VALLEY CLEAN ENERGY ALLIANCE
COMMUNITY ADVISORY COMMITTEE

Staff Report – Item 8

TO:	Community Advisory Committee
FROM:	Mitch Sears, Interim General Manager Edward Burnham, Director of Finance & Internal Operations
SUBJECT:	Cost Recovery Based Rate Policy and Customer Rate Structure
DATE:	October 28, 2021

RECOMMENDTIONS

1. Recommend the VCE Board adopt the following:
    a. Adopt a cost-recovery based rate policy;
    b. Adopt a new rate structure with three customer options: (1) Standard Green (default) and (2) UltraGreen (100% renewable) with rates based on cost-recovery and add a (3) least-cost customer rate option;
    c. Automatically enroll California Alternative Rates for Energy (CARE) and Family Electric Rates Assistance (FERA) customers in the newly created least-cost rate option with an enhanced portfolio beginning in 2024.

OVERVIEW

Beginning in mid-2020, VCE began exploring the concept of cost-recovery based rates to address financial issues associated with power market and regulatory volatility. Steeply rising Power Charge Indifference Adjustment (PCIA) and power market costs have required VCE to draw on reserves to stabilize customer rates and maintain its current rate policy of matching PG&E generation rates. In Q3 of 2021, the Board directed staff to develop an expanded and cost-recovery based rate structure to address these issues. In September, staff presented a background report to the Board and CAC that included a draft outline rate structure and development/implementation schedule.

Based on updated power market forecasts and VCE financial model results that corrected an overestimation of the value of VCE's long-term renewable contracts, the Board approved an accelerated rate adjustment of approximately 2% in mid-October. This cost-recovery based rate adjustment slows the draw on reserves and will be reassessed as final rates for 2022 are set by the Board in December. Note: PG&E's 2022 PCIA and rates are scheduled to be released the 2nd week of November, allowing for VCE to set 2022 rates at the December Board meeting.

This report and recommendation serve to update VCE's rate policy and customer rate structure consistent with recent Board direction. This policy and structure, if adopted by the Board in November, will enable VCE to set rates calibrated to actual cost and reserve requirements rather than simply indexed to PG&E's generation rates.

BACKGROUND

In 2017, prior to launch, VCE adopted its Implementation Plan that included a provision that program rates must collect sufficient revenue from participating customers to fully fund VCE's budget, including the need to establish sufficient operating reserve funds. Over the past three years VCE has systematically analyzed policy options and implemented strategies to stabilize customer rates, reduce cost, and manage reserves. This is in keeping with its Strategic Plan goal to maintain financial stability while continuing to offer customer choice, competitive pricing and establishment of local programs. Several of these key financial mitigation strategies have included: discontinuing a rate discount, scaling back voluntary procurement of renewable energy credits, and signing long-term contracts for fixed price renewable/battery storage projects.

Recognizing that additional steps may be needed to achieve cost recovery objectives, 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, power market prices). As noted in previous reports, research was conducted with input from the CAC Rates Task Group through mid-2021, resulting in a staff concept for an expanded and cost-recovery based customer rate structure. The concept was reviewed with feedback provided by the CAC in September and by the Board in September and October. The staff report related to the concept is at: Item-17-Customer-Rate-Structure-Policy-9-9-21.pdf (valleycleanenergy.org). Additional forecast information on rising power markets, identification of a modeling error, and elevated 2021 PCIA rates prompted the Board to approve a rate adjustment for the remaining months of 2021 and January 2022 to reduce the draw on reserves. Table 1 below shows the significant impact of these updated factors relative to the multi-year financial forecasts provided during the June fiscal year adoption process.

Table 1 – Budget and updated forecast

Adopted Budget FY 2022 (June 2021)	Actuals FY2019	Actuals FY2020	ACTUALS UNAUDITED FY2021	ACTUAL YTD Aug 31 (2 MO) + FORECAST (10 MO) FY2022	Forecasted FY2023	Forecasted FY2024
Revenue	51,035	55,249	55,080	53,534	59,100	59,600
Power Cost	38,540	41,538	54,318	54,548	53,800	49,600
Other Expenses	3,850	4,346	4,267	4,857	5,100	5,200
Net Income	8,646	9,365	(3,505)	(5,871)	200	4,800

Corrected Model (October 1 Power Curve)	Actuals FY2019	Actuals FY2020	ACTUALS UNAUDITED FY2021	ACTUAL YTD Aug 31 (2 MO) + FORECAST (10 MO) FY2022	Forecasted FY2023	Forecasted FY2024
Revenue	51,035	55,249	55,080	53,534	59,100	59,600
Power Cost	38,540	41,538	54,318	57,592	62,223	51,062
Other Expenses	3,850	4,346	4,267	4,857	5,100	5,200
Net Income	8,646	9,365	(3,505)	(8,915)	(8,223)	3,338

Notes:

1. For comparison purposes, Adopted and Corrected forecasts assume an overall 5% increase in customer rates and a 5% decrease in PCIA beginning in calendar year 2022 as adopted by the budget in June 2021. Updates to these two assumptions anticipated for PG&E's 2022 PCIA and generation rates will modify revenues shown.
2. Total difference between Adopted and Corrected forecasts is approximately $13M over the FYs 2022 to 2024.

For reference, the Board staff report related to the accelerated rate adjustment is at: Item-4-Rate-Adjustment-10-21-21.pdf (valleycleanenergy.org).

ANALYSIS

As discussed at previous CAC and Board meetings, all electric utilities develop forecasts of cost and revenue requirements based upon informed technical estimates. These forecasts incorporate factors such as future weather, load, market power prices, and other business conditions. Actual outcomes inevitably vary and in extreme instances, like the heat event of August 2020, outcomes may vary significantly.

Utilities and CCA's affected by such events must recover costs from customers or draw from reserve funds if available. Under its current rates policy, VCE has been drawing from reserves to stabilize customer rates by matching PG&E generation rates. CCAs in general - and VCE specifically - face two additional revenue impacting uncertainties: PG&E rate revisions and changes to the PCIA. Alterations to these components result in a corresponding and direct need for VCE to adjust rates (upward or downward) to maintain adopted financial and other Strategic Plan objectives. As a Community Choice program, VCE's advantages include local control and the ability to develop and implement revenue structures in a timely manner to meet financial policies and goals. Rate levels forecast and implemented in advance of retail sales, however, inevitably result in actual revenues above or below the cost to serve customers and accomplish business objectives. This is especially true in the electric power business because weather events and corresponding price/load volatility (like the heat storms experienced in August and September of 2020) may result in actual power supply costs substantially in excess of forecast costs. Most utilities have adopted rate stabilization mechanisms to compensate for these types of cost uncertainties in order to more closely balance revenues and costs. As shown in Table 2 below, these factors have also impacted other CCA's who have taken steps to implement cost-recovery based rates.

Table 2

CCA	IOU Territory	% Difference to IOU (default product)
Clean Power SF	PG&E	+2%
MCE Clean Energy	PG&E	+7%
Pioneer Community Energy	PG&E	+6%
San Jose Clean Energy	PG&E	+8%
Sonoma Clean Power	PG&E	+5%
Clean Power Alliance (Los Angeles area)	SCE	+8%
Desert Clean Energy	SCE	+20%

As discussed at previous meetings, these rate determining factors and rising power market prices have stretched VCE's financials and forced the Board to adopt cost mitigation measures beginning as early as 2018 (e.g. rate increase, delayed procurement of renewables, reduced program activity). The volatility of these factors make it necessary for VCE to now consider a cost-recovery based customer rate structure.

Cost-Recovery Rate Policy

Currently, VCE sets rates for its default product to match PG&E's generation rates, regardless of market and regulatory movement. While it is simple to calculate and communicate, this approach requires VCE to draw on reserves to smooth this volatility. Due to the noted scale and variability of these cost drivers, VCE's current rate approach is not aligned with its financial objectives and fiduciary responsibility to collect sufficient revenue from participating customers to fully fund expenditures and establish sufficient operating reserves.

A cost-recovery based rate structure addresses this uncertainty and allows VCE to build a financial foundation that is sustainable, enabling the organization to carry out its mission. In the context of these factors, staff's recommended rate policy update and associated implementing procedure is:

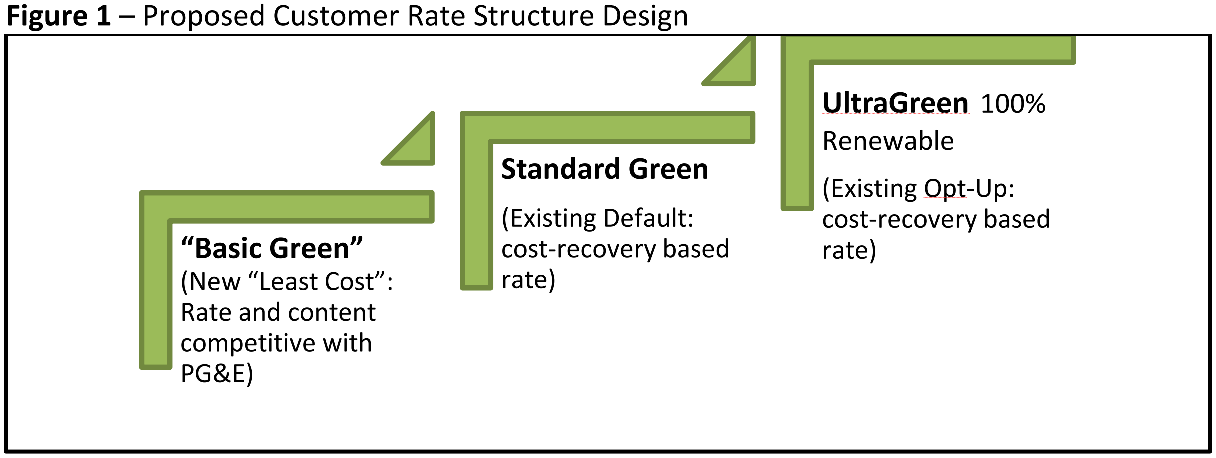
> *Policy: VCE will set customer rates to collect sufficient revenue from participating customers to fully fund VCE's budget and establish sufficient operating reserve funds.*
>
> *Implementing Procedure (budget years 2022 and 2023): Over the next two budget years set customer rates to fully fund VCE's budget, as may be amended from time to time, and rebuild a minimum operating reserve of 30 days cash by the end of 2023; with a targeted operating reserve of 60 days cash by the end of 2023. Beginning in 2024, higher operating reserve targets will be established to support Strategic Plan goals including achieving an investment grade credit rating.*

<u>Recommended Customer Rate Structure</u>

The recommended customer rate structure introduces two key elements to VCE's existing rate structure. First, it increases customer choice by adding a new least cost customer option that would continue to be directly indexed to PG&E's rates. This new option is designed in recognition that many VCE customers have been impacted by the pandemic and that rising utility bills have further strained family and business finances. Second, the existing default (Standard Green) and opt-up (UltraGreen) options would incorporate cost-recovery based rates. The modification to VCE's existing two options would enable VCE to set rates calibrated on actual cost and reserve requirements.

Figure 1 below summarizes the proposed structure.

Figure 1 – Proposed Customer Rate Structure Design



Note: Name of new customer option TBD.

The proposed customer rate structure incorporates the following:

1. Rate Structure
    a. Three customer rate options – (1) Basic (new), (2) Standard (existing default), and (3) UltraGreen (existing opt-up)

2. Customer Distribution
    a. All CARE/FERA customers automatically opted down (approx. 27% of VCE load)
    b. Assumed additional customer load opt-down/out: 5%

3. Portfolio/Price (renewable/GHG content)
    a. Basic Green rate (new): competitive with PG&E generation rate (+/- 2%) and maintain minimum portfolio to comply with regulatory requirements; ineligible for customer dividend program.
        i. CARE/FERA customers maintain existing VCE multi-year portfolio mix for Standard default through 2023; shift to enhanced portfolio in 2024: PG&E renewable content plus a minimum of 5%.
    b. Standard (existing default): cost-recovery based rate and maintain existing VCE multi-year portfolio mix.
    c. UltraGreen (existing opt-up): cost-recovery based rate and maintain existing 100% renewable/GHG free mix.

The following preliminary assumptions are incorporated into the analysis of the proposed rate structure:

1. PCIA 25% lower in 2022; 7% higher in 2023; stable at the 2023 rate for 2024.
2. RA costs stable in 2022 and 2023.
3. Market power costs stable at 2021 rates in 2022; lower exposure in 2023 and beyond as VCE's long-term power purchase agreements begin full delivery.

<u>Updated Schedule</u>

The schedule developed for consideration of the expanded and cost-recovery based rate structure had been updated to include the special Board meeting in October, PG&E 2022 rates/PCIA information release, the CAC review of 2022 rates at its November meeting and the December Board meeting adopting 2022 VCE rates.

- *Sept: 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; draft policy/rate structure.*
- *October: Board special meeting; approved accelerated rate adjustment for Nov 2021 – Jan 2022.*
- **October 28 (current):** CAC consideration/recommendation on final draft policy/rate structure.
- Nov 8: PG&E 2022 rates and PCIA update released.
- Nov 10: Board consideration/action on final draft policy/rate structure.
- Nov 18: CAC update on 2022 PCIA and PG&E rates.
- Dec 9: Board adoption of calendar based fiscal year and budget; set 2022 VCE rates.

- Nov-Jan 2022: Execute customer outreach strategy.
- Jan 2022: Rates update report to Board/CAC.
- Feb 2022: Implement expanded and cost-recovery based customer rates and structure.
- Post-implementation: Monitoring/reporting customer opt-out/opt-down activity.

CONCLUSION/NEXT STEPS

Staff is recommending adoption of an expanded and cost-recovery based customer rate structure similar to those implemented by other CCA's. 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 because it maintains local control, customer choice, cost competitiveness and the ability to execute local programs.

As noted in the revised schedule, staff will be returning to the CAC in November with PG&E's 2022 rates and PCIA. These two key factors will impact VCE's 2022 rates that will be set by the Board in December.