaluation will more appropriately address whether PAM is a better stranded cost recovery mechanism than the current PCIA. More importantly, it will provide the forum to address how to eliminate the creation of new stranded costs and eliminate the stranded cost burden going forward in a more competitive retail market of the future.

AReM and other CCA and DA retail choice advocates have long sought stranded cost reform, which the utilities now seek as well. A new proceeding to examine the broad issues will help advance the discussion of what must be done in order for the full spectrum of California residents and businesses to enjoy the benefits of retail competition for electricity service. A new regulatory model and paradigm needs to be adopted that reflects the watershed changes that are transforming the electricity market.

V. COMMENTS ON THE "BIG THINK PRESENTATION" ON THE FUTURE OF RETAIL ELECTRICITY SERVICE

The Energy Commission should urge the CPUC to commence a new rulemaking to reconsider and modify the existing vertically integrated utility model so as to better facilitate the evolution that is occurring in customer choice, encourage retail competition, support the growth of CCAs and address stranded costs in a manner that leads to their eventual elimination. This will require at least four discrete steps. First, the CPUC must curtail the current IOU over-procurement that exacerbates stranded costs. Second, it must determine how best to monetize the IOUs existing portfolios so that stranded costs can eventually be ended. Third, it must develop mechanisms whereby the IOUs transition to wires companies. And finally, it must decide how the POLR function will be structured. As those tasks are performed, the Energy Commission can provide very valuable input and assist the CPUC in designing the appropriate compliance oversight to ensure all market participants are meeting the reliability and environmental mandates without imposing overly proscriptive investment requirements. In this manner, the Energy Commission and CPUC will continue their roles of ensuring that the state meets its reliability, clean energy and climate goals while at the same time encouraging choice and removing the barriers to competition.

VI. CONCLUSION

The lessons learned from states where retail competition is encouraged are many and varied. The O'Connor paper cited above notes the following in that regard:

- Customer Choice is thriving in 13 states and the District of Columbia, which have full access ("Customer Choice Jurisdictions").
- From 2003 to 2013, in the 14 Customer Choice Jurisdictions, accounts served with supply from competitive suppliers rather than with power supply from local delivery utilities, grew by 524% for Commercial and Industrial ("C&I") customers and 636% for residential, totaling 19 million customer accounts by year-end 2013.
- From 2003-2014, in the 14 Customer Choice Jurisdictions electrical load served by competitive suppliers grew dramatically even in an era of overall flat growth in electricity consumption: 181% for C&I and 673% for residential – accounting for 20 of every 100 kilowatt hours sold in the contiguous United States.

- Competition era price trends in the Customer Choice Jurisdictions have been more favorable to customers than price trends in the 35 traditional monopoly regulation jurisdictions ("Monopoly States"), with average electricity prices falling against inflation in Customer Choice Jurisdictions, but far exceeding inflation in Monopoly States.
- Customer Choice Jurisdictions, as a group, have outperformed Monopoly States in generation, attracting billions of dollars of investment in new, more efficient generation, resulting in higher capacity factors than in Monopoly States and parity in resource adequacy to meet load.
- The five states of the Industrial Upper Midwest offer a compelling intra-regional example of the success of Customer Choice, with the competitive states Illinois and Ohio outperforming the Monopoly States of Indiana, Michigan and Wisconsin with lower price trends and greater generation efficiency.[10]

Results like this provide meaningful evidence that retail competition is good for consumers; good for attracting generation investment; and good for a state's economy. As California plots its course forward the lessons from the Customer Choice Jurisdictions are particularly enlightening and persuasive.

AReM thanks the Energy Commission for its attention to these comments.

Respectfully submitted,

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[10] The data sources for the O'Connor report are DNV GL (choice accounts and volumes) and the U.S. Energy Information Administration (prices, generation and consumption volumes). DNV GL provides authoritative information on competitive electricity markets (www.dnvgl.com/energy) and the U.S. Energy Information Administration is the premier source for federally collected energy data (eia.gov).