

Memorandum



To: Douglas Baron, LAC Office of the Chief Executive
From: Russell Driver, ARC Alternatives
CC: Andrew Meiman, Curtis Schmitt; ARC Alternatives
Date: September 16, 2016
Re: **Third-Party Review of LACCE Business Plan**

Background

The County of Los Angeles is considering forming a Community Choice Aggregation (CCA) program under which the County would provide energy directly to customers located within the County. In order to better understand the process, risks, and financial implications the County hired EES Consulting to develop a Business Plan for the CCA. The Plan was delivered on June 30, 2016.

The Business Plan contemplates establishing a CCA in three phases beginning with County-owned accounts in Phase 1, expanding to all customers within unincorporated County areas in Phase 2, and finally offering power to all customers within the County in Phase 3 – provided the jurisdictions within which the customers reside opt-in. The Business Plan analyzes the costs and rates of the CCA and compares them to SCE rates over a 20-year period. The Plan also examines several different power mix scenarios, forecasting costs and rates for the CCA if it were to offer power comprised of increasing shares of renewable power. The three scenarios examined are CCA rates with the same share of renewables as SCE (28 percent), CCA rates with 50% green power, and CCA rates with 100% power.

The Business Plan concludes that CCA rates offered under the 28% and 50% renewables mix would be lower than SCE's forecast rates (by 5.4% and 4.1%, respectively). The 100% renewables product would be 6.3% higher than forecast SCE rates. The Plan also notes that in addition to being able to offer lower costs to consumers, the CCA would be able to deliver a higher mix of renewables, create local jobs, and generate a positive environmental impact.

As part of their due-diligence, the Chief Executive Office contracted with ARC Alternatives to perform a high-level review of the technical analysis and financial models included in the Business Plan. We performed this review between September 2 and September 16, 2016. It included a review of the written report, the underlying models (provided in Excel), and a meeting with EES Consulting. This memorandum presents the results of our review.

Findings

ARC Alternatives' review focuses on key assumptions and calculations central to the Business Plan. Our areas of focus include current and future SCE and CCA energy costs and rates, sensitivity analysis of key inputs, and the financial pro forma presented in the report.

SCE and CCA Rates – We compared current SCE rates documented in the report to SCE's rate case filing and found them to be consistent. We also compared the rate at which SCE's tariffs escalate in the EES model to forecasts done by the CEC and CPUC, as well as an independent study performed by Energy and Environmental Economics (E3). The utility escalation in the Business Plan is less than these reference estimates, which is appropriately conservative.

We also reviewed the methodology and calculations used to develop CCA energy costs and rates. We find the methodology to be consistent with other CCA studies and the estimated costs to be reasonable. It should be noted that all forward looking estimates are based on assumptions about wholesale energy market prices (primarily natural gas) and the future cost of renewables. In the case of the LACCE Plan, the renewables pricing relates primarily to solar projects and is based on prices obtained by municipal utilities within California. These solar prices serve as a reasonable benchmark and do not assume dramatic price reductions over time. This assumption is appropriate in our view because the rate of decline in solar costs is slowing from what has been seen over the last five to seven years, while the market for purchasing solar power is expected to remain robust (e.g., sufficient supply).

Sensitivity Analysis – The Business Plan examines the sensitivity of the model to changes in several key assumptions, including the cost of procuring electricity, the amount of electricity used by customers, customer participation rates, and SCE rates and surcharges. The Plan ranks these risks and identifies SCE PCIA charges (the "indifference" adjustment), low customer participation rates, and low SCE power costs as the greatest risks. We find that the low and high scenarios for each factor tested in the sensitivity analysis represents a reasonable range. However, given the strong statement in Summary section of the report, "there is no reasonable set of risk-related circumstances that will result in LACCE's rates being higher than SCE's rates for comparable products," ARC Alternatives suggests EES find the break-even point for each sensitivity factor to explicitly identify the set of circumstances that would result in the CCA being revenue neutral. In particular, more discussion of the PCIA charge, its historical rates and possible mitigation strategies would be warranted given the potential effects on CCA pricing. Additionally, we recommend the sensitivity analysis include the compound effect of the factors analyzed. In other words, scenarios should be examined that include several or all factors together, as there is no guarantee that these factors will change in isolation.

Startup and Staffing Costs – ARC Alternatives is of the opinion that in general, given the potential size of the CCA program to be managed, the staffing model is reasonable. However, there are opportunities for some streamlining, particularly in the areas of administration, HR,

and IT where there are models for using shared resources or contracting for some or all of those functions. We also note that the cost per employee rises as the organization grows. The underlying model shows that more senior and more expensive resources are being added over time and this should be made explicit in the report, as one would expect the average cost per employee to decrease as the organization grows.

Report Inconsistencies – ARC Alternatives noted several inconsistencies within the Plan and we have made these known to EES directly. We do not believe these inconsistencies, once corrected, will change any of the conclusions in the Business Plan.

Conclusion and Next Steps

Given the high level nature of our review and the accelerated schedule for performing it, there are several opportunities for a more robust analysis of the Plan. In particular, additional analysis could be conducted on resource costs and the buildup of CCA rates. While we were able to review the EES model, alternative approaches to the modeling could be developed to further test the results presented in the Business Plan. Additionally, a more detailed review could also verify estimates of GHG reductions (the methodology was not explicit in the Plan). Finally, additional research could identify more comparable reference data thereby providing further assurance that the results are reasonable, while also giving additional basis for refinement. However, based on our review of the underlying models, our conclusion is that the analytical approach is reasonable, that there are no material misrepresentations, and that the overall results reported in the Business Plan have been drawn on sound models and assumptions.