BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Implement Portions of AB117 concerning Community Choice Aggregation.	))))	Rulemaking 03-10-003 (Filed October 2, 2003)
	)	**(NOT CONSOLIDATED)**
Rulemaking regarding whether, or subject to what Conditions, the suspension of Direct Access may be lifted consistent with Assembly Bill IX and Decision 01-09-060.	))))))	Rulemaking 07-05-025 (Filed May 24, 2007)

OPENING BRIEF OF THE UTILITY REFORM NETWORK

ON ESP AND CCA FINANCIAL SECURITY REQUIREMENTS

THE UTILITY REFORM NETWORK
115 Sansome Street, Suite 900
San Francisco, CA 94104
Telephone: (415) 929-8876
Facsimile: (415) 929-1132
E-mail: bfinkelstein@turn.org

January 24, 2011

Robert Finkelstein
Legal Director

OPENING BRIEF OF TURN ON FINANCIAL SECURITY REQUIREMENTS

Pursuant to the Assigned Commissioner and Administrative Law Judge (ALJ) Amended Scoping Memo and Ruling, issued January 14, 2011 in R.03-10-003, and the ALJ's Ruling Amending Procedural Schedule, issued January 7, 2011 in R.07-05-025, The Utility Reform Network (TURN) respectfully submits this opening brief on the issues of financial security requirements for Energy Service Providers (ESPs) and Community Choice Aggregators (CCAs) under Public Utilities Code in Section 394.25(e), and the use of such security deposits to cover the required reentry fees if an ESP or CCA involuntarily returns its customers to utility bundled service without adequate prior notice.

TURN addressed many of these very same issues in its "Comments of TURN on ESP Security Deposits and Reentry Fees Pursuant to Decision No. 03-12-015," which were submitted to this Commission in A.00-11-038 on February 4, **2004**, nearly SEVEN YEARS ago. While this issue has clearly languished for quite some time, TURN basic interpretation of Section 394.25(e) has not changed, nor have the substantive requirements of the statute. The following text – taken directly from TURN's 2004 comments – continues to express our position.

"TURN appreciates the Commission's action in seeking comments on this important issue. And, let there be no doubt, TURN firmly believes that this IS an extremely important issue. This Commission must not forget that during the darkest days of the energy crisis in the winter of 2000-2001 a number of ESPs 'dumped' their customers back onto bundled service, sometimes without even notifying the customers of what was happening. And those involuntary returns of customers forced the utilities, and ultimately the State, to purchase significant additional quantities of spot market power at the very time that the cost of that power was at its highest. Indeed, no small portion of the costs that *all customers* are now repaying through the

SB_GT&S_0459170

DWR Bond Charge came about as a direct result of this 'dumping.' Even the direct access (DA) customers who, at the time, were led to believe that they were still getting 'the benefit of the bargain' of their DA contracts are now paying the costs of the DWR bonds that were sold to pay off the State's energy crisis debts. Clearly, there IS a real and important consumer protection issue at stake here, even (and perhaps especially) with respect to those ESPs who serve only large commercial and industrial customers. This sad chapter of California history must never be allowed to repeat itself, and this proceeding provides the perfect time and place to ensure that result.[1]

"The critical statutory language at issue here can be found in Section 394.25(e) of the Public Utilities Code, as enacted by AB 117 (2002):

> If a customer of an electric service provider or a community choice aggregator is involuntarily returned to service provided by an electrical corporation, any reentry fee imposed on that customer that the commission deems is necessary to avoid imposing costs on other customers of the electrical[2] corporation shall be the obligation of the electric service provider or a community choice aggregator, except in the case of a customer returned due to default in payment or other contractual obligations or because the customer's contract has expired. As a condition of its registration, an electric service provider or a community choice aggregator shall post a bond or demonstrate insurance sufficient to cover those reentry fees. In the event that an electric service provider becomes insolvent and is unable to discharge its obligation to pay reentry fees, the fees shall be allocated to the returning customers.

"While this language appears to be relatively straightforward, TURN is concerned that the Commission, in D.03-12-015, appears to harbor some uncertainty as to whether such a 'reentry fee' even exists. Therefore, the first task at hand must be to clearly delineate what is meant by the term 'reentry fee.' D.03-05-034 required that DA customers returning to temporary or transitional bundled service pay 'the incremental cost that will be imposed on the system due

---

[1] TURN notes that not long ago in the state of Texas several ESPs failed during a period of high spot market prices, resulting in their customers defaulting to provider of last resort service.

[2] The word "electrical" was inserted into the statute to replace the word "electric" in 2005. Except for that non-substantive amendment, the statute remains the same today as it was in 2004.

SB_GT&S_0459171

to the additional short-term power supplies procured to serve them' (p.19). This was to ensure that the remaining bundled service customers would not be burdened with added costs, and would remain indifferent to the return of former DA customers. . . . . .

"TURN submits that, to the extent that the TBS rate paid by a returning DA customer exceeds the bundled portfolio price at any given point in time, that *differential* should be understood to represent the 'reentry fee imposed on that customer that the commission deems is necessary to avoid imposing costs on other customers of the electric corporation,' as provided in Section 394.25(e). Indeed it is difficult for TURN to understand how any other interpretation of the TBS rate could be sustained under the statute. The imposition of the TBS rate when spot prices are high appears to be designed precisely to prevent a recurrence of the circumstances that arose during the energy crisis, when the State was forced to purchase high-priced spot power to serve returning DA customers.

"The consumer protection aspect of Section 394.25(e) is apparent in the requirement that the ESP (or community choice aggregator) that *causes the involuntary return* of the customer to bundled service shall be responsible for this reentry fee. Unlike what happened in early 2001, the legislature clearly intended that, in any future occurrence of this nature, it should be the ESP [or CCA] and NOT CUSTOMERS, either bundled or DA, who pays this reentry charge. And a demonstration of the assured ability to pay such a charge was made a condition of registration for ESPs [and CCAs], regardless of the size of the customers they serve.

"In response to the Commission's specific questions in OP 6 [of D.03-12-015], then, it is clear that there IS an important consumer protection value to be served by a properly designed deposit, bond and/or insurance requirement for ESPs [and CCAs] serving customers of *any* size. However, the current security deposit requirement, which would not exceed $100,000 even for

SB_GT&S_0459172

the largest ESP, seems woefully inadequate to cover the potential risk of a large number of DA customers being dumped back onto bundled service when spot prices are high. The amount of security required for this purpose could be substantial, and could be measured by the DA load of a given ESP times the difference between the spot market (TBS) price and the utility's bundled service portfolio price. And the spot price, as history has shown, could readily reach $150 per megawatt-hour or more, ultimately constrained only by whatever price mitigation exists in the wholesale electric markets administered by the ISO.

"In light of these realities, TURN submits that the current deposit requirement MUST be modified and expanded in order to provide adequate protection to both DA and bundled service customers in the event of a large ESP default at a time when spot prices are high. **This protection is especially important for DA customers**, because Section 394.25(e) clearly provides that the returning customer will bear the reentry fees if the ESP cannot. At the same time, TURN does not believe that a cash deposit is the only way of establishing sufficient credit backing for the ESP's obligation. Normal commercial credit mechanisms, such as letters of credit, performance bonds, or insurance coverage should be allowed, as long as there is sufficient assurance that the ESP will be able to cover the reentry charges for any customers that it involuntarily returns to bundled service. TURN must confess some uncertainty, however, over whether the existence of an investment grade credit rating for the ESP (or a parent company offering to guarantee the ESP's obligations) should be considered sufficient security in and of itself. As we learned the hard way over the last few years, even a highly-rated, widely-acclaimed business entity such an Enron can tumble from investment grade to junk status in an astonishingly small amount of time. The Commission must ensure, in establishing the credit requirements for ESPs who will be serving large amounts of load, that there exists sufficient

security to protect both DA and bundled customers if the ESP suddenly decides to return all of its DA load to bundled.service when spot prices are high, and particularly if that ESP ends up declaring bankruptcy."

Returning to the present day, we find that the financial security requirements for ESPs and CCAs remain a hotly contested issue, despite the relatively clear language of Section 394.25(e), which this Commission has thus far FAILED TO IMPLEMENT for over seven years. It has been argued, for example, that the statute does not explicitly *guarantee* returning DA customers the "right" to purchase utility power at normal bundled service rates, given the existence of the TBS rate. TURN respectfully submits that this line of argument turns the statute on its head. Section 394.25(e) *requires* that: "any reentry fee imposed on that customer that the commission deems is necessary to avoid imposing costs on other customers" shall be the responsibility of the ESP or CCA and not the returning customer. To argue that there is no cost to bundled service customers because the returning customer must pay the TBS rate simply ignores one of the major points of the statute. Given that any premium of the TBS rate over the regular bundled service rate would otherwise be the obligation of the returning customer, that premium IS the "reentry fee" that, under the statute, must be the responsibility of the ESP or CCA, and must be secured through appropriate financial arrangements. Any contrary interpretation lacks a reasonable basis in the words of the statute.

Parties have likewise suggested that this Commission has never adopted a "reentry fee" for returning DA and CCA customers. But as TURN pointed out in its February 23, 2004, reply comments in A.00-11-038:

". . . . . From the context of Section 394.25(e) itself, and from other portions of Assembly Bill (AB) 117 (2002) that were enacted at the same time, it should be obvious that the

SB_GT&S_0459174

‘temporary bundled service’ (TBS) rate adopted for customers returning to bundled service in D.03-05-034 (and finalized in D.04-01-013) represents precisely what the legislature had in mind by the term ‘reentry fee.’ The TBS rate is what a customer returning from direct access or community aggregation to bundled service must pay for a six month period, absent prior notice to the utility, pursuant to D.03-05-034 (p.35). And it is clear that the reason for this requirement is that it was deemed ‘necessary to avoid imposing costs on other customers of the electric corporation.’

"In fact, Section 366.2(c)(11) of the Code, enacted at the same time as Section 394.25(e) as part of AB 117, provides clear direction to the Commission for the establishment of a ‘reentry fee’ such as the TBS rate:

> (11) Following adoption of aggregation through the ordinance described in paragraph (10), the program shall allow any retail customer to opt out and to continue to be served as a bundled service customer by the existing electrical corporation, or its successor in interest. Delivery services shall be provided at the same rates, terms, and conditions, as approved by the commission, for community choice aggregation customers and customers that have entered into a direct transaction where applicable, as determined by the commission.
>
> Once enrolled in the aggregated entity, any ratepayer that chooses to opt out within 60 days or two billing cycles of the date of enrollment may do so without penalty and shall be entitled to receive default service pursuant to paragraph (3) of subdivision (a). Customers that return to the electrical corporation for procurement services shall be subject to the same terms and conditions as are applicable to other returning direct access customers from the same class, as determined by the commission, as authorized by the commission pursuant to this code or any other provision of law. **Any reentry fees to be imposed after the opt-out period specified in this paragraph, shall be approved by the commission and shall reflect the cost of reentry**. The commission shall exclude any amounts previously determined and paid pursuant to subdivisions (d), (e), and (f) from the cost of reentry. (emphasis added)

The TBS rate was specifically designed to ‘reflect the cost of reentry’ as required by Section 366.2(c)(11). Indeed, any other type of reentry charge would likely run afoul of this provision as

NOT being based on 'the cost of reentry.' A charge such as the TBS rate is unquestionably what the legislature had in mind when enacting Section 394.25(e).

"The TBS rate is set based on the spot market price of power, which can be higher or lower than the bundled portfolio price at any given time. But, to the extent that the TBS is higher, the excess of that rate over the bundled portfolio price must be considered a 'reentry fee' subject to the provisions of Section 394.25(e). Most importantly, under that section, such a reentry fee 'shall be the obligation of the electric service provider or a community choice aggregator' and **NOT** the returning customer, if the return was involuntary on the customer's part and none of the other statutory exceptions apply.

"Once the governing statutes are properly understood, it becomes clear why **all** ESPs must be required to comply with the bond or insurance provisions of Section 394.25(e). Absent the ability of the ESP to pay the reentry fee, the involuntarily returned DA or community aggregation customer would be forced to pay the fee, which is exactly the outcome that the legislature was attempting to prevent by enacting this section."

In the current proceedings it has also been argued that DA customers are "big boys" that can either negotiate appropriate protections against their ESP's default in their DA service contracts, or else accept the risk of being involuntarily returned to potentially very expensive TBS service. Under this line of reasoning, Section 394.25(e), as interpreted by TURN and IOUs, is unduly "paternalistic" and does not represent good public policy.

Regardless of the merits, or lack thereof, of this argument, it is one that must be presented to the Legislature and not to this Commission. The Legislature has already spoken to the issue when it enacted the statute, and this Commission is bound to enforce the law, whether it

SB_GT&S_0459176

considers it wise or foolish. If DA customers truly believe that they do not need the protections of Section 394.25(e), they are free to seek its repeal.

While the "paternalism" argument has surface appeal, particularly in context of large, sophisticated customers such as Safeway and WalMart, one must remember the historical context in which Section 394.25(e) was enacted, as discussed above. During the height of the energy crisis, the Legislature could have decided that involuntarily returned DA customers should pay spot market rates (as reflected in the TBS rate today), rather than the then-frozen bundled service rates. Indeed, such proposals were given serious consideration in the Capitol. However, legislators' concerns are not limited solely to protecting their residential and small business constituents who take bundled service. If the largest employer in an assembly or senate district is confronted with being subjected to ruinously expensive spot electricity prices because of a DA supplier's default – prices that could put that employer out of business in a matter of weeks – the Legislature can (and *did* via the enactment of Section 394.25(e)) decide that forcing that large employer to pay spot market prices is simply unacceptable from a public policy standpoint. While one might disagree with that policy judgment, it is clearly one that is within the province of the Legislature to make, and it did so by enacting Section 394.25(e).

DA customers have argued that if ESPs are required to post financial security to insure against the costs of a potential supplier default, then the cost of DA service will increase. That observation may very well be true, but the "insurance value" inherent in maintaining an ESP or CCA financial security requirement was apparently worth the cost in the Legislature's view. Just as the Legislature can require all drivers to carry automobile liability insurance, it can also decide that the costs and risks of another electricity crisis (however unlikely that may appear to be

SB_GT&S_0459177

today) are simply too severe to leave uninsured. This Commission is not empowered to second guess that judgment.

There are those who contend that the events of 2000-2001 could never be repeated, and perhaps they will be able to convince the Legislature that they are correct. But TURN would prefer to rest on the adage that "those who forget the past are doomed to repeat it." In any case, this Commission is bound by Section 394.25(e) and must find that ESPs and CCAs are required by that statute to post financial security sufficient to insure that both involuntarily returned DA and CCA customers AND bundled service customers are protected in the event of an ESP or CCA default, or other involuntary return of customers to utility service.

Respectfully submitted,

THE UTILITY REFORM NETWORK

January 24, 2011

By: ____/s/________________

Robert Finkelstein
Legal Director