VALLEY CLEAN ENERGY ALLIANCE
COMMUNITY ADVISORY COMMITTEE

Staff Report – Item 12

TO: Community Advisory Committee

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

SUBJECT: Cost-Based Rate Setting for 2022

DATE: November 18, 2021

RECOMMENDATIONS
Recommend that the VCE Board of Directors approve the following:

1. Adopt customer rates for 2022 to match PG&E 2022 generation rates for all customer classes except CARE and FERA customers to cover VCE's FY 2022 budget expenditures and to achieve 150 days cash reserves by the end of 2022;

2. Adopt a 2022 rates implementing procedure including the following:
   a. Provide a 5% rate discount for CARE and FERA customers in 2022;
   b. Conduct a mid-year rates review in Q2 2022 to assess rates forecast and determine the feasibility of:
      i. Providing a 5% rate discount for all customer classes during peak summer months in 2022 (June – September.);
      ii. Providing an additional 5% rate discount for CARE and FERA customers during peak summer months (June – September.);
      iii. Allocating additional funds for clean energy content procurement;
      iv. Allocating additional funds for community program implementation.

BACKGROUND
On November 8, 2021, PG&E filed a November update for its 2022 Power Charge Indifference Adjustment (PCIA) and Generation Rates. The filing continued the unstable trends associated with these two factors that impact VCE's customer rates. Whereas PCIA increased 74% since January 2020, according to PG&E's November filing it is set to decrease 75% in 2022. Similarly, PG&E's average generation rates have increased less than 10% in the past several years. According to its November filing, PG&E's average 2022 generation rate is set to increase by 36%.

VCE and energy industry analysts have tracked PG&E's filings in 2021 and had forecast much different changes to these two factors. As part of its analysis of these final PG&E filings before 2022 rates and PCIA go into effect, VCE confirmed the accuracy of the 2022 rates and PCIA with CalCCA analysts and VCE's regulatory counsel Keyes & Fox who are also lead counsel to the joint

CCA's group that participate directly in the CPUC's annual rates proceeding. These sources, as well as individual CCA regulatory rates teams all confirm the accuracy of the filings by PG&E and indicate that these are the rates and PCIA that will be implemented by PG&E in 2022. The primary driver for these changes is the elevated power market prices experienced in 2021 and forecast for 2022.

Based on the November filings by PG&E, staff believes it is highly likely that the 2022 PCIA will be lower than originally forecast earlier this year and that PG&E's generation rates will be higher than forecast. However, it is important to acknowledge that some level of uncertainty still exists in these latest forecasts for 2022 and that projections for 2023 and 2024 contain higher levels of uncertainty due to forward power market volatility and the opaque nature of PG&E's rate setting formula. Therefore, as detailed in the analysis section below, staff has incorporated a significant buffer (20%) in its financial forecast to help address the remaining uncertainty in 2022. In addition, staff has run three financial scenarios using different assumptions for PG&E's 2022 rates. Overall, based on the best available information, staff believes its recommendation is fiscally cautious and consistent with VCE's updated rates policy.

ANALYSIS

On November 10, 2021 the Board adopted the following update to the VCE rates policy:

> Cost-Based Rate 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.

The cost-based rate setting approach is designed to meet VCE's annual expenditures and build long-term fiscal stability through the establishment and maintenance of reserves. As the Committee is aware, VCE has drawn on its reserves over the past 18 months and taken other fiscal mitigation actions (e.g. postponing voluntary purchases of renewable energy credits), to stabilize customer rates. These actions have had the intended effect but have left VCE with projected reserves lower than its minimum target. Therefore, VCE's recommended 2022 rates are set to match PG&E to meet 2022 budget expenditures while focusing on rebuilding VCE's reserves and offering modest bill relief to low-income customers. The recommended implementing procedure centers on a mid-year review to assess expenditures/revenues and how they are tracking with forecasts. This review builds-in flexibility to offer additional customer benefits if forecasts are accurate or to make adjustments if necessary.

<u>2022 Financial Forecast</u>

Using the information from the PG&E November filing, staff conducted a financial analysis that included the three following rate scenarios:

1. Most likely – PG&E 2022 rates are consistent with its November filings (36% higher than 2021 rates). Staff recommendation based on this scenario.
2. Less likely – PG&E 2022 rates 4% lower than its November filings (32% higher).
3. Less likely – PG&E 2022 rates 8% lower than its November filings. (28% higher).

Note: each scenario holds the PCIA reduction at the November filing level (75% reduction), as it

is formula based and not likely to differ from the filing.
Table 1 below shows the PCIA and rates under each scenario, and Table 2 shows the financial outcomes based on each of the three scenarios.

Table 1 – PG&E 2022 Rates Scenarios

		RATES		
	PCIA	Scenario 1	Scenario 2	Scenario 3
CY2022	-75%	36%	32%	28%
CY2023	45%	-7%	-7%	-7%
CY2024	-2%	2%	2%	2%
CY2025	2%	1%	1%	1%

*Future PG&E filings will impact generation and PCIA rates.

Table 2 - Budget Scenario Comparison

	Actuals			Actual YTD Sept. 30 (3 MO) + Forecast (3 MO)	Budget Scenarios	Preliminary Forecast*		
Scenario 1	FY2019	FY2020	FY2021	FY2022	CY2022	CY2023	CY2024	CY2025
Revenue	51,035	55,249	54,657	28,606	104,683	93,833	97,175	98,992
Power Cost	38,540	41,538	54,234	29,616	66,990	52,400	47,100	48,400
Other Expenses	3,850	4,346	4,267	2,469	4,940	5,140	5,269	5,400
Net Income	8,646	9,365	(3,844)	(3,478)	32,753	36,293	44,807	45,191
Scenario 2	FY2019	FY2020	FY2021	FY2022	CY2022	CY2023	CY2024	CY2025
Revenue	51,035	55,249	54,657	28,606	101,367	90,725	93,973	95,725
Power Cost	38,540	41,538	54,234	29,616	66,990	52,400	47,100	48,400
Other Expenses	3,850	4,346	4,267	2,469	4,940	5,140	5,269	5,400
Net Income	8,646	9,365	(3,844)	(3,478)	29,437	33,185	41,604	41,925
Scenario 3	FY2019	FY2020	FY2021	FY2022	CY2022	CY2023	CY2024	CY2025
Revenue	51,035	55,249	54,657	28,606	98,051	87,617	90,770	92,458
Power Cost	38,540	41,538	54,234	29,616	66,990	52,400	47,100	48,400
Other Expenses	3,850	4,346	4,267	2,469	4,940	5,140	5,269	5,400
Net Income	8,646	9,365	(3,844)	(3,478)	26,121	30,077	38,402	38,658

* Revenues are highly subject to PG&E filings that impact generation rates and PCIA.

As noted in the Background section of this report, each scenario uses the high-cost year of 2021 as the 2022 baseline for costs. This represents a 20% increase in cost assumptions for 2022 over the average annual costs that VCE experienced prior to the high-cost year of 2021. In summary, staff is taking a cautious approach on cost assumptions which have been incorporated into the financial model for 2022. As shown in Table 2 above, as VCE's long-term fixed price renewable PPA's come fully on-line in 2023 and 2024, power costs are forecast to stabilize below 2021 levels.

Reserves

Consistent with the newly adopted policy, staff is recommending that VCE set rates for 2022 at a level that will fully fund the 2022 budget and build back reserves that have been used over the past 18 months to stabilize customer rates. Staff is recommending that VCE establish a target of 150 days cash reserve by the end of 2022. This would provide two key benefits: (1) increased financial stability while taking a significant step toward establishing an investment grade credit rating, and (2) preparing for future PCIA and power market volatility. Staff is also recommending that VCE take an approach that builds reserves aggressively in the first two quarters of 2022 to minimize the draw on its existing reserves and to avoid cash flow risk in early 2022.

If PG&E's 2022 rates and/or PCIA do not conform to its November CPUC filings, staff believes a reduction to a 120-days cash reserve target for 2022 is reasonable but-sub optimal. Under a 120-days cash reserve target approach, key benefits listed above would be reduced but not eliminated. The recommended mid-year rates review in Q2 would allow VCE to assess the reserves target, the progress being made to meet it, and any needed mid-course adjustments.

<u>2022 Rate Recommendation</u>
Staff is recommending that VCE Adopt customer rates for 2022 to match PG&E 2022 generation rates for all customer classes except CARE and FERA customers. Staff is further recommending that VCE CARE and FERA customers receive a 5% rate discount in 2022 (CARE and FERA customers represent approximately 27% of VCE's load). Based on financial analysis, this will allow VCE to cover its projected FY 2022 budget expenditures while establishing 150 days cash reserves by the end of 2022.

This approach for 2022 satisfies the following key objectives:

- Rates set to meet costs
- Rate support for low-income customers
- Establishment of healthy reserves to help buffer future rate/PCIA volatility, build toward an investment grade credit rating, fund customer programs, and meet financial covenants contained in VCE's long-term power purchase agreements (PPA)
- Moves VCE one-year closer to on-line dates for its fixed-price long-term renewable PPA's (2022: Aquamarine + Putah Creek /2023: Resurgence + Gibson /2024: Willow Springs)

In addition, if PG&E's 2022 rates and/or PCIA conform to its November CPUC filings the financial analysis indicates additional revenue may be available in 2022. Using VCE's existing guidelines for treatment of surplus revenue (Customer Dividend Program – adopted 2019), and past input from the Board and CAC, staff identified three general categories for potential funding with any surplus revenues in 2022. They include (1) reserves, (2) customer rate discounts/dividends, and (3) programs/clean power content increases. However, staff believes it is prudent to consider these potential actions following implementation of PG&E's 2022 rates and PCIA scheduled for January so that an assessment of actual financial performance can be made. This will allow for informed decision making by VCE before additional commitment of surplus revenue. Based on this approach, staff is recommending the following 2022 rates Implementing Procedure:

Conduct a mid-year rates review in Q2 2022 to assess VCE's rates forecast and determine feasibility of:

a. Providing a 5% rate discount for all customer classes during peak summer months in 2022 (June – September.);
b. Providing an additional 5% rate discount for CARE and FERA customers during peak summer months (June – September.);

c. Allocating additional funds for program implementation.
d. Allocating additional funds for clean energy content procurement;

The recommended Implementing Procedure provides a framework for 2022. It is specifically limited to one year due to the level of volatility represented in PG&E's 2022 rates/PCIA and uncertainty associated with these factors going into 2023. The longer-term outlook (2024+) includes increased power cost stability and certainty due to VCE's fixed-price long-term renewable PPA's and cost-based rate structure.

CONCLUSION

Overall, based on the best available information, staff believes its recommendation for VCE's 2022 customer rates is fiscally cautious and consistent with VCE's updated rates policy. The recommendation is designed to begin recovering reserves early in 2022 with a built-in mid-year performance assessment to determine if costs/revenues are tracking with projections. Based on this mid-year assessment, additional revenues could be allocated for customer discounts, local programs, and power content adjustments.