VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 10

TO: VCE Community Advisory Committee

FROM: Lisa Limcaco, Director of Finance & Internal Operations
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SUBJECT: Draft approach to VCE's new Rate Structure / Dividend Program.

DATE: February 28, 2019

BACKGROUND

At the November 15, 2018 board meeting, staff recommended a package of policy modifications that work together to address PCIA volatility and resulting budget shortfalls anticipated for 2019 and 2020. One of the policy modifications approved by the Board in November was to study adoption of a new rate structure starting in July 2019 (VCE's 2020 Fiscal Year).

In January 2019, staff recommended that the Community Advisory Committee (CAC) create a task group to collaborate with staff to develop a new rate structure and dividend program for VCE's 2020 fiscal year. The CAC created a Rates and Services Task Group that would review rate, service and program projects that includes collaboration with staff in developing this draft Dividend program.

Initially VCE's rate structure provided customers with a pre-determined, up front rate discount relative to PG&E service. An alternative would be to set identical rates to that of PG&E and move from a monthly fixed rate discount structure to a yearly "dividend" rate structure where bill credits are awarded annually if VCE meets certain financial thresholds. This is a similar rate structure currently employed by Monterey Bay Community Power (MBCP).

The purpose of this report is to introduce the draft Dividend program and receive feedback from CAC.

ANALYSIS & DISCUSSION

Key considerations identified by staff in analyzing a move to a dividend rate structure include:

- Rate design impacts on customer opt-outs
- Trigger for payment of customer dividend – minimum net margin
- Impact on financial stability of VCE
- Allocation of revenue to reserves, dividends, and local program development/implementation
    - Short-term consideration of NEM Enrollment

Rate Design

During MBCP's analysis, the direct correlation between rate structure (i.e. "dividend") and opt-out rates were uncertain. MBCP concluded that rate structure factors were not the major driver of customer opt-outs based on feedback from customers who chose to opt out of the CCA. A super majority of CCA customers who opted out cited dissatisfaction with being automatically switched from PG&E without their consent and that neither the lower price nor sourcing of cleaner energy seemed to affect that decision. Similarly, a majority of VCE customers that chose to opt out cited dislike of being automatically enrolled into VCE as the reason for their decision.

By setting identical rates to that of PG&E, VCE can shift the focus from rate comparisons and rate design to the goals that define the reasons VCE was established in the first place. Namely, cleaner resources, local control, custom tailored programs responsive to community needs, and improving the local economy by investing in clean power resources and returning some of the annual savings back to the customers.

Financial Stability

Minimum Net Margin

Net margins vary greatly across different industries and sectors. For example, average net margins in the retail clothing industry run lower than the average net margins in the telecommunications sector. Large, national-chain retailers can function with lower margins due to the massive volume of their sales. Conversely, small, independent businesses need higher margins to cover costs and still make a profit. Based on Staff research, the Electric Utility industry average net margin for 2017 ranged from 8%-10%. Similarly, VCE is one of the smaller CCAs with a smaller customer base than other CCAs. Thus, VCE will require higher margins to cover its costs and still build reserves to offer local programs and customer incentives. Therefore, staff believes that VCE should maintain a minimum net margin (after any bank debt principal payment) of 5% before any dividends are paid to our customers.

Cash Reserves

VCE needs sufficient funds to provide for operating capital reserves, rate stabilization, and sufficient credit to support long-term investments in renewable resources. It is prudent business practice to build up reserves that target a level of 90 days cash. In November 2018, the Board approved a reserve policy to build toward a 90-day cash level reserve within the next 4 years.

The speed at which reserves are accumulated is very important. The Board has provided direction in the reserve policy that VCE should dedicate the majority of operating surplus in the early years to reserves. Under the current draft Dividend program, gradually, the portion of the surplus dedicated to reserves should be reduced until the target reserve is met; then, the allocation of the surplus would be dedicated to custom local programs and customer dividends.

The portion of the surplus dedicated to cash reserves would be determined annually by the Board of Directors.

Local Programs

Staff believes that VCE should establish its own portfolio of programs that will be designed specifically for local customers to help further reduce GHGs associated with transportation and other sectors of the local economy. VCE currently allocates 1% of net margin to a local programs reserve. Under the draft dividend program, In lieu of this allocation, any surplus above the 5% minimum net margin will be allocated between the local programs reserve and customer dividends at a percentage determined annually by the Board of Directors.

Customer Dividends (Bill Credits)

CCA programs are community owned, managed and directed by a local Board representing its customers. It is therefore reasonable to provide a return/dividend to VCE customers at the end of each fiscal year as a bill credit. As proposed in the draft dividend program, any surplus above the 5% minimum net margin would be allocated between the local programs reserve and customer dividends at a percentage determined annually by the Board of Directors.

As the VCE fiscal year is July to June, the dividends would be calculated based on the audited financial statements and would be announced in September and credited annually in October. By allocating the dividend or credit annually, VCE would be able to pay out on a "performance basis," and build customer satisfaction and loyalty as well.

CONCLUSION

Staff believes that a well-designed dividend rate structure can help VCE improve financial stability while building customer trust and loyalty. Staff will take feedback from the CAC and make a preliminary report to the VCE Board at their March 14th meeting. Based on Board direction, staff will return with a final recommended rate structure for consideration in April.