VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 17

TO: Board of Directors

FROM: Mitch Sears, Interim General Manager
Edward Burnham, Director of Finance & Internal Operations

SUBJECT: Customer Rate Structure Policy

DATE: September 9, 2021

RECOMMENDTION
Direct staff to continue to analyze and bring back customer rate structure policy changes for implementation in early 2022.

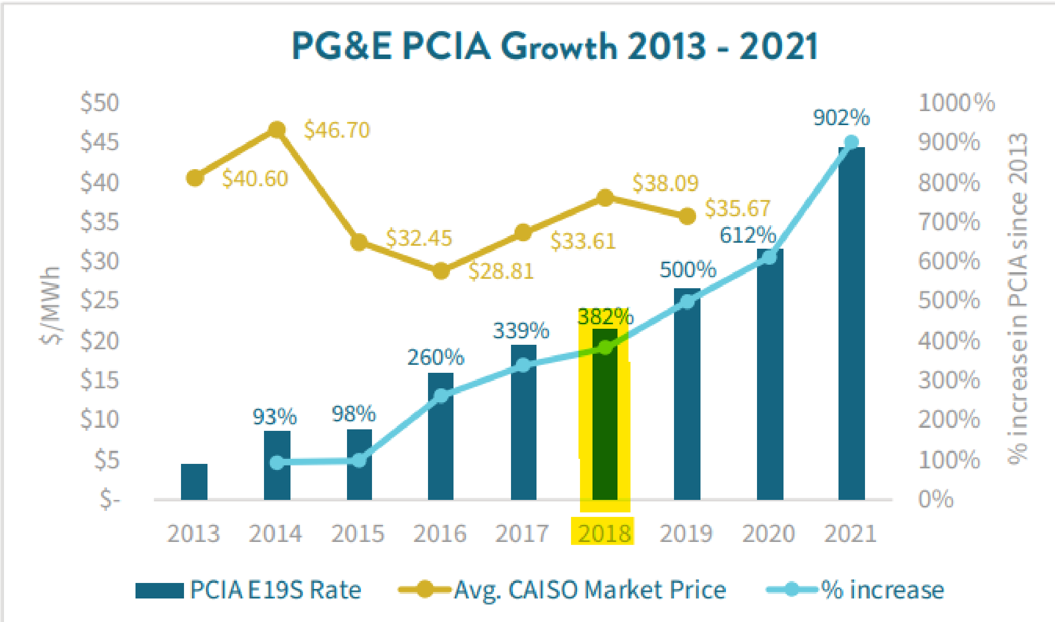
OVERVIEW
Customer rate structure policy options were originally introduced to the Board in June 2020 during the Fiscal Year 2020/21 budget adoption process as a key tool to address on-going fiscal challenges. This report provides additional detail on an expanded and cost-recovery based customer rate structure policy option and seeks guidance on continued analysis and potential implementation timeline.

BACKGROUND
The Board adopted the VCE Strategic Plan in November 2020. The Plan identifies six interrelated goals to guide VCE's activities over the next three-years. The goal set includes Goal 1: Maintain and grow a strong financial foundation and manage costs to achieve long-term organizational health. In addition, Plan objective 1.4 calls for VCE to: Manage customer rates to optimize VCE's financial health while maintaining rate competitiveness with PG&E. These policy statements form the foundation for the work related to examination of VCE's customer rate structure.

Primary Factors
As analyzed and reported to the Board since mid-2018 and as recently as June, changes by the CPUC to the Power Charge Indifference Adjustment (PCIA) and Resource Adequacy (RA) mandates have created volatility and uncertainty for CCA programs across the State. These are the primary factors driving the need to consider a revision to VCE's customer rate structure.

Though VCE and the CCA Trade Association CalCCA are deeply engaged in advancing solutions/fixes to PCIA and RA market issues, inadequate transparency related to such large and largely unforecastable swings in the PCIA and RA market design means that CCA's must be more defensive in their financial posture going forward. This is true for VCE as well as other CCA's particularly in PG&E's service territory. To provide context to these financial impacts, Table 1 below shows that the PCIA has increased almost 5X since VCE launched service to customers in mid-2018. Additionally, RA has increased 2X in that same time-period.

Table 1 – PCIA Growth 2013-2021 (VCE Launch 2018)



Source: San Jose Clean Energy, Feb 2021

These factors, coupled with increased forward power market prices due to real and perceived challenges associated with a transition to a greater renewable portfolio for the State, have resulted in significant financial strains on VCE. Actions VCE has taken over the past three years to mitigate these impacts are summarized in the Discussion section below

<u>Additional Factors</u>

In addition to the primary factors summarized above, other factors also contribute to staff's recommendation to explore customer rate options. While these additional factors are not primary drivers, they are considerations in staff's analysis:

- WCE Bankruptcy. The recent bankruptcy of the Western Community Energy CCA in Southern California has prompted increased scrutiny of the basic CCA finance model by regulators and the financial sector. Based on available information, the overall financial health of the CCA sector is strong but the WCE bankruptcy has reinforced prudent financial planning including examination/implementation of customer rate revisions/options by a majority of CCA's. As a result of the bankruptcy, staff anticipates that the CCA industry will see increased self and/or outside establishment of new standards of practice, including the possibility of basic policies related to long-term balanced budgeting.
- Business Transactions. Reserves provide VCE with a tool to mitigate unforeseen fiscal impacts, allowing the organization to temporarily absorb higher costs/lower revenues without undue impacts to customers or core business activities. Reserves also provide VCE's fiscal partners and power counterparties with a measurable financial buffer to power market price movement and regulatory rulings (e.g. PCIA), that are outside VCE's direct control. Reserve levels are one proxy used by VCE's fiscal partners and counterparties to set interest rates and financial performance metrics which can impact

interest rates and prices paid on long-term power purchase agreements. Strong reserves enable more favorable business terms for VCE.

- Implementation of Programs. Reserves also enhance the ability to execute local programs and provide match funding to attract outside funding from public and private sources.

DISCUSSION

In response to the challenges and related factors summarized above, over the past three years VCE has systematically analyzed policy options and implemented strategies to reduce cost and manage reserves. This is in keeping with its Strategic Plan goal to maintain financial stability while continuing to offer competitive pricing and establishing local programs. Several of these key strategies implemented by VCE over the past three years to address financial pressures include:

- Customer Rates (Fall 2018). At launch VCE offered a 2.5% discount to PG&E's generation rate. The discount was discontinued due to the CPUC's decision in Fall of 2018 to increase the PCIA by ~100%. In response, VCE adopted a policy to match PG&E's generation rates on its default product and offer a customer dividend in years it exceeded its financial and reserve targets.
- Renewable portfolio content (Summer 2020): VCE has scaled back its voluntary procurement of renewable energy credits (RECs) since mid-2020 as it transitions to more cost effective, stable long-term renewable and renewable plus battery storage contracts that will begin energy deliveries in Fall 2021. This strategy has continued into 2021 and will avoid approximately $3.8M in procurement costs over the past and current fiscal years.
- Long-term Power Purchase Agreements (PPAs) (Fall 2019). As noted in the June 2021 budget adoption Board staff report, since 2019 VCE has moved systematically toward long-term PPA's for renewable power and energy storage. This reduces and stabilizes power costs by moving away from the short-term renewable credit (REC) and resource adequacy markets while increasing the overall renewable content of VCE's portfolio. When fully delivering in 2023, these PPA's will result in just over $4M per year in power cost savings.
- Joint Procurement (Spring 2019). VCE partnered with another CCA (Redwood Coast Energy Authority), in a joint procurement of a battery storage project achieving lower energy storage and transaction costs.
- Cost containment (Summer 2018). VCE has never drawn on its Line of Credit and has maintained an overhead of less than 10% since launch.
- Pre-payment of debt (Fall 2019). VCE paid back its member jurisdiction seed loans early, avoiding thousands of dollars in interest.

The remaining major fiscal policy option available to VCE is its most potent: the ability to design and set customer rates to achieve policy objectives.

<u>Customer Rate Options</u>

Recognizing that steps may be needed in addition to those listed above, in early 2020 staff began investigating rate related strategies employed by other CCA's designed to address on-going financial pressures outside of a CCA's control (e.g. PCIA, RA). As previewed in the Fiscal Year 2020/21 budget analysis (May 2020), staff outlined a possible customer rate structure employed by other CCA's to increase choice while helping stabilize finances. The following is an excerpt from the May 14, 2020 Board staff report on policy options:

> ***Rate Changes*** *– Potential Options:*
> *1.b Add a third choice for customer rates that could be set near the minimum State standards for renewable energy content. This would allow customers the option to choose a more cost-effective rate (perhaps set at PG&E's generation rate), while maintaining VCE's other two current rate options that deliver higher renewable and GHG free attributes at a "cost plus" rate. This approach has been employed by Clean Power Alliance (LA/Ventura CCA).*

On June 11, 2020, as part of the adoption of the FY 2020/21 Budget, the Board approved the following recommendation:

> *Direct Staff and the Community Advisory Committee to study additional customer rate choices for future Board consideration.*

The CAC appointed a Task Group in Fall 2020 to work with staff to analyze options. Staff began research of other rate approaches by other CCA's but made less progress than desired during Fall 2020/Winter 2021 due to competing priorities (e.g. Strategic Plan development/adoption). Focused work with the CAC Task Group began this Spring with collection of information from other CCA's who had implemented expanded and cost-recovery based customer rate structures. Five CCA programs in PG&E's service territory have adopted expanded and/or cost-recovery based customer rate structures. This survey of these CCA programs is shown in Table 2 below.

Table 2 – CCA Survey – as of 8/21

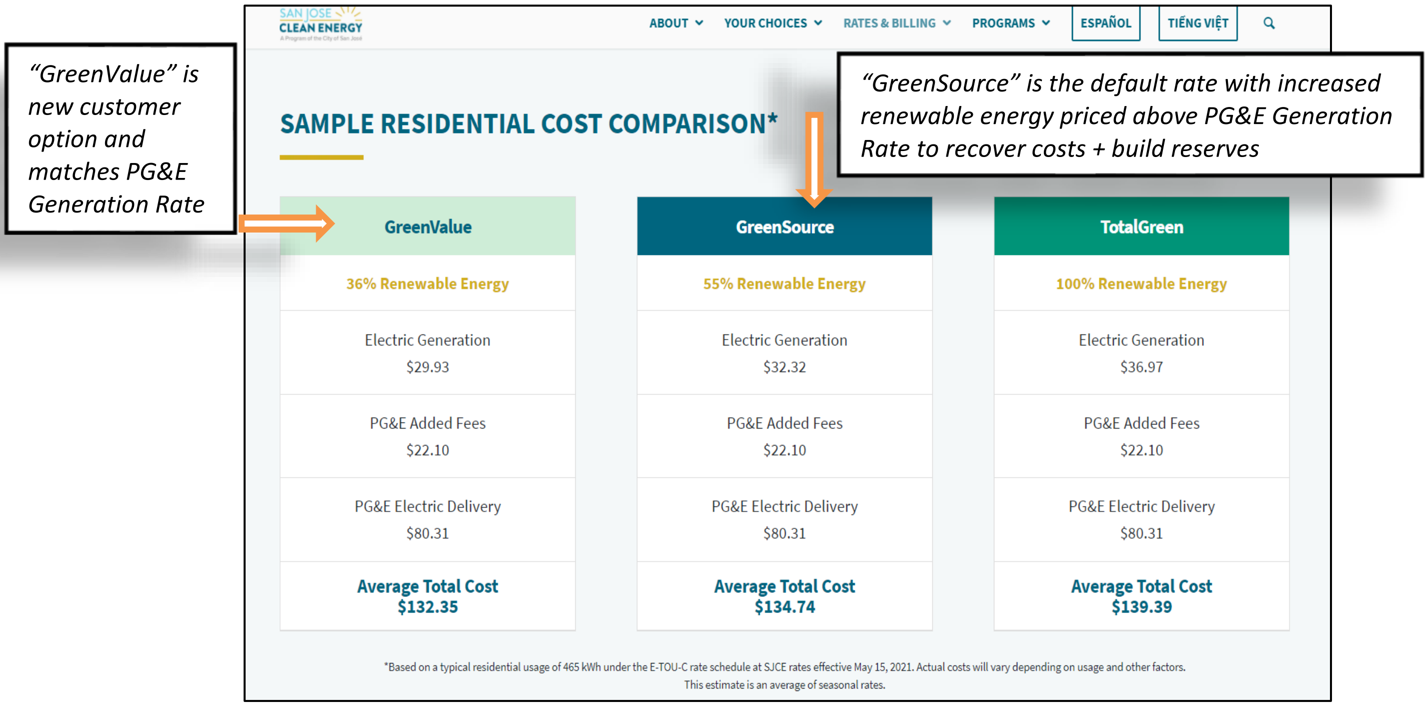
CCA	IOU Territory	Customer Accounts	% Difference to IOU Gen Rate (default product)	Renewable Content Target (default product)
Valley Clean Energy	**PG&E**	**63,509**	**0% (match)**	**42%**
Clean Power SF	PG&E	311,777	+2%	50%
East Bay Community Energy	PG&E	546,707	0%	60%
MCE Clean Energy	PG&E	473,826	+7%	60%
Peninsula Clean Energy	PG&E	287,987	-3%	50%
Pioneer Community Energy	PG&E	87,704	+6%	33%
San Jose Clean Energy	PG&E	350,000	+8%	55%
Silicon Valley Clean Energy	PG&E	225,973	0%	42%
Sonoma Clean Power	PG&E	243,436	+5%	50%
Clean Power Alliance (Los Angeles area)	SCE	1,000,000	+8%	50%
Desert Clean Energy	SCE	37,375	+20%	100%

Notes:
(1) The above information is based on best recently publicly available information and subject to change per IOU and/or CCA rate activities and PCIA adjustments.
(2) VCE current year target renewable content rate is 20% due to cost cutting strategies.
(3) Due to the PCIA structure each CCA has a specific "vintage" date based on what year they launched service and how they phased in their customer base. Therefore, each CCA has

unique financial characteristics that contribute to how they set rates and cost recovery approaches.

<u>Example Rate Structure</u>

In March 2021 San Jose Clean energy adopted an expanded and cost-recovery based customer rate structure. This included an additional "least cost" option that matches PG&E generation rates and higher generation rates as noted in Table 2 above for their default and 100% renewable "opt-up" options. The following is the rate structure adopted by San Jose Clean Energy:



Based on staff research and communications with their staff, CCA programs with additional customer rate options and/or cost-recovery based rates have not seen significant "opt-out" or "opt down" activity in either the residential or commercial/industrial sectors. This includes large and moderate sized CCA's, some having years of experience with rates above their respective investor-owned utilities. Importantly, this also includes information gathered from CCA's in various parts of the State: Southern California, Northern California, inland and coastal.

Staff recognizes that VCE's service territory is not a carbon copy of other CCAs and that if a similar customer rate structure is implemented here results may be different. In order to understand the potential impacts of different outcomes staff has engaged SMUD and VCE's long-time consultant Don Dame to conduct sensitivity analysis of various levels of "opt-out"/"opt-down" scenarios. If direction is given by the Board to advance analysis of an expanded and cost-recovery based customer rate structure for VCE, staff will present the sensitivity analysis to the CAC and Board to inform policy decisions.

Note: VCE's existing Customer Dividend program would remain in place if an expanded and cost-recovery based customer rate structure were ultimately implemented. This would continue to provide VCE a mechanism to credit customers when VCE meets its financial/reserve targets.

Tentative Timeline

As noted above, various factors outside VCE's direct control are shaping the timeline associated with this policy decision. Prudent financial management decisions by the Board have afforded VCE the ability to consider this policy option without pressure to take immediate action. Therefore, staff is proposing the following tentative timeline in the event the Board provides direction to continue the work.

- Sept (current): Board direction; Based on Board direction, staff + CAC Task Group finalize draft rate policy and expanded and cost-recovery based customer rate structure.
- Sept: CAC examination/feedback on draft rate policy and expanded and cost-recovery based customer rate structure; input on customer outreach strategy.
- October: Board update/direction; finalize SMUD analysis and final draft policy/rate structure.
- October: CAC consideration/recommendation on final draft policy/rate structure.
- Nov: Board consideration/action on final draft policy/rate structure.
- Nov-Jan 2022: Execute customer outreach strategy.
- Jan 2022: Update report to Board/CAC.
- Feb 2022: Implement expanded and cost-recovery based customer rate structure.
- Post-implementation: Monitoring/reporting customer opt-out/opt-down activity.

CONCLUSION/NEXT STEPS

Staff is seeking direction from the Board on potential implementation of an expanded and cost-recovery based customer rate structure similar to those implemented by other CCA's. If Board direction is provided, staff would put the tentative timeline outlined above into motion. Staff recognizes that the recommended action is a shift from VCE's current rate structure but also that it is driven by forces outside of VCE's direct control. Staff is making the recommendation to continue to analyze this approach because it maintains local control, customer choice, cost competitiveness and the ability to execute local programs.