



FITCH WIRE

Community Choice Aggregator Risks Highlighted by Bankruptcy

Wed 02 Jun, 2021 - 12:14 PM ET

Fitch Ratings-San Francisco/New York/Austin-02 June 2021: The bankruptcy of Western Community Energy (WCE) highlights some of the credit weaknesses inherent in the Community Choice Aggregator (CCA) business model, Fitch Ratings says. WCE, which is not rated by Fitch, experienced pressures related to power supply planning, serving a noncaptive customer base and accessing capital, which provide evidence of the hurdles for CCAs in obtaining and maintaining investment-grade ratings.

Community choice aggregation programs allow local governments to procure power on behalf of their consumers from an alternative supplier, while still receiving transmission and distribution service from their local utility. CCAs are often created by communities seeking more local control over electricity sources, including those seeking more renewable power. California passed legislation enabling the formation of CCAs in 2002. Today, 24 CCAs operate within the state, including WCE, which was formed to provide electric supply to six cities in Riverside County, CA with an aggregate 114,000 customers.

WCE's May 24, 2021 bankruptcy filing, only one year after commencing service, highlights the challenges CCAs face in procuring market-based energy supply to serve the variable needs of their customer base. CCAs typically do not own physical generating assets and instead rely on contracts and market purchases for power supply. Inadequate risk management, unexpected spikes in demand and compliance with state mandates, including California Senate Bill 350 requiring 65% of renewable energy to be procured under contracts 10-years or longer, can all hinder a CCA's ability to manage costs and provide competitively priced power supply. Many of these factors appear to have contributed to higher than anticipated power needs and energy costs at WCE.

CCAs have the independent ability to adjust rates to recover costs, but maintaining competitive rates is of paramount importance given their competitive business model. While retail customers who elect to join a CCA are automatically switched to service provided by the CCA, customers retain the right to opt out of service for any reason. Fitch believes this dynamic combined with a desire to avoid rate shocks provides a practical limitation on rate setting. WCE adjusted rates earlier this year, but cash flow proved insufficient to meet scheduled payments.

Limited operating reserves and access to capital pose additional risk to CCAs. Most CCAs, including WCE, have no long-term debt, but working capital requirements in support of energy procurement and hedging activities can be significant. CCAs desiring to maintain fixed rates at levels below the regional utility can face even greater liquidity pressures.

Without the benefit of cash reserves built up over years of operation, WCE was unable to buffer the impact of increased pressure on cash flow resulting from both high power costs and rising delinquencies attributable to the coronavirus pandemic, economic hardships and an inability to disconnect customers for nonpayment. CCAs do not benefit from broad access to bank facilities and capital markets like most municipally owned electric utilities.

Two CCAs publicly rated by Fitch maintain investment-grade ratings, Marin Clean Energy (BBB+/Stable) and Peninsula Clean Energy (BBB+/Stable). Both CCAs have demonstrated successful risk management and benefited from additional headroom in rate setting when compared with the local utility, which has provided them time to build sizable cash reserves to manage variations in cash flow.

Most importantly, Marin and Peninsula have adopted financial policies to maintain robust liquidity, including requirements to keep cash reserves of at least 180 days on hand. Both issuers also have multiple years of operating history, versatile portfolios of power supply contracts, and offer competitively priced power supply. The credit quality of other CCAs evaluated by Fitch varies widely, and are unlikely to achieve investment-grade ratings absent these operational and financial distinctions.

Contact:

Jeb Spengler
Director, US Public Finance
+1 415 732-5615
Fitch Ratings, Inc.
One Post Street, Suite 900
San Francisco, CA 94104

Kathryn Masterson
Senior Director, US Public Finance
+1 512 215-3730
Fitch, Inc.
2600 Via Fortuna, Suite 330
Austin, TX 78746

Dennis Pidherny
Managing Director, US Public Finance
+1 212 908-0738
Fitch Ratings, Inc.
300 W. 57th Street
New York, NY 10019

Sarah Repucci
Senior Director, Fitch Wire
+1 212 908-0726