VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 20

TO: Board of Directors

FROM: Edward Burnham, Director of Finance & Internal Operations
Mitch Sears, Executive Officer

SUBJECT: Rate Adjustment Policy

DATE: December 8, 2022

RECOMMENDATION
Approve the attached resolution adopting a Rate Adjustment Policy.

OVERVIEW
Beginning in 2020, VCE faced financial constraints associated with power market and regulatory volatility driven by forces outside VCE's direct control. The primary drivers of volatility were steeply rising/declining Power Charge Indifference Adjustment (PCIA), power market costs for energy and resources adequacy (RA), heat waves and storms, and droughts causing VCE to draw on reserves into early 2022. VCE analyzed various policy options and strategies to stabilize customer rates, reduce/control costs, and manage reserves to address financial constraints for short-term cash and long-term sustainability impacts. As part of the evaluation, the Board adopted a cost-based rate policy in late 2021 and in mid-2022 increased the customer rate option structure to include Base Green. In September 2022, Staff introduced the rate adjustment concept to the Board and received direction to continue to evaluate Rate Adjustment Policy options and return to the Board in December.

The Community Advisory Committee considered the proposed rate adjustment policy at its November 17, 2022, meeting and recommended adoption with amendments by the Board as described below.

If adopted by the Board, this policy and structure will enable VCE to calibrate rates in a more-timely manner to reflect actual cost and reserve requirements.

The recommended Rate Adjustment Policy includes the following key elements:
1. Customer rate adjustments would be calculated no more than once per month;
2. Such monthly adjustment would not result in more than a 5% increase/decrease to VCE's weighted average total generation rate;
3. The net annual cumulative limit for within-year customer rate adjustments authorized under this policy would be a total of 15% unless modified by the Board;
4. Rates would continue to be reviewed annually by VCE Board as part of the annual budget process.

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 four 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.

<u>Community Advisory Committee Recommendation</u>

On November 17, 2022, the Community Advisory Committee (CAC) received the final of three presentations on the draft rate adjustment policy. The CAC considered the analysis of Staff and ultimately voted 8-0-1 to recommend adopting a rate adjustment policy with two edits, as shown in the recommendation below (redlined). Though understanding the overall need to adopt a rate adjustment policy, several Committee members expressed concern that they did not believe there was an adequate need for the monthly and cumulative limits recommended by Staff.

The CAC recommended that the Board adopt the following:

a. Customer rate adjustments shall be calculated no more than once per month;
b. Such monthly adjustment shall not result in more than a ~~7.5%~~ 5% increase/decrease to VCE's weighted average total generation rate;
c. The net annual cumulative limit for within-year customer rate adjustments authorized under this policy is a total of ~~15%~~ 10% unless modified by the Board;
d. Rates are reviewed annually by VCE Board as part of the annual budget process.

Under the Staff recommended Rate Adjustment Policy, the Board retains rate-setting authority, remains informed of all rate adjustments, and reviews rates annually as part of the annual budget process. Staff believes that the CAC's rate adjustment policy limits are appropriate in the context of significant rate changes. However, Staff is concerned that reducing the cumulative limit for rate adjustments may hinder VCE's normal course of business operations (e.g., adjusting rates to follow costs) to implement our policies and is not optimal for establishing and maintaining an investment grade credit rating. For these reasons, Staff has not incorporated all of the CAC's additional language in Staff's recommended policy shown in the Analysis section of this report.

ANALYSIS

As discussed at previous Board and CAC meetings, VCE develops forecasts of cost and revenue requirements based on informed technical estimates. These forecasts incorporate factors such as weather, load, market power prices, and other business conditions. The actual outcomes inevitably vary due to extreme instances like the heat events of August 2020, June 2021, and, most recently, September 2022. The net cost impact of the September event to VCE was approximately $5.5M (and would have been significantly more 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. As part of evaluating options to address external cost factors outside VCE's direct control related to energy cost adjustments and regulatory adjustments, VCE Staff proposes the draft Rate Adjustment Policy similar to other Load Serving Entities (LSEs). The draft policy is designed to help address factors outside VCE's control that influence reserves accumulation, rate stability, and establishment/maintenance of a credit rating.

Over the past four years, VCE has studied policy options and implemented strategies to stabilize customer rates, reduce/control costs, and manage reserves while continuing to offer customer choice, competitive pricing, and establishment of local programs. The impact of external events (e.g. Ukraine conflict, droughts, heat waves/storms) causing power cost increases have, unfortunately, outpaced VCE's cost containment efforts. These recent events and factors have reinforced the value of having a rate adjustment policy to modify rates within a budget year to adjust to external conditions. These general categories of impacts that might trigger consideration of a rate adjustment (up or down) include:

- Price shocks which are quite common in the power business (e.g. September Heat Storm presented in Item 16 to the Board on October 13, 2022); ability of VCE to utilize reserves to absorb these types of impacts.
- VCE's contractual obligation to serve and to pay such added cost for heat waves/storms, drought years, system failures, etc.
- Aligning more closely the "cost event(s)" with the customer's consumption of energy.
- Unlike IOUs, VCE does not have guaranteed "cost recovery" with associated balancing accounts to deposit/collect added costs in the following year.
- PG&E rates / PCIA / regulatory mandates are generally unpredictable in magnitude and timing.
- Rate stability - the recommended Rate Adjustment System can spread out the annual rate adjustment requirements (e.g., less of a one-time price shock at a single point in the year).

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. However, the annual budget and rate setting are completed in advance of retail sales. Inevitably, actual revenues are above or below the cost to serve customers and accomplish VCE's annual objectives. This is especially true in the electric power business because of weather events and corresponding price/load volatility, as VCE has experienced heat storms, resulting in actual power costs exceeding forecasted costs. To balance revenues and costs in a timely manner, most utilities have adopted rate stabilization mechanisms to compensate for these types of cost uncertainties.

Draft Rate Adjustment Policy

As presented to the CAC, the attached draft Rate Adjustment Policy provides a framework to make within-year customer rate modifications promptly and accurately reflect external cost factors outside VCE's direct control. Expressly, within-year rate adjustments permitted under this draft policy would be limited to material financial changes related to the following:

- Market energy supply costs, and/or
- Regulatory decisions that impact VCE's costs or revenues.

Key policy features include:
- Rates are **reviewed annually** by the VCE Board as part of the annual budget Adoption.
- Board **approved parameters** set the total rate adjustments that can be implemented, including an annual limit.
- Within-Year Rate **adjustments are limited** to Energy Cost Adjustments and Regulatory Adjustments.
- Rate Adjustments are not automatic and **require approval** by VCE's Energy Risk Oversight Committee (EROC) before implementation within the Board defined parameters.
- **Accountability and reporting** to the Board describing any implemented rate adjustment would be provided at the next regularly scheduled Board meeting.

Draft Rate Adjustment Policy Authorizations include the following:

Type of Rate Adjustment	Authorized Adjustments
Energy Cost Adjustments	Energy Cost related rate adjustments under this policy may be implemented throughout the year but no more than once per month. Such individual adjustment shall not result in more than a 5% increase/decrease to VCE's weighted average total generation rate.
Regulatory Adjustments	Regulatory cost related rate adjustments under this policy may be implemented throughout the year as warranted following actions by regulatory bodies and/or PG&E, which result in material changes to VCE Board authorized rate discounts/premiums or VCE revenue levels. Such individual rate adjustments shall be limited to no more than one per month. Such individual adjustment shall not result in more than a 5% increase/decrease to VCE's weighted average total generation rate. VCE intends to calculate and implement any such Regulatory Adjustment within 90 days following PG&E's implementation of such actions. The timing, frequency, and financial impact of regulatory body (e.g. CPUC) and PG&E actions that may affect the Regulatory Adjustments are not typically known in advance and may occur multiple times during any given year.
Annual Cumulative Limit	The net annual cumulative limit for within-year customer rate adjustments authorized under this policy is a total of 15%. The Board may modify this limit.

Communications

One of the key considerations of the proposed rate adjustment policy 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. 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 would be emphasizing VCE's success in procuring long-term power purchase agreements for less than PG&E. Communications would focus on easily understandable language (and graphics), that highlight the overriding power cost impacts and VCE's additional benefits such as more choice in electricity supply, local control, and community reinvestment through energy contracts and programs would 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 rate setting and VCE's efforts to keep customer rates competitive.

Based on information gathered from other CCAs undertaking similar rate adjustment policies, Staff does not anticipate significant opt-down or opt-out customer activity in response to rate adjustments made under this policy. VCE would monitor opt-up/down/out activity related to rate adjustments to track VCE's results so corrective action could be taken if necessary.

Rate Adjustment Policy – Best Practice

Over the next two years, while VCE transitions to longer-term fixed-price renewable power contracts, it has relatively high exposure to rising market prices. Although the transition to long-term power purchase agreements and reserve building provides additional cost stability, future rate adjustments may be necessary. The business issue for CCAs (and all electric utilities) is the commitment to make real-time sales to all customers regardless of, and without knowing, the firm cost of attaining that supply and obligation to recover such costs from it's customer base. Utilities and CCAs must recover all costs from customers (including financial reserves). Additionally, this type of rate adjustment system is a utility industry best practice and a recommended standard by lending institutions and credit rating agencies.

Overall, based on the best available information, staff believes its recommendation for VCE's Rate Adjustment Policy is fiscally prudent and connects key fundamentals from VCE's Budget Policy, Rates policy, Reserve policy, and 2021-2023 Strategic Plan. If adopted, the recommended draft Rate Adjustment Policy would be implemented in 2023.

CONCLUSION/NEXT STEPS

Staff recommends adopting a rate adjustment policy similar to those implemented by other utilities and CCAs. Staff recognizes that the recommended approach is a shift from VCE's historic rate approval process and is driven by forces outside of VCE's direct control. Further, staff is making the recommendation because this policy supports prior Board actions regarding VCE's Budget Policy, Rates Policy, Reserves Policy, and Strategic Plan while maintaining local control, customer choice, programs, and cost competitiveness. If the Rate Adjustment Policy is adopted, Staff will begin implementation in 2023.

ATTACHMENT

1. Draft Rate Adjustment Policy
2. Resolution 2022-XXX adopting Rate Adjustment Policy

Valley Clean Energy Alliance
Rate Adjustment Policy

Adopted _________________

A. PURPOSE

The Board of Directors of Valley Clean Energy Alliance (VCE) is responsible for setting customer rates to collect sufficient revenue from participating customers to fully fund VCE's budget and establish sufficient operating reserve funds as defined in the VCE Rate Policy. The Board typically considers customer rate setting at the beginning of each budget year. Due to volatility in energy markets and the unpredictability of regulatory actions, additional flexibility to make limited adjustments to customer rates on a more frequent basis to recover costs is a sound business practice – one adopted by many Load Serving Entities (LSEs).

The Rate Adjustment Policy provides a framework to make timely within budget year customer rate changes, within Board approved parameters, to adjust to external cost factors outside VCE's direct control. Specifically, within budget year rate adjustments made under this policy are limited to material financial changes resulting from either (1) market energy costs or (2) regulatory decisions that impact VCE's costs or revenues. Under this policy, all within budget year customer rate changes are vetted through VCE's Enterprise Risk Oversight Committee (EROC) prior to implementation and reported to the Board at the next meeting following implementation.

B. PRINCIPLES

The following principles guide customer rate adjustment decisions under this policy:

1. Link to annual budget and multi-year forecast - Customer rates shall be set to fully fund operating costs and cash reserve fund targets consistent with multi-year forecasts.
2. Regularly examine Financial Operating Results - Budget variances will be monitored throughout the fiscal year for impacts on annual budgets and multi-year forecast results.
3. Reserves - Customer Rates shall fund reserves consistent with VCE's Financial Reserve Policy and budgeted targets.

C. PROCESS

The Director of Finance and Internal Operations (Director) will monitor and review unaudited operating budget variances and decisions/proposed decisions by California Public Utilities Commission (CPUC) and other regulatory bodies for impacts to net income or cash reserves compared to the adopted budget. If a net impact to income or cash reserves is observed or forecast, the Director will initiate a within budget year rate adjustment assessment based on the following factors:

1. Unless otherwise directed by the Board, within Budget year rate adjustments will only be considered to address two categories of external cost factors outside VCE's direct control: (1) Energy Cost Adjustments and (2) Regulatory Adjustments, where:

    a. Energy Cost Adjustments – These adjustments are intended to recover the power costs, including renewable resources, energy and energy hedges, resource adequacy and capacity products, and demand side management (DSM) costs, including revenue losses, not otherwise included in VCE's retail generation rates.

b. Regulatory Adjustments – These adjustments are intended to recover and adjust VCE revenues to remain within Board authorized revenue requirements/total bundled rate discounts/ premiums when VCE's finances are materially impacted by CPUC or other regulatory body decisions. Regulatory Adjustments typically include Power Charge Indifference Adjustment (PCIA), PG&E retail rates, balancing account charges, and/or other PG&E and/or regulatory body related actions that directly impact VCE's customer rates. These adjustments may also include other regulatory financial requirements required and approved by CPUC or other regulatory bodies that have a material effect on VCE's cost/revenue structure.

2. Customer rate adjustments shall be consistent with the Authorizations in Section D below. The cumulative within budget year customer rate adjustments approved under this Policy in any fiscal year may not exceed the Authorizations in Section D below.
3. Any given adjustment may result in an upward or downward impact on VCE generation rates given the particular impacts of any one or combination of factors related to Energy Cost Adjustments and/or Regulatory Adjustments.
4. Implementation of a within budget year rate adjustment will maintain the current Base Green product discount and the relative revenue requirement contributions of VCE's Standard Green and Ultra Green customer classes.
5. CARE/FERA and other eligible VCE low-income customers subscribing to VCE's Base Green product shall be charged the lower of VCE's Standard Green or Base Green generation rate, in the instance when VCE's Standard Green generation rate may be less than VCE's Base Green generation rate following a given rate adjustment.
6. The particulars of rate design, existing PG&E rate schedules, and customer class and consumption characteristics, actual discounts / premiums / rates experienced by any particular customer or customer class may vary from overall weighted averages.

<u>Approval/Oversight</u>

7. Director of Finance and Internal Operations shall provide timely reporting and analysis to the Executive Officer and EROC of all revenue and energy cost projections for accuracy, content, and compliance with the previously determined priorities and policies.
8. Within budget year customer rate adjustments shall be reviewed and approved by the EROC.
9. The Director shall prepare an informational report to the board of any within budget year rate adjustments at the next scheduled Board meeting. The cumulative within budget year customer rate adjustments shall be reported as part of the Board's annual operating budget and rates adoption process.
10. Staff shall develop and maintain procedures for internal control and accountability of the Rate Adjustment Policy.

D. AUTHORIZATIONS

VCE Customer rates adopted by the Board of Directors may be amended during the budget year within the parameters listed below:

Type of Rate Adjustment	Authorized Adjustments
Energy Cost Adjustments	Energy Cost related rate adjustments under this policy may be implemented throughout the year but no more than once per month. Such individual adjustment shall not result in more than a 5% increase/decrease to VCE's weighted average total generation rate.
Regulatory Adjustments	Regulatory cost related rate adjustments under this policy may be implemented throughout the year as warranted following actions by regulatory bodies and/or PG&E, which result in material changes to VCE Board authorized rate discounts/premiums or VCE revenue levels. Such individual rate adjustments shall be limited to no more than one per month. Such individual adjustment shall not result in more than a 5% increase/decrease to VCE's weighted average total generation rate. VCE intends to calculate and implement any such Regulatory Adjustment within 90 days following PG&E's implementation of such actions. The timing, frequency, and financial impact of regulatory body (e.g. CPUC) and PG&E actions that may affect the Regulatory Adjustments are not typically known in advance and may occur multiple times during any given year.
Annual Cumulative Limit	The net annual cumulative limit for within-year customer rate adjustments authorized under this policy is a total of 15%. The Board may modify this limit.

E. CONTROL & ACCOUNTABILITY

An information report describing any implemented within budget year rate adjustment authorized under this policy will be provided to the Board at the next regularly scheduled Board Meeting following implementation of the rate adjustment.

F. POLICY ADMINISTRATION

The Board must approve amendments to this Policy.

VALLEY CLEAN ENERGY ALLIANCE

RESOLUTION NO. 2022-___

A RESOLUTION OF THE BOARD OF DIRECTORS OF VALLEY CLEAN ENERGY ALLIANCE ADOPTING A RATE ADJUSTMENT POLICY

WHEREAS, the Valley Clean Energy Alliance ("VCE") was formed as a community choice aggregation agency ("CCA") on November 16, 2016, under the Joint Exercise of Power Act, California Government Code sections 6500 et seq., among the County of Yolo, and the Cities of Davis and Woodland, to reduce greenhouse gas emissions, provide electricity, carry out programs to reduce energy consumption, develop local jobs in renewable energy, and promote energy security and rate stability in all of the member jurisdictions. The City of Winters, located in Yolo County, was added as a member of VCE and a party to the JPA in December of 2019; and,

WHEREAS, beginning in 2020, VCE faced financial constraints associated with power market and regulatory volatility driven by forces outside VCE's direct control; and

WHEREAS, on November 10, 2021, the Board adopted a cost-based rate policy via Resolution 2021-023; and,

WHEREAS, on July 14, 2022, the Board adopted a three-tiered rate structure, via resolution 2022-024, designed to offer more customer rate options and increase VCE's ability to set rates to actual cost and reserve requirements while providing a competitive price option to PG&E; and,

WHEREAS, to address volatility driven by forces outside of VCE's direct control there is a need to adopt a rate adjustment policy to set rates in a more timely manner that are calibrated to actual cost and reserve requirements.

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

The Board of Directors hereby approves and authorizes the attached Rate Adjustment Policy.

PASSED, APPROVED AND ADOPTED, at a regular meeting of the Valley Clean Energy Alliance, held on the _____ day of December 2022, by the following vote:

AYES:
NOES:
ABSENT:
ABSTAIN:

____
Jesse Loren, VCE Chair

____
Alisa M. Lembke, VCE Board Secretary

Attachment: Rate Adjustment Policy