

Agenda Report

June 12, 2017

TO: Honorable Mayor and City Council

THROUGH: Municipal Services Committee (May 9, 2017)

FROM: Water and Power Department

SUBJECT: RECOMMENDATION TO HOLD A PUBLIC HEARING AND APPROVE THE PROPOSED INCREASES TO THE ELECTRIC DISTRIBUTION AND CUSTOMER CHARGES FOR ALL CUSTOMER GROUPS

RECOMMENDATION:

It is recommended that the City Council:

1. Find that the Public Hearing for Proposed Changes to the Electric Rates is exempt from the California Environmental Quality Act ("CEQA") pursuant to State CEQA Guidelines Section 15273 (Rates, Tolls, Fares, and Charges);
2. Open a Public Hearing to receive public comment on the Recommended Electric Rate Increases, to be effective on July 1, 2017 or as soon as practicable thereafter:
 - a. Increase the Electric Distribution Charges to generate an additional \$4.8 million annually, thereby increasing the overall Power Fund operating revenues by 2.3%;
 - b. Increase the Electric Customer Charges to generate an additional \$0.54 million annually, thereby increasing the overall Power Fund operating revenues by 0.3%;
3. Direct the City Clerk to report on written comments received from the public;
4. Close the Public Hearing;
5. Approve the aforementioned Recommended Electric Rate Increases; and
6. Direct the City Attorney to prepare an amendment to the Light and Power Rate Ordinance ("Ordinance") implementing the changes to the electric rates described herein.

MUNICIPAL SERVICES COMMITTEE RECOMENDATION:

The Municipal Services Committee recommended that the City Council approve these recommendations at its May 9, 2017 meeting.

BACKGROUND:

General Energy Price Trends

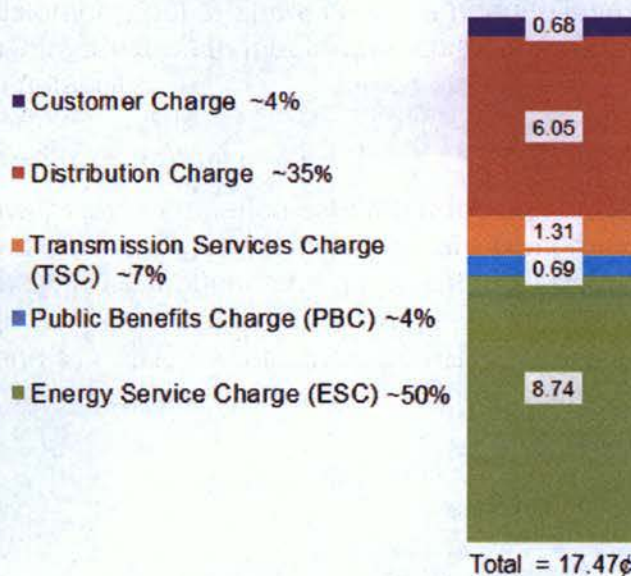
California electric utilities, including the Water and Power Department (“PWP”), are experiencing a number of challenges that are leading to increased costs and will result in higher rates. Legislation to further reduce carbon emissions, increase renewable energy resources to 50%, or up to 100% under proposed Senate Bill 100 (De Leon), and doubling the energy efficiency goals, will lead to higher costs of energy for PWP. The costs for high voltage transmission are increasing due to higher Transmission Access Charges charged by the California Independent System Operator (“CAISO”).

Overall, many actions across the electric utility industry are leading to increased operating costs. As energy costs and rates increase, customers’ choices for self-generation and access to renewables are becoming more cost effective. This in turn increases the cost to the remaining customer base and creates inequity of benefits and costs between customer groups. There is also a need to invest in existing and new technologies and infrastructure to meet future customer needs and maintain a high level of electric system reliability.

PWP Electric Rate Structure

The Light and Power Rate Ordinance sets the rates and charges for electric system customers. Electric rates charged to customers are comprised of five separate components, namely 1) Distribution charge, 2) Customer charge, 3) Energy Service charge including Power Cost Adjustment charge (“PCA”), 4) Transmission Services charge (“TSC”), and 5) Public Benefit charge (“PBC”). Figure 1 shows the electric rate components and their respective percentage of the total system average rate.

Figure 1
System Average Rate (¢ per kWh)
Proposed FY 2018



The Energy, Transmission, and Public Benefit charges have variable components that the PWP General Manager is authorized to adjust in response to changes in retail sales volume and costs associated with energy, transmission, and public benefit programs based on the budget approved by City Council.

PWP's Customer charge is a monthly fixed rate and the Distribution charge is a variable rate based on the amount of energy consumed. Residential customers pay a "tiered" Distribution charge with different rates based on levels of energy used. The same distribution rate is charged on each kilowatt-hour ("kWh") for small commercial customers. Medium and large commercial customers pay a Distribution charge based on kilowatt demand, which includes specific costs related to providing sufficient capacity to meet larger demand on the electric system. Distribution revenues have decreased based on reduced sales due to energy conservation and the impact of distributed energy projects including solar installations and natural gas fuel cells. Increases in the Distribution and Customer charges, as necessary to compensate for higher costs as declining sales volumes, require City Council approval.

Drivers for Proposed Customer and Distribution Rate Increase

Despite efforts to reduce costs, the recommended fiscal year 2018 ("FY2018") Power Fund Operating Budget includes an increase in costs to operate and maintain the electric distribution system. Increased costs include the portion of new debt service from the Electric Revenue Refunding Bond Issue of 2016 that is attributable to the distribution system, the requirement to provide necessary "pay-go" funding for capital investment in Electric System Projects, support of the General Fund, and increased personnel costs.

PWP has implemented several efficiency measures to minimize expenses, including elimination of 28 vacant positions in the Power Fund, realigning overhead costs between Water and Power Funds, and postponing the purchase of vehicles, tools and equipment to the extent possible while maintaining safe and efficient operations. To offset the higher operating costs, PWP is recommending an increase of the power Distribution and Customer charges for all customer groups to generate an additional \$5.34 million annually (\$4.8 million from the Distribution charge and \$0.54 million from the Customer charge), thereby increasing the overall Power operating revenues by 2.6%. The Distribution and Customer charges were last increased in July 2016. The *system-wide average* rate adjustment resulting from this proposed rate action is 3.0%.

Attachment A provides sample bill impacts for a range of residential and commercial customers. Note that the Customer charge is the same for all residential customers and the Distribution charge is higher as more energy is consumed.

Energy Cost of Service and Future Rate Restructuring

PWP regularly performs financial analysis on rate performance and revenue requirements to ensure the financial stability of the Electric System. A cost of service study was most recently completed during fiscal year 2013. In response to continuous and significant changes in the electric market and regulatory environment, PWP

anticipates completing an update of the cost of service and rate model during FY2018. This analysis may result in additional increases in rates and changes to the electric rate design. In the meantime, the recommended rate increase for FY2018 will serve as an interim action to provide the necessary revenue to ensure sufficient net income to meet the Electric utility's obligations to fund operating expenses, support of General Fund services, and projected funding requirements for capital investment.

COUNCIL POLICY CONSIDERATION:

The proposed recommendations are consistent with the City Council's goals to maintaining fiscal responsibility and stability, improve, maintain, and enhance public facilities and infrastructure, and increase conservation and sustainability.

ENVIRONMENTAL ANALYSIS:

The proposed amendments to the Light and Power Rate Ordinance have been determined to be exempt from CEQA per Section 15273 (Rates, Tolls, Fares, and Charges). Under Section 15273, CEQA does not apply to the establishment, modification, structuring, restructuring, or approval of rates, tolls, fares, or other charges by public agencies which the public agency finds are for the purpose of:

1. Meeting operating expenses, including employee wage rates and fringe benefits,
2. Purchasing or leasing supplies, equipment, or materials,
3. Meeting financial reserve needs and requirements,
4. Obtaining funds for capital projects, necessary to maintain service within existing services areas, or
5. Obtaining funds necessary to maintain such intra-city transfers as are authorized by city charter.

FISCAL IMPACT:

It is anticipated that this action will result in approximately \$5.34 million in additional annual power customer and distribution revenues and will be used to offset the electric system's operating costs. The proposed rate increase will result in an additional \$534,000 to be transferred to the City's General Fund.

The results of the upcoming electric cost-of-service update are uncertain at this time, and the recommended increase will be an interim action to provide the necessary revenue to ensure sufficient net income and funding for operating expenses and projected capital investment for the Power Fund in FY2018. If approved, the new distribution rates will become effective for electricity bills issued after July 1, 2017.

Respectfully submitted,



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