



MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

Rely on us.

TO: Commissioners Schlossberg, Brown, Carlson, Barofsky, and McRae
FROM: Deborah Hart, CFO; Adam Rue, Fiscal Services Supervisor
DATE: April 6, 2021
SUBJECT: Ratemaking Principles
OBJECTIVE: Information Only

Issue

The EWEB Strategic Plan identified three phases starting with *Fostering Customer Confidence* and then *Creating Consumption Flexibility* to ultimately provide *Resilient Delivery*. Ratemaking principles are an element of meeting the objectives of the Strategic Plan.

The 2021 Organizational Goals and Performance Measures outlines in January identify cost allocation and rate design as tools to achieve these strategic objectives. This memo is intended to provide some context to historical decisions in recent years and Board ratemaking principles.

Background

EWEB is a locally regulated municipal utility operating under the authority of the Eugene City Charter and pertinent provisions of Oregon law. The responsibilities delegated to the Board, pursuant to the City Charter, are carried out by five elected Commissioners who serve without pay. As an independent municipal agency, the EWEB Commissioners have exclusive jurisdiction to establish prices for water and electric service.

In recent years EWEB has implemented changes in water and electric rate design to adapt to new technologies, customer preferences, and industry trends. These changes included a flattening of electric tiered rates, increases to the basic charge, and elimination of the reactive power charge. These efforts have facilitated customer choice and engagement by pursuing a rate design that, to an increasing extent, makes EWEB indifferent to customer choices and provides customers with price signals that align EWEB and its customer owners' interests.

Discussion

The pricing decisions are a fundamental responsibility of the Board and the rate making principles of *Sufficiency*, *Affordability*, *Efficiency*, *Cost Basis*, *Equity*, and *Gradualism* have been established as a framework for establishing prices for water and electric services.

Sufficiency is the principle that EWEB rates are sufficient to meet the reasonable ongoing costs of utility operations. The principle of rate sufficiency is support by the Board Strategic Direction (SD) Policy of SD6 Financial Policies and SD9 Rate Setting Policy. The SD6 Financial Policies includes

Financial Policy 1.1 Rate Sufficiency Policy, which states:

Rates and charges will be adequate to provide revenues sufficient to maintain a degree of financial soundness over and above requirements for compliance with existing bond covenants

The Rate Sufficiency Policy establishes performance standards for ratios that impact credit ratings and borrowing capacity of the utilities. These metrics also support the financial integrity of both utilities by establishing targets over and above the requirement for compliance with existing bond covenants. Performance standards are based on review with EWEB's financial advisor regarding financial market conditions, rating agency considerations, and industry benchmarks.

The SD9 Financial Policies includes two general standards concerning the establishment of rates. The first addresses rate sufficiency:

The first of these rate making standards allows EWEB to set rates at a level sufficient to recover the ongoing costs of utility operation. These costs include annual operating expense, requirements for capital additions, interest and amortization of outstanding debt, and applicable tax obligations. This standard is intended to ensure the financial integrity of the utility, while defining the costs of operation, which can be lawfully recovered through rates.

These Board Strategic and Financial Policies were established to provide a framework for Board decisions related to rates that ensures the financial integrity of the utilities now and into the future. Staff supports alignment with these policies through its annual budgeting process, financial reporting, long-term financial planning updates, and rate proposals.

Affordability is the principle that EWEB makes all reasonable efforts to make rates affordable for its community owners.

In recent years EWEB has engaged in efforts to mitigate rate impacts through cost containment and debt management. This has afforded EWEB the ability to maintain service levels without increasing overall rates for either utility. In future years EWEB will likely need rate increases to support utility operations, however maintaining affordability will continue to be an important principle.

In addition to cost management to mitigate overall revenue requirement impacts, EWEB also supports customers through conservation programs, and particularly limited income customers through its customer care program and income-based energy efficiency and loan programs. EWEB monitors and publishes utility costs as a percentage of median household income. Among regional comparators EWEB is at the low end of the water utilities and middle of the pack among electric utilities.

Affordability is not specifically governed by Board Policy, however it is aligned with prior Board rate actions and the current strategic plan.

Efficiency is the principle that EWEB will send efficient price signals to customers, that are cost based and minimize subsidies, to allow customers to make investments to either increase or decrease demand that are sustainable long term, without unfavorably impacting other customers. The principle of cost-based rates is support by the Board Strategic Direction (SD) Policy of SD3 Customer Service Policies which states:

Policies are founded on standards of safety, economy and efficiency. Some are a requirement for service, others are optional, and others are recommended.

The commodities of delivered water and electricity demonstrate properties of natural monopolies due to the high level of capital infrastructure investment required to deliver these products. In theory it is more efficient for one supplier of these commodities rather than multiple distribution networks to delivery these products. The relative lack of competition has led regulatory and oversight bodies of natural monopolies to adopt efficient rates, to drive prices closer to an economically efficient marginal cost pricing.

In recent year the industry trends have shifted and increased the incentive for efficient pricing. Customers have an increasing number of choices and utilities are employing efficient prices to address equity concerns and increasingly for strategic long-term financial viability as utilities face increased competition.

The principle of efficiency was employed in recent efforts to align power purchases from retail customers at market price and shift from variable cost to fixed recovery. EWEB has aligned its Annual Renewable Generation Rate, Renewable Net Metered Rate, PURPA Avoided Cost Rates, and Partial Requirement Service Pricing with wholesale power market to increase pricing efficiency. Furthermore, EWEB has increased fixed monthly Basic Charges and reduced volumetric Energy Charges to better align costs and prices to improve pricing efficiency. These industry trends and EWEB initiatives provide customers with clearer, more sustainable long-term price signals, to make decisions to invest in both generation decisions (i.e. solar panels, etc.) or demand decisions (i.e. electric vehicles, etc.).

Cost basis is the principle that EWEB will establish rates as a function of costs. The principle of cost-based rates is support by the Board Strategic Direction (SD) Policy of SD3 Customer Service Policies which states:

It shall be the policy of EWEB that the utility needs of the consumer will be reliably met in accordance with sound business principles; that rates will be uniform to all consumers within various service classifications; and that pricing for utility services and products will be cost based, in accordance with all applicable federal, state and local laws and regulations.

The cost of service analysis is the primary mechanism for cost allocation and rate development to ensure cost-based rates. The use of cost-based rate development helps EWEB to balance the somewhat conflicting principles of *rate sufficiency*, which holds that EWEB will collect sufficient revenue to meet its needs, while maintaining its *affordability* of rates.

The cost of service analysis is an industry standard approach for allocating costs and establishing rates. In recent years EWEB has worked with external consultants specializing in utility cost allocation and rate design to ensure alignment with best practices. Staff is updating those tools to meet the organizational goal of transitioning to a multiyear cost of service analysis.

Equity is the principle that EWEB will charge customers nondiscriminatory prices and customers receiving like services will be treated equally.

The principle of rate equity is support by the Board Strategic Direction (SD) Policy of SD9 Rate Setting Policy. The SD9 policy includes two general standards concerning the establishment of rates. The first standard addresses sufficiency. The second addresses rate fairness and equity:

The second standard requires that rates and charges for utility service be fair and nondiscriminatory. Rates are considered nondiscriminatory when customers receiving like and contemporaneous service under similar circumstances are treated equally in the development and application of specific rates. This second standard protects the equity concerns of individual utility customers, based on established utility policies and practice for allocating costs among customers and customer classes.

In addition to supporting the principle of cost-based rates, the cost of service standard is the primary mechanism to ensure equitable, fair, and nondiscriminatory rates.

Gradualism is the principle that EWEB rate stability is maintained and, to the extent feasible, rates do not unnecessarily shift year to year. This principle also supports transitions to new rate regimes over a multi-year period to allow for customers to adjust usage patterns or investments.

The principle of rate gradualism is support by the Board Strategic Direction (SD) Policy of SD6 Financial Policies. The SD6 Financial Policies includes Financial Policy 1.2 Rate Stability Policy which states:

Certain funds will be held in reserve for the purpose of mitigating the customer rate impact of unanticipated events

The Rate Stability Policy sets forth that certain funds will be held in reserve for the purpose of mitigating customer rate impacts of unanticipated events. Budgets, financial projections, and other statements about the future contain uncertainty and therefore the intent of this policy is to set aside funds or other financial instruments to mitigate impacts to EWEB customers owners when unanticipated events or circumstances impact financial performance of the utilities. The reserves include Power Reserve, Operating Reserves, Self-Insurance Reserves, and Rate Stabilization Funds.

The existing legal authority of the Board and current rate making principles provide significant latitude for the Board to align rate actions with strategic priorities. Staff is currently enhancing tools and internal systems to provide further flexibility in the Board's decision making by improving bill presentment, developing a multi-year cost of service model, enhancing the customer experience, and making internal metering and technology upgrades to better guide Board decision.

Requested Board Action

This item is information only and no Board action is being requested at this time.