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)

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

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The Direct Access Customer Coalition[1] ("DACC") and Alliance for Retail Energy Markets[2] ("AReM") submit this reply to the responses of parties 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]

I. PROPER COST ALLOCATION IS ESSENTIAL TO ENSURING COMPETITIVE NEUTRALITY AND THIRD-PARTY PARTICIPATION.

DACC and AReM represent retail customers and their electric service suppliers ("ESPs"), who are all actively engaged in the competitive retail market. DACC members are also actively engaged in providing demand response ("DR") resources through utility and aggregator-managed programs. These customers are seeking to expand their DR alternatives

[1] DACC is a regulatory alliance of educational, commercial, industrial and governmental customers who have opted for direct access 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.

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beyond utility-run programs and to engage on their own in bidding DR resources into CAISO markets – alternatives that have been lacking in the utility-centric programs that dominate the California DR market. One of the key reasons for this is that the utility-based programs are paid for through utility distribution rates instead of through generation rates. Simply put, remedying this inappropriate cost allocation of utility-based DR programs is key to expanding the competitive DR market and allowing DR to reach its full potential in California.

Both the California Independent System Operator ("CAISO") and the Marin Energy Authority ("MEA") express similar concerns and urge proper cost allocation as a necessary step to promote competitive neutrality and third-party participation. The CAISO[4] and MEA[5] agree with DACC and AReM that cost allocation must adhere to the principle of competitive neutrality. The CAISO explains that the current allocation of DR costs to distribution rates creates an "un-level and anti-competitive playing field," which it describes as a "major policy concern" and a "current barrier to the development of a vibrant and competitive [DR] market."[6] The CAISO proposes to transition the utilities out of providing supply-side DR[7] and an approach in which each DR supplier, be they a load-serving entity ("LSE") (*i.e.,* utility, ESP) or a DR Provider, offers their own DR programs and recovers the associated costs from their own customers.[8] For its part, MEA argues that, while allocating utility costs to distribution rates may have made sense in early program development stages, such cost allocation is no longer reasonable and is "fundamentally unfair."[9] Accordingly, MEA makes the sensible proposal that the costs of all DR programs receiving Resource Adequacy ("RA") credit should be recovered

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[4] CAISO Response, p. 12.

[5] MEA Response, p. 8.

[6] CAISO Response, p. 12.

[7] CAISO Response, p. 13.

[8] CAISO Response, p. 14.

[9] MEA Response, pp. 8-9.

through generation rates, an approach that would be consistent with how other RA procurement obligations are handled.[10] RA procurement obligations apply to *all* LSEs equally and are supply-related expenses that belong in supply-side – generation – rates.

By contrast, the parties whose constituencies benefit by the cost shifting created by the current approach of allocating the costs of utility DR programs to distribution rates, including all three of the jurisdictional utilities, the California Large Energy Consumers Association ("CLECA"), The Utility Reform Network ("TURN"), and the Office of Ratepayer Advocates ("ORA"), all argue that current practices should continue. The utilities benefit from the current cost allocation approach by shifting their costs to their competitors, thereby making participation in DR programs designed by ESPs and community choice aggregation ("CCA") options less attractive to customers. CLECA benefits by shifting costs to distribution rates, which many of their members do not pay,[11] and TURN and ORA benefit by shifting costs away from bundled customers, whom they represent.

As expected, the utilities and others attempt to justify this cost allocation by arguing that (1) costs have always been recovered this way in the past so the practice should continue[12] and (2) the programs are anticipated to provide benefits to all and so "all" should pay for them.[13] These arguments ignore: (1) the anti-competitive effects of the current cost allocation; (2) that DR providing supply-side services is equivalent to generation resources whose costs should therefore be recovered like other generation resources; and (3) that DR providing RA capacity "benefits" the LSE meeting its RA requirement with the DR resource.

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[10] MEA Response, p. 9.

[11] Many of CLECA's members are connected to the utilities at transmission-level voltages and thus pay no distribution rates.

[12] See, for example, PG&E Response, p. 9 and SCE Response, p. A-7.

[13] ORA Response, p. 5; SDG&E Response, p. 9; TURN, p. 10.

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In particular, San Diego Gas & Electric Company ("SDG&E") argues that all LSEs benefit from supply-side DR providing capacity, including ESPs, and thus all such "beneficiaries" must pay for it.[14] DACC and AReM disagree. Indeed, the only reason that RA credits from utility DR programs are allocated to ESPs today is to reflect that fact that their customers are paying for programs that *do* provide RA capacity benefits. This artificial construct would end once proper cost allocation rules are adopted by the Commission. ESPs have made it clear that they are more than willing to forego the RA allocation in return for having the utility DR program costs recovered properly through generation rates. As noted by DACC-AReM[15] and confirmed by Pacific Gas and Electric Company ("PG&E"),[16] RA credits for DR resources with costs recovered through generation rates would accrue solely to the utilities.

Significantly, in a case with similar cost allocation issues, the Commission determined that allocating costs to those who had not procured the product would be unfairly discriminatory as well as arbitrary and speculative. This case involved the proposed allocation of a bond charge to all customers for costs incurred by the utilities in procuring electricity from the California Department of Water Resources ("DWR") during the Energy Crisis, including allocating costs to those who had procured no electricity from the utilities. The Commission rejected the proposed cost allocation in Decision ("D.") 02-11-022, finding that cost allocation based on indirect societal benefits would be "arbitrary and speculative":

> Attempting to assign a charge to DA [direct access] customers *based solely on indirect societal benefits* would be arbitrary and speculative. Moreover, it would be *unfairly discriminatory* to assess a uniform bond charge among DA customers when some of them had actually consumed DWR power *while others had consumed none*.[17] (Emphasis added).

[14] SDG&E Response, p. 9.

[15] DACC-AReM Response, p. 10.

[16] PG&E Response, p. 16.

[17] D.02-11-022, p. 57.

The relevance to this case is clear. The utilities and others continue to advocate that utility DR costs should be allocated to "all" because such DR programs are purported to provide overall and indirect "benefits." However, the Commission has determined that cost allocation based on such indirect societal benefits would be "arbitrary and speculative." DACC and AReM strongly concur. Even the CAISO, the organization responsible for maintaining system reliability, rejects this cost allocation approach as anti-competitive, noting that direct benefits accrue to the LSEs sponsoring the DR programs.[18] The fact that *society* benefits as a result of the DR programs provided by *all* LSEs does not justify allocating the costs of the *utility-run* DR programs to the customers of competing LSEs.

PG&E and CLECA also argue that the DR-related program costs are "customer-service related" and thus are to be recovered through distribution rates.[19] PG&E and CLECA provide no support for why DR costs should be deemed customer-service related or why, if deemed as such, they should be allocated to distribution rates. Moreover, with this proceeding, the Commission is breaking from the past and taking a fresh look at DR-related costs and how they are to be properly allocated to ensure competitive neutrality and promote third-party participation. Therefore, PG&E's and CLECA's arguments on this point should be disregarded.

Ironically, PG&E also cites the "Unbundling" Decision, D.97-08-056, suggesting it as a guide for setting appropriate cost allocation principles for DR.[20] This is ironic because PG&E wishes to continue with the current anti-competitive cost allocation policy, whereas the Unbundling Decision was undertaken to "promote competition."[21] In fact, the Commission considered the proper allocation of "customer-service related" costs in D.97-08-056. Tellingly,

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[18] CAISO Response, pp. 13-14.

[19] PG&E Response, p. 15; CLECA Response, p. 17.

[20] PG&E Response, p. 16.

[21] D.07-08-056, p. 4.

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the Commission *did not* allocate all such costs to distribution, but instead separated out the costs determined to be *generation-related*:

> "We therefore reduce the utilities' distribution revenue requirements to reflect customer service and marketing costs that are more appropriately allocated to generation."[22]

Similar principles should apply here as well. Costs associated with DR performing a generation function, such as supply-side DR or DR granted RA capacity, should be allocated to generation rates.

In addition, CLECA argues that decisions on cost allocation for utility DR programs should be reserved for Phase 2 of the utility General Rate Cases ("GRCs").[23] However, CLECA's description of current cost allocation by utility makes a strong case for establishing consistent and uniform rules for all utilities in one proceeding, as proposed here. Specifically, CLECA explains that "the costs of utility DR programs are not necessarily allocated in the same way for each IOU" – a direct result of the fact that DR costs have been allocated in the *separate utility GRCs*.[24] ORA and SCE also confirm that cost allocation can differ by utility.[25] There is no public policy or cost causation rationale that would reasonably lead to this outcome where similar utility DR programs have differing cost allocations. In fact, this is the primary reason the Commission determined that *rules* for DR cost allocation must be "considered in a consistent manner across all three utilities" and that the Commission intended "to establish overall rules" and apply those rules "in the Utilities' respective rate design applications."[26] Accordingly, CLECA's request to defer cost allocation to each utility's GRC should be disregarded.

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[22] D.07-08-056, p. 26.
[23] CLECA Response, p. 16.
[24] CLECA Response, p. 16.
[25] ORA Response, p. 8; SCE Response, p. A-7.
[26] D.12-04-045, p. 204.

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DACC, AReM, and, now, the CAISO and MEA have explained the anti-competitive barriers created by the existing improper cost allocation. To summarize, utilities are significantly advantaged when their DR program costs are recovered from all customers through distribution rates with no risk of shortfall or non-recovery. 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. Moreover, excluding DR costs from generation rates where they belong, artificially depresses those generation rates, making direct access service and CCAs less competitive when compared to utility rates. Accordingly, DACC and AReM urge the Commission to end business-as-usual and modify current cost allocation practices to fulfill its "new vision" for DR in California and eliminate this current barrier to a competitive DR market.[27]

II. TRANSITIONING THE UTILITIES OUT OF SUPPLY-SIDE DR WOULD ENCOURAGE THIRD-PARTY PARTICIPATION.

The CAISO proposes transitioning the utilities out of providing supply-side DR and allowing the competitive market to provide these services.[28] DACC and AReM agree. The current approach of allowing the utilities to provide the vast majority of DR services with their costs subsidized through distribution rates has stunted the development of a competitive DR market, stymied innovation, and led the Commission to fall far short of its DR goals. Proper cost allocation for utility-run DR programs and a measured transition of the utilities out of supply-

[27] See, R.13-09-011, pp. 9 and 15-16.

[28] CAISO Response, p. 13.

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side DR would encourage third-party participation and put California on the right path toward development of a robust DR market.

III. USE OF BACKUP GENERATORS FOR PROVIDING DR RESOURCES SHOULD BE CLARIFIED IN THIS PROCEEDING.

Several parties note that the use of backup generators is outside of the Commission's jurisdiction and instead the direct responsibility of the California Air Resources Board and local air quality management districts ("AQMDs").[29] In particular, the California Clean Energy Committee ("CCEC") opposes the Commission banning the use of backup generators to provide DR resources and requests that the Commission leave decisions about appropriate permitting conditions to the agencies with the expertise and jurisdiction in these matters, the local AQMDs.[30] Also, the Joint DR Parties explain that backup generators are not a significant part of their DR services and, if prohibited, would lead to the need for replacement resources.[31] As described in the December 13th response of DACC and AReM, the Commission should consider options that clarify when DR resources supported by backup generators will count for RA purposes.[32] For example, if the back-up generator meets the low emission standards of the local AQMD for stationary sources, then the DR resource should be approved for RA purposes. DACC and AReM concur with other parties that such issues are appropriately resolved in this proceeding.

IV. CONCLUSION.

DACC and AReM urge the Commission to disregard the comments of parties seeking to maintain the current anti-competitive approach of allocating costs of utility DR programs to

[29] See, for example, CCEC Response, p. 6; CLECA Response, p. 18; SCE Response, p. A-9;
[30] CCEC Response, p. 6.
[31] Joint DR Parties Response, p. 12.
[32] DACC-AReM Response, pp. 11-12.

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distribution rates. Business-as-usual has failed to advance DR services in California and caused the Commission to fall far short of its DR goals. It is time for the Commission to move forward with the implementation of its new vision for DR in California by removing this barrier to competitive DR markets, thereby facilitating active engagement by third-party DR Providers. DACC and AReM members stand ready to assist in this endeavor.

Respectfully submitted,

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