BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Pursuant to Enhance the Role of Demand Response in Meeting the State's Resource Planning Needs and Operational Requirements R.13-09-011
(Filed September 19, 2013)

RESPONSE OF THE DIRECT ACCESS CUSTOMER COALITION AND ALLIANCE FOR RETAIL ENERGY MARKETS TO QUESTIONS ON FOUNDATIONAL ISSUES

Sue Mara RTOADVISORS, L.L.C. 164 Springdale Way Redwood City, California 94062 Telephone: (415) 902-4108 sue.mara@rtoadvisors.com

CONSULTANT TO THE
ALLIANCE FOR RETAIL ENERGY MARKETS
DIRECT ACCESS CUSTOMER COALITION

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The Direct Access Customer Coalition¹ ("DACC") and Alliance for Retail Energy Markets² ("AReM") submit responses to the questions on foundational issues posed in the *Joint Assigned Commissioner and Administrative Law Judge Ruling and Scoping Memo* issued by California Public Utilities Commission ("Commission") president, Michael R. Peevey and Administrative Law Judge Kelly A. Hymes, ("Scoping Memo"), on November 14, 2013.³

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have opted for direct acce ss to meet some or all of their electricity needs. In the aggregate, DACC member companies represent over 1,900 MW of demand that is met by both direct access and bundled utility service and about 11,500 GWH of statewide annual usage.

² The Alliance for Retail Energy Markets 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 respect to the issues addressed herein.

³ Attachment 1 to Scoping Memo.

A. RESPONSE TO QUESTIONS ON FOUNDATIONAL ISSUES

1. BIFURCATION

a. In the Order Instituting Rulemaking (OIR), the Commission proposes to bifurcate the current demand response programs into demand-side and supply-side resources. The OIR defines the demand-side programs as customer focused programs and rates, and supply side resources as reliable and flexible demand response that meets local and system resource planning and operational requirements. Please comment on the terms, demand-side and supply-side resources, and the definitions provided. If you disagree with the terms and/or definitions, please provide your recommended changes and explain why your recommendation is more appropriate.

DACC/AReM Response: At this time, DACC and AReM do not oppose the proposed bifurcation of demand resources ("DR") into "demand-side" (or load-modifying) and "supply-side" DR resources, subject to the following caveat: The Commission must establish a clear demarcation line between "demand-side" and "supply-side" programs. In particular, the reference to demand-side programs as "customer focused" is a somewhat confusing misnomer and should be removed. ALL DR programs are, by their very nature, "customer focused." DACC and AReM recommend that the appropriate distinguishing characteristic is whether the DR program is bid as a resource into the markets operated by the California Independent System Operator ("CAISO"), and are eligible to provide Resource Adequacy ("RA"). All such DR programs would be categorized as "supply side" and all other programs, such as those that are embedded in utility tariff rates, as "demand side."

b. Are there any potential problems or concerns with the proposed bifurcation or realignment of demand response programs into demand-side and supply-side resources? For example, are there any legal issues or other concerns such as missed opportunities for integration?

DACC/AReM Response: DACC and AReM are unaware of any legal issues associated with the proposed bifurcation, but reserve the right to respond further in reply. Regarding the potential for "missed opportunities," DR programs that are categorized as

"demand side" may have reduced value in meeting the operational requirements of the grid, so to the maximum extent possible, DR programs should be structured as supply-side programs and be bid into the CAISO markets.

c. The OIR describes an ongoing tension between the supply-side and demand-side requirements for demand response. The OIR states that demand response as resource adequacy resources are held to the same requirements as generation resources for system reliability and economic efficiency. Simultaneously, the needs and technical capabilities of customers and providers should also be considered in program design. How could the proposed bifurcation or realignment of supply-side and demand-side resources be designed to serve both sets of requirements? #\Bar{1}

DACC/AReM Response: Providing clear lines of demarcation between demand-side and supply-side DR programs, as discussed in the response to Question 1.a above, should resolve these tensions to a large degree. The preferred approach for designing DR programs is to define the characteristics and/or requirements for supply-side and demand-side DR programs and then allow the market to innovate and develop the programs that meet those requirements. The utilities would obviously design and implement pricing tariffs as a demand-side DR program for bundled customers. However, third-party providers should be free to develop and implement supply-side DR programs that meet the applicable requirements without prescriptive "program design" features dictated by the Commission.

d. What role, if any, will the load impact protocol serve in this realignment? Are revisions required? Should the Commission develop separate sets of evaluation criteria and/or processes for the demand and supply sides?

DACC/AReM Response: DACC and AReM are not experts with respect to the load impact protocols. It is, however, DACC and AReM's understanding that the protocols serve two purposes at present. They are used: (1) to determine whether a particular utility DR program is a cost-effective expenditure of ratepayer funds; and (2) to establish the RA capacity attributable to a particular DR program.

DACC and AReM do not have a position on the continued use of the load impact protocols for determining the cost-effectiveness of the utility DR programs, but note that the load impact protocols should not be required for DR programs that submit winning bids in a procurement auction or solicitation.

Regarding the use of the load impact protocols to establish the RA capacity value, DACC and AReM recommend that the RA counting rules currently being developed in Rulemaking ("R.") 11-10-023 should suffice for establishing the RA capacity value of a supply-side DR program. However, DACC and AReM disagree with the current approach being proposed by Energy Division Staff to require complex probabilistic modeling to set the RA value of DR resources. We believe that the simplest and most efficient RA counting rule for DR resources would be based on testing the capacity of the resource at the CAISO. Setting RA capacity for supply-side DR resources through testing at the CAISO was previously debated in R.09-10-032, where some parties expressed concerns that the load impact protocols are unduly complex and create barriers to entry. ⁴ The Commission decided at that time to continue with the load impact protocols because of a lack of information, but noted that it "did not wish to impose such barriers." Probabilistic modeling appears to be another such barrier.

In any event, DACC and AReM agree that the issue of setting RA capacity for DR resources should be resolved in the RA proceeding and not here. We note, however, that any RA counting rules established by the Commission for supply-side DR resources must be acceptable to the CAISO as well. A market cannot operate with divergent requirements or metrics.

⁵ D.11-10-003, p. 21.

2. COST ALLOCATION

a. Current policy requires the utilities to identify, in their demand response applications, the rates used for cost recovery of each program and the justification for that rate. What, if any, additional information should the Commission require to ensure equitable cost allocation and why?

DACC/AREM Response: The Commission requires that utility applications requesting use of ratepayer funds be supported by testimony, detailed workpapers, and other evidence on the record. In previous proceedings in which the utilities have applied for approval of their DR programs or price responsive tariffs, the utilities have typically requested that the vast majority of the program costs be recovered through distribution rates that are paid for by all customers, including those taking supply service from competitive suppliers, such as the electric service providers ("ESPs") that AREM represents. In support of this request, however, the utilities have not actually proved or provided evidence to support this cost allocation, but merely asserted that (1) costs have always been recovered this way in the past so the practice should continue and/or (2) the programs are anticipated to provide "system" benefits.

6 Put simply, assertions are not showings. Nevertheless, to date, the Commission has accepted these assertions, while acknowledging that further evaluation of appropriate cost allocation is warranted, and that this is the proceeding where modifications to the existing cost allocation regulations will be addressed.

As discussed our response to Question 2.b below, the bifurcation of utility DR programs into demand-side and supply-side programs should simplify the process of determining recovery of the costs associated with utility DR programs: utility DR programs, both supply side and demand side, should be recovered through generation rates that are paid by the utilities'

bundled customers. The time has come for the Commission to recognize and rectify the inappropriate DR program cost allocation that has persisted for too long.

b. If the Commission bifurcates the demand response programs into demand-side and supply-side, does it need to revise its requirements for cost allocation in order to ensure equitable cost allocation? How and why?

DACC/AReM Response: Yes. This new DR Rulemaking sets forth a "new vision" for DR in California. As part of this new vision, the Commission has expressed the desire to move away from the current utility-centric approach for DR programs and "consider other models," in which third-party DR Providers play a larger role. Integral to the success of this new vision is proper cost allocation for utility DR programs.

Competition. As noted above, the Commission has typically approved the utilities' requests to allocate the vast majority of their DR program costs to distribution rates. Utility DR programs funded through distribution rates create barriers to entry for third-party DR Providers, restricting competition, and thereby raising costs for consumers. Specifically, utilities are significantly advantaged when their DR program costs are guaranteed cost recovery from all customers through distribution rates with no risk of shortfall or non-recovery. The CAISO has echoed the concerns that DACC and AReM have been raising in this regard, noting that the Commission's current cost allocation approach creates an un-level and anti-competitive playing field, which prevents a viable competitive DR market from taking root. ¹⁰ The CAISO argues that improperly

⁹ R.13-09-011, pp. 9 and 16.

¹⁰ Initial Response on the Assigned Commissioner and Administra—tive Law Judge's Ruling Soliciting Responses from Questions Arising from Federal Energy Regulatory Commission Order 745 and 745A—,

allocating IOU DR program costs to distribution rates — is both a "major policy issue" and a "current barrier to the development of a competitive demand response market." ¹¹

Put simply, third-party DR Providers have neither guaranteed cost recovery nor ratepayer subsidized programs to offer to customers they are seeking to enroll in programs of their own design. When customers who may otherwise elect service through third-party DR programs nevertheless still have to pay for the utility programs, the third-party programs are automatically less competitive than the utilities' subsidized DR programs. ¹² Third parties are thus hampered in their ability to enter the DR market when utilities' DR services are underwritten by non-bypassable charges (in this case through distribution rates) that must be paid by all customers. The resulting limited engagement by third parties also stymies innovation in DR programs. Utility offerings tend to be prescriptive, one-size -fits-all programs that often do not work well for all customers. As a consequence, the utilities' programs supported by layers of sales teams, marketing specialists, software and systems, not to mention direct subsidies, paid for through distribution rates remain the only game in town.

Thus, in spite of long-standing California policy to "promote" DR, direct third-party offerings in California are few and direct participation in CAISO markets negligible. By contrast, eastern ISO markets have robust DR competition, mainly provided by third parties. This rulemaking provides the opportunity to correct these barriers to third-party participation created by improper cost allocation of utility DR programs.

¹¹ *Ibid*, p. 8.

¹² See: D.12-04-045, pp. 201-202; and Testimony of Mark E. Fulmer on Behalf of the Direct Access Customer Coalition and the Alliance for Retail Energy Markets Concerning Competitive Issues in the 2012-14 Demand Response Program Proposals, A.11-03-001 et al, June 15, 2011.p. 12-20.

Moreover, to the extent the Commission embraces a competitive DR model and transitions away from the current utility-centric approach, ratepayer risk is reduced, as the CAISO has noted. Said another way, ratepayers would no longer bear the risk of failed DR programs or utility cost overruns. Such risks – and costs – would be borne by the competitive third-party DR providers. Allowing third-party DR Providers open access to participate freely in DR markets should, as a result, serve to sharply reduce utility costs.

Neutrality. A goal of the Commission has been to expand DR participation by third-party providers. Potential third-party DR Providers include parties who are DR aggregators, as well as ESPs, Community Choice Aggregators (CCAs), and retail customers on their own behalf. In a recent decision in R.07-01-041, the Commission determined that competitive neutrality is necessary to "ensure a level playing field" for all DR Providers.

14 An important aspect of "competitive neutrality" is ensuring that the costs of the utilities' DR programs are properly allocated, such that the utility is competing on a "level playing field" with third-party DR Providers and not offering programs at subsidized prices. As the Commission recently stated in D.13-12-029: "a goal ... is to promote competitive neutrality and limit anti-competitive behavior." Proper cost allocation of utilities' DR programs is an essential requirement to achieve that goal.

iii. Proper Cost Allocation For Bifurcated DR Programs. As noted above, the bifurcation of the utility DR programs should simplify proper cost allocation, as follows:

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¹⁴ D.13-12-029, pp. 30-31.

¹⁵ D.13-12-029, p. 30.

• <u>Supply-Side DR Programs</u> -- Supply-side DR programs should be defined as DR resources bid into CAISO markets and dispatchable in those markets. Such resources participate in the market on an equivalent basis to generation resources, with both bidding and performance obligations. Like generation resources, their associated costs must be recovered through the utilities' generation rates. The Commission has previously confirmed that supply-side DR is to be treated the same as generation resources. ¹⁶ In addition, the Commission has recently affirmed that supply-side DR resources should have an increased role in meeting Local Capacity Requirements, as an alternative to conventional generation. ¹⁷ Thus, there is no reasonable public policy rationale for treating substitutable resources (*i.e.*, traditional generation and DR) differently for cost allocation purposes.

• Demand-Side DR Programs -- Demand-side DR programs should be defined as "load-modifying" DR programs that are not bid into CAISO markets or dispatchable in those markets. The Scoping Memo explains that utility pricing tariffs are a primary example of load-modifying demand-side programs. Utility pricing tariffs include dynamic pricing tariffs, time-of-use ("TOU") tariffs, and real-time pricing tariffs. Such tariffs are available solely to bundled customers, and, therefore, the associated costs must be solely recovered from the bundled customers through generation rates. In fact, the Commission has applied this cost allocation approach in a recent decision addressing dynamic pricing tariffs proposed by San Diego Gas & Electric Company (Application 10-07-009). In D.12-12-004, the Commission determined that customers ineligible for specific utility pricing tariffs should not be charged any associated costs for those tariffs and that such costs are therefore to be recovered

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¹⁶ See, D.12-04-045, p. 15; D.12-04-045, p. 73; D.12-11-025, Finding of Fact No. 1, p. 59.

¹⁷ D.13-02-015, pp. 55-56.

¹⁸ Scoping Memo, Attachment 1, Figure 1, p. 1.

though utility generation rates:

We are persuaded by the arguments of the Direct Access Parties that requiring the customers of CCAs and ESPs, who cannot enroll in SDG&E's dynamic pricing tariffs, to pay the costs of implementing those tariffs, is not consistent with cost causation principles, and would not be reasonable. ... we require that the costs of SDG&E's dynamic pricing decision be recovered from all bundled customers **through generation rather than distribution rates**. ¹⁹ (emphasis added)

Collection of the costs authorized in this proceeding **through generation rates** will ensure that customers that are not eligible for dynamic rates are not charged for activities associated with those rates.²⁰ (emphasis added)

The Commission has thus already determined that proper cost allocation for demand-side DR programs requires the associated costs to be recovered through utility generation rates.

c. In resource adequacy procurement, costs are allocated across the LSE's. If the Commission bifurcates demand response programs into demand side and supply side, should costs for supply-side procurement be allocated in the same fashion as resource adequacy procurement? If not, recommend other frameworks?

DACC/AReM Response: Only supply-side DR programs would qualify for RA credit under the proposed bifurcation. If the recommendation to allocate and recover the costs of supply-side DR programs through the generation rates is adopted, DACC and AReM would agree that the associated RA capacity contribution would accrue solely to the utilities' bundled customers, and therefore the current practice of allocating the RA to the ESPs who serve DA customers would end. However, if the Commission rejects DACC and AReM's proposal for cost allocation to generation rates, and direct access customers are required to continue paying

²⁰ D.12-12-004, Finding of Fact No. 31, p. 68.

for certain supply-side DR programs, then the associated RA credit should continue to be allocated to ESPs as is the current practice today.

3. BACK-UP GENERATORS

a. #Intp.11-10-003, Conclusion of Law No. 5 states, "fossil-fueled emergency back-up generation resources should not be allowed as part of a demand response program for resource adequacy purposes." The decision required the utilities to work with Commission staff to identify data regarding the use of back-up generators. The Utilities shall provide a description of data they have on customer back-up generator usage in demand response programs. We request other parties to share this information as well.

DACC/AReM Response: DACC and AReM have no comments to offer on this question, but reserve the right to respond to the comments of other parties in reply. "а = 1

b. If the Commission bifurcates demand response programs, how should the Commission develop rules that are consistent with the D.11-10-003 policy statement?

DACC/AReM Response: It is not clear the extent to which the Commission intends in this proceeding to revisit the policy statement included in D.11-10-003 with respect to a prohibition on the use of back-up generation by DR resources. ²¹ Therefore, DACC and AReM confine these opening comments to a discussion of some overarching considerations. If the Commission's goal is to maximize DR resources, a prohibition on the use of back-up generation will reduce participation of DR in CAISO markets, and hamper the economic development of newer back-up technologies, such as fuel cells, batteries, and other emerging storage technologies. Even the use of fossil fuels for back-up generation (including diesel) in certain instances, while creating emissions that would be avoided if the DR resource was foregoing all consumption of power, may still be preferable to new larger-scale peaking facilities. In short, the

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Commission should explore the use of back-up generators to provide supply-side DR in more detail and determine the types of units, fuels, or operation that could be used and still allow the resource to qualify as a RA resource.

DACC and AReM propose the following options for further discussion in this proceeding for determining whether supply-side DR resources supported by back-up generation may qualify as an RA resource:

- Considering the extent to which the resource is subject to and meets all federal, California Air Resources Board ("CARB"), and local air quality management districts' emission standards. For example, if back-up generation meets the low emission standards of the local air quality management districts for stationary sources, then the unit could be approved for use as an RA resource.
- Allowing back-up generation to be bid into CAISO markets as a DR resource (and to receive RA credit) when the unit conducts its required testing.
- Working with CARB to define the acceptable uses of back-up generation for providing supply-side DR resources under the plan for reducing greenhouse gas ("GHG") pursuant to Assembly Bill 32.
- Working with local air quality management districts to consider acceptable conditions for waivers of emission requirements to use back-up generation for providing supply-side DR resources in CAISO markets. For example, back-up generators can be operated in case of emergencies under most air quality district rules. Therefore, if a request for DR resources is considered an "emergency," the restriction on operations should be removed.

c. What are the current laws and regulations regarding back-up generation, including those by the Air Resources Board, local air quality management districts and/or any other related regulatory body?

DACC/AReM Response: DACC and AReM have no additional comments to

offer in response to this question, except to note that the ability for an entity to use back-up

generation for any purpose is heavily regulated in California, and these restrictive policies should

be reviewed in this proceeding as part of the evaluation of the use of back-up generation by DR

resources. DACC and AReM may have further comment on this issue in the future.

B. CONCLUSION

DACC and AReM strongly urge the Commission to move forward with the

implementation of its new vision for DR in California by removing barriers to competitive DR

markets, facilitating active engagement by third-party DR Providers, and reforming existing cost

allocation for utility DR programs so that existing subsidies from retail choice customers are

eliminated. We look forward to transitioning rapidly to this new vision so that DR can more

effectively fulfill its promise as an "essential element of California's resource strategy." $^{22} \mathbb{M} \, \Box \, \eta$

Respectfully submitted,

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Sue Mara

RTOADVISORS, L.L.C.

CONSULTANT TO THE

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DIRECT ACCESS CUSTOMER COALITION

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