

City of Independence

MEMORANDUM

City Council Office

DATE: July 29th, 2015

TO: Honorable Mayor and Members of the City Council

FROM: Zachary C. Walker, Management Analyst

SUBJECT: Independence Power and Light Cost of Service Study



The City Council is being asked to consider a proposal from Independence Power & Light (IPL) pertaining to a Cost of Service study effective October 1st, 2015. In accordance with Section 1.43.007 (E) of the City Code, I have reviewed the consultant's recommendations, attended both the Public Utilities Advisory Board meeting and City Council Study Session reviewing the study with the consultant, and have met with staff from IPL to further review and clarify the study.

Background

On July 21st, 2014, the City Council approved by unanimous vote Resolution 5933, which "declared the City Council's support for renewable electric energy, identified the City Council's goals regarding renewable energy and provided direction to the City Manager regarding City programs and policies related to renewable electric energy." Section 8 of Resolution 5933 authorized and directed that "a rate study of electric rates for residential, commercial and industrial customer classes including provisions to incorporate renewable energy programs identified by the study included in Section 3 of this Resolution and report back to the City Council by May 2015."

In keeping with the terms of Resolution 5933, the City Council unanimously approved issuing a purchase order to Sawvel and Associates Inc. (Sawvel), on October 6th, 2014 for consulting services related to a rate study for the Power & Light Department. Prior rate studies in May 2008 and October 2013 were completed by Sawvel. To capture the synergies of these studies, Sawvel was selected to perform the current Cost of Service study. The Cost of Service study approved by the City Council included the following scope of services:

1. Five-Year Financial Forecast and Rate Design Strategy
 - a. Provide an overall financial condition and revenue needs assessment for IPL over the next five years.
2. Customer Class Cost of Service Analysis
 - a. Provide a classification and allocation of costs for each customer class of IPL based on a historical test year in order to provide a basis for the costs to serve each type of customer of IPL.
3. Development of a Rate Plan:
 - a. Provide recommendations on proposed rate changes by customer class needed to ensure a stable financial position for IPL.

This study has been presented to the City's Public Utilities Advisory Board, which in turn has recommended approval by the City Council. The City Council has received a presentation from Sawvel and discussed the matter at a recent Study Session.

Summary of Findings

Having thoroughly reviewed the recommendations made by Sawvel, it is my opinion that the Cost of Service study be approved by the City Council and implemented as proposed. This determination has been made based upon the fact that doing so will achieve the following key outcomes:

- *Provide equity among customer classes*
 - Sawvel concluded in its study that the residential and general service rate classes are currently paying less than the cost to provide these classes with service (existing rate revenue is 3.9% and 19.6% less than the cost of service for the residential and general service classes, respectively), while the large general service and large power rate classes are paying more than the cost to provide these classes with service (existing rate revenue is 11.5% and 26.4% less than the cost of service for the large general service and large power classes, respectively).

In order to reduce this subsidization issue and provide more equity among and between these rate classes, the study recommends implementing a "cost of service" charge to collect revenues that truly reflect the cost of providing service. Presently, customers pay a minimum bill charge of \$4.14, though the cost of providing customers with service exceeds this amount, even for those customers who use little to no electricity. To address this imbalance, the study recommends replacing the minimum bill charge with a monthly customer cost of service charge (\$14.50 for residential accounts, \$16.00 for general service accounts, \$50.00 for large general service accounts, \$500.00 for large power accounts). This charge would be phased in over a one year period from October 1, 2015 through September 30, 2016 for the residential and general service classes, while the charge would be effective October 1, 2015 for the large general service and large power classes. The base energy use rate will remain unchanged at this time. Sawvel's recommended restructured rates would provide savings of approximately \$7.9 million across the residential, commercial, and industrial customer classes.

- *Establish a competitive balance with neighboring utilities*
 - By moving IPL away from the aforementioned rate subsidization issue, the proposed restructured rates will establish a more competitive balance with neighboring utilities, particularly for the large general service (i.e., large commercial) and the large power class (i.e., industrial). This competitive balance with neighboring utilities will be critical to the City's ability to retain existing large electrical customers within and attract new customers to Independence, which in turn proves essential to economic development and redevelopment opportunities.

The study further seeks to establish a competitive balance in the large customer class by recommending the development of a High Load Factor Rate. This option will likely prove beneficial in attracting and retaining customers that are a constant, high-load energy user. Once again, users in this category are often the very businesses and places of employment that the City seeks to attract and retain through economic development and redevelopment efforts.

Finally, the study seeks to establish a competitive balance by recommending the development of a Partial Requirement Rate. This alternative would be applicable to customers that choose to install on-site generation to supply a portion of the customer's electricity requirements. This rate would not be applicable to backup generators that are used only in the event of an emergency, nor would it apply to net-metering customers.

- *Achieve long-term financial stability and simplify rate structures*
 - Sawvel has proposed the implementation of an unrestricted cash fund balance policy that will insure IPL's rate structure is not under or over collecting revenues from its customers. This policy establishes a formula-based methodology to identify the appropriate unrestricted cash fund balance. This formula considers the various needs for which IPL requires cash reserves, including capital improvement needs, adequate reserves to satisfy costs during low-energy use months, and a reasonable emergency fund. Sawvel concluded that the current unrestricted cash balance is greater than the present operating needs of IPL. Implementation of the study's recommendations will reduce the unrestricted fund balance from \$38.1 million on June 30th, 2015 to approximately \$23 million, primarily by cash-funding current capital improvement projects. More importantly, implementation of the recommendations will help ensure future unrestricted cash fund balances are in line with the operating and capital improvement needs of IPL.

In addition to ensuring the long-term fiscal stability of IPL, the report recommends addressing antiquated, cumbersome rate schedules that are difficult and impractical to administer. Presently, IPL serves approximately 56,510 metered customers under 21 rate schedule customer designations. The report seeks to streamline this process by reducing the number of rate schedule customer designations to four, which in turn will provide rate schedules that are more readily understood by both current and prospective customers while proving to be more easily and effectively administered by IPL.

Finally, the Sawvel study seeks to stabilize the financial well-being of IPL by addressing the Power Cost Adjustment (PCA). Presently, the PCA is set on a monthly basis and swings dramatically and unpredictably. This study addresses this challenge by establishing the Power Cost Adjustment on an annual basis. Though the PCA would be reviewed every six months, it would remain unchanged for a 12-month period.

- *Maintain a highly reliable electrical production, transmission, and distribution system*
 - In Fiscal Year 2014-15, IPL achieved 95% annual continuity rate for electrical service, providing its customer base with a highly reliable production, transmission, and distribution system. Sustaining this level of reliability requires continued capital investment and ongoing maintenance in the electrical system. The report concluded that at present, however, IPL's financial position reflects a negative net income, meaning that the rate at which assets are being depreciated, or aging, is greater than the reinvestment in the system. To that end, the report makes recommendations that encourage IPL to finalize major capital improvements, including transmission and substation projects, based on projected load growth.
- *Create a framework for incorporating future renewable energy developments*
 - An important component of Resolution 5933 was the explicit desire to seek and implement opportunities to utilize renewable resources to satisfy energy demands. Recognizing this City Council priority but also accounting for the

additional dialogue and development that must occur, the study provides a Community Solar Rate that can be used as a template to guide full implementation of a tariff should a solar farm opportunity be identified.

- *Account for unfunded governmental mandates*
 - IPL finds itself operating in an environment that is highly regulated by a multitude of agencies and entities. To continue full operation and avoid severe penalties, IPL must comply with a wide array of governmental mandates, most of which are unfunded. In order to recover these regulatory and environmental costs that are not included in IPL's base rates, the study recommends establishing a Regulatory and Environmental Compliance Rider. This rider would recover any mandated expenditures by IPL from a regulatory agency when not already accounted for in the base rates. Creation of this rider will keep IPL financially secure in satisfying these mandated items.

Conclusion

The recommendations contained within this study achieve a number of positive outcomes that will provide equity among the various rate classes, establish a competitive balance with neighboring utilities, achieve long-term financial stability for IPL, maintain a highly reliable electrical system, create a framework for incorporating future renewable energy developments into the rate structure, and account for unfunded governmental mandates.

Moreover, these recommendations show an appropriate sensitivity to the IPL customer by phasing in the proposed cost of service charge. In the residential class in particular, the consultant recommends assessing a cost of service charge that will be phased in over a 12 month period, and will recover only 60% of the true cost of providing service to this class. Finally, the study recommends no change to the base energy use rate at this time.

In closing, allow me to once again express my confidence that this matter has been carefully researched and developed by the consultant, vetted by City staff, and considered and recommended by the Public Utilities Advisory Board. As such, I am confident that this matter has been thoroughly and carefully reviewed and concur that the proposed adjustments are in fact necessary and appropriate.

Please let me know if you should have any further questions regarding this matter.

C: Robert Heacock, City Manager
E. Leon Daggett, Power & Light Director
Sarah Carnes-Lemp, City Clerk