

**Community Choice Aggregation
Fully Outsourced Service Model Assessment
June 24, 2015**

**Prepared For
County of San Mateo
Office of Sustainability**



Executive Summary

At the request of San Mateo County, Pacific Energy Advisors, Inc. (PEA) completed an assessment of the fully outsourced Community Choice Aggregation (CCA) service model, which has been recently promoted by an organization known as California Clean Power (CCP). In general terms, the “fully outsourced model” purports to minimize risks and guarantee benefits typically associated with CCA implementation and operation. This approach differs from the approach taken by California’s operating CCAs, which have established internal organizations with the intent of providing CCA as a locally focused/locally situated public service organization for the long term. The existing CCAs have opted for more traditional supplier/service arrangements with longer-standing, highly experienced organizations and/or through the development of internal staff, who have been assigned responsibility for certain operational functions. Based on PEA’s research and evaluation, there are numerous risks associated with CCP’s proposed approach that have not been disclosed nor adequately addressed in the proposed contract terms that were made available for our review. In particular, PEA identified the following key concerns/risks during its assessment of the fully outsourced CCA business model. This list is non-exhaustive; these items, as well as several others, are discussed further within the body of this summary report:

- Diminished community benefits: The community benefits represented by CCP appear to be much smaller than the CCA could otherwise achieve under a self-administered model, bearing in mind current market conditions.¹ In particular, CCP appears to be retaining a disproportionate share of the financial benefits that could otherwise accrue to the CCA under a self-administered model.
- Diminished public involvement and general transparency: Some of the fundamental benefits of CCA formation are increased public involvement, transparency and local accountability with regard to energy planning and supply, service offerings, rate setting, program development and CCA administration among many other concerns. These benefits appear to be minimized under the fully outsourced CCA model. Based on PEA’s assessment, it is unclear whether or not the CCA would have any input with regard to CCA rate setting, for example, or if there would be any transparency with regard to the CCP’s resource planning and procurement efforts, general financial performance, credit profile, cost of service or various other concerns.
- Viability of long-term rate savings commitment: PEA observes that long-term retail rate guarantees (relative to a specified benchmark) are highly uncommon, if not entirely unavailable, due to expected volatility/uncertainty within domestic power markets. PEA is not aware of an analogous 10-year rate savings commitment, such as the commitment which appears to be made by CCP, elsewhere in the California retail market, including retail service offerings supported by California’s largest, most experienced energy suppliers. Over a ten-year planning horizon, it is literally impossible to know what utility rates and/or wholesale power prices may be, so offering a comparative rate guarantee is highly speculative. Regulatory and legislative uncertainties with California’s power markets only serve to exacerbate such speculation.

¹ Wholesale energy prices are subject to change without notice; utility generation rates may also periodically change. Such changes will directly impact the CCA-utility rate comparison and potential cost of service for the CCA enterprise (to the extent that power supply requirements are not addressed via fixed-price power supply commitments).

- Potential conflict of interests: PEA observes that CCP appears to serve as both the CCA evaluator and services provider under its business model, eliminating objectivity and potentially introducing a conflict of interest that should be carefully evaluated by the aspiring CCA. None of California’s operating CCAs currently receive energy products/services from entities that contributed to the development of their respective feasibility/technical assessments. Separating these two functions seems necessary and appropriate to promote objectivity during implementation and operation of the CCA enterprise.
- Non-competitive procurement process: PEA observes that the sales approach employed by CCP appears to run counter to the competitive procurement processes typically observed by public entities, eliminating the potential to evaluate CCP’s proposal alongside similar offers from other qualified suppliers.

In the summary report that follows, PEA discusses several concerns/risks along with an evaluation of prospective benefits related to the fully outsourced model. PEA recommends that any community considering the fully outsourced model complete a thorough due diligence effort, including the evaluation of other qualified suppliers and service providers as well as a thorough review of proposed contract terms by qualified legal counsel, before engaging in any contractual commitments.

Background

With an operational track record spanning just over five years, the CCA business model is still relatively new within the state of California, yet the documented benefits of this energy service model – competitive electric generation rates, increased renewable energy supply, reduced attributed greenhouse gas emissions within the electric power sector, economic development and job creation, among other benefits – have been significant. Despite this success, various critics and skeptics continue to search for flaws in an attempt to interrupt the proliferation of new CCA initiatives throughout the state. These attempts have included proposed legislation and regulations to undermine the economics of CCA and/or impose burdensome costs on CCAs, often justified under the guise of protecting other ratepayers from the cost of a potential CCA failure. This realization makes it critically important for all CCA initiatives to exercise discipline and prudence when making key decisions related to implementation and operation.

To date, California’s operating CCAs, including Marin Clean Energy (MCE), Sonoma Clean Power (SCP), and Lancaster Choice Energy (LCE) have chosen to implement their respective programs under one of two organizational structures: 1) Joint Powers Agency, as is the case with the MCE and SCP programs, the members of which include multiple municipal jurisdictions generally located within proximity to one another; or 2) Single Municipality, as is the case with LCE, which currently has a service territory that is limited to the City of Lancaster and operates the program as an Enterprise Fund.

During initial operations, the primary energy supply required to serve the customers of California’s existing CCAs was secured through direct contractual relationships with experienced Energy Services Providers (ESPs), which were independently selected through publicly administered, competitive solicitation processes. These processes included rigorous evaluative efforts through which the CCA entity carefully and deliberately assessed the capabilities and suitability of prospective suppliers to meet some or all of each CCA’s near- and longer-term needs for various energy products, including conventional electric energy, renewable energy, reserve capacity and related services (such as scheduling coordinator services, which must be addressed prior to participating in the California energy market). The competitively administered selection process was critical to identifying the supplier best

suited for this important role. Beyond consideration of the ESP's experience and other capabilities, a key consideration in selecting a primary energy supplier was the financial strength of the ESP and its ability to follow-through on its contractual commitments to the CCA. Each operational CCA selected an entity with an investment grade credit rating, and some required posting of collateral by the ESP to act as performance assurance for the ESP's obligations. Through each competitive solicitation process, there was a great deal of learning that occurred, which allowed each CCA to make an informed decision regarding its preferred supplier(s) in consideration of a wide range of options. Interestingly, each CCA selected a different ESP through its respective solicitation process, which seems to reinforce the importance of such competitive processes when matching unique CCA buyers and suppliers, particularly when the CCA enterprise has limited experience with regard to power procurement. In practice there has been no "one size fits all" solution with regard to necessary energy supply, indicating the importance for aspiring CCAs to consider a broad spectrum of options to best meet their uniquely defined goals and objectives.

While each of the existing CCA's contracted with a primary ESP for purposes of starting service, care was taken to avoid long term dependence upon a single ESP and to ensure the CCA retained ultimate control over its power supply, finances, and compliance with regulatory requirements. An important objective in forming the existing CCA programs has been development of new renewable generation to serve the community and ensuing reductions in greenhouse gas emissions. The ESP contracts have been used as a bridge during the CCA start-up period, while internal capabilities are developed, revenue surpluses are generated and long-term investments in resources and customer programs are made for purposes of providing sustainable value to the community. In short, the CCA programs represent a strategic asset for the community. The long-term approach utilized by existing California CCAs contrasts with the short-term approaches used in some other states, which have tended to rely on outsourcing CCA operation to an ESP under relatively short-term contracts. These programs have been primarily focused on near-term ratepayer savings and have not aspired to increase renewable generation development. Customers in these programs may periodically be served by a different ESP or return to the incumbent utility in accordance with the regulations and market rules existing in those states.

The success of California's CCAs, which has been bolstered in recent years by utility rate increases and prolonged price troughs within wholesale energy markets, has prompted increased interest from aspiring CCA initiatives as well as new market entrants and general opportunism with regard to the CCA business model. Numerous communities are evaluating the feasibility of CCA formation, and new business entities are coming forward in an attempt to capitalize on such interest, including the provision of energy products and related services to CCA enterprises. Certain of these new market entrants aspire to compete with California's most experienced ESPs by promising reduced risk/increased certainty and minimized up-front financial commitments relative to their more "traditional" ESP counterparts.

Selecting a qualified supplier, or multiple qualified suppliers, is one of the most important factors in ensuring the near-term success, particularly with regard to risk mitigation, for aspiring CCAs. The balance of this assessment focuses on the supplier selection process as it relates to a relatively new fully outsourced model, which is being marketed by CCP.

Assessment of the Fully Outsourced Model

As understood by PEA, CCP organized itself in late 2014. Since that time, CCP has assembled a consortium of management, staff and consultants. Certain key personnel represent varying levels of experience within the electric utility industry generally, but appear to have limited direct experience in the areas of CCA evaluation (e.g., technical feasibility assessment), organization, implementation, administration and operation.

Key benefits of the fully outsourced business model are purported to be: expedited implementation, zero up-front costs (including a complimentary technical feasibility study), guaranteed rate savings, increased renewable energy supply and generally reduced risks to participating communities. It is noteworthy that certain of these guarantees are highly atypical within the electric utility industry as a whole. For example, direct access service providers, many of which are large, long-standing, highly experienced companies with robust risk management practices, rarely offer rate certainty beyond a 36-month planning horizon, and none offer comparative rate savings (relative to an investor-owned utility, for example) over such an extended period of time, primarily due to the uncontrollable risk exposure such a commitment entails. Additionally, the investor-owned utilities do not provide commitments with regard to rate stability, regularly changing rates throughout each calendar based on a variety of factors. To date, PEA is not aware of any attempt to implement the fully outsourced CCA model within California, so there is no tangible evidence, nor example substantiating the ability to achieve the benefits represented by proponents of this approach, particularly over a longer-term operating horizon. With this in mind, it is important for all aspiring CCAs to carefully consider the viability and durability of purported benefits as well as the significance of associated risks before agreeing to proceed with CCA implementation under this approach.

Based on PEA's independent assessment, there are a variety of prospective benefits and risks associated with the fully outsourced model, and it is important to consider potential outcomes under a variety of planning horizons: near-, medium- and longer-term. In the near-term, PEA expects that current wholesale market conditions within the electric utility will generally allow for certain cost advantages for CCAs. As a result, near-term rate savings for participating customers also seems to be a reasonably assumed outcome. However, the durability of stated benefits over the medium- and longer-term planning horizons seems highly questionable in light of inevitable uncertainties related to wholesale electricity pricing and future utility electric rates as well as the inexperienced nature of the service provider itself, which has yet to successfully implement its proposed approach. Furthermore, because the underlying contractual commitments (with regard to electric power supply) are apparently not disclosed by CCP, there is a great deal of uncertainty with regard to the ability of this new market entrant to honor the longer-term supply commitments contemplated in its service agreement. With regard to the prospective benefits and risks associated with the fully outsourced CCA model, as promoted by CCP, PEA has identified the following non-exhaustive list:

Potential Benefits (and related concerns)

- **Minimized start-up costs:** As represented by CCP, the fully outsourced model appears to require no up-front financial commitments by the aspiring municipality CCA. Based on prior experience, start-up costs may range from \$1.5 to \$2.0 million plus variable working capital requirements and are typically recovered through near-term operating surpluses accrued by the CCA. Securing such startup funding may be challenging for certain communities, depending on unique financial circumstances. Under the CCP business model, this potential barrier to CCA implementation appears to be removed.

- Revenue stream: Under the CCP fully outsourced business model, CCP has pledged to make an annual “Public Benefit Payment” of \$2 million to Lake County.² Presumably, CCP’s proposed Public Benefit Payment would vary based on the unique characteristics, particularly expected annual energy requirements and customer composition, within each municipality to be served by CCP. To date, PEA has not reviewed other CCP services agreements, so it is unclear how the unique characteristics associated with each municipality may impact the expected Public Benefit Payment. Subject to any legal restrictions on the use of electric rate revenues, these funds could be used for energy-related or other public purposes. Conversely, the revenue stream could be substantially higher under a scenario where the CCA has direct control over operating costs and revenues.
- Administrative simplicity: This generalized benefit suggests that outsourcing necessary services/responsibilities typically undertaken by CCAs will require a reduced level of “hands-on” involvement by the participating community/communities. Conversely, hiring staff and/or consultants to perform such activities under direct oversight by the CCA’s management will increase administrative rigor but will also contribute to the development of internal competency/expertise (and associated local jobs), which will allow the CCA to represent itself in the event of CCP failure or a future transition to an alternative supply arrangement. The decision to fully outsource CCA operational support will also lead to reduced oversight and transparency with regard to the work activities completed by the third party. Furthermore, under the CCP business model, certain activities associated with the ongoing administration of complimentary programs, such as energy efficiency, demand response and feed-in tariffs, seem to require additional staff/consultants and funding, as the ongoing administration of such programs does not appear to be addressed in CCP’s anticipated scope of service.
- Reduced overhead/staffing costs: The benefit of reduced overhead and staffing costs is directly related to the previous bullet – to the extent that the CCA does not hire (or minimally hires) direct staff and/or consultants to support CCA operations, associated costs will be eliminated. It is important to be aware that the decision to forgo hiring or developing staff creates an ongoing dependency between the CCA and CCP. If the CCA chooses to forgo hiring staff, internal technical competency and general self-sufficiency will be diminished, which would not allow continuation of the program in the event that CCP discontinues business operations.
- Rate savings: In consideration of current wholesale energy prices and prevailing utility generation rates, CCP recently represented that participating customers within Lake County will “receive an average of 2% off total electric bills” (with the comparative savings based on utility rates in effect as of January 1st of each year) and also noted that customers of the CCA shall receive rate options similar to those offered by the incumbent utility.³ It is noteworthy that most customers of California’s operating CCAs enjoy cost savings well in excess of the 2% commitment reflected in CCP’s service agreement. For example, average rate savings for SCP customers exceeds 5 percent with certain customer classes receiving rate savings in excess of 10 percent. However, under the term of agreement proposed by CCP, which exceeds ten years in duration, it is unclear whether or not CCP will be able to deliver on this commitment in light of the fact that future utility rates and supply costs are unknown. In the near-term, which includes the next 12-to-24 months, prevailing wholesale electricity prices, including prices associated with in-state renewable energy, will likely allow for comparative cost advantages for new CCAs,

² Draft Agreement for Community Choice Aggregation Services between the County of Lake and California Clean Power Corporation.

³ *Ibid.*

which should translate into highly competitive electric rates. Over the medium- and longer-term, however, this prospect becomes far less certain. For instance, PG&E’s recent Energy Resource Recovery Account filing suggests that retail generation rates will likely decline and CCA surcharges will likely increase in calendar year 2016, highlighting the unpredictability of utility rates and the potential pressure that could be imposed on CCP’s ability to deliver rate savings.

- Increased renewable energy supply (relative to the incumbent utility): CCP recently represented that participating CCA customers within Lake County would receive 33 percent renewable energy, which shall be entirely sourced from Category 1 resources (the Portfolio Content Category, or “PCC,” which generally refers to renewable generating resources physically located and/or interconnected to the state of California).⁴ It is noteworthy that California-based retail sellers are under no obligation to source renewable energy supply in this manner, using more costly PCC 1 resources in place of other eligible renewable energy options, including PCC2 (typically, out-of-state renewable energy products, which are not delivered contemporaneously with the associated electric energy; the PCC2 product is often referred to as a “firmed/shaped” product) and PCC 3 (generally referred to as “unbundled” renewable energy products, which are sold separately from the electric power produced by the associated renewable generator). Current renewables portfolio standard (RPS) procurement rules allow for retail sellers to procure a mix of PCC1, PCC2 and PCC3 resources – under the currently effective RPS program, the proportion of renewable energy that must be sourced from PCC1 products increases over time; the proportion of renewable energy that may be procured from PCC3 products decreases.

Based on current market conditions, the premium charged for PCC1 renewable energy products typically ranges from 10- to 20-times the premium amount associated with PCC3 resources. Despite these cost tradeoffs, many retail sellers are opting to displace PCC2 and PCC3 resources with additional PCC1 purchases (in excess of RPS mandates). Certain proponents of this approach appear to be interested in avoiding potential criticisms focused on the imputed environmental benefits associated with unbundled and/or out-of-state renewable energy products. At this point in time, there is not uniform guidance with regard to attributed GHG emissions accounting, but strong philosophical opposition to the use of unbundled renewable energy products has been building within many communities currently operating or evaluating CCA programs. Identification of this opposition seems to be shifting resource planning efforts towards bundled renewable energy alternatives.

Despite material cost differences between bundled and unbundled renewable energy products, recent pricing downturns for PCC1 renewable energy, particularly California-based, utility-scale solar, have enabled CCA initiatives to plan for increased amounts of bundled renewable energy without significantly impacting associated customer generation rates. However, the specific supply sources, including whether such sources are new or existing, are not identified in the CCP services agreement. There are also no specific commitments made by CCP with regard to longer-term contracts typically required to support the development of new, in-state renewable generating resources. Based on CCP’s specified timelines for service commencement, it seems likely that existing renewable generators would be producing/delivering all near-term renewable energy supply, which is not likely to be regional or local. Use of locally situated renewable resources would be merely coincidental with the existence of previously operating renewable resources in the County. Furthermore, in the event that a participating CCA determined to increase/decrease renewable energy content and/or incorporate other resources

⁴ *Ibid.*

preferences in its supply portfolio, it appears as though this would not be accommodated under the CCP business model.

- Reduced GHG emissions (relative to PG&E) associated with CCA power supply: CCP commits to delivering a supply portfolio that has a lower GHG emission factor than the incumbent utility. Because annual utility emissions factors are typically reported on a lagged basis (12-14 months following the conclusion of each operating year), CCP will need to be conservative with regard to procuring requisite GHG-free energy supplies to ensure that this commitment can be fulfilled. For example, sufficient quantities of hydroelectric generation will need to be delivered to ensure that the CCA's GHG-free supply portfolio exceeds PG&E's GHG-free content, which approximated 56% in 2014 (comprised of renewable energy – 27%, nuclear energy – 21%, and large hydroelectric generation – 8%, based on PG&E's recently submitted Power Source Disclosure Report for the 2014 calendar year). The methodology, including attributed emissions factors for certain conventional generating sources and/or market purchases, that will be used to complete this comparison is not described by CCP.

Key Risks

- Supplier/service provider experience: When evaluating, implementing and operating a new CCA, direct experience is critically important to promote the achievement of successful outcomes. Based on PEA's understanding, the CCP organization has only limited direct experience with CCA operation and virtually no prior experience with CCA evaluation and implementation (other than what has been learned since CCP's formation approximately six months ago). CCP may have professional relationships and/or associations with organizations representing increased levels of direct CCA experience, but this is not described in the CCP materials that PEA has reviewed. The identity of third parties that will be providing key functions related to interfacing with the grid operator and the distribution utility has not been disclosed. With no proven track record and the lack of complete information regarding this organization, there is a high degree of uncertainty with respect to CCP's ability to effectively implement and manage a CCA program.
- Conflict of interest: Based on PEA's understanding, CCP appears to serve as both the CCA evaluator and sole services provider, introducing the potential for a conflict of interest. To date, none of California's operating CCAs have received delivery of energy products/services from organizations which have contributed to the development of their respective CCA feasibility studies. The separation of responsibilities associated with feasibility assessment and energy product delivery seems particularly important, as there is the potential for significant financial benefit once the CCA determines to pursue CCA implementation and begins executing related supply agreements. To the extent that the feasibility analyst is also the intended services provider, it is impossible to ignore the potential conflict that exists. If the feasibility analyst suggests that benefits can be achieved through CCA implementation, the same business stands to financially benefit once supply agreements are consummated. Even if current market conditions and prevailing utility rates clearly point to potential benefits for a prospective CCA, it seems inappropriate to eliminate all objectivity through an exclusive business relationship. At a minimum, aspiring CCAs should seek independent evaluation of anticipated CCA operations prior to selecting a power services provider.
- Supplier non-performance or failure: One of the key risks associated with any power supply agreement is non-performance – a scenario under which the supplier of contracted energy products is not able to fulfill its contractual responsibilities, leaving the buyer (the CCA in this example) exposed to potentially volatile market prices and related financial consequences, regulatory non-compliance (including financial penalties), general planning uncertainty and

other concerns. Once a California community registers with the California Public Utilities Commission as a CCA, certain obligations are created, including compliance with applicable laws (such as California's RPS) and regulations (including the procurement and demonstration of sufficient reserve capacity). The CCP services agreement clearly states that CCP is responsible for "strict ongoing compliance with California and federal laws and regulations applicable to CCA and retail electric commodity service." Further, CCP agrees to indemnify the municipality for any penalties. However, under the CCP business model, the municipality retains ultimate responsibility for shortcomings and deficiencies with regard to these requirements in the event of a default by CCP.

PEA would recommend that adequate performance security in the form of cash, letter of credit or other acceptable instrument should be provided by CCP for the benefit of the municipality to mitigate the risk of a CCP default. This performance security should be separate and apart from the collateral that might be posted by CCP to back its wholesale power purchases and should be appropriately distinguished from the collateral and/or performance security associated with other communities that may be served by CCP.

PEA also recommends that any aspiring CCA retain the services of qualified legal counsel prior to executing any long-term services agreement. Such legal counsel should represent the aspiring CCA member(s) during contract negotiation to ensure that member interests, including specified responsibilities and liabilities, are appropriately reflected in the contract document and that all pertinent terms and conditions are clearly and completely understood prior to contract negotiation.

Further, in the event of supplier failure, the CCA might find itself unprepared to address the necessary customer transition. In a recent memo from CCP to Lake County in which certain responses and clarifications were issued in relation to questions focused on the CCP services agreement and business model, CCP indicated the following: "If CCP is rendered incapable of performing under the contract due to complete dissolution of CCP as a going concern, the County can join another CCA, administer the CCA in house, or forfeit the CCA bond and seamlessly return customers to PG&E service. Because CCP covers the cost of the bond for the return to PG&E service, the return to PG&E service would occur at no expense to the County."

The implications of this response are highly concerning. In particular, CCP seems to suggest that the CCA could readily join another CCA or administer the CCA in house, but neither of these opportunities can be taken for granted, particularly when there is only one operating CCA, MCE, which has a standing policy/protocol for evaluating new members. MCE's new membership process has typically occurred over a period of several months, including a detailed quantitative analysis and multiple publicly-noticed meetings during which prospective membership is discussed and ultimately voted upon by MCE's governing Board. CCP seems to imply that the failed CCA could simply and quickly complete this process without a disruption of service to customers of the failed CCA. In practical terms, this is not feasible.

CCP also suggests that the municipality (Lake County, in this case) could proceed to administer the CCA in house, but this is also practically infeasible due to the fact that participation in the fully outsourced model likely left the municipality with little to no internal technical competence, as such functions were expressly outsourced to CCP. Stated somewhat differently, the CCP business model creates a dependency between the CCA and CCP by virtue of the CCA not needing to develop internal competency/capabilities/expertise. Again, this outcome is practically infeasible due to reasonable timelines required to identify qualified (and available)

technical consultants and/or develop internal technical expertise within the affected community.

The final option noted by CCP is the most concerning: “forfeit the CCA bond and seamlessly return customers to PG&E service.” This sounds simple enough, but the potential impacts to California’s remaining CCAs could be disastrous: diminished credibility amongst regulators, the California legislature and prospective suppliers; potential increases to the CCA bond amount, which could irreparably harm existing and future CCA initiatives; customer fear and distrust; and a variety of other adverse consequences. The progress of CCAs has been filled with hard-fought successes but has also been obstructed by various critics, skeptics and antagonists, who continue to search for flaws and shortcomings in the CCA business model. To the extent that any new CCA enterprise fails, it may also compromise the ground gained by California’s other CCAs. To be perfectly clear, there would be nothing “seamless” about this transition for CCAs at large. The fully outsourced business model appears to leave associated CCAs entirely unprepared to deal with the transitional responsibilities that would be required in the event of CCP failure. Without a certain level of internal expertise and technical competence, CCAs are woefully disadvantaged in such a situation. The fully outsourced business model unfortunately exacerbates this risk.

- Disproportionate allocation of financial benefits and lack of transparency: One of the most intriguing prospects of CCA formation is the ability of a CCA to generate customer savings and/or operating surpluses, which can be directed towards the development of locally focused energy programs or projects as well as other needs of the participating community/communities. Currently, MCE and SCP both offer customer rate savings while having accrued significant financial reserves. Over time, it is expected that the City of Lancaster will fare similarly. Under these examples, the CCA’s participating customers and the communities in which the CCA offers electric service will be the primary beneficiaries of this financial success – there is no sharing of financial benefits with investors, shareholders or other third parties. Under the CCP business model, it appears as though CCP is passing through a disproportionately small benefit to the CCA while keeping for itself the lion’s share of surpluses generated through CCA operations. PEA completed an independent, high-level financial analysis to demonstrate the potential inequities embodied in this business model, which are summarized in the table below.

2015 Community Choice Profit Margin Worksheet		
Community Inputs		
Community Retail Sales (MWh/Yr.)		350,000
Renewable Energy Content (%)		33%
Discount to PG&E Electric Bill (%)		2%
Community Payment (\$/Yr.)	\$	2,000,000
Revenues and Profits		
Revenue @ PG&E Generation Rate (\$/Yr.)	\$	33,803,000
Less CCA Surcharges (\$/Yr.)	\$	(3,570,000)
Less Discount (\$/Yr.)	\$	(1,202,320)
Less Community Payment (\$/Yr.)	\$	(2,000,000)
Less Power Supply Costs (\$/Yr.)	\$	(19,376,000)
Gross Profit Available to Operator (\$/Yr.)	\$	7,654,680

The structure of this analysis is quite simple but reasonably represents the expected surpluses that could be generated given current market pricing by a relatively small CCA enterprise similar to Lake County (serving annual customer energy requirements of 350,000 MWh/year; by comparison, the annual energy requirements of MCE are expected to be approximately 1,800,000 MWh, roughly five times the aforementioned volume)⁵ PEA's analysis assumes, for the sake of simplicity, that this hypothetical CCA enterprise generally represents the customer composition and usage characteristics observed throughout PG&E's entire service territory. Based on this assumption, PEA applied PG&E's system average generation rate as the utility proxy against which CCA rate savings would be evaluated under the CCP services agreement. PEA also assumed that 33 percent of the CCA's total anticipated retail electricity sales would be sourced from Bucket 1-eligible renewable energy products; an appropriate cost premium, based on recently observed wholesale renewable energy transactions. PEA's financial analysis also accounts for other operational expenses such as scheduling fees, electric grid operator costs, and energy losses resulting from the transportation of electricity on the grid.

The results of this prospective scenario are staggering, suggesting that the hypothetical CCA enterprise would forgo more than \$7.6 million in additional benefits, as represented by gross profits, under the CCP business model. As specified in CCP's services agreement, the CCA would receive \$2 million per year in the form of a "Public Benefit Payment," but CCP would retain more than \$7.6 million in gross profits. Admittedly, CCP would reasonably require a certain portion of this amount to cover its staffing, overhead, collateral requirements and other operating expenses, but the anticipated net profits still appear to be much higher than the Public Benefit Payment issued to the CCA.⁶ In effect, this scenario appears to demonstrate that under the CCP business model, near-term financial surpluses generated by CCA formation disproportionately benefit CCP as opposed to CCA customers or the participating community.

In substantial part, this analytical exercise highlights the lack of transparency associated with CCP finances. This practice cuts across the grain of typical public processes, which tend to readily disclose information in an effort to ensure that nothing is hidden or obscured, particularly when public finances are in play. PEA recommends that any community pursuing the CCP business model request and receive detailed financial projections prior to executing any contract documents to ensure a thorough understanding of the prospective allocation of financial benefits. Following contract execution, PEA recommends that the participating CCA receive a periodic accounting of CCP operations in support of the CCA enterprise, including a detailed breakout of financial benefits accruing to CCP relative to the CCA.

CCA's are public entities and are required by law to disclose almost all information related to CCA operations. Accordingly, it is critical that local government officials and staff responsible for the CCA have all the information necessary to respond accurately to such inquiries. Due to the lack of transparency in the fully outsourced business model, the ability to respond timely and accurately is a significant risk to the CCA, especially without any checks and balances to validate any information provided by CCP. Even more concerning is that there doesn't seem to be any liability on CCP in the case that inaccurate information is provided to the CCA and subsequently released to the public. Without access to all data and information related to CCA operations, it will be difficult for the CCA to confidently provide accurate information to the public in general.

⁵ As previously noted, wholesale energy prices are subject to considerable volatility. To the extent that wholesale energy prices change, projected operating results may be materially affected.

⁶ The May 2015 feasibility study prepared by CCP for Lake County (Page 26) indicates that these other expenses represent less than 10% of the total costs.

- Supplier creditworthiness: In the aforementioned memo from CCP to Lake County, CCP indicated that it “demonstrates creditworthiness with \$15 million in funding to secure power purchases for up to 200,000 people.” Presumably, the noted \$15 million is held in the form of a letter of credit or cash collateral to enable these power purchases. However, nothing in the CCP services agreement specifically addresses this amount nor the maintenance thereof. Instead, the services agreement vaguely addresses requisite credit as follow: “At all times CCP shall maintain collateral or capitalization sufficient to ensure performance under this Agreement. The amount of collateral or capitalization deemed sufficient shall be determined using industry standard electric commodity procurement practices.” Again, this vague language provides no specific metrics to assure collateral sufficiency nor any process for ensuring that CCP maintains itself as a creditworthy entity throughout the term of the agreement. If CCP were to be on the verge of bankruptcy, there doesn’t appear to be any obligation for it to disclose such information nor does there appear to be any provision addressing the periodic sharing of information substantiating or evaluating CCP’s financial health. This lack of credit protection for the municipality stands in stark contrast to standard power supply contract credit terms. In the event that such a situation existed, there is no performance security (posted by CCP) against which the CCA could draw nor are there specific remedies identified. If an aspiring CCA is to reasonably consider such a long-term services agreement, including the delivery of requisite energy products, clearly defined credit provisions protecting both parties are recommended.
- Rate setting: Under the CCP business model, the proposed rate setting process appears to be quite different compared to California’s successfully operating CCAs. In particular, the CCP business model lacks detail about the mechanisms for consumer protections, customer disclosure, due process and general customer input during the rate setting process, all of which are fundamental features of currently operating California CCAs. According to the CCP services agreement, the rate setting process seems to be a forgone conclusion, tying directly to PG&E’s annual rate changes. This approach generally renders customer input useless, as CCP’s prescribed approach will result in a predetermined outcome, regardless of customer input. In addition, it is unclear to PEA how CCP will assure the equitable treatment of customer classes during the rate setting process. There also appears to be no consideration of cost of service for particular rate classes relative to retail electric rates. Finally, the forgone nature of CCP’s rate setting process substantially minimizes the potential for customized economic development rates and/or other rate schedules that could be designed to attract particular customer groups, incentivize/disincentivize certain customer behaviors and/or promote the achievement of local policy objectives. CCP’s rate setting process also ignores the importance and value in rate stability, which is currently provided through the annual rate setting process of California’s three operational CCA’s.
- Durability of rate savings commitment: In practical terms, it is impossible to know what PG&E’s rates may be next year, let alone five or ten years from now. Even if CCP were to secure long-term, low-cost supply commitments from viable sources, inevitable uncertainties regarding PG&E’s future generation rates and related exit fees make the prospect of honoring CCP’s stated rate savings commitment highly speculative, particularly over a ten-year contract term. In fact, the duration of the CCP rate savings commitment heightens the risk of contract default (with regard to the rate savings commitment) or an eventual attempt to pass through costs to CCA customers.
- Economic development and job creation: Under the fully outsourced business model, there are no incentives to promote the development of innovative, locally focused energy projects and

programs, which have been a huge success for California's existing CCA's. The ability to invest and build within a CCA's actual jurisdictional footprint also leads to the creation of jobs and general economic development. Furthermore, adopting the fully outsourced business model eliminates the addition of long-term jobs in order to internally administer the CCA program. As MCE, SCP, and LCE continue to grow in size, adding new product and program offerings, permanent, long-term jobs become necessary and are created in turn. The fully outsourced model inevitably reduces local input and control over resource decisions and energy programs.

- Lack of complimentary energy program administration: Under the CCP business model, certain activities associated with the ongoing administration of complimentary programs, such as energy efficiency, demand response and feed-in tariffs, seem to require additional staff/consultants, as the ongoing administration of such programs does not appear to be addressed in CCP's anticipated scope of service. Further, no revenues would be available to support these programs apart from the public benefit payment made by CCP, since all customer revenues would be assigned to CCP. As clarified in the aforementioned memo from CCP to Lake County, CCP appears to be willing to provide no-cost support in developing various complimentary energy programs that may be of interest to the participating CCA. However, the CCA is independently responsible for the ongoing administration of such programs, including staff and related costs. In light of the relatively modest revenue sharing that is being offered by CCP, participating communities may find it challenging to cover such administrative costs over time.

General observations related to the CCP services agreement: Based on PEA's review, much of the language included in CCP's proposed services agreement, particularly language describing CCP's obligations and commitments, is vague and lacking sufficient detail to fully understand and/or verify the commitments being made by CCP. Typical agreements addressing the relatively complex relationship between CCAs and suppliers/service providers are lengthier as well as more detailed and carefully worded to minimize the potential for misunderstanding and misinterpretation between the parties. Examples of areas within the CCP contract that could be further developed in an effort to improve clarity include: CCP's rates savings commitment; the commitment to local renewable utilization; and the scope of the change in law provision. As to the change in law provision, the contract should address changes in: utility rates and departing load charges, RPS and resource adequacy requirements, storage obligations, integration costs, congestion costs, and bond requirements.

Conclusion

CCA formation is not without risk. Regardless of the chosen implementation approach, there will be inevitable uncertainties. How many customers will opt-out? What will PG&E's rates be next year? What price will I pay for wholesale energy after my current contracts expire? What proportion of my supply portfolio should I secure under fixed-price contract arrangements? These questions, as well as many others, are involved with the process of CCA evaluation, implementation and operation. California communities can minimize the variables surrounding the CCA service model by employing proven practices and experienced teams. In particular, the recent successes of MCE, SCP and LCE are the result of a common formula that relies on California's most experienced service providers, minimizing risk while maximizing potential rate savings and community benefits.

New implementation strategies, such as the fully outsourced business model promoted by CCP, should be carefully evaluated to ensure that risks and benefits are fully understood. Based on information provided to date, PEA's assessment indicates that the risks associated with such an approach

substantially outweigh prospective benefits. In particular, CCP's approach all but removes the elements of transparency, community involvement and local accountability that are fundamental features of the CCA business model. Further, the municipality would be insufficiently protected from risks associated with non-performance by CCP. In many ways, the fully outsourced business model retains elements of the investor-owned utility business model in which the customer has limited operational insight, limited influence with regard to rate setting and limited access to the individuals who are directly involved in day-to-day utility operations and decision making. Certain benefits are conferred to the customer by CCP, but the benefits are disproportionately shared. Ultimately, many communities will fare far better, minimizing risk while maximizing benefits, under the proven implementation approach that balances the development of internal technical competencies with strategic support from experienced service providers. Such an approach preserves operational flexibility and transparency while promoting long-term success of the CCA enterprise.

Sources

- “Draft Agreement for Community Choice Aggregation Services between the County of Lake and California Clean Power Corporation”
- “Lake County Community Choice Program Feasibility Report”, prepared by California Clean Power Corporation, May 2015
- County of Lake, an Ordinance Authorizing the Implementation of a Community Choice Aggregation Program
- “Overview of Community Choice Aggregation and a Turnkey Contract with California Clean Power”
- Memorandum, “Request for Response to Community Choice Questions,” California Clean Power Corporation to County of Lake