BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Rulemaking Regarding Whether, or Subject to What Conditions, the Suspension of Direct Access May Be Lifted Consistent with Assembly Bill 1X and Decision 01-09-060.	Rulemaking 07-05-025 (Filed May 24, 2007)

COMMENTS OF COMMERCIAL ENERGY OF CALIFORNIA ON PROPOSED DECISION ADOPTING DIRECT ACCESS REFORMS

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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Rulemaking Regarding Whether, or Subject to What Conditions, the Suspension of Direct Access May Be Lifted Consistent with Assembly Bill 1X and Decision 01-09-060.	Rulemaking 07-05-025 (Filed May 24, 2007)

COMMENTS OF COMMERCIAL ENERGY OF CALIFORNIA ON PROPOSED DECISION ADOPTING DIRECT ACCESS REFORMS

Pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure, Commercial Energy of California ("Commercial Energy") hereby submits these opening comments on the Proposed Decision Adopting Direct Access Reforms ("PD"), which focus on the electric service provider ("ESP") financial security requirements set forth in the PD. The onerous bonding requirement adopted by the PD at the recommendation of PG&E and SCE is strongly opposed by the DA customers and the ESPs, and is also opposed by SDG&E. Nor is it necessary. The use of existing tariff rules to place involuntarily returned customers on the transitional bundled service (TBS) rate for 6 months upon their return to utility procurement service would fully protect utility bundled customers from any incremental procurement costs. This would, therefore, negate the need for the Commission to adopt any reentry fee for such returning customers. If no re-entry fee is necessary to avoid shifting costs to utility bundled customers then, contrary to the conclusion in the PD, there is no need for the ill-conceived financial security requirements proposed by PG&E and SCE.

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I. ADOPTION OF THE PROPOSED ESP FINANCIAL SECURITY REQUIREMENTS WILL CRIPPLE THE DIRECT ACCESS MARKET BY MAKING IT UNECONOMIC.

Commercial Energy urges reconsideration of the ESP financial security requirements set forth in the PD as such requirements would cripple the ability of ESPs to provide Direct Access ("DA") service by substantially increasing the cost of providing such service and substantially increasing the uncertainty in the changing cost of the financial security bonds. Furthermore, the ESP financial security requirements in the PD are wholly inconsistent with Commission precedent extolling the benefits of the continuation of the DA program and carefully crafting the DA program requirements to avoid making DA uneconomic.

A. The Proposed ESP Financial Security Requirements Could Result in a Huge Cost Increase for ESPs.

The ESP financial security requirements in the PD create the risk of an exorbitant increase to ESPs in the cost of providing DA. As noted in the PD, historical prices during the commodity price run-up in 2008 would have resulted in a bond amount in Southern California Edison Company's ("Edison") service territory of $112 million for an ESP with $2 million dollars in annual sales.[1] The PD goes on to state that a $112 million bond would cost about 1% of the face value of the bond or about $1.1 million dollars.[2] Thus, in the example of the ESP with $2 million in annual sales, the PD would require that ESP to pay over 50% of its *sales* (not net revenue) just to meet the financial security requirement. This is a grossly unreasonable requirement and practically guarantees that ESPs will fail.

The ESP financial security requirement is particularly inexplicable in light of the changes made by the PD to the power charge indifference amount ("PCIA") methodology. In

[1] PD at 57.
[2] *Id.*

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terms of changes to the PCIA, the parties focused on making small, incremental changes to the PCIA in order to better reflect regulatory and industry changes that have taken place in recent years. Those incremental changes to the PCIA are meaningless if the Commission adopts an overly burdensome financial security requirement that could impose costs on ESPs that are orders of magnitude higher.

B. The Proposed ESP Financial Security Requirements Create Substantial Uncertainty Regarding the Costs of Providing DA.

The proposed financial security requirements also create a substantial amount of uncertainty with regard to the cost for providing DA service. The PD requires the bond to be recalculated twice a year,[3] which means that an ESP's costs to meet the financial security requirement could change twice a year. One of the major reasons why customers choose DA as opposed to investor-owned utility ("IOU") service is price stability. ESPs and DA customers can negotiate fixed rates for a specified amount of time, which allows DA customers to have certainty with regard to their energy prices for the term of the agreement. However, if ESPs face changes in the bonding costs required to provide DA service every 6 months, it will be difficult for them to negotiate fixed price deals with DA customers for terms exceeding 6 months. This is particularly true if the costs associated with meeting the financial security requirements will be one of the ESPs' largest, if not the largest, cost of doing business, as described in the example in the preceding section where the financial security requirement equaled over 50% of the ESP's annual sales.

In addition, the PD does not account for the fact that the proposed financial security bond methodology does not include a calculation for implied procurement cost volatility. The PD acknowledges that several parties questioned the appropriate calculation for

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[3] *Id.* at 89.

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implied volatility.[4] The PD rejects a proposal by Pacific Gas & Electric Company ("PG&E") to use SP 15 data as a proxy for NP 15 data.[5] The PD then goes on to direct that historical data be used to calculate implied volatility, and further directs PG&E to present a proposal concerning what period of historic data should be used.[6] This improvised solution means that none of the parties, or the Commission, actually know what the ultimate bond calculation will amount to and whether that amount will bear any sort of reasonable or proportional relationship to actual market conditions. This is a substantial flaw in the adopted methodology that creates unacceptable uncertainty for ESPs attempting to continue to provide DA service.

C. The Proposed ESP Financial Security Requirements are Inconsistent with Prior Commission Decisions Which Seek to Avoid Making DA Uneconomic.

The proposed ESP financial security requirements also contravene Commission precedent, which explicitly acknowledges the benefits of the continuation of DA and approaches DA program requirements in a manner that ensures that DA will not become uneconomic.

In D.02-03-055, the Commission stated:

> AREM and others contend that an earlier suspension will negatively affect California businesses, and thus, affect the California economy. With increased electricity costs resulting from an earlier suspension, California's economy may suffer if firms relocate or choose not to enter the state. Further, as University of California & California State Universities (collectively, UC/CSU) and the Los Angeles Unified School District (LAUSD) point out, such increased costs also affect important state functions, such as the delivery of quality education. . . . Further, ORA states "direct access is a means of diversifying the California electric power market, and therefore helps to protect California against uncertainty." Moreover CMTA/CLECA notes that the growth of direct access load in summer 2001 contributed substantially to a $2.6 billion reduction in the level of the DWR revenue requirement estimate for the period through December 31,

[4] *Id*. at 80.
[5] *Id*. at 81.
[6] *Id*.

> 2002. We agree . . . that there are significant risks associated with an earlier suspension date as well as benefits associated with retaining a viable direct access market.[7]

The benefits associated with retaining a viable direct access market were also acknowledged by the Commission in D.03-05-034 (regarding switching rules) and D.03-07-030 (regarding the DA cost responsibility surcharge). In D.03-05-034, the Commission stated:

> *Not to permit the switching exemption would place all DA customers who have already switched ESPs in a position of substantial uncertainty, and could place the continued viability of the DA program in further jeopardy.* Such action would be contrary to our previously stated policy in D.02-03-055 that there is value in maintaining DA. In D.02-03-055, we noted that DA diversifies the California electric power market, and therefore helps to protect California against uncertainty. (D.02-03-055, pp. 14, 15; (slip op.).) We further observed that the growth of DA load in summer 2001 contributed to a substantial reduction in the level of the DWR revenue requirement estimate for the period through December 31, 2001. (Id.) *Eliminating the switching exemption would not advance the viability of DA.*[8]

In D. 03-07-030, the Commission stated that the continuation of DA is in the public interest[9] and that "*there are benefits to the State of California as a whole resulting from the continuation of the DA program. The benefits of DA include more jobs for Californians and a stronger tax base as well as diversification of California energy supplies. By avoiding making DA uneconomic, these benefits to the public as a whole can continue.*"[10] Based on these benefits, the Commission found that "*in the interests of maintaining the benefits to the public interest that DA offers in terms of jobs, enhanced tax base, and energy diversification, we seek to maintain a DA CRS cap level that avoids making DA uneconomic, threatening the continuation*

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[7] D.02-03-055, pgs. 15-16 (March 25, 2002).
[8] D.03-05-034, pg. 9 (May 9, 2003) (emphasis added).
[9] D.03-07-030, p. 67 (July 22, 2003).
[10] *Id.* at 24 (emphasis added).

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of DA."[11]

These cases illustrate that the Commission has explicitly considered the benefits associated with DA in several aspects of DA program implementation. Furthermore, D.03-07-030, specifically considered the costs imposed on DA service and found that those costs should be carefully balanced in order to avoid making DA uneconomic and thereby threatening the continuation of DA.

The PD fails to fully and accurately identify the costs of the proposed financial security requirements and fails to consider whether those costs will make DA uneconomic, thereby threatening the continued viability of DA. This failure is abundantly clear in the example of the ESP with $2 million in annual sales that, under the PD, could be expected to pay $1.1 million to meet a $112 million bond requirement. The PD's failure to carefully consider the costs of the proposed financial security requirements is also evident in the adoption of a financial security bond methodology that is incomplete and has not produced a single actual bond calculation. [12] The absence of a key input for the model (the implied volatility) indicates that the financial impact of the proposed security requirements cannot have been fully considered. The emphasis in prior Commission decisions recognizing the benefits provided by DA and taking concrete steps to avoid making DA uneconomic must be followed in this proceeding, and the adoption of an incomplete, uncertain, and excessively expensive financial security requirement for ESPs directly contradicts Commission policy in this regard.

D. The Proposed ESP Financial Security Requirements are Inconsistent with the Purpose of SB 695.

The proposed security requirements and their potentially immense financial

[11] *Id.* at 67.

[12] As stated in the testimony of both SCE and PG&E, the sample calculations provided by them were for *illustrative purposes only*. SCE, Singh, Tr. Vol. 2, p. 252, line 28 to p. 253, line 2; PG&E, Hessami, Tr. Vol. 3, p. 615, line 25 to p. 616, line 14.

consequences undermine the fundamental purpose of SB 695 to make DA more, not less, available to certain customers. As discussed above, the enormity of the potential costs of the financial security requirements greatly increases the risk of the failure of ESPs and the DA market as a whole, precisely the opposite result that the legislation is trying to accomplish—the expansion of the direct access market. The purpose of SB 695 is to expand consumer choice for commercial and industrial customers. The language in Public Utilities Code section 394.25(e)[13] regarding financial security requirements should not be implemented in a manner which will frustrate that purpose.[14]

II. THE PD'S LEGAL ANALYSIS OF THE REQUIREMENTS OF SECTION 394.25 IS INCORRECT.

The PD concludes that section 394.25(e) requires ESPs to "indemnify their customers from the re-entry fees imposed on them as a result of an involuntary return to IOU procurement service."[15] This is incorrect because: (i) the plain language of section 394.25(e) indicates that its purpose is to prevent cost-shifting to utility bundled customers, not customers involuntarily returned to IOU service; (ii) section 394.25(e) gives the Commission the discretion to determine that there are no re-entry fees necessary to avoid imposing costs on utility bundled customers; and (iii) placing involuntarily returned customers on the transitional bundled service ("TBS") rate for a period of 6 months would not constitute a re-entry fee.

A. The Plain Language of Section 394.25(e) Indicates That Its Purpose is to Prevent Cost-Shifting to Utility Bundled Customers.

The PD concludes that the purpose of section 394.25(e) is to protect involuntarily

[13] All statutory references are to the Public Utilities Code unless otherwise noted.

[14] *McCarther v. Pacific Telesis Group*, 48 C.4th 104 (2010) (statutes or statutory sections relating to the same subject must be harmonized, both internally and with each other, to the extent possible); *Prospect Medical Group Inc. v. Northridge Emergency Medical Group,* 45 C.4th 497 (2009) (courts do not consider statutory language in isolation but in context of the statutory framework as a whole in order to harmonize the various parts of the enactment).

[15] PD at 67.

returned customers as well as utility bundled customers from costs associated with an involuntary return of customers to IOU service. The plain language of section 394.25(e) indicates that is not the case, and that the purpose of the statute is to protect against shifting costs to utility bundled customers. Section 394.25(e) provides that "any reentry fee imposed on that customer that the commission deems is necessary *to avoid imposing costs on other customers of the electrical corporation* shall be the obligation of the [ESP] or community choice aggregator [CCA]." Webster's Dictionary defines the term "other," when used as an adjective, as "being the one (as of two or more) left." An alternate definition is "being the ones distinct from those first mentioned."[16] Both of these definitions contemplate the term "other" as being distinct and exclusive of something else. Under either of these definitions, it is clear that the term "other customers" refers to utility bundled customers and does not include involuntarily returned customers. The plain meaning of the expression is further proven when the PD itself uses the term "other customers" in a manner consistent with the meaning of the phrase advanced by the DA parties' when it states that "ESPs are ultimately responsible for re-entry fees necessary to avoid imposing costs on the *other customers* of the electric corporation when a [DA] customer is 'involuntarily returned to service provided by an electrical corporation.'"[17]

Statutes should be interpreted according to their plain meaning.[18] Consistent with the unambiguous, dictionary definition of the word "other," and in accordance with the word's ordinary usage as evidenced in the PD, the term "other customers" refers to utility bundled customers, *not* customers of an ESP or a CCA who have been involuntarily returned to utility

[16] Webster's New Collegiate Dictionary, p. 806 (1980).

[17] PD at 67 (emphasis added).

[18] "*When the words are unambiguous, we presume the lawmakers meant what they said. . . . The courts may not, under the guise of statutory construction, rewrite the law or give the words an effect different from the plain and direct import of the terms used.*" *City of Pasadena v. AT&T Communications of California, Inc.*, 103 Cal. App. 4th 981, 984; 127 Cal. Rptr. 2d 276, 278 (2002) (emphasis added)(internal citations and quotations omitted).

service. Thus, the Commission need not adopt a re-entry fee designed to provide specific benefits or protections to involuntary returning customers, and need not place such customers on bundled procurement service (BPS) as PG&E and SCE recommend.

B. Section 394.25(e) Gives the Commission the Discretion to Determine That There Are No Re-Entry Fees Necessary to Avoid Imposing Costs on Utility Bundled Customers.

The PD states that section 394.25(e) requires that any re-entry fee imposed on customers involuntarily returned to IOU service shall be the obligation of the ESP.[19] However, a prerequisite to ESPs being obligated to incur re-entry costs is finding that there actually are re-entry costs necessary to avoid imposing costs on utility bundled customers. Section 394.25(e) gives the Commission the discretion to determine whether there are any re-entry fees necessary to avoid shifting costs to utility bundled customers. Section 394.25(e) states that in the event a customer of an ESP or CCA is involuntarily returned to utility service, "*any* reentry fee imposed on that customer that the commission *deems* is necessary to avoid imposing costs other customers of the electrical corporation shall be the obligation of the [ESP] or [CCA]." This language allows the Commission the discretion to determine that there is no reentry fee necessary to avoid shifting costs to utility bundled customers.

The TBS rate is an existing rate contained in the DA tariffs of all of the major electric utilities. The TBS rate is the rate which all customers returning to IOU service with less than 6 months notice are currently placed on, and it is designed to address the procurement-related costs associated with a customer's return to utility service from DA or CCA service, and prevents cost-shifting from DA (or CCA) customers to utility bundled customers.[20] Placing involuntarily returned customers on the TBS rate for 6 months upon the return to utility

[19] PD at 68.
[20] *Id.* at 40.

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procurement service would not impose costs on utility bundled customers and would, therefore, negate the need for any reentry fee. If there is no re-entry fee necessary to avoid shifting costs to utility bundled customers then, contrary to the conclusion in the PD, there is no need for the ill-conceived financial security requirements set forth in the PD.

C. <u>Placing Involuntarily Returned Customers on the TBS Rate For a Period of 6 Months Would Not Constitute a Re-Entry Fee.</u>

The PD states that section 394.25(e) does not define what costs must be included in re-entry fees,[21] and that "even if incremental procurement costs were imposed on involuntarily returned DA customers through the TBS rate, those costs would remain the ultimate obligation of the ESPs as re-entry fees."[22] Both of these statements are incorrect.

Other provisions of the Public Utilities Code demonstrate that the TBS rate cannot be deemed a re-entry fee. While section 394.25(e) does not define what costs to include in re-entry fees, section 366.2(c)(11) pertaining to re-entry costs for CCAs specifically specifies certain costs that shall *<u>not</u>* be included in re-entry fees.[23] These costs include, among other things, "any additional costs of the electrical corporation recoverable in commission-approved rates, equal to the share of the electrical corporation's estimated net unavoidable electricity purchase contract costs…."[24] Pursuant to subsections (d), (e), and (f) of section 366.2, CCA customers must pay for these types of costs through what is known as the Cost Responsibility

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[21] *Id.* at 58.

[22] *Id.* at 68.

[23] While 366.2(c)(11) only specifically refers to reentry fees associated with CCA customers, "[i]t is a basic rule of statutory interpretation that, when a statute is but one in a series of like statutes and a particular phrase or expression appears in each of them those other statutes may be looked to as a guide to the proper construction or interpretation of the instant statute." *Frediani v. Ota*, 215 Cal. App. 2d 127, 133; 29 Cal. Rptr. 912, 914 (1963). Both sections 366.2 and 394.25(e) were added by AB 117 (St. 2002, ch. 838, § 7). The Commission has also already determined that section 366.2(d) applies to both ESPs and CCAs in D.02-12-027.

[24] Section 366.2(f)(2).

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Surcharges ("CRS").[25] These charges are paid by DA customers as well. According to the utilities' Rule 22.1 (Direct Access Switching Exemption Rules),[26] customers electing the TBS option are subject to the provisions and applicable charges of the DA CRS. The TBS rate includes the CRS charges, including the costs set forth in subsections (d), (e) and (f) of 366.2, which charges are statutorily prohibited from being included as re-entry fees. Therefore, the TBS rate, while serving a similar purpose to a re-entry fee, cannot itself be a re-entry fee. Instead, placing involuntarily returned customers on the TBS rate for a period of 6 months simply results in charging such customers an alternative rate that *avoids the need to impose re-entry fees and the associated financial security requirements under section 394.25(e).*

III. THE COMMISSION SHOULD RETAIN THE EXISTING TBS/SAFE HARBOR MECHANISM TO PROTECT BUNDLED UTILITY CUSTOMERS.

A. The Existing TBS Service Rules are Adequate to Protect Bundled Customers Because the Utilities Have Sufficient Time to Modify Their Portfolios While Returning Customers are on TBS Service.

This proceeding is not the first time that the parties and the Commission have addressed the issue of customers returning from Direct Access to utility service. In fact, a tremendous amount of time and effort when into formulating the existing tariff rules that mandate that all customers returning to utility service, irrespective of the reason, should take service from the TBS rate for a specified time period, and thereby be exposed to market prices for energy, in order to avoid impacting the utility's existing procurement portfolio and increasing

[25] See letter from Paul Clanon, Executive Director of the California Public Utilities Commission, to Mike Campbell, Community Choice Aggregation Director of the San Francisco Public Utilities Commission, regarding the Community Choice Aggregation Implementation Plan and Statement of Intent submitted by the City and County of San Francisco (May 18, 2010). The letter specifically found that the costs referred to in subsection (d), (e), and (f) of section 366.2 are paid through the CCA CRS. Also see letter from Paul Clanon, Executive Director of the California Public Utilities Commission, to Dawn Weisz, Interim Director of the Marin Energy Authority, regarding the Implementation Plan submitted by Marin Energy Authority (February 2, 2010).

[26] Rule 25.1 for San Diego Gas & Electric.

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costs for bundled customers.[27] These rules work well, and do not need to be changed.

Current tariff provisions require returning DA customers to spend a 6 month period on TBS rates.[28] The record demonstrates that 6 months on the TBS rate is sufficient time for utilities to adjust their procurement portfolios so that bundled customers do not bear additional costs due to returned DA customers. Witnesses from all three utilities agreed that this was true.[29] The PD concurs, stating that "charging the DA customers the TBS rate protects bundled customers against cost shifting." PD p. 59. PG&E and SCE have not offered any credible evidence that returning DA customers would create any other costs (other than minor administrative costs that are covered by existing tariffed fees) for bundled customers to absorb.

The existing TBS service provision is effective because the utilities have many tools at their disposal to manage their energy procurement portfolios, including a substantial quantity of spot and short term purchases, and routinely adjust their portfolios to account for variations in load due to weather or economic factors that are just as great as the changes in DA load that they experience. PG&E data responses showed that it routinely faced annual load changes that equal or exceed the magnitude of annual changes in DA load experienced since 2004.[30] For example, since 2004, the annual changes in total retail sales due to temperature have ranged from approximately minus 913,000 MWhs to over 1.3 million MWhs. The net change in DA usage in the same time period has been a smaller range (from minus 1.4 million MWhs to plus 694,000 MWhs). Utility portfolios have the ability to adapt to changes due to DA migration

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[27] See D.03-05-034 (adopting switching rules for DA customers).

[28] PG&E and SCE, Rule 22.1, section A; SDG&E, Rule 25.1, section A.

[29] SCE, Schictl, Tr. Vol. 1, p. 117, lines 1-6; SCE, Singh, Tr. Vol. 1, p. 178, lines 1-15; Vol. 2, p. 250, line 16 to p. 251, line 4; PG&E, Hessami, Vol. 3, p. 665, lines 3-10; SDG&E, Spurgeon, Vol. 3, p. 691, lines 22-27.

[30] Ex. 404.

without significant additional cost.[31]

The effectiveness of the TBS rate in protecting bundled customers from the impact of returning DA customers is further evidenced by the fact that even SCE agrees that if its bonding proposal is not adopted, returning DA customers should go on the TBS rate.[32]

B. DA Customers Should Retain Their Existing Safe Harbor Options That Would be Denied Them Under the PG&E/SCE Bonding Proposal.

The combination of the TBS rate and the existing safe harbor provisions in existing tariff rules allow a customer who is returned by an ESP to find a new ESP to supply its energy and to go back to DA service within a limited period of time.[33] This is a very important consideration for direct access customers following the adoption of SB 695. While the new legislation allowed the DA market to expand to historical levels, this still is a very limited additional amount of DA load. The approximate amount of DA load for the larger utilities will increase from about 7% to around 12% of total load.[34] As a result, there has been tremendous competition for the limited additional space in each of the open season enrollment periods, with the allocated DA load filling completely within minutes, if not seconds.

The impact of this intense competition for new DA capacity means that if a customer if returned from DA, it is extremely valuable to retain the right to find a new ESP and return to DA service without having to compete with the vastly oversubscribed demand from customers who are not on DA already.

However, the PD adopts the punitive proposal of PG&E and SCE that involuntarily returned customers should be returned to bundled service, without the existing right

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[31] PG&E, Renson, Tr. Vol. 3, p. 560, line 9 to p. 561, line 5; SCE, Schictl, Tr. Vol. 1, p. 115, lines 1-21.

[32] Schictl, SCE, Tr. Vol. 1, p 116, line 28 to p. 117, line 6.

[33] PG&E and SCE, Rule 22.1, section A; SDG&E, Rule 25.1, section A.

[34] D.10-03-022.

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to return to DA service during a safe harbor period. PD at 87-88. This rule will effectively punish a returning customer—in this case a customer who was involuntarily returned to bundled service through no fault of its own—by making it practically impossible for the customer to return to DA service. This proposal only makes sense if you are trying to destroy customers' confidence in the reliability of DA service, which appears to be the goal of PG&E and SCE. It is nonsensical to claim, as SCE does, that returning the customer to bundled service is "consistent with fundamental notions of fairness" because the involuntarily returned customer should not have to pay the potentially higher TBS rate merely because the ESP did not give the utility the necessary 6 months notice of a return of the customer.[35] Commercial Energy contends that any DA customer would rather pay the TBS rate and keep its right to return to DA service once it finds a new ESP than pay bundled rates for 18 months and lose any realistic chance of returning to DA service.

On page 89 the PD seems to argue that it is protecting the interests of other DA-eligible customers' interests by keeping involuntarily returning customers from holding DA space while on the TBS rate for six months. It is not necessary to permit such customers to have a safe harbor right for an entire 6 months, but a reasonable time is appropriate. Other DA-eligible customers are already in a situation where their chances of obtaining DA service are extremely slim. It is far more "fair" for DA customers to enable them to keep the right to take DA service having once achieved it, rather than to drive them back to bundled service on a virtually permanent basis in the event of an involuntary return for which they are not responsible.

A customer who has selected DA service, and who is returned to utility service by a decision of the ESP is highly likely to desire to remain on DA service, and removing the safe harbor tariff rights that the customer legitimately expected to rely upon when it first chose DA

[35] *Opening Brief of SCE*, p. 45 (May 6, 2011).

service is unfair and unreasonable. The net effect of this proposal would be to "trap" the returned customers on bundled service with no reasonable expectation of returning to DA. As discussed above, the Commission has repeatedly stated its intention to not adopt provisions that will make DA service uneconomic or infeasible. This is another such provision that should be rejected.

C. The PD Errs by Concluding That the TBS Rate Allows Returning DA Customers to Avoid Certain Procurement Costs.

On pages 81-82 of the PD there is a telling discussion which reveals the key reasoning on which the PD bases the decision to adopt the PG&E/SCE bonding proposal. On those pages, the PD asserts that while the TBS rate avoids shifting incremental power costs, it does not adequately protect bundled customers from certain other procurement costs caused by returning DA customers, specifically Resource Adequacy (RA), Renewable Procurement Standard (RPS) costs and CAISO-related costs. Thus the PD appears to conclude that the bonding proposal must be adopted to ensure that bundled customers are not burdened with these additional costs.[36]

However, this assertion is not correct, because TBS rates will ensure that returning DA customers will pay their fair share of *all* procurement related costs, and this is demonstrated by the PD's own discussion of modifications to the TBS rate in other portions of the decision. For example, consider the discussion on pages 39-41 of the PD. As explained in that portion of the PD, all the parties in this case "generally agree that whatever changes are adopted with respect to the PCIA and MPB, consistent modification should be reflected in the TBS. *This includes the commodity cost of power, the incremental cost of RPS compliance, and any incremental capacity/RA costs."* In addition, the PD goes on to state that while CAISO

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[36] PD at 82.

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costs will be removed from Total Portfolio Costs and the MPB, these CAISO costs will *not* be removed from the TBS rate.[37] Thus the PD's own description of the changes to the TBS rate reveals that returning customers on the TBS rate will pay their fair share of RA, RPS, and CAISO costs, and bundled customers will be fully protected if returning customers pay the TBS rate. As it is not necessary to adopt the complex and expensive bonding requirement to shield bundled customers from these costs, the TBS mechanism should be retained for all returning customers.

IV. ADOPTION OF THE PG&E/SCE BONDING PROPOSAL IS UNREASONABLE AND IS NOT SUPPORTED BY THE RECORD.

A. While Designed to Address a Very Limited Circumstance, the Bonding Requirement Will Severely Penalize the Entire DA Market.

The PG&E and SCE proposal for bonding adopted by the PD is designed to address an unlikely circumstance that will only impact a limited number of DA customers, yet complying with the bonding requirement will severely penalize every ESP and all Direct Access market participants. PG&E and SCE do not propose to change the requirement that all voluntarily returning DA customers take TBS service for 6 months if they fail to give the utility six months advance notice, the bonding requirement is only designed to protect the utility and bundled customers in the unlikely and ill-defined situation of a "mass return of customers" from a single ESP. Yet to protect against this very limited event, *all ESPs and all their DA customers* will have to bear the cost of exceedingly expensive bonds, whose prices will change every six months, damaging the certainty of fixed price contracts for Direct Access service and degrading the cost effectiveness of Direct Access service every day of the year. It is a poison pill for the Direct Access program, borrowed from the CCA proceeding, where an entirely different set of customer concerns are present, and it should be rejected by the Commission for the very reason

[37] *Id.* at 41.

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that it will make Direct Access uneconomic for all customers.

B. PG&E and SCE Have Not Met Their Burden of Proof to Justify a Change in the Existing Rules That Require TBS Service for All Returning Customers.

Neither the PD nor PG&E and SCE establish the need for such a bonding requirement, other than their erroneous legal interpretation of SB 695, as addressed above. SB 695 limited the very modest increase in DA participation to commercial and industrial customers only. These parties are sophisticated businesses with experience in obtaining goods and services via contracts. ESPs have significant financial and contractual incentives not to breach their contracts to such customers.[38] And the customers have contractual provisions to protect themselves in event of a breach. They are also aware of the potential to return to TBS rates if they leave DA service. That is the existing tariff rule. SCE admits that there has been no mass involuntary return of customers since the energy crisis.[39] In essence, no credible factual case has been made to modify the existing DA tariff rules to add a bonding requirement. The erroneous legal analysis of PG&E and SCE, adopted in the PD, appears to be the sole rationale for adopting the bonding requirement. See the discussion in Section III.C., above. The PD confirms on page 86 that the existing DA switching rules draw no distinction between voluntarily and involuntarily returned customers, and further states that the "statutory requirements for a bond for involuntarily returned customers under Section 394.25(e) drives the need to distinguish between [them] for purposes of the switching rules." If the PD's unreasonable interpretation of SB 695 is overturned, as it should be, the rationale for adopting a bond requirement vanishes.

In addition, there is very little likelihood of a mass return of DA customers, and the remaining bundled customers are protected even in the event that an ESP does fail, because the existing TBS rate provisions ensure that returning customers will pay spot energy prices, and

[38] SCE, Singh, Tr. Vol. 1, p. 169, line 28 to p. 170, line 22; p. 173, lines 6-23.
[39] SCE, Schictl, Tr. Vol. 1, p, 98, lines 13-20.

will not impact the existing utility portfolio serving the bundled customers.[40] Without a far more compelling explanation of why a bonding requirement is necessary, the Commission should find that PG&E and SCE have not met their burden of proof to justify a change to the existing TBS rate mechanism for all returning customers.

C. The CCA Settlement Does Not Provide Justification for Adopting a Similar Bonding Requirement for the DA Market.

The Community Choice Aggregation ("CCA") bonding proposal from which PG&E and SCE derived the proposal adopted by the PD in this case is under fierce attack in the CCA docket. R.03-10-003. The CCA parties have filed briefs suggesting that the bonding proposal will increase the likelihood of CCA failure and should be substantially modified to eliminate the very same provisions that PG&E and SCE urge the Commission to adopt for all DA customers in this case.

The Marin Energy Authority ("MEA") states that its initial experience in the CCA market reveals that the bonding requirement is unworkable and requires severe modification. In its Supplemental Reply Brief, MEA stated:

> [I]it was discovered that "on average, the bond amount over the period (approximately $24/MWh) is 500% higher than the average re-entry fee (approximately $4/MWh) that could have become due during the period." (CCSF Brief, at 12.) Furthermore, as MEA proceeded through a pragmatic process of seeking out entities willing and able to provide the bond as specified by the Settlement Agreement, MEA found the terms of the Settlement Agreement unworkable and has found that the requirements of the Bond could cause an otherwise healthy community choice aggregator …to fail, not due to any operational reason, but solely due to a Bond that does not reflect actual costs or risks. [41]

Likewise, the City and County of San Francisco has questioned the validity of the

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[40] SCE, Schictl, Tr. Vol. 1, p. 117, lines 1-6; SCE, Singh, Tr. Vol. 1, p. 178, lines 1-15; Vol. 2, p. 250, line 16 to p. 251, line 4; PG&E, Hessami, Vol. 3, p. 665, lines 3-10; SDG&E, Spurgeon, Vol. 3, p. 691, lines 22-27.

[41] R.03-10-003, *Supplemental Reply Brief of Marin Energy Authority*, pg. 3 (March 14, 2011).

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implied volatility data used in the bonding calculation, stated that the implied volatility and stress factor multiplier can produce unreasonable bond amounts, and further argues that the resulting bond obligations could force financially stable CCAs out of business.[42]

The objections of the CCA parties lend credibility to the urgent concerns of DA parties that the bonding proposal adopted by the PD will prove unworkable and make the DA market uneconomic. In addition, it should be noted that the CCA customers are primarily residential and small commercial customers. Only a very small percentage of DA customers are residential customers, and there was no testimony in the record to demonstrate that there is any significant number of returns of such customers.

Commercial Energy believes that a mechanism designed for the CCA market should not be applied in a cookie cutter manner to the significantly different class of commercial and industrial customers who comprise the vast majority of DA customers. These customers routinely negotiate sophisticated energy contracts, and do not need to be "protected" by being returned to bundled service.

Equally importantly, the CCA bonding proposal appears to have grave flaws and has not been finally adopted by the Commission in R.03-10-003. The "Settlement" in which it was adopted is now under significant attack by parties who were initially involved in the case. These facts should give the Commission significant pause in adopting the bonding mechanism for the DA markets.

D. **The PD Fails to Address the Many Serious Flaws in the Bonding Proposal Raised by DA parties, the Sum Total of Which Justify Rejection of the PG&E and SCE Proposal.**

While the PD claims that it will judge the bonding proposal on its own substantive

[42] R.03-10-003, *Reply Brief of City and County of San Francisco*, pgs. 2-4 (March 14, 2011).

merits[43], it fails to do so. The PD recites the many objections of the DA parties and customer groups to the PG&E/SCE bonding requirement, but fails to respond to these arguments in any substantive manner, merely asserting that the PG&E/SCE proposal is reasonable. See the litany of criticisms of the bonding proposal referenced on pages 74-78 of the PD.

The CCA parties point out the objections to the bonding methodology that have been raised in the CCA docket, R.03-10-003. PD at 74-75. However, the PD does not address the CCA allegations that that bonding methodology will produce excessive bond costs, and potentially drive healthy providers out of the market. The PD instead avoids these arguments by stating that it will consider the merits of the mechanism without reference to the CCA docket. PD at 79.

The PD recites Commercial Energy's objection that the bonding proposal is not fully developed, and that key elements of the calculation are not specified, and only "illustrative" numbers are used for certain inputs. PD at 74. The PD fails to address the fact that the bonding requirement has not been presented to the Commission or the parties in a way that would allow a sample calculation using actual data to determine if the end result is, indeed, reasonable.

The PD recites the objections of several parties that the volatility data which PG&E proposes to use in the model for Path NP 15 is not available from any broker or consultant. PD at 76. The PD's inadequate response is to suggest using historical volatility data, without specifying either the period of time to be studied (which is crucial, given swings in energy prices in last decade) or examining the results of using such inputs. PD at 81.

To the DA parties, it appears that PG&E and SCE knew that their bonding requirement was financial dynamite, and thus made no effort to enable parties to view the actual results of the model. By relying on two year old data for an incomplete sample calculation and

[43] PD at 79.

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using a key input for volatility that was not fully developed, no accurate bond costs could be produced. A working model would have allowed the parties to test the model and see what bond levels it would create at varying levels of energy market prices and volatility. When the DA parties sought such a calculation during the hearings, the utilities refused, objecting that it was unduly burdensome, and were upheld by the ALJ. If it is unduly burdensome for ESPs and their customers to know the amount of the bond they will be charged, this is procedure run amok over substance. The Commission cannot adopt such a Trojan Horse bond requirement without an adequate record to show what such bonds with actually cost.

This degree of uncertainly about a key ratemaking mechanism is simply unacceptable in this situation because there is a significant possibility that the bond model will produce rates that seriously disrupt the DA market. The testimony of the DA Parties' witness confirmed that the bond model could produce values that vary by hundreds of millions of dollars during a single year.[44] SDG&E's witness described the bond amount as "potentially insurmountable" and recommended placing returning customers on the TBS rate to avoid the bond requirement.[45]

The PD cites, but does not address, the criticism of Commercial Energy that the new bonding requirement will be applied to existing DA customers and their ESPs, who had no opportunity to account for this substantial additional financial risk in making their term contracts for power. PD at 77. Only the last tranche of new DA load, about 1% of total utility load will be able to prospectively assess and address the risk of such a bond. The DA parties contend that this "after the fact" imposition of huge new costs is unfair and will severely damage existing DA contractual relations.

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[44] DA Parties, Fulmer, Tr. Vol. III, p. 466, lines 18-20.

[45] SDG&E, Spurgeon, Tr. Vol. III, p. 685, line 17 to p. 686, line 7.

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The PD also fails to address the argument of Commercial Energy that there is no record evidence to show that the return of all the customers from a single ESP (a "mass involuntary return") requires any additional security at all. PD at 78. As explained by Commercial Energy, the data shows that the utilities routinely accommodate substantial variations in total load due to weather and economic factors. Neither the PD nor PG&E or SCE demonstrated that a return of customers from a single ESP would create the need to make substantially greater adjustments in the procurement portfolios. If PG&E and SCE can already accommodate such swings by adjusting their substantial portfolio of short term power deals and spot purchases, then there is no record to support the need for additional security.

E. The PD Errs by Ignoring Record Evidence That the Bonding Requirement is Commercially Infeasible.

The PD states on page 57 that, "We are not persuaded that a bond that covers the incremental procurement costs would necessarily be commercially infeasible for an ESP." This is a bold statement when the record contains no reliable calculation of the cost of a bond. But the statement is proven clearly wrong when you consider that the very same page of the PD recites record evidence that the cost of a bond could be more than 50% of gross revenues of an ESP. It is impossible to consider such a result reasonable. The cited example indicates that an ESP with $2 million in annual sales could face a bond cost of $1.1 million for the purchase of a $112 million bond.[46] The absurdity of such amounts is obvious. Can anyone deny the outrage that would ensue from the utilities and their customers if the Commission increased their cost of doing business by 50% in one fell swoop?

The PD makes passing reference to the need to keep the bonds affordable in a

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[46] *Id.* at 57. In addition, Commercial Energy strongly disputes that most ESPs could obtain such security at a rate of only 1%. It is far more likely to range between 2 and 3% although the record is scant on this issue.

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discussion in which it chooses to limit the period covered by the bond to one year. See PD at 79. However, the PD has no basis in the record for determining that such a change will make the bonds affordable, particularly in face of the potential for requiring bonds that are so large as to rival the total energy sales by the ESP to its DA customers.

Equally damaging to the entire DA market is the fact that the utilities will be able to file Advice Letters twice a year that could make enormous changes in cost of bonds by adopting new volatility inputs for the bond calculation. See PD at 90. This uncertainty will effectively kill long term DA contracts. DA customers, particularly industrial and commercial customers, seek fixed price DA contracts over multiple years. Certainty in energy costs is valuable to such customers, and it is one of the prime attractions of the DA market. A provision that would unravel the certainty of energy prices for DA customers would be immensely damaging to the entire DA program.

V. **CONCLUSION**

The PD states that PG&E and SCE presented the only model to determine financial responsibility requirements for ESP bonds. PD at 78. This fails to take into account that an alternative model has been presented to ensure that utilities and bundled customers are protected from the costs of serving returning customers. The alternative of the existing TBS rate is an existing, well-understood, and viable means for complying with the statute. Recall that the key provision in SB 695 (§394.25(e)) does not compel the Commission to adopt a re-entry fee, nor does it compel that returning customers be placed on bundled service instead of the TBS rate. See PD at 63. If, instead, the Commission determines that a returning customer on the TBS rate will pay all incremental costs related with its energy procurement and related costs (RA, RPS and CAISO), then no bond is required to ensure that a re-entry fee is paid by the ESP, and the entire unreasonable bonding proposal can be jettisoned.

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It is relatively simple to modify the PD to reach this conclusion, as indicated in the attached appendix addressing proposed changes to the Findings of Fact, Conclusions of Law and the Ordering Paragraphs of the PD.

The bonding proposal of PG&E and SCE is a shockingly burdensome requirement that is not mandated by statute and is not fair to existing DA customers or the ESPs who serve them. The Commission should adhere to its previously adopted policy and carefully refrain from adopting a bonding requirement that could render the DA program uneconomic and deny the California energy economy the substantial benefits of a more diverse energy market.

Respectfully submitted this 12th day of September, 2011 at San Francisco, California.

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Appendix A

Proposed Changes to Findings of Fact, Conclusions of Law, and Ordering Paragraphs for the Proposed Decision Adopting Direct Access Reforms

Proposed Changes to Findings of Fact

Delete Findings of Fact 26 through 39 in their entirety and replace with the following:

26. The bond calculation proposed by SCE could result in very large bond requirement amounts.

27. Even if the cost of any financial security bond was a fraction of the actual bond amount, that cost could represent an extremely excessive cost of doing business for ESPs.

28. Under the financial security bond methodology proposed by PG&E and SCE, the financial security bond amount would be recalculated every 6 months upon the filing of an Advice Letter.

29. DA customers, particularly industrial and commercial customers, seek fixed price DA contracts over multiple years.

30. Certainty in energy costs is valuable to such customers, and it is one of the prime attractions of the DA market.

31. The financial security bond methodology proposed by PG&E and SCE is incomplete because it lacks a definitive calculation for implied volatility.

32. PG&E and SCE have only presented illustrative bond calculations.

33. Prior Commission decisions have recognized the benefits of DA and avoided making DA uneconomic, thereby threatening its continuation.

34. The purpose of SB 695 is to expand the availability of Direct Access.

35. Section 394.25(e) states that the Commission may deem re-entry fees necessary in order to avoid imposing costs on other customers of electrical corporations.

36. Section 394.25(e) requires ESPs and CCAs to post financial security to the extent the Commission finds there are re-entry fees necessary in order to avoid imposing costs on other customers of electrical corporations.

37. Currently, all DA customers returning to IOU service without 6 months notice are placed on the TBS rate.

38. The purpose of the TBS rate is to address the procurement-related costs associated with a customer's return to utility service from DA or CCA service.

39. Section 366.2 sets forth costs that cannot be included in re-entry fees.

40. The costs prohibited to be included in re-entry fees under section 366.2 are included in the Cost Responsibility Surcharge paid by DA and CCA customers. The Cost Responsibility Surcharge is a component of the TBS rate.

41. The utilities have many tools at their disposal to manage their energy procurement portfolios, including a substantial quantity of spot and short term purchases, and routinely adjust their portfolios to account for variations in load due to weather or economic factors that are just as great as the changes in DA load that they experience.

42. SCE states that involuntarily returning DA customers should go on the TBS rate, if its bonding proposal is not adopted. The DA parties, many customer parties in the proceeding and SDG&E concur that all returning DA customers, including involuntary returning customers, should go on the TBS rate.

43. The combination of the TBS rate and the safe harbor provisions in existing tariff rules allow a customer who is returned by an ESP to find a new ESP to supply its energy and to go back to DA service within a limited period of time.

44. There has been tremendous competition for the limited additional DA capacity under SB 695.

45. The proposal by PG&E and SCE would essentially eliminate the existing safe harbor provisions for involuntarily returned customers and effectively denies them a realistic opportunity to return to DA service.

46. The updated TBS rate will include all procurement related costs, including the commodity cost of power, the incremental cost of RPS compliance, any incremental capacity/RA costs, and CAISO costs.

47. The PG&E and SCE bond proposal is designed to address an unlikely circumstance that will impact a limited number of DA customers, but it will increase costs for all DA customers and the ESPs who serve them.

48. The limited re-opening of DA under SB 695 is for commercial and industrial customers only. There is no record evidence indicating that the same proportion of existing DA customers who are residential have experienced significant returns to utility service.

49. Commercial and industrial customers are sophisticated businesses with experience in obtaining goods and services via contracts.

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50. Commercial and industrial customers likely have contractual provisions to protect themselves in event of a breach, and are aware of the potential to return to TBS rates if they leave DA service.

51. ESPs have significant financial and contractual incentives not to breach their contracts to such customers.

52. There has been no mass involuntary return of customers since the energy crisis.

53. The CCA settlement adopting a bonding requirement has not been approved by the Commission.

54. The Commission re-opened the record in R.03-10-003 to reconsider bonding requirement in the CCA settlement in light of the actual market experience of CCAs.

55. The CCA parties have filed briefs suggesting that the bonding proposal will increase the likelihood of CCA failure and should be substantially modified to eliminate key provisions of the bonding requirement that PG&E and SCE have requested the Commission to adopt for DA customers in this case.

56. CCA customers are primarily residential and small commercial customers.

57. A very small percentage of DA load serves residential customers.

58. Residential and small commercial customers are not similarly situated to large commercial and industrial customers.

59. The financial security requirements proposed by PG&E and SCE would be applied to existing DA customers and their ESPs, who had no notice of the bonding requirement when they entered into their contracts and thus have no opportunity to account for the proposed substantial, additional financial risk posed by the financial security requirements.

Proposed Conclusions of Law

Delete Conclusions of Law 8 through 19 in their entirety and replace with the following:

8. The financial security bond methodology proposed by PG&E and SCE could impose unreasonable costs on ESPs.

9. The financial security bond methodology proposed by PG&E and SCE is incomplete as key inputs have not been identified; in addition, it would need to be recalculated twice a year, and these factors would result in substantial uncertainty regarding the costs of providing the bonds required under the financial security requirements.

10. Substantial uncertainty regarding the financial security costs required to provide DA service will damage the viability of the DA market.

11. PG&E and SCE have failed to provide a meaningful sample bond calculation.

12. It would be unreasonable to adopt a proposed financial security bond methodology without considering actual sample calculations and determining the actual financial impact of the proposed methodology.

13. The financial security bond methodology proposed by PG&E and SCE threatens the continued viability of DA and thereby contravene Commission precedent, which recognizes the benefits of the continuation of DA and seeks to avoid making DA uneconomic.

14. The financial security bond methodology proposed by PG&E and SCE is inconsistent with the purpose of SB 695 to expand the availability of Direct Access for certain customers.

15. The purpose of section 394.25(e) is to prevent shifting costs to utility bundled customers.

16. Section 394.25(e) does not require the imposition of re-entry fees if there is no cost-shifting to utility bundled customers.

17. The Commission may find that no re-entry fees are necessary in order to avoid imposing costs on the remaining bundled customers of electrical corporations.

18. The financial security referred to in section 394.25(e) is only required to the extent that the Commission finds there are re-entry fees necessary in order to avoid shifting costs to utility bundled customers.

19. Placing all involuntarily returned customers on the TBS rate as modified in this Decision for 6 months will prevent cost-shifting from DA customers to utility bundled customers.

20. Placing involuntarily returned customers on the TBS rate would serve a similar purpose as a re-entry fee, by avoiding the shifting of costs to utility bundled customers.

21. The TBS rate is not itself a re-entry fee because it includes costs that are statutorily excluded from the definition of re-entry fees by the provisions of Sections 366.2(c)(11).

22. Placing involuntarily returned customers on the TBS rate for a period of 6 months simply makes efficient use of an existing alternative rate schedule that avoids the need to impose re-entry fees and the associated financial security requirements under section 394.25(e).

23. PG&E and SCE have not demonstrated that current tariff provisions, which require all DA customers returning to IOU service without 6 months notice to spend 6 months on

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TBS rates, are insufficient for utilities to adjust their procurement portfolios so that bundled customers do not bear additional costs due to returning DA customers.

24. Utility portfolios currently have the ability to adapt to changes due to DA migration without significant additional cost.

25. For existing DA customers, it is extremely valuable to retain the right to find a new ESP and return to DA service without having to compete for the vastly oversubscribed demand for limited additional DA capacity under SB 695.

26. Eliminating existing safe harbor provisions will make it practically impossible for a customer to return to DA service once it is involuntarily returned to IOU bundled procurement service.

27. Placing excessive financial security requirements on ESPs to guard against a highly unlikely scenario that will only affect a limited number of customers is unreasonable.

28. PG&E and SCE have failed to demonstrate that the financial security bond methodology is required to prevent shifting costs to utility bundled customers.

29. It is unreasonable to adopt a financial security bond methodology for DA based on the CCA settlement, which: (i) was negotiated for an entirely different set of customers and circumstances, and (ii) is still being actively contested by parties to the CCA proceeding.

30. It is unreasonable to apply substantial, additional financial security requirements to existing contracts already negotiated and executed by DA customers and their ESPs.

31. There is no evidence that the failure of one ESP would require a utility to make adjustments to its procurement portfolio significantly greater than the adjustments already required to be made to accommodate variations in weather or economic factors.

Proposed Ordering Paragraphs

Delete Ordering Paragraphs 13 through 26 in their entirety and replace with the following:

13. The financial security bond methodology proposed by PG&E and SCE is not adopted.

14. All DA customers returning to IOU service without 6 months notice will be placed on the TBS rate, consistent with current DA tariff provisions.

15. The TBS rate will be updated to include all procurement related costs, including the commodity cost of power, the incremental cost of RPS compliance, and incremental capacity/RA costs, and CAISO costs, as set forth in the body of this decision.

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