Joint Utilities’ Rebuttal Testimony Proposing a Methodology for Calculating and Implementing the CCA Financial Security Requirement

Before the
Public Utilities Commission of the State of California

Rosemead, California
August 25, 2017
JU-02: Joint Utilities’ Rebuttal Testimony Proposing a Methodology for Calculating and Implementing the CCA Financial Security Requirement

Table Of Contents

Section | Page | Witness
--- | --- | ---
I. INTRODUCTION | 1 | R. Sekhon
II. CCA PROPOSALS FAIL TO MEET THE REQUIREMENTS OF PU CODE SECTION 394.25(E) BECAUSE THEY ASK THE COMMISSION TO IGNORE THE LEGISLATIVE MANDATE THAT CCAS POST A FINANCIAL SECURITY INSTRUMENT SUFFICIENT TO COVER REENTRY FEES | 2
III. RISKS OF AN INVOLUNTARY RETURN OF CCA CUSTOMERS ARE REAL | 6
   A. CCAs Are Not Currently Required to Demonstrate to the Commission That They Are “Stable Entities” | 7
   B. California’s Procurement Framework Does Not Eliminate Disruptions in the Electricity Market that Can Cause High Energy Prices | 8
   C. Increased Reliance on Renewables Does Not Reduce a Load Serving Entity’s (LSE’s) Exposure to Market Fluctuations | 9
   D. CalCCA’s Reliance on the Municipal Utilities to Support its Assertion that CCAs Will Not Fail is Flawed | 10
   E. No Reasonable Alternative Protections to the FSR Exist | 12
IV. JOINT UTILITIES’ PROPOSAL IS FAIR AND APPROPRIATELY PROTECTS CUSTOMERS IN A HIGH-PRICED ENERGY MARKET | 14
   A. Joint Utilities’ Proposal Does Not Represent an Undue Burden on the CCAs | 15
   B. Joint Utilities’ Proposal is Consistent with the Methodology Adopted by the Commission for ESPs for Setting the FSR Under Section 394.25(e) | 17
### Table Of Contents (Continued)

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
<th>Witness</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The CCA FSR Protects All CCA Customers</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>2. The CCA FSR Should be Recalculated Monthly</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>3. The CCA FSR and Reentry Fees Should Cover a One-Year Period</td>
<td>21</td>
<td></td>
</tr>
<tr>
<td>4. The CCA FSR and Reentry Fees Should Utilize Updated Benchmarks</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>V. CCAS SHOULD BE SUBJECT TO INDUSTRY-STANDARD REQUIREMENTS FOR FINANCIAL SECURITY</td>
<td>24</td>
<td>K. Lock</td>
</tr>
<tr>
<td>A. Collateral Requirements are Common Practice</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>B. An Investment Grade Credit Rating does not Eliminate the Need for an FSR</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>C. Utilities Are Required to Prove Liquidity Analogous to the CCA FSR</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>D. CCAs’ Financial Strength and Risk Profile Can and Should be Assessed by the Issuer of Their FSI</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>E. It is Common Practice to Regularly Review and Refresh Collateral Requirements</td>
<td>29</td>
<td></td>
</tr>
<tr>
<td>VI. SELF-INSURANCE, SURETY BOND, AND PROOF OF RATE STABILITY FUNDS SHOULD NOT BE CONSIDERED ACCEPTABLE FSIS</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>A. Self-Insurance Does Not Meet the Requirements of Section 394.25(e)</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>B. Because Utility Should be Able to Promptly Draw Upon Collateral in an Involuntary Return, Surety Bonds will not be Adequate</td>
<td>31</td>
<td></td>
</tr>
</tbody>
</table>
JU-02: Joint Utilities’ Rebuttal Testimony Proposing a Methodology for Calculating and Implementing the CCA Financial Security Requirement

Table Of Contents (Continued)

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
<th>Witness</th>
</tr>
</thead>
<tbody>
<tr>
<td>VII. PROPER SECURITY FOR ADMINISTRATIVE COSTS</td>
<td>33</td>
<td>D. Gutierrez</td>
</tr>
<tr>
<td>A. CCA-SF is the Most Appropriate Proxy for Administrative Costs</td>
<td>33</td>
<td></td>
</tr>
<tr>
<td>B. The Forecast of Involuntarily Returned Customers Should Not Be Arbitrarily Discounted</td>
<td>35</td>
<td></td>
</tr>
</tbody>
</table>
I.

INTRODUCTION

Southern California Edison Company, Pacific Gas and Electric Company, and San Diego Gas and Electric Company (together, the Joint Utilities) submit this rebuttal testimony to the opening testimonies of Marin Clean Energy (MCE) and California Community Choice Association (CalCCA) on their proposals for implementing the financial security and reentry fee requirements for Community Choice Aggregation (CCA) programs, pursuant to Public Utilities (P.U.) Code Section 394.25(e).

CalCCA’s primary proposal is to define the financial security requirements (FSR) as covering only administrative costs, with no FSR required for incremental procurement related exposure which may develop over time (CalCCA proposal). MCE supports CalCCA’s proposal, and also proposes to exempt creditworthy entities from any FSR (MCE proposal). This testimony addresses and rebuts both proposals. It is organized as follows:

Chapter I introduces CalCCA’s and MCE’s proposals (generally referred to as CCA proposals). Chapters II and III establish why both proposals fail to meet the requirements of P.U. Code Section 394.25(e). Chapter IV describes how the Joint Utilities’ proposal appropriately protects customers in all energy market environments, and based upon current market conditions would not result in an FSR that is an “unnecessary burden” on CCAs’ day to day operations. Chapter V explains how the CCA proposals are tantamount to requiring the Investor-Owned Utilities (IOUs) to extend a free open credit limit to each CCA, a result that is inconsistent with industry-standard practice and Section 394.25(e). Chapter VI describes why CCAs should not be allowed to use proof of “cash on-hand” – or self-insurance – to satisfy the FSR. Finally, Chapter VII describes how CalCCA’s proposed method for forecasting administrative costs under-estimates the incremental administrative cost of placing involuntarily returned CCA customers back to IOU procurement service.
II.

CCA PROPOSALS FAIL TO MEET THE REQUIREMENTS OF PU CODE SECTION 394.25(E) BECAUSE THEY ASK THE COMMISSION TO IGNORE THE LEGISLATIVE MANDATE THAT CCAS POST A FINANCIAL SECURITY INSTRUMENT SUFFICIENT TO COVER REENTRY FEES

As described in detail in the Joint Utilities’ Direct Testimony, Section 394.25(e) imposes financial security requirements on CCAs to protect both IOUs’ bundled service customers and CCA customers from the costs associated with a CCA’s mass involuntary return of its customers to IOU procurement service.1 Specifically,

If a customer of an electric service provider or a community choice aggregator is involuntarily returned to service provided by an electrical corporation, any reentry fee imposed on that customer that the commission deems is necessary to avoid imposing costs on other customers of the electric corporation shall be the obligation of the electric service provider or a community choice aggregator … As a condition of its registration, an electric service provider or a community choice aggregator shall post a bond or demonstrate insurance sufficient to cover those reentry fees. In the event that an electric service provider becomes insolvent and is unable to discharge its obligation to pay reentry fees, the fees shall be allocated to the returning customers.2

Bundled service customers are protected through the reentry fees imposed on involuntarily returned CCA customers, which are intended to avoid shifting costs onto bundled service customers. In turn, the reentry fees imposed on involuntarily returned CCA customers are the obligation of the CCA under the statute, and the CCA must post a bond or insurance “sufficient to cover those reentry fees.”3

---

1 As discussed in Exhibit JU-01, Appendix A, the protections of Section 394.25(e) extend only to mass involuntary returns, which involve all or substantially all of the CCA’s customers, not to involuntary returns that can arise if, for example, a customer fails to pay its bill or otherwise fails to meet the terms or conditions of CCA service and is involuntarily returned to the IOU as the Provider of Last Resort (POLR). Thus, any discussion of involuntary returns in this Volume means mass involuntary returns, unless expressly noted otherwise.

2 See §394.25(e), emphasis added.

3 Although § 394.25(e) uses the term “bond,” the Joint Utilities interpret this requirement to refer more broadly to any acceptable financial security instrument. Please see Section D for the Joint Utilities’ proposal on acceptable forms of financial security instruments.
To avoid imposing costs on bundled service customers as a result of involuntarily returned CCA customers, as the statute expressly requires, the Joint Utilities’ proposal defines the reentry fees as the incremental administrative and procurement (energy, resource adequacy (RA) and renewable portfolio standard (RPS)) costs incurred by the IOU as a result of a CCA’s involuntary return of its customers to the IOU’s procurement service; proposes a method for forecasting the reentry fees and setting the financial securities requirement (FSR); and contemplates that the CCA post a financial security instrument (FSI) in the form of a letter of credit (LOC) or cash, sufficient to cover the FSR. In other words, the Joint Utilities’ proposal reasonably implements the statute’s requirement that the CCA, and not bundled service customers or the involuntarily returned CCA customers, should absorb the risks associated with the CCA’s ability to involuntary return its customers to IOU bundled service, by posting an FSI sufficient to cover the costs that would be caused by that event, including incremental procurement costs.\textsuperscript{5}

On the other hand, MCE and CalCCA in their testimony propose to shift the risks of an involuntary return almost entirely onto the bundled service customers and involuntarily returned CCA customers, contrary to the express requirements of the statute. They propose that CCAs should cover—at most—only the administrative costs to re-integrate the involuntarily returned customers to IOU procurement service by claiming that the likelihood of failure of any CCA, at all times from now until forever, is “very unlikely,” and that in any event, forecasting incremental procurement costs is “highly speculative.”\textsuperscript{2} MCE takes this notion one step further by proposing that any “creditworthy” CCA\textsuperscript{8} be

\textsuperscript{4} Incremental costs are defined as costs for resources or services above those recovered in the IOU’s bundled service rates at the time of the involuntary return.

\textsuperscript{5} The Joint Utilities propose that involuntarily returned CCA customers protected by an FSI be immediately placed on IOU bundled procurement service.

\textsuperscript{6} Additionally, CalCCA proposes that the forecast of the administrative costs be discounted by multiplying the per-customer administrative fee by a discounted number of customers. This aspect of CalCCA proposal is addressed in Chapter VII.

\textsuperscript{2} CalCCA Testimony at p. 3, MCE Testimony at pp. 5, 34-35.

\textsuperscript{8} MCE defines a creditworthy CCA as a CCA with a Moody’s credit rating of Baa3 or Standard and Poor’s credit rating of BBB-.
entirely exempt from the requirement for an FSI. These claims are far flung and speculative, and they
provide no credible basis for shifting the risks associated with CCA involuntary returns almost entirely
to bundled service and CCA customers, contrary to the consumer protections in Section 394.25(e).

The CCA proposals fail to meet the requirements of Section 394.25(e). As CalCCA itself
acknowledges, it is “very difficult to predict” and consider what would happen in a “stressed,” or
enduring high priced, environment. Instead of ignoring the possibility or deemphasizing the impact of
such an occurrence, as the CCAs essentially propose to do, the Joint Utilities propose to set forth a
process for forecasting and regularly updating the FSR based on then-current market conditions. As is
described in further detail in Chapter IV, it is critical that the Commission adopt a durable framework
that appropriately sets and adjusts the FSR in all market environments (low, normal, and high-priced
conditions) and establishes criteria for the security (e.g., type, when it should be posted, how it should be
adjusted, etc.) well in advance of any adverse conditions so that all customers are protected and
expectations for the FSI performance are clearly defined. The Joint Utilities’ proposal meets these
criteria. Moreover, it meets the requirements of Section 394.25(e) and is consistent with both the
Commission-adopted FSR methodology for Energy Service Providers (ESPs) and industry standard
practice.

Absent a sustainable process for establishing and maintaining the CCA FSR, the IOUs, their
bundled service customers and CCA customers will be unsecured creditors of the CCAs for the reentry
fees that are the responsibility of the CCA under the statute, and will be entirely exposed to those costs
in the event of a CCA’s failure or service cessation. Moreover, the IOUs as POLR will be expected to
remain financially viable to serve their bundled service customers while also planning for conditions
under which CCA customers may be involuntarily returned without sufficient advance notice.
The liquidity burden on the IOU in such a case is unfair and would provide a direct subsidy to the CCAs

\[CalCCA\] Testimony at p. 29.
of the cost of the liquidity that the CCAs, by law, are required to plan for, procure and have in place to operate.

The Legislature has already weighed the risks of CCA involuntary returns, and determined in Section 394.25(e) that the IOUs and customers should not be unsecured and exposed to the reentry fees in the event of a CCA’s failure or service cessation. As such, this proceeding should not countenance proposals that question the need for the consumer protections of Section 394.25(e); rather, this proceeding should focus on how to implement the financial security requirements of Section 394.25(e).
III.

RISKS OF AN INVOLUNTARY RETURN OF CCA CUSTOMERS ARE REAL

CalCCA asserts that an involuntary return of CCA customers to IOU procurement service will only occur “if a CCA program fails due to a confluence of…unlikely events persisting for a number of years.”10 CalCCA reaches this conclusion by speculating about the stability, creditworthiness, compliance, hedging practices and rate stabilization efforts of CCAs generally. Its testimony assumes, with little or no supporting facts, that all CCAs, both existing and those that form in the future, do and always will behave in the same manner and engage in the same behaviors that may mitigate the risks of failure. The problem is that there is no way to credibly testify as to how CCAs, including those that have not yet formed, may ultimately operate. Moreover, generalizations about CCAs that have little or no factual support, as is the case with CalCCA’s testimony, should be given no weight, particularly when it seeks to contradict the Legislature’s determination of what is necessary to protect customers.

As described in further detail below, the Joint Utilities disagree with CalCCA’s unsupported assessment that all of the events would need to occur and persist for a number of years for the CCA program to fail. Moreover, CalCCA’s testimony fails to acknowledge that CCAs have the “free option” to terminate their procurement services and return their customers to IOU procurement service at any time and for any reason – CCAs do not have to “fail” in order to exercise this option. Because CCAs are not the POLR, they have no legal or financial obligation to continue to provide procurement services to their customers. Changes to city or county leadership and priorities, CCA regulatory requirements, or energy market structures are all reasons why a CCA may elect to terminate service and involuntarily return its customers to the IOU. The potential for CCA “failure” or service termination presents real risks to bundled service and CCA customers – risks that those customers have no control over and are unable to reasonably mitigate. As such, it is critical that the Commission implement a durable FSR that will protect customers, as the Legislature directed.

10 CalCCA Testimony at p. 11.
A. **CCAs Are Not Currently Required to Demonstrate to the Commission That They Are**

**“Stable Entities”**

Sections IV.B of CalCCA’s testimony claims that CCAs are “stable entities” whose diverse generation portfolios mitigate against the risk of market fluctuations and their financial practices and operational decisions are closely monitored and reviewed by “advisory committees.”11 However, pointing to one CCA’s resource plans12 or financial reports does not prove CalCCA’s assertion that all CCAs are “stable entities;” nor does it support the implication of CalCCA’s testimony that all CCAs will always be stable entities. Moreover, the decision to publish an IRP and subject its financial practices to independent audit are decisions made at the sole discretion of the CCA. Unlike the Joint Utilities, CCAs’ procurement plans, contracts for generation resources, and proof of financial liquidity are not currently submitted to the Commission for review and approval. CCAs have made their position clear that, while “the Commission must review and accept, modify, or reject an electrical corporation’s [Integrated Resources Plan],” the Commission has far less authority over CCA programs’ activities, where its role is primarily relegated to “certification.”13

While certain CCAs may at this moment be “stable entities,” without requirements for all CCAs to submit such information to the Commission for review and approval, the Commission should not rely upon a few anecdotal examples as proof that all CCAs are (and will always be) stable and unlikely to fail, and decline to implement the FSR requirement of Section 394.25(e), as CalCCA and MCE ask. The promise of stability is simply not enough for the Commission to decline to implement the clear directive of Section 394.25(e) to secure an FSI from each CCA sufficient to cover the reentry fees in an involuntary return. And, even if CCAs agreed to provide the Commission access to the necessary information, it is not practicable for the Commission to constantly monitor and assess the

---

11 *See generally* CalCCA Testimony at pp. 16-24.

12 CalCCA excerpts statements from Marin Clean Energy’s Integrated Resource Plan (IRP). It is unclear whether any of the other voting members of CalCCA have published their own IRPs at this time.

13 *See* March 21, 2016 Comments of Marin Clean Energy, Sonoma Clean Power, and City of Lancaster on Preliminary Scope of Rulemaking 16-02-007, at pp. 3-5.
creditworthiness of each CCA in order to justify an exemption from the FSR of Section 394.25(e). It is far more practicable, and consistent with the statute, to require a reasonable FSR to protect customers, and expect the CCAs to cover the FSR because doing so entails the cost of implementing a CCA program in California.

Furthermore, stability of an entity is not uniformly viewed by all parties involved. One entity’s view of stability may not conform to another’s view of financial strength and liquidity requirements to do business. As history has proven, the financial strength of market participants can change over time. This is largely why, as discussed in Chapter V.B below, the Commission should not simply defer to the credit rating agencies to determine whether to require an FSR from a CCA. Thus, instead of defining the FSR to exclude incremental procurement costs on the assumption that all CCAs are and will always be stable entities, as the CCA parties advocate, the Commission should adopt a single FSR methodology that applies equally to all CCAs, and allow the issuers of FSIs to account for the individual CCA’s risk profile and creditworthiness in pricing the FSI. This approach is consistent with the Commission’s implementation of Section 394.25(e) for ESPs serving Direct Access (DA) customers. Indeed, the Commission in its decision expressly rejected a proposal that any ESP with investment grade credit rating should be exempted from Section 394.25(e)’s FSR.14

The Joint Utilities’ proposal provides a fair and consistent approach to quantifying the reentry fees, the necessary FSR to cover those reentry fees, and provisions to adjust the FSR so that it does not place unnecessary costs or burden on the CCAs, while reasonably protecting bundled service and CCA customers as Section 394.25(e) intends.

B. California’s Procurement Framework Does Not Eliminate Disruptions in the Electricity Market that Can Cause High Energy Prices

Although CalCCA correctly observes that the Commission and the State have implemented various requirements, such as regulatory reporting requirements, RA obligations and the RPS, that help

14 See D.11-12-018 at p. 75.
to limit the exposure of the California electricity market to high prices, those mitigation measures do not eliminate the risk that California will face periods of sustained high energy prices. Indeed, adverse events such as unusual and prolonged weather phenomena (e.g., the polar vortex in 2014, and a disruption in fuel supply caused by Hurricanes Katrina and Rita in 2005) and economic downturns (e.g., 2008 financial crisis) have all caused disruptions in California’s electricity market and resulted in periods of high energy prices. The risk of a CCA’s failure or service cessation is greater during periods of high prices, thus the risk to customers of an involuntary return is greater, as well. Therefore, while the FSR should be expected to remain low when the market is stable, the FSR needs to adjust to cover the increased risks during periods of high prices.

C. Increased Reliance on Renewables Does Not Reduce a Load Serving Entity’s (LSE’s) Exposure to Market Fluctuations

CalCCA asserts that CCAs’ preference for renewable or greenhouse gas-free electricity procurement helps to mitigate the risks of market fluctuations. However, incorporating greater amounts of renewable generation into its generation portfolio does not necessarily reduce an LSE’s exposure to the market fluctuations. In fact, a generation portfolio that relies heavily on renewable generation resources may have a greater exposure to market fluctuations resulting from energy curtailments, negative prices, and increased ramping requirements, and may have a greater need for resources that provide flexible RA or energy storage resources to accommodate the renewable energy integration.

There has been an increased frequency of incidences of renewable curtailment over the past three years. CAISO studies forecast that approximately 13,000 MW of renewable generation will be curtailed

---

15 CalCCA Testimony at pp. 12-16.
16 CalCCA Testimony at p. 19.
17 See California Independent System Operator (CAISO) Time-of-Use Periods Analysis, filed with the Commission on January 22, 2016 in Rulemaking (R.)15-12-012 at pp. 5-9, accessible at: http://docs.cpuc.ca.gov/PublishedDocs/Efile/G000/M157/K905/157905349.PDF
annually by 2024.\[^{18}\] Per the contractual provisions of most renewable power purchase agreements, LSEs bear the curtailment risk; accordingly, LSEs are obligated to pay the contract costs during the curtailment hours or, alternatively, may be required to absorb the negative prices if there are no contractual provisions for curtailments. As such, an LSE with a generation portfolio that is heavily reliant on renewable generation will have an increased exposure to curtailment-induced market fluctuations. Additionally, LSEs whose portfolios primarily consist of renewable generation may not have the “flexible,” or dispatchable, resources that are expected to be “on the margin” during the daily ramp hours when renewable resources’ output tapers down, and will thus be exposed to ramp-induced market fluctuations.

D. **CalCCA’s Reliance on the Municipal Utilities to Support its Assertion that CCAs Will Not Fail is Flawed**

CalCCA points to the experience of municipal utilities during the Energy Crisis, contrasted with the experience of the IOUs, and suggests that CCAs would “similarly fare well” in a high-priced environment.\[^{19}\] The analogy and comparisons are flawed and should be accorded no weight in determining the need for FSR from CCAs under Section 394.25(e).

First, CCAs are different from municipal utilities in that municipal utilities, like IOUs, are the POLR in their service territories and, unlike CCAs, do not have the ability to return their customers to another energy provider in the event of failure or service cessation. Therefore, the risks faced by the municipal utilities and the CCAs with respect to their procurement services are different and may result in different procurement planning and risk management practices among them. In other words, even though CCAs and municipal utilities are all public agencies does not lead to the conclusion that CCAs’ business models and procurement practices match those of municipal utilities.\[^{20}\]


\[^{19}\] CalCCA Testimony at p. 30.

\[^{20}\] It should also be noted that municipal utilities provide other service (e.g., transmission and distribution) to their customers and, unlike CCAs, own significant amount of physical assets.
Moreover, despite municipalities having the right for many years to form municipal utilities under California law,\textsuperscript{21} in the last two decades, other than through limited annexations of IOU service territories or spot municipalizations, very few electric customers have been served by new municipal utilities. This is in contrast with recent activities and interest by municipalities to form CCAs. This suggests that municipalities see lower risk in forming a CCA over a municipal utility. The ability of CCAs to return customers to the IOU, as the POLR, at any time for any reason, coupled with the low cost of entry\textsuperscript{22} accounts for much (if not all) of the lower risk of forming a CCA versus a municipal utility. The Legislature enacted Section 394.25(e) to balance the risks associated with this ability of CCAs to involuntarily return customers to the IOU among the bundled service customers, involuntary returned CCA customers, the CCAs and the IOUs. The Commission should follow the Legislature’s directive and adopt an appropriate FSR for all CCAs to maintain this balance.

Second, CalCCA contrasts the experiences of the IOUs and municipal utilities during the Energy Crisis of 2000-2001 in an apparent attempt to establish that public agencies such as the CCAs will be able to manage high-priced market conditions better than the IOUs.\textsuperscript{23} CalCCA’s testimony fails in this attempt because it ignores the procurement rules under which the IOUs and municipal utilities operated during those years and earlier.\textsuperscript{24} Among the rules applicable to the IOUs, but not the municipal utilities, were:

1) IOUs were required to sell all of their generation into, and buy all of the energy requirements of their bundled service customers from, the California Power Exchange (the so-called “buy all- sell all” rule”);

\textsuperscript{21} See, for example, California Constitution Article XI, section 9 authorizing municipal corporations to establish, purchase and operate public works to furnish its inhabitants with electricity.

\textsuperscript{22} For example, a CCA, unlike a municipal utility, does not have to acquire or build transmission and distribution systems to serve load.

\textsuperscript{23} CalCCA Testimony at pp. 30-32.

\textsuperscript{24} As CalCCA testimony notes, these different rules even resulted in municipal utilities selling any excess energy they had in dysfunctional markets to benefit at the expense of the IOUs’ customers.
2) IOUs were not allowed to enter into long-term contracts to hedge their energy procurement risks;

3) IOUs were required to divest substantial amounts of their utility owned generation;

4) IOUs had to deal with the procurement uncertainties resulting from their customers’ ability to switch to DA service and the IOUs’ requirement to compensate those customers through an inflated California Power Exchange credit (“PX credit”); and

5) IOUs were statutorily prohibited from increasing rates for their customers, despite the skyrocketing wholesale market prices for electricity.

These requirements on the IOUs – which did not apply to the municipal utilities – severely impacted the liquidity and financial stability of the IOUs.

In summary, CalCCA’s testimony fails to establish that IOUs and municipal utilities (and CCAs by CalCCA’s analogy) will fare differently under high-priced market conditions when subject to similar procurement rules; and that municipal utilities’ historical procurement practices are any indication of how CCAs will behave or fare under high-priced market conditions.

E. No Reasonable Alternative Protections to the FSR Exist

As discussed in the Joint Utilities’ Direct Testimony (Exhibit JU-01), Section 394.25(e) is a consumer protection law. It protects customers from the risks and costs of involuntary returns, thereby obviating the need for each customer to have to protect itself from the risks (which is not a reasonable expectation), and to sue a city or county to recover the costs (i.e., the reentry fees, or “damages” in a lawsuit) they would incur in an involuntary return but for the statutory protections. While the Commission in setting the FSR for ESPs removed large customers from the protections of the FSR under a theory that they are able to protect themselves (including negotiating for protections in their contracts and/or suing their ESP for damages), that theory should not be applicable to any CCA customers, for several reasons. First, having individual customers sue a city or county for damages incurred as a result of an involuntary return is contrary to the Legislature’s intent and directives in

25 See Chapter IV.B.1, infra, for further discussion.
Section 394.25(e). Moreover, unlike DA customers, CCA customers are defaulted into the CCA’s service and are served pursuant to tariffs, not bilaterally negotiated contracts. And, a customer seeking to recover damages caused by a CCA’s failure or service termination and involuntary return, would face a substantial risk that the CCA has no remaining assets to cover any unsecured liabilities.\(^{26}\) Most CCAs so far have been formed as a joint powers authorities (JPA), which may not be backed by the credit of the constituent members. Moreover, even if the constituent members of a JPA may be liable for these kinds of damages,\(^{27}\) it is possible that no member of a JPA is jointly or severally liable for the JPA’s liabilities,\(^{28}\) which means that the customer would need to successfully sue each member of the JPA in order to recover its damages. As stated earlier, the Legislature, in enacting Section 394.25(e), did not intend for customers to face these kinds of obstacles in order to be protected from the risks posed by CCAs, after they are defaulted into the CCA’s service once a program is formed and operational.

---

\(^{26}\) See Joint IOU Direct Testimony at p. 5, discussing CCAs operating as Joint Powers Agencies not backed by the credit of third parties, and City CCA Programs that may not be backed by the full faith and credit of the participating City.

\(^{27}\) See Government Code Section 895 et seq., requiring members of JPAs to be liable for the torts of the JPA.

\(^{28}\) See Government Code Section 6508.1, permitting JPA members to agree to not be jointly and severally liable for the liabilities of the JPA.
IV.

JOINT UTILITIES’ PROPOSAL IS FAIR AND APPROPRIATELY PROTECTS CUSTOMERS IN A HIGH-PRICED ENERGY MARKET

Given the increased interest in CCA formation, cities and counties may be focusing on current market conditions and discounting the risk that the markets can, and do, experience disruptive events that cause periods of high prices. It is therefore imperative that the FSR methodology and the collateral framework be finalized without further delay in order to protect customers from the financial risks of involuntary returns of CCA customers, and to ensure that the expectations of FSI performance are clearly defined so CCAs have certainty as to the requirements and can plan to acquire the necessary credit facilities. After CCA formation and in adverse market conditions, it is too late and potentially impossible for a CCA to acquire liquidity. The Joint Utilities’ proposal fully and reasonably satisfies the requirements of Section 394.25(e) and should be adopted.

Additionally, forecasting the incremental procurement costs for inclusion in the FSR is not “highly speculative” as CalCCA claims. To the contrary, the utilities forecast procurement costs and market conditions for the following year in their annual Energy Resource Recovery Account (ERRA) Forecast proceedings for purposes of setting bundled service generation rates, and Energy Division uses subscription-based forward energy prices for the following year to establish the Market Price Benchmark for departing load cost recovery. The Joint Utilities’ proposal to set the FSR using forecasts over the following 12-month period is no more speculative than either of those activities. Moreover, refreshing the calculation monthly, as the Joint Utilities have proposed, reduces uncertainty and ensures that the FSR reflects current market conditions at all times. And any provider of procurement service in California, like a CCA, should be well-versed in forecasting market prices; otherwise, they would be unable to anticipate and hedge against high priced environments. It is thus reasonable and necessary, as discussed below, to include a forecast of the incremental procurement costs in the FSR.

CalCCA Testimony at p. 35.
A. **Joint Utilities’ Proposal Does Not Represent an Undue Burden on the CCAs**

CalCCA and MCE assert that an FSR that protects customers from the risks of involuntary returns would “burden” CCAs and would be a “barrier” to CCA operations and further CCA formation.\(^{30}\) The Commission should reject any notion that complying with California law on consumer protections is unfair or burdensome to CCAs. The Commission successfully implemented the requirement for ESPs five years ago, when DA partially reopened pursuant to Senate Bill 695, and the CCAs were on notice then that this requirement also applies to CCAs and would be finally implemented at some point in the future. Now is that point in time, and calls for further delay from the CCA parties on implementation should not be entertained, particularly given the expectation that CCAs may be serving up to 67 percent of retail end-use load by 2020.\(^{31}\) The Joint Utilities have provided a fair and durable framework that provides the necessary protections for consumers as required by Section 394.25(e). The mechanism of the proposed FSR provides for flexibility such that little to no additional security will be required beyond the minimum requirements\(^{32}\) unless and until adverse market conditions occur, when the risks of an involuntary return are greatest. The CCAs’ proposals, on the other hand, excludes consideration of market conditions entirely and thus fail to protect consumers should an involuntary return of CCA customers occur during a high market price environment.

Based upon current market conditions, where incremental procurement costs are less than or equal to the average cost of the bundled service generation portfolio, the Joint Utilities’ proposal is expected to result in an FSR that is equal to the forecast administrative costs or proposed minimum FSR, whichever is greater. Indeed, the FSR for the past 12 months, as calculated using the Joint Utilities’ proposed methodology, would have been set at the proposed minimum level because market conditions

---

\(^{30}\) CalCCA testimony at p. 35. *See also* MCE testimony at p. 5.

\(^{31}\) *See* Commission President Picker’s “Customer and Retail Choice in California” presentation, dated May 19, 2017 and accessible at [http://www.cpuc.ca.gov/uploadedFiles/CPUCWebsite/Content/News_Room/NewsUpdates/17/Picker.pdf](http://www.cpuc.ca.gov/uploadedFiles/CPUCWebsite/Content/News_Room/NewsUpdates/17/Picker.pdf).

\(^{32}\) As described on pages 33-34 of Exhibit JU-01, the Joint Utilities propose that all CCAs be required to post an instrument covering the minimum FSR of either $147,000 or the forecast administrative cost, whichever is higher.
have been relatively stable. Additionally, because the Joint Utilities have proposed to include two
additional “deadband” criteria (10 percent and $20,000), there will be no adjustment to required
posting amount unless there is a significant (i.e., $20,000) increase to the calculated FSR.

Under higher-priced market conditions, where procurement costs exceed the average cost of the
bundled service generation portfolio, the FSR increases to also cover the incremental procurement costs
that would be incurred if the CCA were to involuntarily return its customers to the IOU’s procurement
service during the forecast period and without a one-year advance notice, causing the IOU to have to
procure for the involuntarily returned customers in those higher-priced market conditions without the
ability to plan to serve them. As explained on pages 19-21 of the Joint Utilities’ Direct Testimony,
monthly updates to the FSR calculation ensure that the FSR reflects the current market outlook and thus
mitigate the need for a “stressed-market based FSR” because volatility and risk exposure are, by
definition, lower in a 20-22 trading day window (monthly calculation) than in a 126 (bi-annual
calculation) or 252 (annual calculation) trading day window. If the higher-priced market conditions are
short-lived in nature, and are not a permanent shift in the market fundamentals and conditions, the prices
will adjust, the FSR will decrease, and the security is returned.

Additionally, it is important to note that the “stressed-market based FSR” of $140 million cited
on page 7 of CalCCA’s testimony represents the overall costs of procuring 2,100 GWh of energy at a
price of $67/MWh, and is not the incremental procurement costs that would have been secured under
PG&E’s original FSR proposal, nor is it representative of what would be secured under the Joint
Utilities’ proposal. As described above and in the Joint Utilities’ Direct Testimony (Exhibit JU-01), the
Joint Utilities’ proposal compares procurement costs at the current market prices to the average cost of
the bundled service generation portfolio to determine an incremental procurement cost amount. As
such, the $140 million figure in that example should be reduced by the cost to serve the load (2,100
GWh) at the prevailing bundled service average generation rate. Based on PG&E, SCE, and SDG&E’s

---

33 See Exhibit JU-01 at p. 32.
current generation rates, a “market price” of $67/MWh would result in the required posting of the proposed minimum FSR (which would be hundreds of thousands of dollars for most CCAs),\textsuperscript{34} not an FSR of $140 million, as the CalCCA testimony implies.  

Lastly, the Joint Utilities note that their proposal to update the FSR monthly is far less stringent than power and gas contractual requirements and the well-established and accepted industry practices that require the daily adjustment of the collateral or issuance of fixed collateral for term of contract regardless of market conditions, which can be costly. Indeed, collateral requirements vary with changes in energy prices and increase for all entities in higher-priced market conditions; when this occurs, IOUs are expected to adjust collateral within a few days of a collateral call. Thus, the Joint Utilities’ proposal to calculate the FSR monthly based on then-current market conditions, which is the responsibility of the IOUs, and to require additional collateral in higher-priced market conditions is consistent with industry practices and does not represent an “undue” burden on the CCA.  

B. Joint Utilities’ Proposal is Consistent with the Methodology Adopted by the Commission for ESPs for Setting the FSR Under Section 394.25(e)  

The premise of the Joint Utilities’ proposal is similar to the methodology adopted by the Commission for setting the FSR for ESPs, except as described below. Specifically, with respect to the risks of involuntary returns of customers served by ESPs, the Commission stated that “the stressed market conditions that prevailed during the 2000-2001 energy crisis are not currently present. Nonetheless, the procurement market could become stressed in the future, and an ESP could be forced to terminate service and immediately return its customers to the IOU without prior notice.”\textsuperscript{35} Accordingly, the Commission adopted an FSR that is based on a forecast of administrative and incremental procurement costs and is estimated using a methodology nearly identical\textsuperscript{36} to the Joint Utilities’ proposal.

\textsuperscript{34} As described on pp. 33-34 of Exhibit JU-01, the proposed minimum FSR is $147,000 or the administrative costs (Schedule CCA-SF re-entry fee, which is currently under $5 per service account for all of the utilities, multiplied by the number of service accounts), whichever is higher.

\textsuperscript{35} D.11-12-018 (R.07-05-025) at p. 58.

\textsuperscript{36} The ESP FSR methodology for forecasting incremental procurement costs uses different data sources for the forecast energy, REC, and RA prices. The Joint Utilities note that the REC and RA prices used in the ESP (Continued)
in this proceeding. In that proceeding, there was near universal acknowledgement from parties and the Commission that there could be incremental procurement costs arising from an involuntary return of ESP customers to IOU service, and most importantly, that those incremental procurement costs were not to be shifted to bundled service customers. The Joint Utilities’ proposal to include incremental procurement costs is consistent with the principles adopted in D.11-12-018. However, the CCA proposals deviate from the ESP FSR in the following respects and for reasons described below.

1. **The CCA FSR Protects All CCA Customers**

As discussed in Chapter III.E above, the CCA FSR and reentry fees should protect all CCA customers. The Commission-adopted FSR and reentry fees framework for ESPs does not do so. Specifically, large commercial and industrial DA customers, and small DA customers affiliated with these large customers, are not protected by the FSR; therefore, when they are involuntarily returned to the IOU, they are subject to Transitional Bundled Service (TBS) rates, which rely on spot market energy prices that will be high if the return occurs during a high-priced environment. Thus, for large and affiliated small DA customers, the ESP framework places the full responsibility of risks and costs of the incremental procurement in an involuntary return on those customers, rather than the ESP. In deciding not to protect those DA customers the Commission explained that, given the “sophisticat[ion]…[and] experience in obtaining goods and services via contracts, large commercial and industrial DA customers should have the ability to negotiate contractual provisions with an ESP to

FSR methodology are higher than the REC and RA prices proposed in the Joint Utilities’ proposal for CCAs, as they reflect the benchmarks that are currently adopted by the Commission for calculating the Market Price Benchmark for departing load cost recovery purposes. The Joint Utilities propose different data sources for the CCA FSR methodology that are directionally more in line with current market prices and are expected to reduce the FSR for CCAs.

37 See generally D.11-12-018 at pp. 60-67.

38 TBS rates are intended to reflect “spot market prices” and protect bundled service customers from incurring additional procurement costs that result from the return of individual departing load customers without sufficient advance notice (6 months in the case of voluntary returns), before the utility has been able to plan to serve those voluntarily returned customers’ load. See D.11-12-018 at p. 41.
protect themselves in the event of a breach, recognizing the potential to pay TBS rates if they return to the IOU.”\textsuperscript{39} They were also presumed to be sophisticated enough to sue their ESP for damages. On the other hand, the Commission found that “residential and small commercial customers subscribing to direct access may not possess the same business sophistication as large commercial and industrial customers in terms of protecting themselves in the event of a breach by their ESP,” and required that each ESP’s FSR be set to cover the incremental procurement costs associated with residential and small commercial DA customers, as well as the incremental administrative costs for all DA customers (including the large and small affiliated customers).

The reasons underlying the Commission’s decision to require large and small affiliated DA customers to protect themselves from reentry fees in an involuntary return are not applicable to CCA customers. CCA customers cannot negotiate for contract protections from the reentry fees, because CCAs generally serve pursuant to standard tariff terms and conditions, rather than bilaterally negotiated contractual terms and conditions, like those negotiated between ESPs and their customers. CCA customers cannot easily sue the CCA or its city or county members for damages, as discussed in Chapter III.E above. As such, it is not reasonable to assume that large commercial and industrial CCA customers and their affiliated small CCA customers will have any means of protecting themselves from, or obtaining recourse from the CCA or the underlying city and/or county to compensate them for, any reentry fees arising out of an involuntary return.

Given that CCAs are the “default service provider” for the customers within their service territory, contrasted with the voluntary nature of DA service (\textit{i.e.}, CCA is “opt-out,” while DA is “opt-in”), it is important that the CCA FSR cover the incremental procurement costs for all of the CCA customers, not just the residential and small unaffiliated commercial customers. As described in Chapter II, the Joint Utilities’ proposal is designed to protect bundled service customers and all involuntarily returned CCA customers, as Section 394.25(e) intends.

\textsuperscript{39} D.11-12-018, Finding of Fact 47.
2. **The CCA FSR Should be Recalculated Monthly**

As adopted in D.13-01-021, the ESP FSR is calculated every six months and does not account for any market volatility or “stress” that could occur during the forecast period.\(^{40}\) The Commission in adopting this simple methodology sought to mitigate the complexity of the ESP FSR calculation and reasoned that a simplified approach was warranted given its decision to limit the scope of the procurement-related FSR to residential and small commercial customers.\(^ {41}\) However, the simplicity of it, coupled with the infrequent updates of the ESP FSR, means that by design the ESP FSR will not be sufficient to fully cover reentry fees for involuntary returns occurring in high-priced or volatile environments.

For the CCA FSR, the Joint Utilities seek to improve on the framework adopted for the ESP FSR in order to mitigate the risk that the CCA FSR will be insufficient to cover the reentry fees in an involuntary return, while maintaining simplicity in the methodology. Specifically, the Joint Utilities propose a monthly update to the FSR calculation with no market volatility or “stress” factor. As described above, and in the Joint Utilities’ Direct Testimony,\(^ {42}\) volatility and “stress” factors can be discounted or ignored in the methodology only if the risks and associated FSR amounts are assessed and updated frequently. More frequency in the absence of volatility and “stress” factors ensures that the FSR reasonably accounts for movements in market prices – movements that do not wait six months to occur but in fact occur daily, hourly and minute by minute. While a six-month update with no volatility or “stress” factors leaves the ESP FSR extremely vulnerable to being undersecured in a high priced or volatile environment, a monthly update greatly mitigates those vulnerabilities. Accordingly, for the CCA FSR, a monthly update with no volatility or “stress” factor is expected to ensure that the FSR is

---

\(^{40}\) D.13-01-021 at p. 21.

\(^{41}\) See generally D.11-12-018 at p. 69, in which the Commission concludes that a simplified approach to forecasting the procurement risk was warranted given the more “modest” and limited risk exposure involved in covering procurement for this limited customer group.

\(^{42}\) Exhibit JU-01 at pp. 20-22, and Appendix A.
appropriately sized for the risks it should cover, thereby striking a reasonable balance between administrative ease and forecasting uncertainties.

Notwithstanding the Joint Utilities’ proposal to define the reentry fees to include the incremental procurement costs for all classes of customers, residential and small commercial customers will likely make up a significant portion of CCA load, and CCA load (unlike DA load) is not capped, is growing and is expected to increase significantly. As such, the procurement risks associated with CCA involuntary returns are not “modest,” and a monthly update is appropriate to ensure that the CCA FSR is sufficiently sized. As discussed in this chapter, the CCA FSR is expected to be set at or around the proposed minimum CCA FSR under normal market conditions. This, coupled with the Joint Utilities’ proposal to not adjust the FSR unless a deadband threshold has been exceeded, ensures that the monthly calculation, and adjustments to the FSR when necessary, will not be an administrative burden on either the CCAs, the IOUs, or Commission staff.

3. The CCA FSR and Reentry Fees Should Cover a One-Year Period

While the ESP FSR and reentry fees cover an eight-month period, the CCA FSR and reentry fees should cover a one-year period. The longer duration for determining incremental costs is warranted for the CCA FSR for several reasons. First, as discussed in the Joint Utilities’ Direct Testimony, the Commission-approved tariffs governing CCA service require that a CCA give the IOU a one-year advance notice of any voluntary service termination (i.e., a service termination at the behest of the CCA, whether due to failure, insolvency, or for any other reason). The tariffs require this advance notice in recognition that it takes at least a year’s time for the IOU to properly plan to assume

43 See generally D.11-12-018 at p. 69, explaining that the ESP customer risk is more modest: “Because the ESP bond calculation proposed by SCE and PG&E anticipated covering energy procurement risks for all involuntarily returned DA customers, the degree of complexity in the bond formulas and assumptions underlying those calculations may not be necessary for a bond that covers a much more modest procurement risk limited only to small commercial and residential DA. In view of the more limited risk exposure involved in covering procurement for this limited customer group, more simplified assumptions may be appropriate with respect to the methodology for estimating the incremental amount of the ESP bond necessary to cover such risks.”

44 Exhibit JU-01 at p. 16.
procurement responsibilities for the CCA’s customers; without such time, the IOU may be forced to procure resources more quickly and at higher prices. As in a voluntary return of a CCA customer to IOU procurement service, where the customer elects to return to IOU procurement service and must provide a six-month advance notice of its return or otherwise must bear the incremental costs to the IOU of serving it for a six-month period of time, the CCA in an involuntary return is required to provide the IOU a one-year advance notice of its election to return all or substantially all of its customers to IOU procurement service, or otherwise the CCA should bear the incremental costs to the IOU of serving those customers for a one-year period of time. These incremental costs are the costs of reentry (or reentry fees), and to be sufficient to cover these reentry fees in an involuntary return, the CCA FSR must also cover a one-year period of time.

The longer duration of time for determining incremental costs for the CCA FSR and reentry fees versus the ESP FSR and reentry fees is also justified because a CCA likely serves more customers than an ESP, and therefore will likely have a larger impact on the IOU in an involuntary return. CCAs are likely to serve more customers than ESPs because CCAs must offer universal service to customers in their jurisdictional boundaries, notably residential customers, whereas ESPs have no such obligation, can cherry-pick their customers, and can offer new service only to non-residential customers. Moreover, CCA service is uncapped and growing, whereas DA service is capped, has been at capacity for several years now and is not growing.

Finally, upon an involuntary return to IOU procurement service, CCA customers have a one-year minimum stay requirement on the IOU’s procurement service. For DA customers, in the

---

45 See Rule 23, Sections L.1, L.2, L.3.c, L.3.d.
46 See Section 366.2(c)(13) directing that the reentry fees “shall reflect the costs of reentry.”
47 Only non-residential customers can switch to DA service. Those residential customers who were served on DA service in 2010 when DA was partially reopened were grandfathered into DA service and can remain on it, but cannot switch back to DA service should they ever return to IOU procurement service. See SB 695 (codified at Section 365.1; also D.10-03-022, Section 6.2 and Conclusion of Law 13).
48 Pursuant to Section 365.1, DA service remains capped unless the Legislature acts to reopen it further.
49 See Rule 23, Section L.3.
event their ESP fails or otherwise elects to involuntarily return its customers to the IOU’s procurement
service, the switching rules provide DA customers a 60-day safe harbor period, during which they can
seek to procure service from another ESP. Only after the 60-day period runs does a minimum stay
period apply to DA customers on IOU procurement service. Accordingly, it is likely that at least some
DA customers will elect to contract with new ESPs and depart IOU procurement service during the
60-day safe harbor, thereby lessening the overall impact to the IOU of the involuntary return caused by
the original ESP’s failure/service cessation.

These differences between CCA and DA service justify a longer duration for determining
incremental costs for the CCA FSR and reentry fees (one year) than what the Commission adopted for
the ESP FSR and reentry fees (8 months) pursuant to Section 394.25(e).

4. **The CCA FSR and Reentry Fees Should Utilize Updated Benchmarks**

The CCA FSR and reentry fee proposals should incorporate updated benchmarks for
determining the costs of RA and RPS compliance for the CCA customer load involuntarily returned to
IOU procurement service. For reasons explained in the Joint Utilities’ Direct Testimony, the RA and
RPS benchmarks used to determine the ESP FSR and reentry fees are outdated and greatly overestimate
the market price of RA and RPS. Accordingly, the Joint Utilities’ proposal to use updated RA and
RPS benchmarks to set the CCA FSR and reentry fees, as described in their Direct Testimony, is
reasonable, as are the other differences between the established ESP FSR/reentry fees and the proposed
CCA FSR/reentry fees described above.

---

20 Exhibit JU-01, at pp. 24-27.
21 Indeed, the Commission has recognized the need to examine and reform these benchmarks and associated
methodology as part of the recently issued PCIA OIR (R.17-06-026).
V.

CCAS SHOULD BE SUBJECT TO INDUSTRY-STANDARD REQUIREMENTS FOR FINANCIAL SECURITY

CalCCA’s proposal to exclude procurement costs from the FSR calculation, and MCE’s proposal to exempt all investment grade CCAs (if any)\(^{52}\) from any FSR, are inconsistent with industry-standard requirements for financial security. As described in Chapter IV above, the Joint Utilities’ proposal to use a regularly-updated forecast of procurement costs appropriately protects customers by ensuring that the FSR is sufficient to cover the costs of an involuntary return over a forward 30-day period. While the CCA FSR, as calculated using the Joint Utilities’ proposal, is expected to be set at or around the proposed minimum level based upon current market conditions, it will appropriately increase in high-priced environments. On the other hand, an FSR calculated during a high-priced environment using the CalCCA’s Proposal will, by design, be at all times wholly insufficient to cover the financial risk of procuring for the involuntarily returned CCA customers, and particularly so when market prices are high. And, MCE’s Proposal to waive the FSR altogether for all investment grade CCAs (if any), would result in the IOUs and their bundled service customers (including the involuntarily returned CCA customers) bearing the financial risk of all incremental administrative and procurement costs in an involuntary return.

As discussed below, declining to impose any FSR (MCE’s Proposal), or setting a wholly insufficient FSR (CalCCA’s Proposal), would be tantamount to requiring the IOUs to extend a free open credit limit to each CCA. This free open credit limit would be equal to the incremental procurement costs, which could be significant in a high-priced environment and compounded because collateral and liquidity would likely be limited in such an environment, or equal to the administrative and incremental procurement costs under MCE’s Proposal. Such a result is wholly inconsistent with industry-standard requirements.

\(^{52}\) As MCE acknowledges in its testimony, currently no CCA has investment grade credit, nor is any CCA even rated by the credit rating agencies. MCE’s testimony, p. 4: “Credit rating agencies do not currently rate any CCAs in North America.” MCE’s proposal is based entirely on a hypothetical circumstance of a CCA having investment grade credit rating; accordingly, the proposal should be rejected.
practice, and is contrary to Section 394.25(e) and the IOUs’ formal governance of and requirements for
managing the credit risks of parties with whom the IOUs transact (i.e., counterparty risks). Because the
IOU is the POLR for involuntarily returned CCA customers, providing a free credit limit to CCAs, as
the CCA parties propose, would require the IOUs to continue to procure and pay each year for liquidity
facilities that would be needed to serve both bundled service customers and departing load customers in
the event of an involuntary return – an unreasonable burden, which the Legislature did not intend in
adopting Section 394.25(e).

A. Collateral Requirements are Common Practice

Appendix B of the Joint Utilities’ Direct Testimony highlights the market practices for managing
counterparty risks in both the gas and power commodities and the financial markets. The variety of
contracts and terms are discussed in detail to clarify and describe the industry-accepted credit risk
management practice. The contracts are all different in regards to the framework for establishing open
credit limits. Some have prescriptive conditions, while others are performed on an ad-hoc basis based
on specific, mutually agreed-upon terms for transaction type, volume price, and tenure. However, the
amount of open credit and the form in which it is granted, depend on a number of factors, not just the
counterparty’s external credit ratings.

When determining whether, and how much, open credit should be extended to a counterparty, a
market participant, such as the IOU, typically takes into account the following: 1) the finite amount of
credit available; 2) an internal assessment of the counterparty based on a number of factors, such as its
external ratings, liquidity levels, tangible net worth, etc.; 3) the market participant’s internal policies and
controls to limit open credit amounts; 4) term, location and other restrictions that would indicate risk and
if credit limit is aligned; 5) market liquidity; and 6) benefit considerations for extending the credit (i.e.,
is it reciprocated, does it enhance price, etc.). Internal policies are typically set by the Board, Risk
Management, or Finance Committees of the market participant and cannot be changed at random.

Granting open credit is subject to a number of variables and is limited by the risk tolerance of the
credit issuer, who is accepting the risk of loss resulting from non-performance. As such, investment
grade entities are typically still required to post collateral even if they have been granted some amount
of open credit. For example, CAISO market participants with acceptable credit ratings are still required to post financial security above the threshold, which changes over time, as defined by CAISO. Additionally, futures markets and exchanges require frequent (daily) and immediate posting of collateral and do not provide open credit lines, regardless of ratings.

Therefore, it is not reasonable to require the IOUs to assume the burden of issuing free open credit to the CCAs, especially without ceilings or consideration of the risk it can bring to the financial security of the IOU, as the CCA parties propose. In the case of an involuntary return of CCA customers to the IOU, the credit needs resulting from the obligation to serve a large group of involuntarily returned CCA customers are a burden on the IOU. The lack of any FSR or an insufficient FSR would be akin to requiring the IOUs to provide CCAs with a free option of open credit for an unlimited period of time. This unlimited exposure would violate internal governance and controls, the risk the IOUs would need to account for and the liquidity they would need to carry, which they would otherwise not carry, may be viewed negatively by the financial markets and investors, as discussed below.

B. **An Investment Grade Credit Rating does not Eliminate the Need for an FSR**

MCE claims that “an investment grade rated CCA does not pose a significant risk of failure,” and proposes that any CCA with a credit rating of Baa3 with Moody’s or BBB- with Standard and Poor be exempt from the requirement to post *any* collateral.\(^53\) However, as described above, credit ratings are only one measure of financial strength, and are not the only criteria used by parties when engaging in a financial transaction.

Furthermore, an investment grade credit is not a guarantee that the party’s liquidity is sufficient for all transaction types or engagements or that the investment grade can hold forever. In fact, ratings are subject to change at all times given market conditions, debt levels, and business conditions that can impact an entity’s ability to meet its obligations. No two parties have the same risk tolerance and thus parties may not agree on the same amount of open credit when reviewing a counterparty’s financial

\(^{53}\) MCE Testimony at p. 6.
statement. There are entities that have strict internal guidelines for open credit lines, if any are extended at all, and other entities who may not find the counterparty strong enough for the type of risk a default can bring to their own ability to continue to operate.

As such, external credit ratings are generally considered a secondary source of information and a benchmark opinion. As the financial crisis of 2008 proved, reliance on external ratings alone did not work well for many companies, because these ratings, while based on respectable opinions and research, may not be updated quickly enough to reflect changes to the fundamental conditions of the market or the entity itself. A number of institutions that had investment grade ratings became insolvent and filed for bankruptcy protection.

The external ratings alone do not form the basis for any open credit, unless internal policies, risk tolerance and guidelines and liquidity positions justify the extension of open credit in return for some benefits to the issuer. On the other hand, MCE’s proposal would require the IOUs to essentially provide a free option of open credit to any investment grade CCA with no benefit or protection to the IOU or its customers in return for the cost and risk they are assuming. The IOUs would have to pay and carry sufficient liquidity to cover the risks associated with involuntary returns, even those occurring in high price conditions, if a reasonable CCA FSR is not in place. The Legislature did not intend this result in enacting Section 394.25(e); indeed, MCE’s proposal directly contradicts this statute’s express requirements. For this reason the Commission, in adopting the ESP FSR, rejected a similar proposal by ESPs and definitively concluded that “[a]n ESP will not be permitted to meet the security obligation simply…by showing that it has an investment grade credit rating.”54 MCE’s proposal to exempt CCAs, if they someday achieve investment grade ratings, from the FSR requirement of Section 394.25(e) should also be rejected.

---

54 D.11-12-018 at p. 75.
C. **Utilities Are Required to Prove Liquidity Analogous to the CCA FSR**

The IOUs have internal and regulatory requirements to manage their liquidity positions. The short-term borrowing capacity of the IOUs is subject to Commission review and approval,\(^{55}\) and the costs associated with these liquidity resources are regularly reviewed in the IOUs’ General Rate Cases. These measures have helped the IOUs plan for the liquidity needed to reliably serve bundled service customers’ load. CCAs are not required to provide similar controls and notices to the Commission.

Without an FSR in place under Section 394.25(e), each IOU must carry sufficient liquidity to account for the free option of open credit it would be required to extend to all CCAs in its service territory, which would be unreasonable and contrary to the requirements of Section 394.25(e), as discussed above.

D. **CCAs’ Financial Strength and Risk Profile Can and Should be Assessed by the Issuer of Their FSI**

To comply with the requirement of P.U. Code Section 394.25(e), all CCAs must post a FSI sufficient to cover their FSR. The IOUs themselves should not be required to assess the creditworthiness of the CCAs because: 1) each IOU has its own corporate risk tolerance and credit risk management programs to meet its internal governance; 2) the CCAs serving in each territory have their own distinct governance and liquidity positions; 3) the size of the CCAs and risk imposed on IOU varies; 4) whether or not the CCA has the full support of city or county it represents or if it is formed as a JPA; and 5) IOUs and CCAs are all energy market participants, and the risk mitigation strategies detailed by CalCCA cannot, and should not, be evaluated by fellow market participants.

Therefore, the assessment of the CCA creditworthiness and its FSR should be performed by the financial institutions that provide the credit facilities to the CCAs in the same manner as IOUs currently do with their financial institutions. The issuer is best suited to provide the assessment and will price the required instrument accordingly.

\(^{55}\) See e.g., D.09-05-002 for PG&E and D.08-10-015 for SCE.
E. **It is Common Practice to Regularly Review and Refresh Collateral Requirements**

Appendix B of the Joint Utilities’ Direct Testimony describes the market practices for managing counterparty credit risks for gas, power commodities and the financial markets. This includes daily adjustments to the financial security required to be posted with counterparties, exchanges and CAISO. In fact, even products that have a fixed credit term such as RA or RPS contracts, require securities that need to be renewed from time to time depending on the expiry terms. So, the requirement to post letter of credit or cash is routine and considered a necessity to be in the gas and power business. The CCAs need to have the banking relationships, liquidity and ability to wire cash or issue letters of credit to participate in California’s energy and environmental markets. So the claim that an FSR would be burdensome to CCAs contradicts the basic activity and functional financial infrastructure and capabilities that are required of the CCAs to participate in the energy markets.
VI. SELF-INSURANCE, SURETY BOND, AND PROOF OF RATE STABILITY FUNDS SHOULD NOT BE CONSIDERED ACCEPTABLE FSIS

CalCCA proposes that CCAs be allowed to meet their FSR through “such mechanisms as cash on-hand via rate stabilization funds and reserves, a guarantee from a creditworthy entity, a surety bond, or a letter of credit.”\(^5\) The Commission should reject CalCCA’s proposal to allow proof of “cash on-hand” – or self-insurance – to satisfy the FSR for reasons discussed below. Additionally, as described below, given the significant lead time that may be associated with surety bonds and guarantees, as well as the often protracted and litigious nature of the claims process for surety bonds, the Commission should require CCAs to use cash deposits or letters of credit to satisfy the FSR.

A. Self-Insurance Does Not Meet the Requirements of Section 394.25(e)

CalCCA proposes that a CCA should be able to meet its FSR through self-insurance means, such as rate stabilization funds.\(^5\) It states that some CCAs have substantial amounts now set aside for such purposes. However, the fact that an entity has some cash on hand now does not mean that this cash serves as adequate security, for several reasons.

First, this cash can be used for multiple purposes, as explained in the CalCCA testimony. It notes that “MCE provide[s] a reserve to manage the risk of adverse economic or regulatory events…”\(^5\) It states that SCP uses such funds for “rate reductions, and contribution to a Project Fund to support local renewable energy projects, energy efficiency and other projects consistent with SCP’s mission.”\(^5\) These entities could spend these amounts at any time, including times of market stress, and once spent, they would be unavailable to cover the FSR or reentry fees.

\(^5\) CalCCA Testimony at p. 39.
\(^5\) CalCCA Opening Testimony at p. 39, lines 5-6. See also p. 40, stating that “If a CCA program has a cash balance within its rate stabilization fund that meets or exceeds the scale of the CCA FSR ultimately deemed necessary by the Commission, the CCA should have the choice to leverage that cash balance to satisfy the CCA’s FSR requirement.”
\(^5\) CalCCA Opening Testimony at p. 27.
\(^5\) CalCCA Opening Testimony at pp. 27-28.
Similarly, even if not actually spent, these amounts could be pledged to others. In the event of insolvency and bankruptcy, secured creditors would be entitled to these funds, and they would not protect unsecured customers.

It is for these reasons that the Commission rejected a similar proposal by ESPs to meet their FSR through self-insurance. In its discussion on this proposal, the Commission explained that there is no way to ensure that the ESP is actually…setting aside the money sufficient to cover estimated self-insurance losses. The IOU would have no assurance of recovering its losses from the ESP through self-insurance of some or all of its re-entry fee obligations, if the ESP failed to set aside the necessary funds, and then becomes unable to discharge its obligations under § 394.25(e).\textsuperscript{60}

For these same reasons, rate stabilization funds as a means of self-insurance are not adequate security for Section 394.25(e) purposes, as the statute requires an FSI from each CCA sufficient to cover the reentry fees in an involuntary return. The Commission should reject CalCCA’s proposal to allow CCAs to use cash balances within rate stability funds or other means of self-insurance to meet the FSR, and find that CCAs that wish to use available cash can post it to meet the FSR or they can used it to secure a letter of credit.

\textbf{B. Because Utility Should be Able to Promptly Draw Upon Collateral in an Involuntary Return, Surety Bonds will not be Adequate}

The IOUs have internal and regulatory requirements to manage liquidity position. There are thresholds for notifications to the Commission for liquidity positions, and authorized capacity that the IOUs must acquire to meet the necessary requirements to reliably serve load. Over time as load departs, the liquidity capacity acquired will change and be lowered. In the absence of a security, such as cash or letters of credit, that can be counted on for prompt relief in the event of an involuntary return where reentry fees are due to the IOU to cover the costs of serving involuntarily returned CCA customers, an IOU depending on size of involuntary return may not have the necessary funds to acquire the incremental energy, renewable energy credits and RA needed to serve that load. These conditions and

\textsuperscript{60} D.11-12-018 at p. 75.
sudden increased procurement needs can adversely impact its financial ratings if the IOU is unable to meet those requirements. There are terms in bilateral contracts to which the IOUs are parties that can consider such failures as defaults, which would expose the IOU to other risks, such as termination and contractual damages, or may trigger additional collateral posting requirements.

Surety bonds should not be accepted as an instrument to protect customers from adverse market conditions, including involuntary returns. When market prices are high and the customers are involuntarily returned to the IOUs, either because the conditions have forced a CCA to cease operation or the CCA does not see sufficient benefits to continue operation and decides to cease operations without the necessary one-year advance notice to the IOU, there will be pressure on IOUs’ liquidity requirement to procure for the involuntarily returning load. This could require immediate additional collateral posting to CAISO for short-term procurement of energy and RA. This does not even account for additional funds needed to adjust the portfolio for other obligations, such as RPS compliance needs. Under this scenario, there must be an FSI that can provide a prompt liquidity relief to the IOU. Surety bond are not like cash or irrevocable letters of credit. Collection may take months if not years and will not make any contribution to the costs of the immediate procurement needs.

Should the Commission decide to permit surety bonds for the FSR, it should direct that in the case of an involuntary return by a CCA that has a surety bond to cover the reentry fees, the IOU is permitted to collect the reentry fees from the involuntarily returned customers upon their return to the IOU’s procurement service, and proceed to make a claim under the surety instrument for those reentry fees, and refund to those customers any amounts ultimately recovered from the surety company for the reentry fees owed by that CCA.
VII.

PROPER SECURITY FOR ADMINISTRATIVE COSTS

CalCCA proposes that “the FSR should be set at the tariffed CCA Mass Enrollment Fee plus an estimate of the number of customers being switched over to bundled service multiplied by the tariffed CCASR Fee,” and that the estimate of the number of customers being involuntarily returned be determined using a discount factor. Both of these proposals should be rejected. As discussed below, the Joint Utilities’ proposal to calculate the administrative portion of the FSR by multiplying the CCA-SF re-entry fee (i.e., the tariffed per-customer re-entry fee for voluntary returns) by the number of customers is a more reasonable means of estimating the administrative costs that would occur in the event of an involuntary return of CCA customers. Moreover, the approach proposed by the Joint Utilities is consistent with the Commission’s decision setting the administrative costs portion of the ESP FSR.

A. CCA-SF is the Most Appropriate Proxy for Administrative Costs

CalCCA proposes that the administrative costs of “re-integrating CCA customers into IOU bundled service” be forecast by including a fixed amount, equal to the tariffed CCA Mass Enrollment Fee, and a per-customer amount, equal to the CCASR fee multiplied by the estimated number of customers being involuntarily returned to IOU bundled service. Specifically, CalCCA states:

The FSR should be based on easily calculated and verified values while reflecting a reasonable estimate of the costs to return the customers to bundled service. The Mass Enrollment fee reflects the cost of the transfer of many accounts from bundled to CCA service. I find it reasonable to assume that the costs an analogous mass switch from CCA to bundled service would be similar. However, due to the unexpected nature of the switch, the simple mass enrollment fee would likely not be sufficient, nor reflect any economies of scale of switching many accounts relative to just a few. Therefore, including a per-customer variable element in the FSR calculation—the CCASR estimated fee—will reflect an amount to cover the variable per-customer costs in setting the CCA FSR.

The Joint Utilities do not agree that the CCA Mass Enrollment Fee plus the CCASR fee are sufficient to cover the incremental administrative cost of involuntarily returned customers. The IOU

---

61 CalCCA Opening Testimony at p. 36, lines 1-3.
62 CalCCA Opening Testimony at p. 36, lines 9-18.
mass enrollment process is designed to provide for an orderly switch of customers to CCA Service on
their next scheduled meter reading date, a process which is generally automated, and cannot simply be
“reversed” to return customers to bundled service on a single preselected date. More importantly, this
mass enrollment process does not provide for the off-cycle meter reads, the creation of off-cycle
customer bills, and the provision of notification to the impacted customers. In other words, the Mass
Enrollment Service Fee, even when coupled with the per-service account CCASR Fee, does not
account for the cost of these manual activities. On the other hand, the voluntary reentry fee proposed by
the IOUs reasonably approximates this off-cycle process, albeit for returns of individual customers.
For this reason, the Joint Utilities submit that the tariffed per-service account CCA-SF re-entry fee for
voluntary returns is a more reasonable proxy for estimating incremental administrative costs for
involuntary returns.

Moreover, use of the CCA-SF re-entry fee as the proxy for administrative costs is consistent with
the methodology adopted for ESPs in D.11-12-018. Specifically, the Commission held that “[t]he
administrative costs of an involuntary return include any incremental meter reading, billing, and tracking
and monitoring costs….We therefore authorize that administrative fees to cover involuntarily returned
DA customers be set using the IOU’s authorized service fee rate for voluntarily returning CCA accounts.
The per-[service account] fee would be multiplied by the relevant number of ESP customer [service
accounts].” The fee mentioned in the decision is the same fee proposed for use to estimate incremental
administrative costs for the CCA FSR and reentry fees.

---

63 The tariff CCASR Fee only recovers the per service account expense of fulfilling an electronic switching
request on the customer’s next scheduled meter reading date.
64 Joint Utility Opening Testimony p. 40. The Joint Utilities’ proposal reserves the right, depending on the size
of the involuntary return, to calculate administrative costs in an involuntary return on a time and materials
basis.
65 D.11-12-018, pp. 70-71.
B. The Forecast of Involuntarily Returned Customers Should Not Be Arbitrarily Discounted

CalCCA also proposes that the administrative portion of the FSR be calculated by multiplying the per-customer administrative fee by a discounted number of customers. In other words, the administrative costs portion of the FSR would not cover the administrative costs for all of the currently enrolled CCA customers. CalCCA states that

[A] failure of a CCA is not likely to occur without warning or without CCA Board actions. A CCA Board may significantly raise rates to cover its costs, which in turn would likely result in some number of customers voluntarily returning to bundled utility service. To reflect this likelihood, in calculating the per-customer element of the FSR, the actual number of customers should be multiplied by a value less than one to reflect this likelihood. Since there is no historical data to use to precisely estimate this factor, I recommend using a value between 0.6 and 0.8....

The Joint Utilities disagree. First, the Commission should be wary of any argument that posits that voluntary returns forced by rising CCA prices, which precede an involuntary return, are not part of the involuntary return. If the CCA effectively forces voluntary returns through price inflation prior to an involuntary return, those customers that voluntarily return to the IOU under those circumstances should be protected by Section 394.25(e). Otherwise, the scenario described by CalCCA creates an incentive for a CCA to try to rid itself of as many customers as it can before it executes an involuntary return, to minimize its cost responsibility under Section 394.25(e).

Moreover, the number of customer service accounts that may voluntarily depart prior to an involuntary return is speculative and there is no way to reasonably predict it in order to discount the FSR. The FSR is proposed to be evaluated monthly; therefore, using the number of customers actually served by the CCA each month is appropriate, and no discount should be applied, because it is reasonable to assume that the CCA will be serving the same number of customer service accounts during that 30-day forward period, particularly when customers are expected to give 6-months advance notice to voluntarily return to IOU procurement service.

---

66 CalCCA Opening Testimony p. 37, lines 2-8.
As for the reasons CalCCA gives in support of its discounting proposal, they do not support any
discounting of the customers protected by the FSR. Customers may be unaware that the CCA rate is
higher than the IOU rate, and even if they are aware, it may not incent them to return to IOU
procurement service. As CalCCA itself notes, CCA rates have, at times, been higher than IOU rates,
and that has not caused any significant number of customers to opt out of CCA service. Moreover,
customers may not be aware of developments in the finances of the CCAs or the energy markets. It is
unreasonable to arbitrarily discount the administrative portion of the FSR. The administrative fee
should be based on the total number of CCA customer service accounts, not discounted by 20-40% or
any amount.

67 CalCCA Testimony at p. 29.