COMMUNITY CHOICE AGGREGATION PROMISES TO ACHIEVE MULTIPLE POLICY OBJECTIVES SIMULTANEOUSLY

According to the EPA, Community choice aggregation (CCA) programs, also known as municipal aggregation, allow local governments to procure power on behalf of their residents, businesses, and municipal accounts from an alternative supplier while still receiving transmission and distribution service from their existing utility provider.

CCAs are an attractive option for communities that want more local control over their electricity sources, more green power than is offered by the default utility, and/or lower electricity prices. By aggregating demand, communities gain leverage to negotiate better rates with competitive suppliers and choose greener power sources.

In doing so, CCAs are a practical intermediate form between no retail choice, the historical norm in California (CA), and the theoretical ideal of full retail competition. This level of aggregation enables CCAs to participate in wholesale markets, while the customer still gets a retail choice between the CCA and the existing utility in the area. Beyond California, CCAs are becoming popular in many other states in the United States, including Massachusetts, Ohio, Illinois, New Jersey, New York, and Rhode Island.

While CCAs are an innovation on the energy procurement side with a primary focus on cost reduction, they also allow for aggressive decarbonization of the participating communities across key segments that need to be focused on as part of respective climate goals. These segments include electricity, transportation, and buildings. The basic idea is to first decarbonize electricity completely and then electrify the rest. Many CCAs, such as Silicon Valley Clean Energy, are already very active in these segments.
However, CCAs come with their own set of issues for policymakers, including maintaining grid and supply reliability in the presence of increased penetration of variable and intermittent renewables, ensuring that the wires (T&D) businesses stay profitable and that customers staying with utilities are not unfairly penalized, ensuring that regulatory transaction costs stay under control, etc. While all of these need to be resolved in due course, we focus here on a specific issue – of credit risk!

One on the main issues with CCAs is of credit ratings, which are related to the financial stability of a business. Either the CCAs do not have credit ratings at all given that they are relatively new businesses, or their credit ratings are not investment grade (i.e., credit worthy) given that they do not yet have strong balance sheets. For example, even getting credit ratings requires at least three years of financial statements, and very few CCAs have received credit ratings so far.

This issue of credit ratings raises two related sub-issues for the CCAs. One, it makes it harder for CCAs to raise debt, which is typically a cheaper form of capital than equity. Getting access to debt would allow CCAs to reduce their weighted average cost of capital, leading to lower financing costs and hence lower overall costs, eventually making them more competitive in the marketplace. In the absence of access to debt, the opposite would happen (i.e., CCAs would struggle to become more cost competitive).

Two, given the issue of so-called off-taker risk, it makes it harder for CCAs to procure energy from power producers under long-term contracts. Simply put, the off-taker risk means that the creditors (e.g., banks) to the renewable energy projects supplying power to CCAs do not feel comfortable lending to the projects given the perceived uncertainty around reliable payments—given no or low credit ratings—from the CCAs. This, in turn, makes the projects themselves hesitant to sign long-term power purchase agreements with CCAs, exposing CCAs to the price volatility of power markets and making it harder for them to minimize costs and stay competitive in the marketplace.

Multiple solutions exist to address barriers to scaling of community choice aggregation

Many different solutions have been suggested for solving this issue of credit ratings. One solution suggested by CCAs themselves is that these CCAs could be provided revenue certainty, and hence greater financial stability, by giving them monopoly status. That is, the idea would be to take away the option for the customer to opt-out from CCA procurement. However, this goes against the principle of retail competition, a rationale for supporting CCAs in the first place.

Alternatively, there has been a proposal that a new state level intermediate procurement entity, backed by the State, be created to procure all the power on the behalf of the CCAs. However, this would require not only the creation and governance of another entity, but also the provision of state-level guarantees to renewable energy projects selling power to this entity. Further, this entity would still need to worry about selling power to the CCAs with their perceived credit issues. So, the off-taker risk issue still lingers on.
CREDIT GUARANTEES PROVIDE AN ATTRACTIVE NEAR-TERM SOLUTION FOR SCALLING
COMMUNITY CHOICE AGGREGATION

In this context, a particularly attractive near-term solution would be to keep the current market structure and to create a public-funded contingent facility that would guarantee against payment and credit defaults from CCAs to ensure that the underlying financial transactions are perceived as investment-worthy. (An unfunded contingent facility is also possible. However, the design parameters would remain similar). The guarantees would be full ones until CCAs obtain credit ratings and would convert to partial guarantees afterwards with the credit enhancements depending on the actual and target credit ratings.

This facility would be similar to facilities used in many other jurisdictions and applications, including for municipalities as well as residential mortgages. The facility could be funded directly from state funds, especially from the state revenues from the carbon market; and run either independently or by an entity already tasked to catalyze green investments, such as the Green Bank. In California, the treasurer’s office would be the appropriate entity since it already serves as the Green Bank.

This facility, however, would need to be designed appropriately to ensure it achieves various objectives. These design parameters would include, among other aspects, appropriate sizing of the facility, addressing the issue of moral hazard so that guarantees are not gamed, and ensuring that the facility has a sunset clause as the CCA segment matures. A well-designed credit guarantee facility will ensure CCAs get the required support, and scale to their full potential in California.

ABOUT THE AUTHOR

Gireesh Shrimali is a Precourt Scholar at the Sustainable Finance Initiative (SFI) at Stanford University. His research focuses on the intersection of policy and finance: in climate in general and energy in particular. At SFI, he is examining the relationship between climate and financial risks, and how effective polices can be designed to address financial risks being brought about due to the changing climate. The promising topic of community choice aggregation has brought his attention to scaling CCAs.