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The Clean-Tech/Regulatory Nexus
By Arthur O'Donnell, The Energy Overseer

Today, we are experiencing an influx of new ideas for energy services that combine emerging technologies with information systems and a drive to displace traditional industrial modes – call it Clean-Tech/Green-Tech.

Unfortunately, these entrepreneurs and their venture capital funders too often fail to realize how regulation defines and proscribes their potential markets.

When they think about regulation, it is generally financial regulation by the Securities and Exchange Commission, which will oversee their hoped-for initial public offerings of tradable stocks. Or, perhaps they might have to register with the Commodity Futures Trading Commission, if they contemplate establishing an exchange platform for carbon offsets or renewable energy futures. Build almost anything that involves manufacturing and the Environmental Protection Agency or local air-quality permitting agencies are involved.

They neglect that fact that energy markets are mediated markets, largely controlled by utilities and overseen by energy and utility regulatory commissions.

Non-utility power generators, of course, learned this lesson over two decades of fighting with utilities for legitimacy, site licenses, power sales contracts, and transmission access. Even today, energy payments are driven more by regulated pricing benchmarks than by competitive bidding. Energy Service Providers must register and meet financial security requirements and, even under the reopened direct-access regime in California, find their ability to sign up customers carefully titrated by concerned regulators.

The new classes of energy companies – Demand Response Providers (DRPs), Smart Meter makers, electric vehicle chargers, battery and storage services, and others – face the real prospect of having their business models undermined if they do not take traditional regulation into account. Even prospective makers of biofuels must realize that their market prospects will be determined by the state and federal regulatory agencies that are charged with enacting policy to address climate change, via certification standards, available subsidies and competing special interests.

In recent years, the most popular technologies for venture capital investments included energy efficiency, smart-grid, electric vehicles and fuel-cell companies. Each of these niche services faces energy regulatory risk.

Currently, we are seeing the parameters of this new regulatory nexus being defined at the California Public Utilities Commission, although there may soon be court involvement.

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At a recent Clean-Tech forum in Los Angeles, Jeanne Clinton, Climate Strategies Program Manager for the CPUC asserted that the agency wants to send a “clear message” about its support for the new energy industry as it delivers policies to avert climate change.

“[W]e want to see investments in new technologies, we want to see new solutions, new approaches and innovation,” Clinton told attendees at the VERDExchange 2011 conference on January 24.

What that really means is that emerging Clean-Tech companies trying to address climate change need to understand how CPUC actions will directly affect their business plans. While regulatory policies promise to open new opportunities for entrepreneurs, they also threaten to limit what those opportunities are, who will be able to participate, and the structure of the marketplace.

How regulated utilities implement such climate-change related policies as renewable portfolio standards or California’s cap-and-trade program, will determine “what products or services you can bring,” she said.

The question for this new industry is: Exactly how deeply will regulators control these markets? And will that involve direct regulation of new market players?

For certain sectors of the business, the parameters of regulation are clearly defined. Essentially, if you sell electrons, meters or direct energy services to regulated utilities, you know that your market, your contracts and possibly the prices you charge are subject to regulatory control, or at least a reasonableness review. And if you compete with the utilities for customers, you had better be active in every commission proceeding that defines our system of regulated competition.

However, some companies are discovering that even if they do not directly sell to utilities, their market opportunities could well be subject to regulatory oversight.

Currently, the lines of such regulation are beginning to be drawn around a new class of entrepreneurs that manage customer energy use with the intent of minimizing peak period costs while aggregating load reductions to bid into new demand markets operated by the CAISO.

In a little noticed order last June *[D10-060-002]*, the CPUC asserted its regulatory authority over these Demand Response Providers (DRPs). The order directed participation in the new CAISO program by utilities on a pilot program basis, and it allowed bidding by energy service providers. But it barred DRPs from bidding on behalf of utility bundled customers.

Three companies involved in this market, EnerNOC, EnergyConnect and CPower, challenged the CPUC ruling on the basis that such limits were not called for under law, not justified in terms of regulatory authority. The joint parties in the complaint asserted that the commission violated their due process rights by “imposing impermissibly vague regulations” and generally treating them as if they were regulated utilities.

When the CPUC finally got around to dismissing the rehearing request as a last order of business at its December 16 meeting, regulators took pains to explain their rationale. “It was never our intent to assert the Commission’s general regulatory authority over DRPs as if they were public utilities,” regulators wrote *[D10-12-060].* However, the broad jurisdiction over energy consumer protection and its policies requiring demand reduction provide ample authority, the CPUC held.

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DRPs are similar to ESPs in that they operate in regulated markets to provide a particular type of energy service to utility customers. In addition, load-reduction "may directly impact energy procurement planning and decisions" made by the utilities and the grid operator and, according to the CPUC, "could affect the safety and reliability" of commission-regulated services.

In clarifying this jurisdiction, the CPUC somewhat modified the impact of its previous order, but still limited DRP business until it decides whether specific consumer protections are warranted. "We expect that regulation would be limited to possible registration and/or consumer protections of IOU residential and small commercial retail customers that receive DR services from DRPs."

If you are in the business of analyzing prospects for Clean-Tech companies, those words translate to "Regulatory Uncertainty" which is a major red flag for investors.

Because as reasonable as the commission's position sounds, it has opened the door to proposals for extensive regulation of DRPs. Pacific Gas & Electric, for example, advocates requirements "to ensure that DRPs are legitimate entities that have the intent and capability to provide demand response, and have reasonable financial capability."

The utility recommended mandates would include registration with the CPUC, signing of direct service agreements with each of the IOUs before being able to market their services to retail customers, publishing the names and credentials of technical and operational personnel, and posting of "appropriate collateral" to support its services.

Additionally, PG&E argues, there should be a formal consumer complaint process governing DRP customer interactions and enact an analogous set of regulations to the existing Rule 22 requirements governing all load-serving entities. In case after case, regulators have begun to hold LSE's to the same standards and requirements as they impose on utilities.

Seeing this all as a fast track to full regulation, the DRPs have taken their case to the state Appellate Court, where they are asking a judge to overturn the underlying CPUC order *[EnerNOC v. CPUC; First Appellate Division; No. A130913].*

Clearly, this case has serious implications for the emerging Clean-Tech industry, and it is not difficult to imagine a similar regulatory assertion covering any company that potentially stands in-between utilities and revenues. Electric vehicle charging stations, companies that hope to interface with retail customers via the Smart Grid, possibly even sellers of battery storage systems, fuel cells and residential solar installations.

This is a case to watch.

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