VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 15

TO: Board of Directors

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

SUBJECT: Cost-Based Rate Policy and Customer Rate Structure

DATE: November 10, 2021

RECOMMENDTIONS

1. Approve the attached resolution adopting:
   a. A cost-based rate policy and implementing procedure;
   b. A revised rate structure with three customer options: (1) Standard Green (default) and (2) UltraGreen (100% renewable) with cost-based rates and adding a (3) least-cost customer rate option; and
   c. Automatic enrollment of 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-based rates to address financial issues associated with power market and regulatory volatility. Steeply rising Power Charge Indifference Adjustment (PCIA) (+46% for 2021) and power market costs (+57% since May 2021), 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-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% on the average customer bill in mid-October. This cost-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, which will inform the Board's December action to set VCE's rates for 2022.

The Community Advisory Committee considered the proposed cost-based rate policy and structure at its November 28, 2021 meeting and recommended adoption by the Board.

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, 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 and registered its Implementation Plan with the California Public Utilities Commission (CPUC). The Plan 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 (RECs), 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 CCAs designed to address on-going financial pressures outside of a CCA's control (e.g. PCIA, RA, power market prices). Based on general Board direction, research was conducted with input from the CAC Rates Task Group through mid-2021, resulting in a staff concept for an expanded and cost-based customer rate structure. The concept was reviewed 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).

Rate Adjustment – October 2021

Additional forecast information on rising power markets, correction of an overestimation of the value of VCE's long-term renewable contracts, and elevated 2021 PCIA rates prompted the Board to approve a rate adjustment on October 21, 2021. The rate adjustment of approximately 2% on the average overall VCE customer bill for the remaining months of 2021 and January 2022 will reduce the draw on VCE's financial reserves. This adjustment went into effect on November 1st and will be evaluated as part of VCE's overall 2022 rate setting action scheduled for December. For reference, the Board staff report related to the accelerated rate adjustment is at: Item-4-Rate-Adjustment-10-21-21.pdf (valleycleanenergy.org).

Updated Financial Factors

On November 8th PG&E's 2022 PCIA and rates will be filed with the CPUC. The information in this filing will allow VCE (and other CCAs), to update assumptions for these key factors that impact rate setting and affect financials. VCE's current budget and forecasts incorporate a 5% PG&E rate increase and 5% PCIA decrease for 2022. Analysists and consultants for CalCCA track PG&E's filings related to these key factors and are continually updating their forecasts for the upcoming year. Recent PG&E filings indicate a greater increase in PG&E's rates and a greater decrease in the PCIA for 2022 than were assumed in VCE's current budget that was adopted in June. Based on these updated forecasts, staff believes that movement of these two factors are likely to improve VCE's financial outlook for 2022 but not eliminate the need to enact rate adjustments for 2022. Due to the timing of the filing, these assumptions are not reflected in this staff report. However, if they are filed on time, staff will include general information in our presentation to the Board on November 10th.

Community Advisory Committee Recommendation

On September 23, 2021 the Community Advisory Committee (CAC) received a background presentation on the rate-based concept and structure. On October 28, 2021 the Committee considered the recommended rate-based policy and structure. The CAC considered the analysis of staff and its own ad-hoc Rates Task Group and ultimately voted 9-0 to recommend adoption of a rate-based policy with one edit as shown in recommendation "a" below (underlined). The Committee also voted in support of the companion motion to recommend adoption of the expanded rate structure (7-0-2). Though understanding of the overall need to adopt a rates-based policy and structure, several Committee members expressed concern that they did not believe there was adequate time for the CAC to fully analyze the policy and therefore abstained from the vote on the cost-based rate structure (Shewmaker and Braun). Note: Staff and the CAC agreed that the rate structure design should incorporate a clear differentiation between the customer rate option portfolios to demonstrate the value of each option.

The CAC recommended that the Board adopt the following:

a. 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. Changes in rates are to be approved by the Board in consultation with the Community Advisory Committee. (9-0-0);

The CAC recommended that the Board also adopt the following:

b. Cost-Based Rate Structure: 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.

   And,

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. (7-0-2)

Under the staff recommended rates policy the Board retains rate setting authority. Staff believes that CAC review of rates in the context of a significant rate restructuring, as in the current case, is appropriate. However, staff has some concern that adding a blanket requirement for CAC review of all rate adjustments may hinder VCE's regular course of business operations (e.g. adjusting rates mid-year to follow a minor PG&E rate change). For these reasons, staff has not incorporated the CAC's additional language in the staff recommended policy shown in the Analysis section of this report, but would suggest that the Board direct staff to work with the CAC to refine the policy language to retain operational flexibility and return with proposed policy changes by mid-2022.

ANALYSIS

As discussed at previous Board and CAC 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. For example, VCE, much like other California utilities, experienced just such variability during August 2020 when excessively hot weather and market price increases impacted the western United States. The net cost impact of this event to VCE was approximately $800K (and would have been closer to $2.5 million absent VCE's risk management and hedging practices). These events continue to “ripple” through the energy sector in the form of higher forward power market prices. During the current period while VCE transitions to longer-term renewable fixed-price power contracts over the next two years, it has relatively high exposure to these rising market prices.

Utilities and CCAs 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 factors 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 policy goals and objectives. 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-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, multi-year strategy for procurement of renewables, reduced program activity). The volatility of these factors makes it necessary for VCE to now consider a cost-based customer rate structure to augment its existing cost mitigation measures.

Cost-Based Rate Policy

Currently, VCE sets rates for its default product to match PG&E's generation rates, regardless of market movement and/or changing regulatory requirements. While this current approach is simple to calculate and communicate, it 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-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 is recommending the following rate policy update and associated implementing procedure:

> **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.

The recommended policy and implementing procedure are designed to collect adequate revenue to meet VCE's expenditures and build reserves at a moderate pace over the next several years to manage customer rate impacts. This approach will allow VCE to effectively transition into its fixed-price long term renewable contracts over the next several years, thereby significantly reducing exposure to short-term power market volatility.

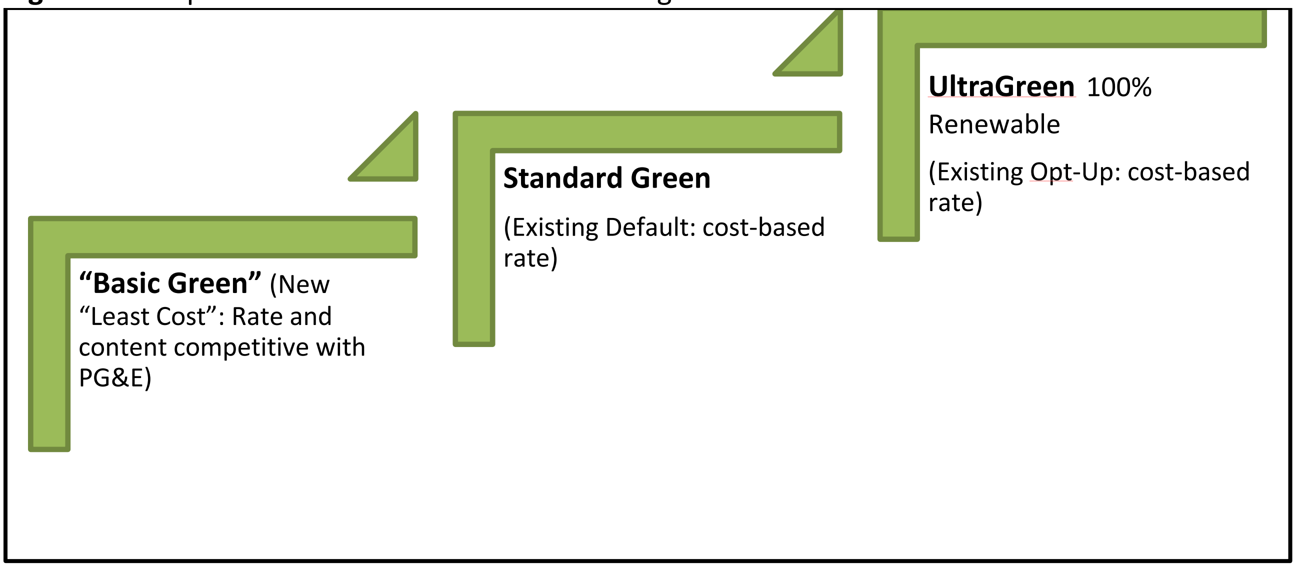
In summary, with this action VCE's longer-term financial outlook (2024+) includes increased stability and cost certainty due to its long-term PPA's and cost-based rate structure, allowing VCE to rebuild reserves and re-establish positive margins going forward. See companion agenda item 16 (2022 Preliminary Budget), for additional information on budget forecasts.

Recommended Customer Rate Structure

The recommended customer rate structure serves to implement the recommended rate-based policy by introducing 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-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 detail is listed below and shown in Table 2.

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 net of PCIA and Franchise Fees (+/- 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-based rate and maintain existing VCE multi-year portfolio mix.
    c. UltraGreen (existing opt-up): cost-based rate and maintain existing 100% renewable mix.

Table 2 below shows the recommended cost-based rate structure information listed above in table form.

Table 2 – VCE Cost-based Rate Structure

Customer Rate Option	Rate	Portfolio	Notes
Basic (new)	Competitive with PG&E (+/- 2%)	• Minimum portfolio for VCE to comply with regulatory requirements	• Not eligible for customer dividend program • CARE/FERA customers maintain existing VCE multi-year portfolio mix for Standard default through 2023; shift to enhanced portfolio in 2024
Standard Green - Default (existing)	Cost-based	• Maintain existing VCE multi-year portfolio mix	• Portfolio minimum percent renewable content above Basic • Eligible for customer dividend program
UltraGreen – Opt-up (existing)	Cost-based	• Maintain existing 100% renewable portfolio	• Eligible for customer dividend program

The recommended cost-based rate policy and structure are included in the attached resolution. If approved, the cost-based rate policy and structure is scheduled to be implemented in February 2022.

<u>Communications</u>

One of the key considerations of the proposed rate policy and structure change is how it is communicated to VCE's customers, as well as to the general public. Based on feedback from other CCAs and VCE's consultants, staff recommends a measured, transparent customer outreach strategy with an emphasis on the additional choices to be offered. This approach would also be designed to acknowledge that VCE is in the competitive energy business and that rate adjustments driven by market forces are not uncommon or unexpected.

A key focus of the communications strategy will be emphasizing VCE's success in procuring electricity for approximately 25% less than PG&E, but that the PCIA eliminates that competitive advantage by "eating up" any potential savings customers would have realized. Communications will focus on easily understandable language (and graphics), that highlight the overriding impact of the PCIA as a cost driver. VCE's additional benefits such as more choice in electricity supply, local control, and community reinvestment through energy contracts and programs will also be emphasized.

Recommended outreach actions would include listing the changes on VCE's website with an introductory message from the Board Chair and Vice-Chair. This piece would recognize the PCIA's role in keeping electricity rates high, and VCE's success so far in keeping our rates low, protecting our customers from paying too much.

Because of the current uncertainty around changes to PG&E's 2022 rates and PCIA, staff recommends measured direct outreach to key accounts (including agricultural) beginning in Q1 2022, after there is more certainty in how VCE's rates compare. Based on information gathered from other CCAs undertaking similar rate actions, staff does not anticipate significant opt-down or opt-out customer activity in response to the new rate structure – especially if additional choice of a competitive customer rate is offered as recommended. To confirm similar outcomes, analysis of opt-up/down/out activity is planned to track VCE's results so corrective action can be taken if necessary. The communications strategy will be finalized after Board and CAC feedback in November 2021 and will encompass the time period November 2021-March 2022.

Updated Schedule

The schedule developed for consideration of the expanded and cost-based rate structure has 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-based customer rate structure.*
- *Sept: CAC examination/feedback on draft rate policy and expanded and cost-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: CAC consideration/recommendation on final draft policy/rate structure.*
- *Nov 8: PG&E 2022 rates and PCIA update released.*
- **Nov 10 (Current): Board** consideration/action on final draft rate policy/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-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-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.

If the expanded and cost-based customer rate structure is approved, staff will bring recommended 2022 customer rates to the Board for consideration at the December meeting.

ATTACHMENT

1. Resolution adopting Cost-Based Rate Policy and Revised Customer Rate Structure

VALLEY CLEAN ENERGY ALLIANCE

RESOLUTION NO. 2021 - ____

A RESOLUTION OF THE VALLEY CLEAN ENERGY ALLIANCE ADOPTING A COST-BASED RATE POLICY, IMPLEMENTATION PROCEDURE AND REVISED RATE STRUCTURE

WHEREAS, on June 19, 2019, the Board adopted via Resolution 2019-007 a New Rate Structure and Dividend Program Guidelines, which outlined the purpose of setting a new rate structure and set program guidelines, including matching PG&E electric generation rates less Power Charge Indifference Adjustment (PCIA) exit fee; and,

WHEREAS, in mid-2020, VCE began exploring the concept of cost-based rates to address financial issues associated with power market and regulatory volatility; and,

WHEREAS, steeply rising PCIA, Resource Adequacy (RA) and power market costs have required VCE to draw on reserves to stabilize customer rates to maintain its current rate policy of matching PG&E generation rates; and,

WHEREAS, to address rising power markets, correction of an overestimation of the value of VCE's long-term renewable contracts, and elevated 2021 PCIA rates prompted the Board on October 21, 2021 to approve a rate adjustment effective November 1, 2021 for the remaining months of 2021 and January 2022 to reduce the draw on VCE's financial reserves; and,

WHEREAS, there is a need to update VCE's rate policy and customer rate structure consistent with recent Board direction and to set rates calibrated to actual cost and reserve requirements rather than simply indexed to PG&E's generation rates.

NOW, THEREFORE, the Board of Directors of the Valley Clean Energy Alliance resolves as follows:

1. VCE adopts a cost-based rate policy and implementing procedure as shown Attachment 1;
2. VCE adopts a revised rate structure with three customer options: (1) Standard Green (default) and (2) UltraGreen (100% renewable) with cost-based rates and add a (3) least-cost customer rate option as shown in Attachment 2;
3. VCE will 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.

PASSED, APPROVED, AND ADOPTED, at a regular meeting of the Valley Clean Energy Alliance, held on the ___ day of _____________ 2021, by the following vote:

AYES:
NOES:
ABSENT:
ABSTAIN:

____
Dan Carson, VCE Chair

____
Alisa M. Lembke, VCE Board Secretary

Attachments:

1. VCE Cost-based rate policy and implementing procedure
2. VCE Revised rate structure

Attachment 1 - VCE Cost-based rate policy and implementing procedure

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.

Attachment 2 - VCE Revised rate structure

1. Rate Structure
   a. Establish three customer rate options – (1) "Basic[1]" Green (new), (2) Standard Green (existing default), and (3) UltraGreen (existing opt-up)

2. Customer Distribution
   a. All CARE/FERA customers automatically opted down to "Basic" rate (approx. 27% of VCE load)

3. Portfolio/Price (renewable/GHG content)
   a. "Basic Green" rate (new): competitive with PG&E generation rate net of PCIA and Franchise Fees (+/- 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-based rate and maintain existing VCE multi-year portfolio mix.
   c. UltraGreen (existing opt-up): cost-based rate and maintain existing 100% renewable mix.

Table below shows the VCE revised rate structure information listed above in table form.

VCE Cost-based Rate Structure

Customer Rate Option	Rate	Portfolio	Notes
Basic Green (new)	Competitive with PG&E (+/- 2%)	• Minimum portfolio for VCE to comply with regulatory requirements	• Not eligible for customer dividend program • CARE/FERA customers maintain existing VCE multi-year portfolio mix for Standard default through 2023; shift to enhanced portfolio in 2024
Standard Green - Default (existing)	Cost-based	• Maintain existing VCE multi-year portfolio mix	• Portfolio minimum percent renewable content above Basic • Eligible for customer dividend program
UltraGreen – Opt-up (existing)	Cost-based	• Maintain existing 100% renewable portfolio	• Eligible for customer dividend program

[1] "Basic" Green name to be determined.