

City of Independence

Q&A On Electric Cost of Study and Rate Design Report

Q: First, can portions of the study be adopted and some not be adopted?

A: Not without increasing, the “rates” charged for energy in order to keep the utility financially sound and to protect Bond ratings to maintain low financial costs.

Q: For example, if we don’t adopt the customer charge, what effect if any will it have on your suggested rates for the various classes? I know that the reserve fund would be depleted quicker than if we adopted the customer charge, but is there any other effect? If not, how fast will the fund go down? What is the cost to us per year of keeping the old charge at \$4.14 and using the reserve to pick up the deficit?

A: IPL’s current budget shows the Reserve Fund meeting the proposed target level by fiscal year-end June 20, 2016.

Q: Second, I also reviewed the funding of capital improvements listed in section G, last page of the report. I see that some improvements are suggested to be funded with RER charges and some are to be funded with rate income. I am guessing that RER is “regulatory environmental rider”; is that correct?

A: Yes.

Q: Do we have RER separate charges now?

A: No.

Q: If not, are the charges paid through the rates now?

A: Yes.

Q: If they are, are we giving a rate reduction but then collecting the same amount of money but calling it a RER charge?

A: Yes.

Q: Bottom line, can the study recommendations stand alone or are they interdependent for success?

A: They are Interdependent.

Q: Third, does the analysis anticipate an increase in the citys cost in employee wages and benefits?

A: Yes.

Q: If yes, what is anticipated and for what period of time? There is a public proposal of a 3 percent increase in wages for some work classes within power and light; 3 percent per year for five consecutive years. It is a cumulative 15 percent increase in costs for the city. What does the study include in terms of those operating expenses?

A: It includes these wage increases.

Q: Fourth, if we cleaned up the depreciation schedule used by power and light, would that help us on the “negative net income” that the financial community may perceive? Would it affect the cash reserve fund reported amount?

A: The answer to this is somewhat difficult to say in that a depreciation study would help determine more appropriate lives/rates, and that could potentially go either way depending on the specific “plant” account. The perception, however, has been that we may be depreciating plant too aggressively, thus a reduction of depreciation rates would reduce expense and increase net income. We have experienced increased depreciation expense over the past several years as we’ve accelerated depreciation on the coal burning facilities, which will no longer be useful after this year. Because of this, depreciation expense is projected to decrease this year and next before leveling out; these estimates are part of the pro forma projections used in the rate study.

Q: Depreciation is a non-cash item, a paper loss, and not a real cost to me. I question the depreciation we have used as I think you do when you suggested a review of the depreciation rates and expense before we look at additional rate increases.

A: You are correct – depreciation is a non-cash expense, changing rates would not affect cash reserve funds.

Q: Fifth, is there some idea as to the timetable of the final FERC determination of our net revenue and expenses realized by IPL?

A: Initial results are expected in July 2016. Appeals or other issues may delay the decision beyond that date.

Q: Sixth, the hospital and church rate is separate from other business rates. I thought it was recommended that way because that is how we as a city have always done it. However, our old hospitals were non-profits and our new one is for-profit. Is there any reason to give a special rate to a for-profit business that happens to be a hospital?

A: The proposed rates do not include a separate rate for Hospitals. Under the current rates, only Swope Health Center is on the Hospital rate.

Q: What is the actual cost to run IPL? No depreciation, no pro forma adjustments. Is it \$105,175,004 (B-3) or \$130,191,419 (B-2)? Another number?

A: \$105,175,004 refers to our direct annual operating and maintenance expenses. The \$130,191,419 includes non-O&M items such as gross receipts taxes, property taxes, debt service, and new capital expenditures. The \$130,191,419 figure represents the actual cost to run IPL.

Q: Why is there no interest income reflected in Section 3 or the Appendix B on the suggested reserve of \$23 or \$25 million? Is it there and I just don't see it?

A: No interest income has been included, but finance is addressing the issue. Any change in policy that brings in added interest revenue will be reflected in a future cost of service studies.

Q: Are we going to pay \$8,008,000 on capital improvements in the same year we are spending \$8,921,057 on bond payments (Table B-2)? If we are, is that an industry norm?

A: Yes. The \$8.9 million in bond payments is the debt service (principal and interest) on assets already in place that were funded through debt issued since 2010. The \$8,008,000 is part of the total "Capital Improvements," i.e. spending on new capital projects, which will be funded from our reserves until we achieve our targeted cash fund reserve balance. This is typical for the industry. Our cash flow from operations should fund debt service, and our depreciation expense should somewhat mirror capital expenditures for routine additions, thus funding routine capital expenditures.

Q: \$8,375,054 is listed as "Revenue Credits". Where is the \$3,000,000 coming from as a revenue reduction? Is it real money or a paper credit because our rates are too high or is it coming from the reserve?

A: The \$3 million comes from IPL's structural change in our SPP membership agreement. This is actual dollars, not just paper. The structural change is part of IPL staff's on-going focus on improving efficiencies and reducing costs.

Q: What is "Miscellaneous" of \$750,000 under Total Other Operating Income? (B-3)

A: Miscellaneous income is comprised of damage claims and salvage claims on obsolete assets and is based on historical averages with anticipated adjustments.

Q: What does footnote 1 refer to on B-3?

A: The "Pro Forma" (a.k.a. "test year budget & forecast") referenced in this footnote is a forward-looking budget/financial forecast. It is based on ACTUAL operating (budget) results from FY ending June 30, 2014 PLUS known/budgeted changes over the next five years.

Q: What are the different classifications your study proposes we adopt?

A: The key rate classes proposed for the future are shown below:

- Residential Service (RS-1): Single-family homes and metered apartments.
- General Service (GS-1): Commercial businesses (restaurants, hair salons, Quick Trips, and similar small businesses).
- Larger General Service (LGS-1): Commercial and Industrial businesses with higher usage and higher "demand" (i.e., higher 1-hour peak usage.) This includes larger grocery stores and other high-use businesses.
- Large Power Service (LP-1): Large customers taking service at "Primary Voltage" (i.e., directly connected to our 69 kV or 13.2 kV distribution lines).

Additional changes were made to Private Outdoor Lights (PL-1), City Traffic Signals (TRS-1), and Public Street Lighting Service (PSL-1FR, 1CF, and 1DF). The Fuel Cost Adjustment was changed to the Power Cost Adjustment (PCA-1) and initially set at zero dollars (so there is no added cost in the current proposal). We also added the Regulatory and Environmental Compliance Rider (REC-1), and a Partial Requirements Service (PR-1). The Net Metering Contract was not changed.

Q: Who fits into each one? I don't know who is a large general service customer versus a large power customer.

A: Commercial customers are placed in the various "commercial" rate classes based on expected usage and are placed in the class of service expected to provide the lowest cost of service for each specific customer. Large Power customers require larger transformers and service lines to support their direct connection to 69 kV or 13.2 kV distribution lines.

Q: Do hospitals get a special rate with churches?

A: In the proposed rates, all hospitals will be served under the Large General Services rate (LGS-1). Under existing rates, only one hospital was included on the Church and Hospitals rate: Swope Health Services.

Q: What classifies as a hospital if Centerpoint does not? Why have that special rate if it is our only hospital and it doesn't apply to it?

A: We do not have a special rate for hospitals in the Proposed Rates.

Q: I am confused as to what the rate will be for the different classes separate and apart from the customer charge. I need plain English so:

- **What are the rates in each classification, separate and apart from the customer charges, from Oct. 1, 2015 to Sept. 30, 2016?**

A: The "Energy" Rates do not change going forward and will not change unless and until new rates are approved by the City Council. Residential customers will pay \$0.14/kWh for all energy used during summer months. During winter months, they'll pay \$0.14/kWh for each kWh used up to 300 kWhs; \$0.112/kWh for each kWh used over 300 kWhs but less than 1,000 kWhs; and \$0.084/kWh for all kWhs above 1,000 kWhs.

- **From Oct. 1, 2016, and Oct. 1, 2017 forward?**

A: The "Energy" rates will not change after Oct. 1, 2016, until future rate changes are approved by City Council action.

- **What are the customer charges in each rate classification for both time periods?**

A: The Customer Charge will phase-in.

Residential: Customers will pay \$5/month from 10-1-15 to 4-30-16; \$9.50/month from 5-1-16 to 9-30-16; and \$14.50/month on and after 10-1-16.

GS-1: Customers will pay \$10/month from 10-1-15 to 4-30-16; \$13/month from 5-1-16 to 9-30-16; and \$16/month on and after 10-1-16.

LGS-1: Customers will pay \$50/month starting 10-1-15 and beyond.

- **Specifically, what is being paid with the .66 REC charge?**

A: This includes the annual recurring costs paid to the Missouri Department of Natural Resources (MoDNR), e.g., Permitting fees, emission testing, water sampling, underground tank inspections, and ash pond monitoring/reporting. Additionally, known environmental projects are included based on budgeted expenditures. This includes the required additional of a Missouri City Settling Basin (pond), the Missouri City ash pond closure, and the projected Decommissioning costs for Missouri City after January 31, 2016 (\$921,000).

Q: Is it permissible for the city to charge one rate for out of city customers and a different rate for in city customers? If yes, did we look at the date that those contracts can be renegotiated? Do other municipal utilities charge out of city charges different than their in city charges?

A: We do not bill any customers outside the City limits. This question appears to address “Border Customers.” This includes customers located inside the City limits (IPL service territory), but due to their proximity, they are connected to KCPL’s distribution system. It also includes customers located outside the City limits (KCPL service territory), but due to their proximity to IPL distribution lines, they are connected to IPL’s distribution system. To save the cost of building duplicate distribution lines, KCPL and IPL have reached an Agreement (the Border Customer Agreement) where we bill customers in our service territory at our standard rates, but pay KCPL a flat fee for each kWh serving the customer.

Q: When I asked how we compared to other municipally owned utilities, I meant in terms of rates, not customer service charges. How do we compare to them in our rates?

A: A comparison of “Energy” rates is shown below. However, please note that total monthly bills will depend on a number of factors not shown by the “rates”, including the Customer Charge and many other fees such as franchise fees, taxes, etc. that may not be included or shown in the published rates. FYI: In response to questions during the 7-22-15 Study Session we also surveyed Muni and Co-Op Customer Charges:

- All Munis in the State of Missouri with energy sales above 81,000 MWh/year have a monthly Residential Customer Charge. This includes Springfield (\$11.75) and Columbia (\$15.60).
- We also found that the smaller Munis with Minimum Bills, are predominately much higher than IPL’s current Minimum Bill of \$4.14.

Q: Do they have “out of city rates” different than “in city” rates?

A: It is likely other Municipal Utilities have Border Customer Agreements similar to IPL and KCPL, but those rates are not published.

Q: Finally, what is the reserve your study suggests? \$23 million or \$25 million? What is that based on?

A: The Reserve Fund Balance Policy is formula based using industry norms for Reserve Fund Balances. Therefore, the total Reserve Fund will change from year to year based on IPL expenses. Using IPL’s 5-year operating expense forecast, the Reserve would vary from a low of \$22.3 million to a high of \$25.3 million. The formula includes 11.0% of annual fuel and purchased power expense; 12.5% of annual

O&M expense (cash basis) less annual fuel and purchased power costs; 50% of the sum of current budget year and next year's recurring routine system additions and cash funded capital improvements and expenditures; and a \$2 million emergency contingency reserve.

Questions and Comments regarding the Sawvel IPL Rate Proposal:

Q: I am supportive of most of the recommendations of the Sawvel proposal including those pertaining to industry. However, I am not supportive of the recommendation to institute a large residential customer charge. Therefore, my comments and questions only apply to the residential rates. In researching this topic I found the following:

With a customer charge "Small-use customer, such as apartment dwellers, receive much higher electric bills; the vast majority of low-income consumers are also low-use consumers. This is anathema to public policy objectives that normally tend to protect low-income customers and/or reward low usage: (Jim Razar with Regulatory Assistance Project).

A: Jim Razar makes a very broad statement to support his arguments against a Customer Charge: "In the long-run, all cost are variable." Alex Gupta, who will present at the Indy Energy program on 9-12-12 also uses this statement to object to a customer charge. This is the foundation and basis for their arguments, yet they provide no support for this statement: a statement, which is only true if the "long-run" means 40 or more years and even then it is easily challenged.

The majority of our Energy (nationally and at IPL) comes from generating assets with direct ownership or "life-of-plant" contracts. These assets are financed over 30 to 40 years. The finance charges (the total cost of construction) for these investments are fixed for the duration of the loan. Similarly, large investments in the transmission and distribution systems have fixed long-term financing. Historically before these fixed finance charges expire, load growth and system expansions have created the need for new investments and new long-term (fixed-cost) financing.

Additionally, manpower and overheads don't change based on production or energy usage. They are in place over the long run and remain fairly constant over time.

The Customer charge recognizes these long-term fixed costs and ensures adequate revenue recovery. The charge is based on the costs associated with serving the customer. These costs don't change with the amount of energy being used. For example, the "wires" cost, the meter cost, the cost of reading meters, processing bills, etc., do not change if the customer uses 0 kWh or 1,000 kWh during a month.

Q: Most businesses charge based upon volume and the cost of the product. They do not have a fixed customer charge. For example, a customer that goes to the gas station pays based upon the price per gallon times the number of gallons purchased. There is no customer charge for taking the nozzle off the gas pump to cover the infrastructure of the gas station. If there were a customer charge the customer that only purchased five gallons would pay much more per gallon than the truck driver that purchased 50 gallons.

A: This comparison fails to consider the massive differences between a gasoline station and an electric utility. Energy cannot be "stored" like gasoline (storage technology is not where it needs to be to change this reality). Gasoline stations don't install pipelines and pumps to everyone's

home and do not face the large, fixed costs associated with an electric utility. There are significant reasons why “most businesses” are different than the electric industry and have different rates to recover their costs. Customer Charges are common for many businesses: the phone company, most water and sewer companies, cable TC, cell phones, Costco, and many others require a Customer Charge.

Q: While a customer charge is common among some utility companies it is becoming more controversial among regulators.

A: Utility revenues are highly dependent upon the weather and other events beyond the control of utilities. A customer charge:

- Ensures that utilities recover adequate revenue to cover fixed, non-variable costs during “bad” weather years when revenues would normally be lowered;
- Helps maintain stable revenues and stable rates over the long-term (requiring fewer “rate studies” and rate increases;
- Helps avoid having the majority of customers subsidize the few customers who can afford on-site self-generation and those able to take advantage of net-metering; and
- Supports the effective use of a Reserve Fund Balance Policy without wild swings in reserve fund balances.

Due to the previously mentioned long-term fixed costs and other considerations, a Customer Charge is the proper and the “business-like” way for today’s utilities to structure rates. For these and other reasons, it is recognized as the preferred rate structure for modern utilities.

Q: The Missouri Public Commission turned back Ameren’s request to increase the customer charge from \$8.00 to \$8.50. The Missouri Office of Public Counsel has testified against the proposed KCPL customer charge increase. If the PSC does not approve the KCPL customer charge increase how will the KCPL residential rate compare with the proposed Sawvel IPL residential rate?

A: For KCPL, the Missouri Public Service Commission approved a customer charge of \$11.88: a nearly 50% increase above the prior \$8.00 customer charge. We are waiting to see the official new RATES posted on the KCPL website before we can completed an accurate rate comparison.

Addendum: KCPL’s new rates are posted. Under KCPL’s new rates: Low- use customers would pay more and high-use customers would pay less than they would under IPL’s proposed rates.

Q: The proposed rates are based upon a projected increase in revenue from the SW Power Pool agreement. What would be the effect on rates if the agreement does not go through or if the agreement produces 50% more revenue than is estimated?

A: The proposed Rate Structure included the MINIMUM additional revenue we’ll get from SPP. Because we may get more revenues, our proposed rates included a recommendation for a new Rate Study after a final resolution is determined at FERC. We’re hopeful we’ll get additional revenues and be able to offer additional rate reductions in the proposed future Rate Study (likely in 2017, for 2018 implementation).

Q: The following table shows under the proposed plan as energy usage goes up the cost per kWh goes down. This is because the customer charge is a smaller percentage of the bill as usage increases and the Off-Peak Season kWh charge decreases as usage increases. This creates a disincentive to conserve energy. This is counter to IPL’s energy efficiency programs which encourage energy conservation. What are the pros and cons of going to the approach used by Columbia in which the kWh charge increases as usage increases?

Winter kWh/Summer kWh	Average Monthly kWh Usage	Average Monthly Charge	Charge/Usage
400/400 kWh	400 kWh	\$69.49	17.4¢/kWh
700/1100 kWh	867 kWh	\$129.96	15.0¢/kWh
1400/2000 kWh	1650 kWh	\$205.92	12.5¢/kWh

A: The more a customer uses, the more it will cost that customer. The incentive to conserve energy remains.

Addendum from above: KCPL’s new rates are posted. Under KCPL’s new rates: Low- use customers would pay more and high-use customers would pay less than they would under IPL’s proposed rates.

As described in the Rate Study Report, the proposed rates are based on the Cost of Service. The cost of “energy” is a small portion of the overall cost to serve load (due to the fixed costs previously mentioned). Because the customer charge does not fully recover fixed costs, rates for initial or “early” energy usage is set higher to ensure decreases (we recover our fixed costs through the customer charge and the charge for “early” energy usage). Again, this ensures stable and adequate revenues during “bad” weather years. And again, this is the preferred business-like rate structure for modern utilities.

Q: As shown in Attachment A the proposed rate recommendation increases the cost for low use customers, keeps the rate about the same for typical use customers and decreases the cost for high use customers. I question if it is good public policy to increase the rate for those who can least afford a rate increase and decreases the rate for those who can best afford a rate increase. Was this taken into account when the proposal was developed and does IPL feel this is fair?

I have heard the argument that the increase in the dollar amount is small (\$8.96/mo) for low use customers. Individuals on SSI typically get \$733 per month. The rate increase represents 1.2% of their income if they are a low use customer. A comparable 1.2% increase for a family making \$4,000 per month would be \$48 per month, which most people would say is a large increase.

A: We can’t comment on the speculative income levels of customers or the monthly SSI figure provided above. Although it seems logical to assume that low-income equates to low usage, this is often not the case. Many low-income customers have high usage due to the lack of insulation and the lack of newer, higher efficiency HVAC systems and appliances.

For low-income customers, numerous social programs are available to help with all types of bills including food, housing, utility bills, and many others. IPL also provides programs to further assist with electric bills.

Q: Sawvel proposes to generate \$9,340,137 of annual revenue from the combined \$14.50 customer charge and \$0.66 REC charge times the 51,342 IPL residential customers. Attachment A shows a different approach in which the customer charge is decreased from \$14.50 to \$5. \$5 is the amount suggested by the utility economist Steve Kihm.

The energy charge is increased by 7.9% to make up for the \$5,852,988 lost revenue from decreasing the customer charge. Under this approach the small use customer would have a 6.2% increase instead of the Sawvel 14.4% increase. The typical use customer charge would remain the same as the existing charge. The high use customer would have a small 2.1% increase over the existing charge.

This appears to be a more equitable approach. From the IPL and customer perspectives what are the pros and cons of lowering the customer charge or not instituting a customer charge, if the energy charge is increased to make up for the lost customer charge revenue?

A: There are any number of alternative rate structures that could be implemented regardless of the industry involved. The proposed structure is the preferred business model for today’s electric utilities. Eliminating the customer charge will not lower customer bills, as it would require higher “rates,” which is the hidden goal of groups like Indy Energy. Eliminating the REC charge would similarly increase energy “rates.” Additionally, the value of the REC will change based on expense: it can go higher or lower in the future. Including a REC charge to cover future potentially high-cost regulatory mandates, eliminates the need to perform future rate studies to recover these unknown future costs saving the cost of rate studies.

Attachment A			
Sawvel Proposal			
	Low Use Customer 229kWh Winter 640kWh Summer	Typical Use Customer 700kWh Winter 1100 kWh Summer	High Use Customer 1425 kWh Winter 1935 kWh Summer
Average Monthly Existing Charge	\$62.24	\$129.55	\$238.32
Proposed Monthly Customer Charge	\$14.50	\$14.50	\$14.50
Proposed Schedule REC Charge	\$0.66	\$0.66	\$0.66
Proposed Average Monthly Energy Charge	\$56.04	\$114.80	\$220.34
Proposed Average Monthly Total Charge	\$71.20	\$129.96	\$235.50
Dollar Amount Change	\$8.96	\$0.41	-\$2.82
Percent Change	14.4%	0.3%	-1.2%
Customer Charge as % of Proposed Total Charge	20.4%	11.2%	6.2%

Different Approach			
Monthly Energy Charge Based Upon 7.9% Increase Over Sawvel Energy Charge	\$60.47	\$123.87	\$237.75
Monthly Customer Charge	\$5.00	\$5.00	\$5.00
Monthly REC Charge	\$0.66	\$0.66	\$0.66
Total Monthly Charge	\$66.13	\$129.53	\$243.41
Dollar Amount Change from Existing Charge	\$3.89	-\$0.02	\$5.09
Percent Change from Existing Charge	6.2%	0.0%	2.1%
Dollar Amount Change from Sawvel Proposal	-\$5.07	-\$0.43	\$7.91
Percent Change from Sawvel Proposal	-7.2%	-0.3%	3.4%
Customer Charge as % of Total Charge	7.6%	3.9%	2.0%

Below is the Missouri Public Service Commission’s order on KCPL’s most recent electric rate increase. There are a couple of items in that order which relate to some of the questions that have been raised regarding IPL’s rate study; namely the proposed residential customer charge, impact on the poor and weatherization.

Residential Customer Charge (see pages 88 – 90 of Commission’s Order)

Essentially, the Commission said the residential customer charge should be set to a cost of service rate, that does not include any distribution system costs. The Commission’s order states:

“Customer-related costs are generally recovered through the customer charge, which serves to prevent higher usage customers from subsidizing lower usage customers, sends all customers more accurate energy pricing signals, and provides more stable and predictable funding for utilities’ fixed costs. Other costs are recovered through volumetric rates that vary with the amount of electricity used. Staff’s class cost of service study determined that the costs related to residential customers are \$11.88 per month. While KCPL requests that additional costs related to local facility equipment be included in the customer charge, the Commission finds that inclusion of those additional costs would be inappropriate because that request is inconsistent with KCPL’s own class cost of service study.

Determining an appropriate customer charge is a question of rate design, not a question of the company’s revenue requirement. Any increase in the company’s customer charge should be accompanied by a decrease in volumetric rates so that, in theory, the company recovers the same amount of revenue. The Commission considers that an important goal of rate design is to recover costs from those who cause the costs to be incurred. Therefore, the Commission concludes that the appropriate residential customer charge is \$11.88 per month, based on Staff’s cost of service study.”

(highlighting added for emphasis)

If you would like, we could calculate IPL's residential customer cost of service excluding distribution costs; but I would suspect it will be about the same as KCPL's customer cost.

FYI: Comments from the MPSC regarding KCPL's Customer Charge are listed below.

Also: Examples of regional "Municipal" Customer Charges:

- Columbia = \$15.60/mo
- Springfield = \$10.75/mo
- Poplar Bluff = \$15.25/mo
- Rolla = \$15.00/mo
- BPU = \$16.00/mo

Q: Can you figure what the customer charge would be if we excluded the distribution costs?

A: If we eliminate the Distribution portion of the Customer Charge, the total fixed cost would be \$15.07/Mo. That seems high, but remember our actual fixed costs for residential service WITH the Distribution costs was \$23.96/Mo. If we take 60% of the NON-Distribution fixed cost (as we did with the total fixed cost), the Customer Charge would be \$9.04/Month. As previously indicated, lowering the customer charge would require increasing the proposed "Energy" rates to maintain the required level of revenues.