

Agenda Report

November 19, 2001

TO: City Council
THROUGH: Municipal Services Committee

FROM: City Manager

SUBJECT: Pasadena Water and Power Electric Rate Restructuring Plan and Elimination of Stranded Investment Surcharge

RECOMMENDATION

It is recommended that the City Council:

1. Direct the City Attorney to prepare an ordinance in conjunction with Pasadena Water and Power (PWP) to restructure electric rates as described herein, to be effective in February 2002.
2. Eliminate collection of the non-bypassable, non-taxable Stranded Investment Surcharge (SIS) of \$0.0137 on each kWh delivered to all customers, effective with the implementation date of the new rate design.
3. Authorize PWP to refund all SIS charges collected from each customer since July 1, 2001 through the implementation date of the new rates.
4. Recognize the Reserve for Stranded Investment (Reserve) balance of approximately \$150 million as of June 30, 2001, and authorize withdrawals from the Reserve to pay debt associated with the Intermountain Power Project (IPP), effective with the implementation of the new rates.
5. Eliminate the Underground Surtax Rebate Program, effective with the implementation date of the new rate design.
6. Eliminate the Utility Users Tax Rebate Program of 0.17% for electric customers, effective with the implementation date of the new rate design.

EXECUTIVE SUMMARY

This proposal is comprised of two major components:

- Elimination of the Stranded Investment Surcharge effective July 1, 2001, one year earlier than originally planned and a proposal to utilize the funds
- Restructuring of electric rates to eliminate any subsidies between customer groups and alignment of rates for business and residential customers with their respective costs of service

The imposition of the Stranded Investment Surcharge and the restructuring of rates were part of a strategy adopted by the Council in 1996 to position PWP to compete in a deregulated electric industry. The surcharge, along with numerous other actions by the City Council, has created a stranded debt reserve of approximately \$150 million as of June 30, 2001.

In conjunction with the elimination of the SIS, the City proposes to eliminate the two related temporary rebate programs. The first is the Underground Surtax Rebate program, and the second is the rebate of a portion of the City's Utility User Tax rate.

Together, the net affect of these adjustments will result in a reduction in electric bills for most customers, and no increase for others. The reduction due to the elimination of the stranded investment surcharge is approximately 1.3 cents per KWh and the reduction due to the defeasement of PWP debt related to IPP is expected to be approximately 1.5 cents per KWh. Low-income and lifeline customers will continue to be eligible for the rebates provided through the Public Benefits program.

In summary, the rate proposal:

1. Effectively terminates the 1.3 cents per KWh SIS one year earlier than planned and rebates SIS charges between July 1, 2001 and the implementation date;
2. Provides for the pay down of IPP debt from the Stranded Investment Surcharge, which will result in a rate reduction of approximately 1.5 cents per KWh for PWP's effective with the new rates;
3. Eliminates the rebate of the underground surtax, effective with the implementation date;
4. Eliminates the Utility Users Tax rebate of .17%, effective with the implementation date;
5. Implements a new electric rate structure that is revenue neutral to the power utility in terms of operating revenue income;

6. Creates new customer group definitions and separates customers into three broad groups: Residential, Commercial and Industrial, Street Lighting and Traffic Signals;
7. Eliminates all subsidies between customer groups;
8. Segments commercial and industrial customers by demand, and then by primary or secondary voltage delivery level;
9. Provides appropriate price signals to encourage efficient usage of electricity;
10. Reflects an unbundling of costs into the components of energy, transmission and distribution;
11. Offers seasonal flat rates, time-of-use (TOU) rates and market rate options for energy services to all customers except large commercial and industrial customers whose demands are greater than 300kW;
12. Offers TOU and market rate options to large commercial and industrial customers with demands greater than 300kW;
13. Offers a \$2 per month multi-family discount to residential customers with at least four meters per location and eliminates the all-electric residential customer discount;
14. Offers a curtailable service rider to medium and large commercial and industrial customers that is paid only during curtailment, not as a reduced rate;
15. Adopts a self-generation rider for customers with self-generation; and
16. Offers other rates such as a Green Power rate.

BACKGROUND

Stranded Investment Surcharge

In 1996, the City Council approved the PWP Deregulation Plan (Plan) in preparation for competition in the electric industry. As part of this Plan, the City Council also established the SIS, effective in November of 1997, to address the estimated difference between PWP's portfolio of electricity costs and the market price of electricity. If there was a significant difference between these two costs, the Stranded Investment Reserve was to be utilized to cover that difference. This reserve was to be funded from a variety of sources, including the Stranded Investment Surcharge and PWP operational efficiencies.

In conjunction with the elimination of the SIS, the City proposes to eliminate the two related temporary rebate programs. The first is the Underground Surtax rebate

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program, which will once again allow the City to resume the undergrounding of overhead power, telephone and cable lines. The second is the rebate of the City's Utility User Tax rate. The City Council approved an across the board increase in the City's Utility User Tax rates in fiscal year 2000 with the caveat that the increase imposed upon the consumption of electricity be rebated until the Stranded Investment Surcharge was removed. The above recommendations accomplish this directive.

The surcharge was expected to sunset on June 30, 2002. However, based on the latest stranded investment valuation analysis, the current Stranded Investment Reserve balance of approximately \$150 million is now adequate to cover the projected stranded investment valuation. Staff therefore recommends that the Stranded Investment Surcharge be eliminated one year earlier than planned. The present value of the stranded investment was recently estimated to be about \$124 million (2001\$) at a 6% discount rate. This amount was determined using the same market forecast philosophy developed by Henwood Energy Services, Inc., that PWP has used in previous forecasts. It should be noted that this amount varies widely, based on the forecast of electricity prices, and the interest rate.

The future of deregulation in California is not clear. There is continued movement towards retail competition in other parts of the country (i.e. Texas and Pennsylvania). There are also predictions of volatility in future electric prices because of a potential surplus of electricity from new plants coming on line. The R.W. Beck Company recently completed a Strategic Resource Plan for PWP. In its analysis, they indicate that wholesale price forecasts are extremely uncertain and that there is a possibility that prices can drop by the year 2004 to levels similar to those in place in 1999 after adjusting for fuel prices and emission offset credits. This means that some PWP resources will continue to be stranded in depressed wholesale markets.

The stranded investment consists of out-of-market costs for Pasadena's share of the Intermountain Power Project (IPP) in Utah and the Palo Verde Nuclear Project in Arizona. The latter is being paid down to a projected market level through a defeasance plan established by the Southern California Public Power Authority (SCPPA) on behalf of all the public power participants in Palo Verde. PWP currently pays for its pro-rata share of the Palo Verde stranded investment pay-off from the Stranded Investment Reserve. Withdrawals will also be made from the reserve to pay down IPP debt to a level that results in a cost for electricity that equals the Henwood estimated market prices. This will result in PWP's cost for electricity from IPP varying from 3.74 cents/kwh in 2003 to 4.53 cents/kwh in FY2021, as compared to today's cost of about 5.5 cents/kwh.

New Electric Rate Design

On September 13, 1999, PWP presented the City Council with its Rate Restructuring Plan, which outlined the need for restructuring PWP's electrical rates to be competitive in the new power market environment. This plan also outlined the need for a cost of service study and rate design. On November 15, 1999, the City Council authorized PWP to retain Christensen and Associates to perform an electric cost of service study and rate design, and to develop a cost of service model. This model was utilized to develop the proposed restructured and unbundled electric rate structure for PWP. It separated PWP's costs into energy, transmission, customer, and distribution and then allocated them across the various customer groups.

This restructuring proposal aligns rates for business and residential customers with their respective costs of service. The unbundling of rates into components of energy, transmission and distribution makes it easier for customers who may seek to explore alternative energy sources in the future to make a comparison. It also ensures that such customers will pay their fair share of transmission and distribution costs that would continue to be provided by PWP.

The results of the cost of service analysis indicate that PWP's residential customers are paying about \$2.95 million less than their fair share of the allocated power system costs, and are being subsidized by the commercial and industrial, and the street lighting and traffic signal customer groups. The recommended rates eliminate all subsidies between customer groups.

The distribution, customer, and transmission charges apply to all customers and are set to recover operating and capital costs, including a return of 9% on PWP's net rate base. This 9% computed weighted cost of capital includes a General Fund transfer of 5% and retained earnings. These amounts are consistent with what is in place today.

Another action approved by the City Council that was also related to rate design was the allowance of Direct Access for PWP's electric customers beginning January 1, 2000. Under the Direct Access concept, customers may choose to purchase electricity from other energy suppliers. Since no customers have yet opted for Direct Access, all current customers are "Core" customers in the new rate design. These customers will benefit directly from PWP's portfolio of generation assets as well as any withdrawals from the SI Reserve Fund. If any customers choose to participate in Direct Access, they will be "Market" customers and will not benefit from PWP's portfolio and SIS fund. Under the new rate design, Core customers may also choose from various new energy service rates such as a green power energy rate for environmentally clean sources of power. For those customers who opt to purchase power from environmentally friendly sources, i.e.: 'green power', their loads will be aggregated and green power will be purchased from the market on

their behalf. Based on today's market energy prices, green power customers will pay a premium over the core energy rate.

An important rate design policy objective adopted by City Council was to achieve market competitive rates for all customers, and to implement a system average rate reduction of about 30 to 35% effective July 1, 2002. Based on the projections of energy costs decreasing to about 3 cents per kWh by 2002, the recommended rate design accomplishes this objective with a system-wide reduction of about 33%, excluding taxes. This is illustrated in Attachment I. However, since PWP's average energy costs have increased to about 9 cents per kWh, a 300% increase over the projection, the net reduction in rates system-wide is actually about 9.5%. To help offset this cost increase, the implementation of staff's proposal to utilize the reserve this fiscal year will result in a system wide reduction of about 16.22%. This reduction is summarized on the chart on page 7 of this Agenda Report.

Clearly unanticipated, all utilities have seen higher energy costs and thus higher than anticipated rates for their customers. For example, compared to PWP's proposed rates for a residential customer using 500 kWh per month in the summer, the rates being imposed on some investor owned utility customers will be as much as 29% higher than PWP.

BILL IMPACT

This proposal will result in a system-wide rate decrease of about 16.22% after the IPP pay down in the electric rates, excluding taxes. The following chart provides the breakdown of this rate decrease by customer group.

**Overall Change In Rates By Customer Group
 (Excluding taxes)**

Customer Group	Group Average Rate Decrease Before Reserve	Group Average Rate Decrease After Reserve
Residential	3.74%	10.46%
Small C&I Non-Demand	10.74%	17.19%
Medium C&I Demand - Secondary	11.86%	18.84%
Medium C&I Demand - Primary	7.86%	15.07%
Large C&I Demand - Secondary	13.41%	20.20%
Large C&I Demand - Primary	8.97%	16.24%
Street Lighting and Traffic Signals	17.36%	17.36%
Overall	9.47%	16.22%

The attachment provides additional information on the impact of this rate restructuring for selected customer types under winter and summer rates. It also provides a comparison between the proposed PWP rates and those of neighboring utilities.

Below is an example of bill impacts with the taxes added back. It identifies the existing rates including taxes, the proposed new rates without taxes, the dollar amounts of the reinstated Underground (UG) surtax and the eliminated Utility User Tax (UUT) rebate and the total new bill with taxes.

**EXAMPLES OF CUSTOMER BILL IMPACTS
 AFTER RESERVE
 WINTER RATES**
 (Monthly or Bi-Monthly bill)

	Current Total Bill (W/SIS & W/Taxes)	New Total Bill (W/O SIS & W/O Taxes)	Reinst- ated Under- ground Surtax	Rein- stated .17% UUT	Other taxes & SLATS	New Total Bill W/Taxes	Total \$ (Decrease) in Total Bill w/Taxes (%)
Residential Customer 1000 kwh, 60 day bill	\$152.76	\$117.28	\$4.97	\$0.19	\$8.80	\$131.24	(\$21.52) (14.09%)
Residential Customer 2000 kwh, 60 day bill	\$317.24	\$228.92	\$9.70	\$0.38	\$17.16	\$256.16	(\$61.08) (19.25%)
Small Com'l & Ind 2000 kwh, 30 day bill	\$326.39	\$232.07	\$10.07	\$0.39	\$29.29	\$271.82	(\$54.57) (16.72%)
Med Com'l & Ind- Secondary 100 kw, 35,000 kwh, 30 day bill	\$5,632.73	\$3,731.47	\$99.92	\$6.18	\$542.26	\$4,379.83	(\$1,252.90) (22.24%)
Med Com'l & Ind- Primary 250 kw, 35,000 kwh, 30 day bill	\$14,693.66	\$10,179.30	\$313.87	\$16.84	\$1,476.75	\$11,986.76	(\$2,706.90) (18.42%)
Large Com'l & Ind-Secondary 500 kw, 200,000 kwh, 30 day bill	\$31,860.21	\$20,526.06	\$564.05	\$33.97	\$2,981.28	\$24,105.36	(\$7,754.85) (24.34%)
Large Com'l & Ind-Primary 1,000kw, 450,000 kwh, 30 day bill	\$65,632.07	\$44,894.26	\$913.78	\$74.25	\$6,538.30	\$52,420.59	\$13,211.48 (20.13%)

SLATS – Street Lighting & Traffic Signals
 Other Taxes – State Surcharge & Utility Users Tax

On May 8, 2000, City Council authorized PWP to enter into a contract with Orcom Solutions, Inc. (Orcom) that was comprised of two phases to furnish and install a new customer information system. The first phase included handling all billing and collections for PWP and Public Works (refuse and sewer billings). The second phase involved custom modifications to meet deregulation transaction requirements and certain functions for the Public Works Department. The programming of the proposed electric rate structure represents a portion of the requirements of Phase II. If this Rate Restructuring Proposal is approved, ORCOM will modify the utility billing system. This is expected to be completed in 3rd QTR FY 2002.

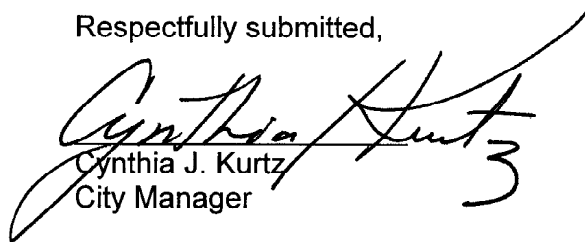
Presentations were made to the Municipal Services Committee on the rate restructuring in June and August 2001, and to the Utility Advisory Commission in August 2001.

FISCAL IMPACT

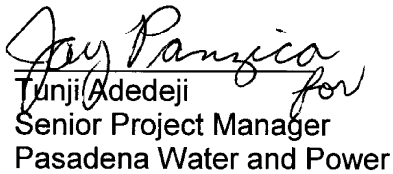
The proposed rate restructuring and the elimination of the SIS will result in no additional funds to the Stranded Investment Reserve and no increase in revenues to the power utility. Customers and the City will save about \$14.8M and \$0.7M per year, respectively, from the elimination of the SIS. In addition, rebates currently forecast to be about \$7 million and \$300,000 will be made to customers and the City respectively for the SIS collected from July 1, 2001 to the implementation date of the new rate design. The date of implementation of the new rates will determine the actual amount to be rebated.

The electric power annual bill for the City's Street Lights and Traffic Signals will be reduced by about \$380,000 due to the elimination of the SIS. The elimination of the Underground Surtax Rebate Program will also generate about \$3 million per year for the Underground Surtax Fund, while the elimination of Utility Users Tax Rebate Program will generate \$210,000 per year for the General Fund. In addition, City buildings and facilities will experience varying reductions based on their usage and respective customer group.

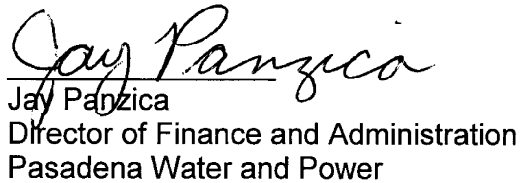
Respectfully submitted,


Cynthia J. Kurtz
City Manager

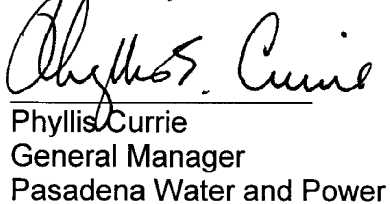
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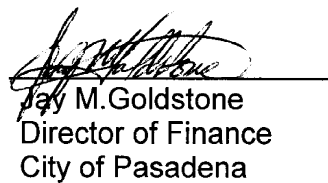
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