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## Marin Clean Energy, California; Retail Electric

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# Marin Clean Energy, California; Retail Electric

## Credit Profile

ICR

*Long Term Rating*

A/Stable

New

## Rating Action

S&P Global Ratings assigned its 'A' issuer credit rating (ICR) to Marin Clean Energy (MCE), Calif. The outlook is stable.

### Credit overview

MCE is a joint powers authority (JPA) originally formed in 2010 to procure retail electric commodity on behalf of about 490,000 accounts serving over 1,000,000 people across 36 member communities across four San Francisco Bay Area counties.

Although MCE operates as a JPA with many member communities, it simultaneously provides direct retail service to all of its customers (albeit through the billing systems and physical assets of the incumbent investor-owned utility [IOU]). Given this direct retail service, S&P Global Ratings views MCE's creditworthiness under the scope of our retail electric criteria.

MCE provides service as a community choice aggregator (CCA) under the California Public Utilities Code, section 366.2. Under the code, all of the incumbent IOUs' customers automatically become MCE customers, but have the option to opt out and return service to the previous provider, Pacific Gas and Electric Co. (PG&E; BB-/Negative/--). Importantly, MCE does not own, operate, or maintain any of the generation, transmission, or distribution infrastructure used to serve its customers, which we believe distances it from wildfire liability under California's inverse condemnation laws. However, management must procure electricity supply and balance the obligation to enter into contracts for long-term power supply volumes and a potentially fluid customer base that could migrate during the tenure of the CCA's commitments to purchase power. Management anticipates adding 56,000 accounts in 2021 with the addition of new members Pleasant Hill and Vallejo, with another 50,000 accounts in 2022 with the addition of Fairfield, CA. MCE also reported that several other Bay Area cities could join in the future, including Antioch, Dixon, and Vacaville.

MCE was formed to provide clean and renewable power to its members at a competitive cost, while also generally reducing greenhouse gas emissions and stimulating the local economy. The CCA has the rights and powers to set rates for the services it provides, incur indebtedness, and issue bonds or other obligations. MCE has no debt outstanding, nor does it plan to issue any debt in the near term; however, management has indicated the CCA would explore the idea if the additional debt and associated assets were economical and fit within its risk management plan's tolerances. We would likely revise our assessment of MCE's leverage and overall risk portfolio should it issue debt and/or acquire direct or indirect ownership of capital assets.

The rating reflects our opinion of MCE's adequate enterprise risk profile and strong financial risk profile.

The enterprise risk profile reflects our view of the CCA's:

- Deep and diverse customer base. MCE derives more than 56% of its revenues from residential customers, which, in our view, enhances revenue stability. Furthermore, the Community Choice Aggregator (CCA)'s almost 490,000 customers provide economies of scale. Finally, MCE benefits from robust incomes within its service territory, with the top 20 members exhibiting median household effective buying incomes of 135% of the national average, on a weighted-average basis;
- Significant historical member growth, coupled with additional customer growth of more than 100,000 over the next two years, as three member communities are added;
- Protective JPA member agreements with municipalities, compared with retail customers who retain the right to depart the CCA. A municipal or county member can depart the MCE with six months' notice; however, the JPA contracts stipulate that a departing member must make the CCA whole for any power purchase agreements (PPAs) signed prior to its departure. (Ratepayers are not subject to this clause, lowering the barrier for individual customers switching providers.) Although this remains untested in court, each member agreed to this stipulation before joining the CCA, and we believe the exit penalty serves as a disincentive to member communities to terminate their contracts with MCE;
- Diverse power supply and relatively low cost of power;
- Credit-supportive policies and procedures, including fundamentally robust JPA contracts, a comprehensive risk management program highlighted by a balanced approach to power supply management and contract procurement, with conservative hedging practices, coupled with robust long-term financial forecasting;
- Limited exposure to wildfires through California's strict liability standard and inverse condemnation due to the absence of ownership of transmission and distribution assets. However, if MCE were to acquire full or partial ownership in transmission, distribution, and/or generation assets, we would likely worsen our assessment of this risk; and
- Core mandate to provide renewable power, which positions MCE well for California's renewable portfolio standard (RPS), as well as potential future federal regulations.

Offsetting factors include:

- Direct retail competition with the incumbent IOU, Pacific Gas and Electric Co. (PG&E), which constrains MCE's rate-setting flexibility. Unlike rated peers, MCE does not maintain a core mandate to maintain all-in costs (MCE rates plus the power charge indifference adjustment (PCIA) levied by PG&E) below that of PG&E, which does afford it a relatively higher degree of flexibility. However, current all-in costs (as defined above) are 8%-10% above those of PG&E, which we believe increases competitive pressures. Although neither historical rate increases nor competitive position relative to PG&E have strongly correlated with opt-out rates, management believes rate-raising flexibility is currently somewhat constrained, given its current competitive position. Similarly, we believe retail customers' price elasticity is not limitless, and that the more ratepayers' bills are elevated relative to PG&E, the more likely MCE could face higher customer opt-out trends.
- The risk associated with MCE's limited rate-setting flexibility and elevated all-in costs is compounded by the uncertainty surrounding the power charge indifference adjustment (PCIA), which could further pressure competitiveness. MCE's current opt-out rates are elevated relative to those of rated peers, at a cumulative 13.7%. As the first CCA in California, MCE experienced significant opt-outs during the first several years of operation, which management attributes to an aggressive marketing campaign by PG&E, resulting in a cumulative opt out rate of

about 20%. Since 2012, MCE's opt-outs have been much lower, averaging about 10% for newly added communities, which has continued to bring down the CCA's overall opt-out rate. Management reported that many opt-outs, are attributable to seasonal patterns or following the enrollment of a new member community. Importantly, opt-out rates have not been strongly correlated to periods of higher all-in rates, relative to PG&E. We believe this demonstrates a level of customer resiliency against the backdrop of MCE's rate history. Management does not expect material deviations in future opt-out trends, which we view as reasonable given the historical stability of total customer counts, seasonal and growth-related fluctuations notwithstanding.

- MCE faces power-procurement constraints, as the utility must balance its obligation to enter into long-term contracts with a potentially volatile load profile (and must balance its renewable mandates with the need for reliable baseload energy), and the risk of members exiting the CCA. This risk is somewhat tempered, in our view, by MCE's robust risk-management policy and integrated resource planning.

MCE's very strong financial risk profile is highlighted by robust financial performance, including historical fixed cost and imputed charge coverage (FCC) around 1.3x on a historical and projected basis. FCC is S&P Global Ratings' internal calculation of a utility's obligation to meet its fixed obligations on an ongoing basis. We have imputed a portion of MCE's purchased power expenses as debt-like under this calculation. The profile also reflects the CCA's very strong liquidity, with almost 200 days' cash, or \$184 million, as of March 31, 2020. Although distribution-only utilities generally require less cash on hand, relative to vertically integrated utilities, we believe MCE's risks associated with its core business model (specifically, the potential for customer exodus, rate-setting constraints, and associated power-management pressures) necessitate an enhanced level of reserves.

The stable outlook reflects our expectation that MCE will maintain rates toward achieving financial performance commensurate with historical results, and that it will not experience material load disruption as a result.

### **Environmental, social, and governance (ESG) factors**

We believe the CCA's direct environmental risks are low, based on its predominantly carbon-free resource portfolio. However, as a practical matter, the intermittency of renewable resources might frustrate the CCA from achieving those goals in the absence of storage technology breakthroughs. The CCA faces social risk related to COVID-19, as efforts to protect the health and safety of the community could affect the utility's financial metrics if customers continue to be unable to pay utility bills in a timely fashion, although no such pressures have materialized to date. Finally, we view the utility's governance factors as credit-supportive, as they include robust JPA member agreements, full rate-setting autonomy, comprehensive policies and planning, and a sophisticated and conservative management team. However, the potential for retail customer opt-out tempers our view of the CCA's governance factors somewhat.

## **Stable Outlook**

### **Downside scenario**

We could lower the rating if customers continue to struggle to make timely bill payments in light of current economic pressures. If increases in the PCIA materially pressure MCE's rate competitiveness, which, in turn, spurs significant retail customer opt-out or the loss of one or more of its member communities, the utility could be forced to sell surplus contracted power to the market. In the event market prices fall significantly below those of MCE's portfolio, the utility could face significant financial pressure, which, in turn, could lead us to lower the rating.

## **Upside scenario**

We do not expect to raise the rating in the next two years, given the inherent risks posed by the direct competition for MCE's entire retail customer base, above-average electric rates, and financial projections that indicate a largely stable financial profile. However, if MCE can establish and maintain competitive rates while preserving financial metrics, we could raise the rating.

## **Credit Opinion**

MCE's 490,000 customers provide revenue diversity and economies of scale, and management expects to continue adding members over the next several years. The 20 largest member cities' median household effective buying incomes were 135% of the U.S. average in 2019, on a weighted-average basis. No single retail customer accounted for more than 3.5% of operating revenues in 2020, providing further revenue stability.

## **Market position**

CCA's customers are obligated to directly reimburse the incumbent IOU in the form of an exit fee, or PCIA. The PCIA was established to ensure the IOU's remaining bundled customers do not disproportionately shoulder above-market generation costs that had been procured for the departing customers. According to the California Public Utilities Commission (CPUC), the PCIA is calculated by taking the difference between the actual portfolio cost and the market value of the IOU's portfolio, as calculated using CPUC methodology. The total magnitude and method of capture are still being refined by the CPUC. Currently, the PCIA is limited to 0.5 cent/kilowatt annual increases, although a Power Charge Indifference Adjustment Undercollection Balancing Account (PUBA) was also added to capture potential undercollection caused by this cap. If this account balance reaches 7% of forecast unbundled customer PCIA revenues and reaches 10% by year-end, the incumbent IOU must file a request to over-collect on the PCIA. Continued increases in the PCIA could further erode MCE's competitive position relative to PG&E, further constraining rate-setting flexibility in our view. This could be exacerbated by any changes to the underlying formula.

## **Power portfolio**

MCE's power portfolio is diverse, in our view, with over 350 power purchase and resource adequacy contracts in place. Similarly, the CCA's fuel mix is diversified among a number of clean and renewable resources. MCE projects its 2021 fuel mix will consist of 36% large hydro resources, 24% solar, 16% wind, 8% other renewables, 6% geothermal, 4% each of small hydro and biomass, and 2% of CAISO System purchases. Under state mandate, MCE must secure 65% of its RPS-compliant power supply under 10-year or longer contracts (with the balance served by a mix of short, intermediate, and longer-term contracts at MCE's discretion.) While we generally view positively the long-term price certainty these contracts provide, the possibility of customer dislocation, coupled with this mandate, could result in MCE holding a great deal of surplus power. While MCE could sell its excess energy position into the wholesale market, in a scenario where one or more larger members departed or there is a retail customer base dislocation and contract prices exceed market prices for an extended period of time, MCE could face significant financial pressure. As previously mentioned, each member has agreed to make the CCA whole following its departure, mitigating this risk at the wholesale level, but not at the retail level. MCE layers its PPAs to temper the exposure of retail or wholesale customer departures.

## **Related Research**

- [Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020](#)

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