**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

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

REPLY BRIEF OF THE DIRECT ACCESS PARTIES

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SUMMARY OF RECOMMENDATIONS

The Direct Access ("DA") Parties make the following recommendations for adoption by the Commission:

Defined Terms: The DA Parties recommend that the Commission adopt the following definitions:

1. An ***involuntary return*** of a Direct Access customer to service from an Investor-owned Utility ("IOU") has occurred when the IOU has initiated the Direct Access Service Request ("DASR") process to return a customer to IOU bundled service due to any of the following events:
    a. The Commission has revoked the Electric Service Provider's ("ESP") registration.
    b. The ESP-IOU Agreement has been terminated.
    c. The ESP or its authorized California Independent System Operator ("CAISO") Scheduling Coordinator ("SC") has defaulted on its CAISO SC obligations, such that the ESP is no longer has an appropriately authorized CAISO Scheduling Coordinator.
2. An ***involuntary return*** of a Direct Access customer to IOU bundled service has not occurred as a result of the following events:
    a. A customer's contract with an ESP has expired.
    b. An ESP discontinues service to a customer due to that customer's default under their service agreement with the ESP.[1]
3. A ***voluntary return*** of a Direct Access customer to IOU bundled service has occurred under either of the following conditions:
    a. An ESP has ceased to serve a customer because the contract between the ESP and the customers has expired.
    b. A customer has given the IOU six months notice that the customer intends to return to IOU bundled service.
4. ***Re-entry fees*** are the sum of (i) the difference between marginal portfolio costs incurred or benefits obtained by the IOU to serve a customer that has been involuntarily returned to IOU bundled service, and the amounts collected from that customer for service during the first six months that a customer is on IOU bundled service after the involuntary return; and (ii) the administrative costs incurred by the IOU to enroll the customer into IOU bundled service. For clarity, Re-entry Fees are applicable with respect to the IOU's procurement plan and resource adequacy requirements, and are not applicable to any costs associated with transmission or distribution or other IOU charges already paid by Direct Access customers.

<u>**Temporary Bundled Service ("TBS") Rate**</u>**:** With respect to the TBS rate, the DA Parties recommend that the Commission adopt the following:

- A TBS rate that is in calculated in the same manner as, and with the same components as, the Market Price Benchmark used to formulate the Indifference Amount.

[1] P.U. Code Sec. 394.25(e) may be read as referring to these two groups of returnees (expiring contract and defaulting customer) as "involuntary," but only in the context of excluding them from the treatment otherwise applied to "involuntarily returned" customers. As such, they are logically treated as "voluntarily returned" customers, and we define them as such.

<u>Switching Rules</u>: With respect to rules that will govern customer switching from IOU service to DA service and from DA service back to IOU service, DA Parties recommend that the Commission adopt the following:

A. Switching Restrictions Applicable to *voluntary return* customers:

1. ***Voluntary return*** customers must give six months notice before returning to IOU service from Direct Access service.
2. If a ***voluntary return*** customer remains on Direct Access service for the full six month notice period, upon the customer's return to IOU service at the end of the six month notice period, the customer will receive service under the applicable tariff.
3. A ***voluntary return*** customer that returns to IOU service without six months notice will be charged the TBS rate for IOU service for up to six months.
4. During the first 60 days of the of the six month period that the customer is on TBS service (referred to as the safe harbor period), the ***voluntary return*** customer may leave IOU service and return to Direct Access service by having an ESP submit a DASR for service that will begin no later than the first meter read after the end of the 60 day safe harbor period.
5. The ***voluntary return*** customer who leaves IOU service for new Direct Access service within the safe harbor period will retain the non-bypassable charge vintage to which the customer was subject at the time of the voluntary return.
6. The ***voluntary return*** customer who has not elected new Direct Access service by the end of the safe harbor period will be provided service by the IOU for the remainder of the six month service on TBS service, after which time the customer will be returned to the applicable tariff, and will be subject to the minimum stay provision.
7. The ***voluntary return customer*** who elects to leave IOU service to return to Direct Access after the minimum stay will be subject to the non-bypassable charge vintage applicable to its new Direct Access service.
8. A DASR may be submitted for a ***voluntary return*** customer to leave IOU service at then end of the minimum stay as of (1) the first scheduled meter read date that is 5 days after the customer has provided notice to the IOU that the customer intends to return, so long as that scheduled meter read date is after the end of the customer's minimum stay period, or (2) the date of a special on-time meter read that is agreed to by the IOU, ESP, and customer and is after the end of the customer's minimum stay period.

B. Switching Restrictions Applicable to *Involuntary Return* Customers:

1. ***Involuntary return*** customers will pay the TBS rate for the first six months that they are on IOU service after the involuntary return.
2. The ***involuntary return*** customer may notify the IOU that it plans to return to Direct Access service any time during the first 60 days that it is on TBS service, and will then have the remainder of the six month period to return to Direct Access service by having an ESP submit a DASR for service that will begin no later than the first meter read after the end of the six month period.

3. An ***involuntary return*** customer who leaves IOU service within the six month period will retain the non-bypassable charge vintage to which it was subject at the time of the involuntary return.
4. The ***involuntary return*** customer who has not elected Direct Access service by the end of the six month period will be returned to an applicable tariff service, and will be subject to the minimum stay provision.
5. The ***involuntary return*** customer who elects to leave IOU service to return to Direct Access after the minimum stay will be subject to the non-bypassable charge vintage applicable to its new Direct Access service.
6. A DASR may be submitted for an ***involuntary return*** customer to leave IOU service at the end of the customer's minimum stay as of (1) the first scheduled meter read date that is 5 days after the customer has provided notice to the IOU that the customer intends to return, so long as that scheduled meter read date is after the end of the customer's minimum stay period, or (2) the date of a special one-time meter read that is agreed to by the IOU, ESP, and customer and is after the end of the customer's minimum stay period.

Minimum Stay Provisions: With respect to minimum stay provisions, the DA Parties recommend that the Commission adopt the following:

The minimum stay for ***voluntary return*** customers will be 12 months, which begins at the end of the safe harbor period or when the customers returns to IOU service after having given six months notice. The minimum stay for an ***involuntary return*** customer will be 12 months and will begin at the end of the six month TBS rate period.

ESP Financial Security Requirements: With respect to ESP financial security requirements, the DA parties recommend that the Commission adopt the following:

The ESP security requirement should equal the difference between marginal costs incurred by an IOU to serve a customer that has been involuntarily returned to bundled service and the amounts collected from that customer for service for six months plus the administrative costs incurred by the IOU to enroll the customer into bundled service. Consistent with the Joint Parties' January 24, 2011 brief on ESP and CCA Bonding requirements, the DA Parties believe that involuntarily returned customers should pay the TBS rate for the first six months of their IOU service after their involuntary return. As result, the difference between the costs to serve them, and the revenue collected from them should be minimal, consisting almost entirely of administrative costs. Additionally, ESPs should be allowed flexibility as to how to meet the security requirement (beyond simply posting a bond or letter of credit), and the security requirement should be recalculated annually.

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REPLY BRIEF OF THE DIRECT ACCESS PARTIES

In accordance with the directive of Administrative Law Judge ("ALJ") Pulsifer on the last day of hearings, March 30, 2011,[2] the Direct Access ("DA") Parties[3] submit this reply brief on certain Phase 3 hearing issues.[4] The DA Parties do not address the Power Charge Indifference Adjustment ("PCIA") rate component and calculation in this reply brief, as that issue was fully briefed in both the opening brief of the Joint Parties, to which the DA Parties are co-sponsors as well as in the Joint Parties' reply brief to be filed today.

This reply brief responds solely to other parties' proposals and recommendations regarding calculation of Temporary Bundled Service ("TBS") rates, Direct Access switching rules, minimum stay provisions, and Electric Service Provider ("ESP") financial security requirements ("FSRs"). It is important to note that, throughout this proceeding the DA Parties have not looked at these issues in isolation, but have instead offered a comprehensive proposal with respect to the TBS rate, the minimum stay provisions that are a key element of the switching rules, and the FSRs. Details of our proposal , are summarized at the start of this brief

[2] Reporter's Transcript ("RT") at 716: 5-7.

[3] The Direct Access Parties include the following entities: California State University, University of California Alliance for Retail Energy Markets, Direct Access Customer Coalition, BlueStar Energy, Pilot Power Group, Inc., California Alliance for Choice in Energy Solutions, the Retail Energy Supply Association, School Project for Utility Rate Reduction, Safeway Inc. and the Energy Users Forum.

[4] Numbering of this opening brief reflects the numbering that parties agreed to in the model briefing outline, which accounts for the gap in numbering that will be seen below.

to show the comprehensive nature of the DA Parties' proposal, even as this brief replies to other parties' comments on these issues separately in the sections that follow.

I. Methodology for determining the PCIA and ongoing CTC

This issue is addressed in the Joint Parties opening and reply briefs, for which the Direct Access Parties are co-sponsors.

II. The Transitional Bundled Service (TBS) rate components and calculation – proposals and recommendations

As noted in our opening brief, the policy behind the TBS rate is to ensure that Investor-Owned Utilities' ("IOUs") bundled customers will not incur any additional costs because departed load customers return to IOU service before the IOU has been able to incorporate that load into its procurement planning.[5] The current TBS rate equals the CAISO's hourly Integrated Forward Market Locational Marginal Price at the respective IOUs' Load Aggregation Points, multiplied by an allowance for unaccounted for energy plus an allowance for Ancillary Services and the CAISO Grid Management Charges.[6]

In both our opening testimony and opening brief, the DA Parties recommended that the TBS rate be calculated in a manner consistent with the Market Price Benchmark ("MPB").[7] That is, the TBS rate should mirror the same components used in the MPB to reflect the market value of the IOU supply portfolio. This includes the commodity cost of power, the incremental cost of

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[5] *See*, D.03-05-034.

[6] E.g., Southern California Edison Schedule PC-TBS

[7] The MPB that is used to calculate the Indifference Amount also reflects an estimate of the current market prices: market-based commodity power, renewable attributes sufficient to cover the Renewable Portfolio Standard ("RPS") requirement of that customer, the capacity to meet the Resource Adequacy ("RA") obligations to serve the customer, and all necessary variable California Independent System Operator ("CAISO") costs associated with that customer's load.

RPS compliance, any incremental capacity/RA costs and all volumetric CAISO costs, each of which was discussed in more detail in the DA Parties opening brief.

The opening briefs show widespread consensus with this recommendation. For example, Pacific Gas & Electric ("PG&E") states, "In general, parties in Phase III have agreed that whatever changes are made to the PCIA and MPB should also be reflected in the TBS."[8] Southern California Edison ("SCE") stated that, "the record reflects strong consensus that whatever methods is adopted for calculating RA and RPS values for inclusion in the MPB, and for identifying the IOUs' Total Portfolio costs related to the CAISO's load-related costs, should also be used to adjust the TBS rate to include these costs."[9] The California Large Energy Consumers Association ("CLECA") and the California Manufacturers and Technology Association ("CMTA") and San Diego Gas & Electric also generally agreed.[10]

A. Resource adequacy costs

The DA Parties recommend that the capacity/resource adequacy adder used in the current MPB calculation be included in the TBS rate as well. Specifically, the same adder that is used for the most recent MPB should also be included in the TBS rate. CLECA/CMTA "recommend the same CAISO ICPM proxy for RA costs as would be used in the Indifference calculation."[11] SDG&E says that, "an RA adder is needed in the TBS rate to cover costs for the capacity that SDG&E procures for RA to serve its load," but is non-specific as to precisely what should be used.

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[8] PG&E, at p. 20.

[9] SCE, at p. 25.

[10] CLECA/CMTA at pp. 9-10 and SDG&E, at p. 11.

[11] CLECA/CMTA, at p. 10.

PG&E states that, "Parties agree that whatever capacity adder is used for the MPB should also be included in the TBS rate."[12] However, PG&E opposes the use of the ICPM and CPM, based on their perception that the ICPM and CPM prices are too high to be reflective of short-term capacity prices. SCE notes in response that, "Demonstrating – as PG&E and DRA do – that the CPM is on the high side of a potential range of RA prices does not establish that CPM is not reflective of short-term capacity prices. The use of the same adder that is used for the most recent MPB is reasonable and logical and should be adopted.

B. RPS compliance costs

The DA Parties opening brief articulated the fundamental principles that incremental IOU costs to meet RPS requirements should be included in TBS rates and that such costs should reflect market value. These principles are equally applicable to the determination of the appropriate adder to the MPB, such that the RPS adder used for the MPB should also be applicable to the TBS rate to ensure that the TBS rate reflects an appropriate component for renewable energy. Therefore, the DA Parties recommended that the TBS rate be adjusted using the same Green Benchmark proposal put forth for the MPB in the Joint Parties' testimony in this proceeding.[13] The DA Parties also proposed that Green Benchmark for the TBS rate should be applied based on the overall percentage RPS requirement for the then current year. For example, if the RPS percentage in a particular year was 22%, then the TBS would equal (a) the commodity cost of power times 78%, plus (b) the Green Benchmark times 22%. The commodity cost of power would vary month to month, as is does currently, but the Green Benchmark would be set in that year's ERRA Forecast proceeding.

[12] PG&E, at p. 21.

[13] Exh. 101, at p. 4.

PG&E concurs that, "Most parties also appear to agree that whatever RPS adder is used for the MPB, this adder should also be used for the TBS rate."[14] SDG&E says that, "an RPS adder is needed in the TBS rate to account for RPS-eligible purchases SDG&E must procure for its load, since RPS purchases are not currently accounted for in the TBS rate."[15] CLECA/CMTA also agree that, "the TBS should also include a renewables element."[16] SCE offers a more specific proposal when it recommends that the RPS adder should be based on the Renewable Energy Credit ("REC") index when available, and in the interim on a Commission-determined price, that would be calculated as follows:

> SCE proposes that the market energy rate from which TBS is constructed be scaled proportional to the renewable premium reflected in the revised MPB calculation. For example, if the weighted average forward market price, after adjusting for renewable premiums, is $50/MWh, and the forward market price is $40/MWh then SCE would propose to scale TBS energy price inputs up 25% (scalar = $50/$40 or 1.25).[17]

SCE's specific proposal is premature, both because there is no index as well as because the scaling up does not reflect an accurate adjustment. The DA Parties continue to recommend that the Commission find that the TBS rate be calculated in a manner consistent with the MPB and that the details, such as SCE's proposal, be addressed in a workshop.

In summary, there are three points that must be made. The first is that all parties agree that TBS should reflect RPS. The second is most, if not all agree that the RPS adder for TBS should mirror the MPB. The third is that while parties may disagree on the details of MPB calculation, the proposal described in the Joint Parties opening brief is the preferable approach that should be adopted by the Commission.

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[14] PG&E, at p. 21.

[15] SDG&E, at p. 11.

[16] CLECA/CMTA, at p. 10.

[17] SCE, at p. 26.

C. CAISO load-related costs

As pointed out in the DA Parties opening brief, the current TBS rate formula includes an allowance for Ancillary Services and CAISO Grid Management Charges and these should not be changed. SDG&E recommends that the TBS rate should reflect incremental load-related CAISO charges;[18] PG&E observes that "Parties agree that CAISO load-related costs should still be included in the TBS" and that it is appropriate to do so;[19] and more specifically, SCE states that, "As previously discussed, the Joint Parties entered into evidence a list of load-related CAISO's charge-types, which no party challenged. Accordingly, the record supports adopting the Joint Parties' list of load-related CAISO charge-types for use in including CAISO's load-related costs in the TBS rate."[20] This issue appears to be resolved. The Joint Parties' list of CAISO load-related costs should be adopted for use in the TBS rate.[21]

III. Direct Access switching rules and minimum stay proposals and recommendations

The DA Parties have put forth a comprehensive proposal for modifications to the switching rules that is logical, sensible and has the support of the DA community. This comprehensive proposal is fully described in the Summary of Recommendations at the front of this Reply Brief.

A. Minimum stay requirement

1. The IOUs' minimum stay proposal is neither reasonable nor necessary to address concerns about seasonal "gaming."

The IOUs are proposing an eighteen month minimum stay, starting at the end of the returning customer's six month stay on TBS service. In contrast, the DA Parties recommend that

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[18] SDG&E, at p. 11.

[19] PG&E, at p. 21.

[20] SCE, at p. 27.

[21] *See* Exhibit A of Exhibit 100.

the minimum stay for ***voluntary return*** customers should be 12 months, which begins at the end of the safe harbor period or when the customers returns to IOU service after having given six months notice. The minimum stay for an ***involuntary return*** customer should be 12 months and begin at the end of the six month TBS rate period.

PG&E raises and then knocks down a straw man in its opening brief when it says that, "If a returning DA customer can elect to return to bundled service after giving six months notice, and has no requirement to stay on bundled service for any specific period of time, as soon as market prices change, the customer may try to return to DA service and capture lower prices. This type of price arbitrage is exactly what the Commission tried to address when requiring a minimum stay for returning DA customers."[22] Of course, no one is proposing that the minimum stay be eliminated, as noted above.

PG&E also argues that the minimum stay provision minimizes stranded costs, claiming that, "If returning DA customers could simply leave bundled service without a minimum stay requirement, costs for transactions entered into on these customers' behalf would effectively be shifted to the remaining bundled customers."[23] Contrary to PG&E's statement, no party to this proceeding is advocating elimination of the minimum stay requirement. In fact, all parties concur that the current three-year minimum stay provision should be reduced. The only controversy is over how much that reduction should be.

SCE spends much of its opening brief explaining the rationale behind why the switching rules were first adopted in D.03-05-034 and why they justify a longer minimum stay. As noted in the DA Parties opening brief, this reliance on an eight year old order ignores the fundamental facts that we are not making policy in the immediate wake of an energy crisis, as was the case

[22] PG&E, at p. 22.

[23] PG&E, at p. 23.

when D.03-05-034 was issued, and that we now have a capped DA market with very predictable load. Finally, the idea that an 18-month stay is necessary in order to prevent "seasonal gaming" ignores the fact that seasonal cycles all occur within a twelve month period. Further, SCE raises the same straw man argument as PG&E when it states that there is a potential for cost shifting to occur "if DA customers were permitted to abandon bundled service at will without any responsibility for the ongoing costs the utility may incur." As SCE and all parties know full well, no party is advocating such a position. SCE's argument may be an effective rebuttal to the argument that there should be no minimum stay. But it is not relevant to the actual DA Parties' proposal on the table.

Furthermore, a longer minimum stay is not required because of RA requirements, as SCE contends. In fact, the 12-month minimum stay advocated by the DA Parties better comports with the RA advance purchase requirements. The utility suggests that the IOUs' 18-month minimum stay requirement "strikes a better balance because it mitigates the risk of stranded RA costs, among other potential stranded costs."[24] A minimum stay period of 18 months is not necessary to ensure that the minimum stay matches the Commission's RA advance purchase requirements. The DA Parties reiterate that the SCE concern does not accurately reflect the Commission's RA requirements, as discussed in the following exchange with SCE witness Schichtl:

> Q Would you please turn to page 15 of your opening testimony, and footnote 17? Do you say there the current Commission rules for RA require IOUs to procure RA capacity 18 months forward?
>
> A Yes.
>
> Q In fact, don't the RA rules actually require that by the end of October of each year a load-serving entity must procure 90 percent of its system RA requirement for May to September of the following year and 100 percent of its local RA requirement for SCE's two local capacity areas?
>
> A I believe those are the rules, yes.

[24] SCE, at p. 36.

> Q And the remaining system RA requirements must be procured two months in advance of the month in which it is required, correct?
>
> A Those are the monthly showings, yes.
>
> Q So in fact there is no Commission rule requiring 18 months advance procurement of RA capacity, is there?
>
> A My understanding of the RA rules is limited. We have a -- the other SCE witness Ranbir Singh is much more conversant on the actual RA rules and I think would be better served -- better able to answer this question.
>
> Q But the statement was actually in the portion of the testimony that you sponsored, correct, Mr. Schichtl?
>
> A That's correct.[25]

In summary, the RA requirements that SCE cites do not provide justification for a longer minimum stay.

SDG&E also argues that the DA Parties 12-month minimum stay proposal, "would likely facilitate seasonal gaming."[26] The "gaming" concern is overstated and unproven, particularly given the fact that the 12-month minimum stay proposed by the DA Parties certainly eliminates the possibility for "seasonal gaming."

B. Notice period to go to DA service or return to bundled service

1. The current six-month notice to return to DA should be eliminated

PG&E inaccurately states that, "All of the parties in the proceeding appear to agree that a six-month notice period is required for a bundled customer switching to DA service."[27] While it is true that the other IOUs all recommend keeping the current requirement that bundled customers provide six-month notice prior to leaving IOU service for DA service, the DA Parties have contended that this notification period is not necessary and that assuming there is room

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[25] RT, at pp. 92-93.

[26] SDG&E, at pp. 16-17.

[27] PG&E, at p. 25.

underneath the cap, a bundled customer should be able to take DA service on the next billing cycle.

SDG&E argues that, "the DA Parties propose that the six-month notice period should be fully eliminated based on the unfounded assumption that because DA is fully subscribed, it will remain so" and argues "that this may not always be the case."[28] The Commission should make its decision based on the facts that exist and not on speculation, as SDG&E would have it. One thing is abundantly clear from the DA sign-up process to date, and that is that there is overwhelming interest among customers in opting for direct access service. The utility also states that "the DA Parties fail to provide any evidence to overturn the Commission's finding that six-months is an adequate time period. In point of fact, SDG&E has itself offered no evidence to suggest that this interest is likely to abate. What SDG&E also conveniently ignores is the fact that for the first five years of direct access service no six months notice was required for a customer to go to DA and the IOUs functioned quite efficiently during that period.

As noted in the DA Parties opening brief, SCE argues that the six-month notice is needed to account for selling excess RA and energy, which it may be forced to do at a loss.[29] This argument does not acknowledge either the current capped DA market, or the fact that the departure of a single or a few DA customers at a time is obviously quite small relative to SCE's overall bundled load. The price an IOU would obtain for any energy or RA must be sold will be based on market prices rather than on how much time it has to sell it. In summary, none of these rationales offered by IOUs provides a compelling reason for retaining the six month notice requirement for a customer to transfer from IOU service to DA service.

[28] SDG&E, at p. 14.

[29] Exh. 300, at p. 8.

2. The current six month notice for DA customers to return to bundled service is appropriate.

The DA Parties recommend that ***voluntary return*** customers must give six-month's notice before returning to IOU service from Direct Access service. This represents no change from the current rules. This is another area where parties seem to be in widespread agreement.

C. Interaction, if any, with TBS rate

PG&E notes in its opening brief that, "for DA customers that are involuntarily returned and under current tariffs are returned to TBS for six months, PG&E and SCE have proposed that, if appropriate ESP financial security requirements are established by the Commission, these customers would immediately go on bundled service rates and would not be required to pay the TBS rate."[30] This issue is addressed in far more detail in the following section of this reply brief on ESPs' financial security requirements. The DA Parties have presented a logical proposal for the FSR that is simple to administer and would provide that involuntarily returned customers should pay the TBS rate for the first six months of their IOU service after their involuntary return.

PG&E also proposes that "involuntarily returning DA customers electing to exercise the safe harbor provision within 30 days of their return to utility bundled service would be treated similarly to a voluntarily returning DA customer that also elected to use the safe harbor provision. Both the involuntarily and voluntarily returning DA customers have 60 days from the date they return to bundled service to find a new ESP and submit a DASR, and both groups of customers are on the TBS rate the entire time they are in the 'safe harbor.' The only difference in treatment is that voluntarily returning DA customers have to give notice to the utility that they

[30] PG&E, at p. 27.

are exercising the safe harbor option when they return."[31] SCE offers a different approach with its recommendation that, "DA customers included in an ESP's mass involuntarily [sic] return to IOU procurement service should be placed on bundled service, which would not provide for a safe harbor; however, they should be permitted to provide the IOU with a six-month advance notice to depart to DA."[32]

The DA Parties see no reason for imposing an extra obligation on involuntarily returned DA customers to provide the notice proposed by PG&E. In the unlikely event that there are involuntarily returned customers, asking them to provide a notice that is not required of voluntarily returning customers will be unnecessarily confusing. Nor is the SCE proposal fair to such customers. Rather, the Commission should direct that the ***involuntary return*** customer may notify the IOU that it plans to return to Direct Access service any time during the first 60 days that it is on TBS service, and will then have the remainder of the six month period to return to Direct Access service by having an ESP submit a DASR for service that will begin no later than the first meter read after the end of the six month period.

SCE also notes that with the addition of RA and RPS requirements to the IOUs' procurement obligations as well as CAISO's costs since 2003, the TBS rate must be modified to include RA and RPS cost components, as well as CAISO's load-related costs.[33] As discussed above, the DA Parties concur with this recommendation.

IV. ESP financial security requirements calculation – proposals and recommendations

The most fundamental issue to be resolved with regard to the FSR is the question of whether involuntarily returning customers should be placed on bundled service or the TBS rate.

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[31] PG&E, at p. 28.

[32] SCE, at p. 47.

[33] SCE, at p. 40.

There is widespread support for the approach offered by the Direct Access Parties that the latter should occur. Parties such as California State University, University of California, Alliance for Retail Energy Markets, Direct Access Customer Coalition, BlueStar Energy, Pilot Power Group, Inc., California Alliance for Choice in Energy Solutions, the Retail Energy Supply Association, School Project for Utility Rate Reduction, Energy Users Forum, Safeway Inc. and CLECA/CMTA all support this concept. Most importantly, one of the three IOUs also supports this concept as SDG&E has endorsed this approach.[34] The other two IOUs, PG&E and SCE, are outliers on this issue and their joint position should be recognized as being outside of the mainstream of opinion in this proceeding.[35]

It is critical to acknowledge that the DA Parties' FSR recommendation protects bundled service customers from cost shifting, as required by statute. SCE in fact noted in its opening brief that, "The Commission in D.03-05-034 found that by charging DA customers for the incremental costs of short-term power during the six-month advance notice period or the safe harbor period, no costs will be shifted to bundled service customers."[36] While all parties tend to be in agreement that the TBS rate needs to be updated, as discussed above in Section II, the fundamental finding adopted by the Commission remains true – the TBS rate protects bundled customers from cost shifting. Therefore, it is an eminently practical and reasonable element to be included in the resolution of the FSR issue.

Moreover, it needs to be reiterated that an inordinate amount of time is being spent in this proceeding on debating the consequences of a highly unlikely event – a mass involuntary return

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[34] SDG&E prefers that involuntarily returning customers remain on the TBS for 12 months, as opposed to the 6 months proposed by the DA Parties and other supporters of the TBS approach. This issue is discussed in more detail below.

[35] The joint PG&E/SCE proposal is that the methodology proffered in the CCA Bonding Settlement be adopted to establish the FSR for ESPs.

[36] *See* D.03-05-034, FOF 10, 15. SCE, at p. 40.

of DA customers. Direct Access as a service offering is now in its fourteenth year of operation in California. The market has matured, ESPs are sophisticated entities that are subject to the same resource adequacy, renewable portfolio standard and greenhouse gas requirements as are the IOUs and its customers are overwhelmingly large and sophisticated consumers. As noted by SDG&E in its opening brief, "In fact, the Commission has recognized that DA customers, especially larger commercial customers, are sophisticated energy consumers that have adequate civil remedies and are adequately protected by existing commercial law." D.03-12-015, at p. 15.[37] Therefore, the resolution of the FSR issue needs to recognize and acknowledge these facts. The DA Parties proposal does so, while the SCE/PG&E proposal does not.

Additionally, the risk of misspent time extends into the future and onto the Commission under the PG&E/SCE proposal. If there is a substantial difference between the rates seen by an involuntarily returned customer and a short-notice voluntarily returned customer, the Commission is likely to spend considerable time deciding whether or not individual customers were returned on a voluntary or involuntary basis--essentially getting into the heart of the contractual relationship between the ESP and the DA customer, which is exactly the situation that the legislature sought to avoid with the terms of P.U. Code Sec. 394(f), which leaves ESP/customer disputes to the courts. Despite the protestations of SCE that Sec 394.25(e) "should" apply only to "mass involuntary returns,"[38] that section, by its own terms, applies to ALL involuntary returns except those exempted for expiration or customer default. IOUs are not free to redefine the Public Utilities Code as it suits them. It is easy to see how every dispute between an ESP and its (terminated) customer over bill payment or (non)exercise of a renewal clause could become a significant CPUC complaint case if the customer saw an immediate and

[37] SDG&E, at p. 25, fn 44.

[38] SCE, at p. 43.

sizable benefit to claiming "non-exempt involuntary" status and gaining bundled rate treatment instead of TBS. The unnecessary levels of complexity in the PG&E/SCE proposal will result in additional burdens to the workload of the Commission itself.

A. Overview of ESP financial security requirements and definition of reentry fees.

As noted in multiple parties' opening briefs, Section 394.25(e) of the Public Utilities Code provides that an ESP or CCA must pay any reentry fee that is imposed on their customers that are returned involuntarily to IOU service, in order to avoid imposing costs on other existing customers of the IOU. The ESP or CCA must post financial security to cover that re-entry fee. The actual term "reentry fee" is not defined in the statute, meaning that the Commission has the latitude and discretion to determine precisely how it should be defined.

The DA Parties believe that the "reentry fee" should be defined as being those costs that are incurred by an IOU due to a mass involuntary return of customers that should not be imposed on other existing customers of the IOU. Acceptance of the Commission's prior statement that "by charging DA customers for the incremental costs of short-term power during the six-month advance notice period or the safe harbor period, no costs will be shifted to bundled service customers"[39] means that the costs that are incurred by the IOUs will be primarily the administrative costs incurred to process the customer returns. Therefore, the FSR should specify that ESPs are required to post financial security sufficient to cover such reasonably anticipated costs.

PG&E suggests that its proposal, "will serve as an appropriate measure to protect bundled customers from costs shifts that arise when ESPs take excessive risk above and beyond their financial strength, and subsequently default or are unable to perform, resulting in the involuntary

[39] *See* D.03-05-034, FOF 10, 15. SCE, at p. 40.

return of DA customers."[40] However, there is nothing in the record that indicates any likelihood that such behavior is likely to occur, and in fact a great deal of evidence on the record that it would not, meaning that the utility's proposal is essentially based on wild and alarmist speculation.[41]

PG&E also observes in its opening brief that, "The financial security approach proposed by PG&E and SCE in this proceeding is consistent with efforts of the Commodities Futures Trade Commission ("CFTC") and the FERC in restructuring the credit risk of markets, noting that the CFTC has clearly recognized that unsecured credit exposures pose a tremendous risk to market failure."[42] As a preliminary observation, it is procedurally inappropriate for PG&E to introduce new evidence in its opening brief. The CFTC and its activities are not mentioned at any point in PG&E's opening or reply testimony, which means that other parties were denied the opportunity to test the accuracy of these assertions through the vehicle of hearings and the rigor of cross-examination. As a result, this discussion in PG&E's opening brief should be disregarded. In direct response to this discussion, however, it should be noted that PG&E continually confuses throughout its opening brief the type of credit exposure that may exist between counterparties to a contract and the vastly different relationship that exists in this circumstance. Other than through the UDC-ESP Service Agreement that each ESP must sign with utilities in whose service territories they seek to do business, there is no contractual relationship between IOUs and ESPs. Furthermore, the UDC-ESP Service Agreement provides no undue credit exposure and is not under discussion in this proceeding. Trying to analogize the credit exposure that exists between contract counterparties to the FSR situation is strained at

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[40] PG&E, at p. 31.

[41] Exh. 201, at pp. 8-12.

[42] PG&E, at p. 32.

best. The "market failure" cited above sounds alarming unless one logically analyzes the limited IOU-ESP relationship and recognizes that there is no "market" between them that is subject to failure. Certainly there is credit exposure as and between counterparties to direct access transactions, meaning ESPs and their respective customers. And those parties protect against those credit risks through their individual contractual agreements, which is all the more reason why layering unnecessary "protections" through the FSR is uncalled for and inappropriate.

In support of its position, SCE argues that, "Section 394.25(e) protects *both* bundled service customers *and* ESP customers from costs associated with mass involuntary returns to IOU procurement service."[43] However, it ignores the fact that the statute specifically states that, "If a customer of an electric service provider or a community choice aggregator is involuntarily returned to service provided by an electrical corporation. . . ." SCE reads into the statute a fact that does not exist, namely, that the referred to "service" must be ***bundled*** service. Had the Legislature wished to specify this requirement it could easily have elected to do so. Having not done so, however, the SCE (and, for that matter, PG&E) assertion that customers must be returned to bundled service has no basis in statute.

Moreover, PG&E and SCE ignore the fact that the majority of ESPs serve large commercial and industrial customers. In fact, SCE make an inaccurate assertion when it states that the "majority of DA customers are residential and small C&I customers"[44] and that "Residential and small commercial customers may not be able to afford to pay the spot market prices on TBS, particularly during a stressed market, which is the risk scenario for mass involuntary returns"[45] PG&E also inaccurately states that "because ESPs potentially serve

[43] SCE, at p. 51 (footnote omitted).

[44] SCE at p. 52

[45] SCE at pp. 54-55

thousands of residential and small commercial customers, it is unlikely that these DA customers have the sufficient resources, time or ability to carefully evaluate an ESPs financial strength."[46] In fact only a 1/3 of the ESPs serve residential and small commercial customers and the vast majority of direct access load is consumed by large commercial, governmental, educational and industrial customers. Consequently the majority of ESPs serve customers that are sophisticated and willing to accept the risk associated with a mass involuntary return to TBS.

The DA Parties do agree with SCE on one matter however. As the utility states, "Moreover, the protections of Section 394.25(e) should apply in the context of *mass* involuntary returns, only."[47] SCE also argues that, "In absence of an ESP bond covering the exposure to incremental procurement costs in a mass involuntary return, the Commission's ability to prevent cost shifting is questionable."[48] Actually, the Commission has the ability to quite effectively eliminate the threat of cost shifting simply by providing that involuntarily returned customers be placed on the TBS rate.

B. Calculating reentry fees

The DA Parties have proposed that existing IOU customers will be fully protected against paying the costs of involuntarily returned customers if the re-entry fees are calculated as the sum of:

- the difference between marginal portfolio costs incurred (or benefits obtained) by the IOU to serve a customer that has been involuntarily returned to bundled service and the amounts collected from that customer for service during the first six months that a customer is on bundled service after the involuntary return; plus

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[46] PG&E at pp 30-31

[47] Ibid.

[48] SCE, at p. 54. *See also*, pp. 58-59

- the administrative costs incurred by the IOU to enroll the customer into bundled service.

This calculation greatly simplifies the FSR and eliminates the possibility that DA customers will be forced to pay the costly and potentially exorbitant requirements proposed by SCE/PG&E. It also concurs with the SDG&E recommendation that the DA reentry fee should include the costs associated with the administrative process to switch the customer.[49] DA customers are willing to assume the unlikely risk of being returned involuntarily to utility service; recognize that they have contractual remedies that can be enforced in the event of an involuntary return; and therefore do not need the duplicative and costly remedy that SCE/PG&E seek to impose upon them.

In their opening briefs, SCE and PG&E dispute this approach. PG&E cites a presentation made by DA Parties witness Fulmer in a July 2010 workshop presentation and concludes that, "Determining the amount of the potential cost exposure in a stressed market is necessary to determine the potential amount of re-entry fees, and thus the corresponding financial security requirements."[50] In fact, as noted above, this is no different than the DA Parties proposal. The only difference is that PG&E would increase that potential exposure to itself and to its bundled ratepayers by insisting that involuntarily returned customers must return to bundled service. It should be questioned why PG&E and SCE are in fact proposing a mechanism that *increases* potential cost exposure to their respective bundled customers as opposed to accepting the far more logical recommendation by SDG&E and the DA Parties that such customers should be returned to the TBS rate precisely so that risk to bundled customers will instead *decrease*.

PG&E also argues that, "The most likely scenario is that there will be involuntarily returned DA customers when market conditions are "stressed" (*i.e.*, wholesale prices are high),

[49] SDG&E, at p. 25.

[50] PG&E, at p. 35.

as was witnessed during the 2000-2001 energy crisis. Since ESP procurement practices are not reviewed by the Commission, in a stressed market an ESP could easily default or encounter serious financial troubles if it had not adequately hedged or otherwise procured sufficient energy and capacity at a price that it was able to charge its customers." PG&E neglects the fact that the record demonstrates that there have been other instances of "stressed" markets since the energy crisis and that these did *not* result in any "mass involuntary returns" of direct access customers. SCE in fact notes in its opening brief that, "Most DA customers probably do not know that spot market prices got as high as $150/MWh in the commodity price run-up in 2008."[51] A logical conclusion, of course, is that whether or not they knew, they were protected by the terms of their power sale and purchase agreements with their ESPs and that in fact the run-up cited by SCE caused none of the risks and exposures that SCE/PG&E spend so much time cautioning against.

SCE argues against the DA Parties' TBS approach by contending that, "Of course, the DA Parties carefully caveat their position by testifying to the need to modify TBS to allow the IOU to recover RA costs, RPS costs, and CAISO load-related costs to avoid shifting costs to bundled service customers. One wonders why the DA Parties did not simply tack onto their list of TBS modifications a proxy for IOU incremental administrative costs, and attempt to dispose of the bond requirement for their involuntary returns entirely."[52] Aside from the snide tone and obvious pettiness of this remark, it is notable that SCE certainly does not indicate any objections to the DA Parties proposals to modify the TBS rate, and in fact, supports them. Indeed, the DA Parties have acknowledged repeatedly that a fundamental element of their approach is to ensure that the TBS rate accurately reflects utility costs precisely so that bundled customers are protected from cost shifting.

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[51] SCE, at p. 52.

[52] SCE, at p. 58.

SCE also alleges, without merit, that the DA Parties' comparative analysis of the bonds and reentry fees is flawed.[53] In fact, it is SCE's rebuttal that is flawed, as explained below. First, the utility notes the price run-up that occurred in July 2008, and states that at that time the bond amount would have hit $55/MWh, since market prices were as high as $150/MWh. "Consequently, SCE's procurement exposure to an ESP's mass involuntary return of its DA customers would have been significant."[54] SCE ignores two facts. First, no returns of customers actually occurred during this event, thus suggesting that the risk of "mass customer returns" is overstated. Second, this allegedly significant exposure could have been fully addressed by placing returning DA customers on the TBS rate.

SCE next cites the fact that the price of a $112 million bond would be expected to cost about 1% of the face value of the bond – or $1.1 million – for an ESP with investment grade credit. This ignores the fact that not all ESPs have investment grade credit. Moreover, DA customers have repeatedly stated in this proceeding that they prefer to negotiate their own protections against such risks as opposed to having this unnecessary cost imposed on them unilaterally through their contracts with ESP suppliers.

SCE recommendation to give no weight to the DA Parties demonstration that SCE's proposed method for calculating ESP financial security requirement results in grossly excessive values is based on exaggeration and misdirection.[55] First, SCE notes that RPS costs were not added into the estimate of the utility's actual exposure from 2005 to 2010, conveniently ignoring the fact that RPS compliance costs have only recently been an issue, as significant new renewables did not come on line in this time period. Thus, even if the DA Parties attempted to

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[53] SCE, at pp. 62-65.

[54] SCE, at p. 63.

[55] SCE, at p. 63.

include some RPS costs, they would have been quite minimal and would not have affected the overall demonstration being made in the exhibit. Second, SCE assumes that RA costs are not appropriately reflected in the utility's cost to serve, based solely on the uncertainty of the witness under cross examination.[56] In fact, RA costs were included in the calculation, even if the witness could not recall this under questioning. Third, SCE quibbles that hourly data were not used to calculate the exposure, ignoring the obvious fact that the daily peak and off-peak market prices used in the calculation should approximate well the average of the hourly prices that SCE claims should have been used.[57] SCE hammers misdirection in later, saying: "the comparison does not reflect that market prices can change significantly from day to day depending on the volatility in the market."[58] This begs the question of how the daily prices used in the DA Parties analysis do NOT reflect daily price volatility. In summary, SCE's attempts to misdirect the Commission with exaggerated or incorrect criticisms of the DA parties' analysis should be seen through and ignored.

C. Security requirements administration

PG&E has proposed that the financial security requirements for each ESP be re-calculated every six months. The financial security would be calculated by the IOU and presented to the ESP. The ESP would then be required to provide sufficient financial security, either through a bond, letter of credit, cash collateral or acceptable guarantee.[59] The DA Parties believe that, consistent with practices in other states, once a year should be a sufficient period for the security requirement to be recalculated. We agree with PG&E, however, that a variety of

[56] Ibid.

[57] SCE, at p. 64.

[58] SCE, at p. 65.

[59] PG&E, at p. 36.

mechanisms should be permitted to post the necessary FSR. We have recommended that ESPs should be allowed maximum flexibility to meet their financial security requirement through having an investment grade credit rating, a parent company guarantee, a surety bond, a letter of credit, or cash. The main difference is the DA Parties' proposal that the possession of an investment grade credit rating should be an additional means for satisfying the FSR requirement. Since the TBS rate approach favored by SDG&E, the DA Parties and other parties will make the FSR a much lower amount than that proposed by PG&E/SCE, an investment grade credit rating should be provide a totally reasonable means of fulfilling the FSR.

SDG&E did not address the types of collateral that could be used, although it is notable that it did state in opening testimony that whether the ESP bond approach or the TBS approach is adopted, "In SDG&E's view, bundled customers are indifferent under either approach."[60] In summary, there appears to be no dispute that a variety of financial security products should be permitted and that flexibility in this regard is disputed by no party.

D. FSR Discussion Conclusion

There is a fundamental fact that must be considered in connection with the FSR debate. If SCE and PG&E are successful in imposing exorbitant and highly variable costs on DA customers, the net result will be that the Commission may well witness a historic *voluntary return* of DA customers as Direct Access becomes uneconomic. This is not a result that is in any way logically consistent with the premise of this proceeding nor with Senate Bill 695,[61] the statutory change that permitted the direct access market to be reopened. It would be particularly disheartening if, in a proceeding devoted to the implementation of the reopened direct access market, the Commission were to impose financial requirements that are so onerous as to make

[60] Exh. 500, at p. JS-8.

[61] Chapter 337, Statutes of 2009.

direct access an uneconomic alternative to utility bundled service. While this may be the furtive motivation of SCE/PG&E, it should not be made the official policy of this Commission.

With respect to the SCE/PG&E proposal it is clear that their FSR calculation model suffers from three serious flaws, as discussed more thoroughly in the DA Parties opening brief. First, the costs are egregiously high. Second, the SCE/PG&E model is very volatile and can move by tens of millions of dollars over the course of a year, thereby placing significantly higher costs on direct access customers. Third, it will have the effect of deterring customers from electing direct access, particularly since the SCE/PG&E model requires a 12-month bond instead of the 6-month period recommended by the DA Parties. In addition to these intractable practical problems, the SCE/PG&E FSR proposal has additional flaws, in that it (1) implicitly assumes that all of the involuntarily returned customers will remain on utility service and not elect to return to DA service within the safe harbor period, which is clearly counter to historical precedent; (2) it assumes that the key inputs are reliable, while it is clear that they are not; e.g. one key input to the model, the implied price volatility, is not even quoted by any broker for NP-15, and the values available from brokers for implied volatility for SP-15 are "indicative" and thus based on broker opinion;[62] and (3) it assumes that the key inputs are available to "anyone in the public,"[63] which also is false. In contrast, the DA Parties' proposal is reasonable, easily administered, complies with the statute and avoids placing unreasonable costs on ESPs and the direct access customers they serve.

Finally, as noted in the DA Parties opening brief, there is no need to reiterate all of the arguments that underlie the legalities of the TBS approach. In summary, however, nothing in § 394.25(e) precludes adoption of the Direct Access Parties' proposal to place ESP customers that

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[62] Exh. 201 at 17

[63] Exh. 400 at p. 4-15

are involuntarily returned to IOU service on their IOU's TBS tariff. PG&E alleges that, "The DA Parties' effort to shift their statutory obligations to their own customers is contrary to the statute and should be rejected."[64] There are two observations that must be made in response. First, the PG&E legal argument is deeply flawed and writes into the statute ideas and concepts that have no basis in fact in the language of the statute. Second, PG&E's statement is misleading as it implies that the DA Parties is simply a group of ESPs. In fact, there are far more direct access customers than ESPs that comprise the DA Parties and any effort to suggest that customers are being disadvantaged by the DA Parties proposal is unfair, unsupported by the facts and should be ignored.

V. Conclusion

In conclusion, the record compiled in this proceeding demonstrates convincingly that the DA Parties have offered a comprehensive package of proposals with regard to calculation of the TBS rate, switching rules, minimum stay provisions, and ESP security arrangements. These proposals are logical, reasonable and easily administered. They should be adopted by the Commission so that direct access can continue to be a viable option for the benefit of customers.

Respectfully submitted,

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[64] PG&E, at p. 33.