

## Seattle City Light Review Panel Role in Reviewing Rates and Rate Policy

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This document sets forth the portions of Ordinance 123256 (Creating Review Panel) that relate to the Review Panel's role in reviewing rates and rate policy. The text in boxes is language from the Ordinance. Below each text box is an explanation to provide context and define terms used.

### Section 4. Role of the Panel

(d) **review changes to City Light's rates not already authorized by the Seattle Municipal Code** and provide an opinion to the Mayor and the Council on the adequacy and prudence of such rate changes in light of **adopted planning assumptions and financial policies**.

#### What does this mean?

"*Changes not already authorized by the Seattle Municipal Code*" means changes to rates not included in the "automatic rate change authorizations" now in place. There are two such "automatic rate change authorizations." These include:

1. **Pass through of BPA rate changes:** City Light is authorized to adjust rates to pass through BPA contract cost changes without further Council authorization (SMC 21.49.081, Council ordinance 120247 of January 2001).
2. **Adding Rate Stabilization Account (RSA) surcharges** within certain prescribed limits—this does not require further Council authorization.\*

Accordingly, matters that would be brought to the Review Panel would include the creation of any new automatic type rates, **or** changes in existing "standard" rates. For example, "standard" rates could increase or decrease as a result of budget changes, cost allocation methodology changes, or changes in rate design components. .

*Adopted planning assumptions* are assumptions in the approved budget, financial and rate policy resolutions, and, eventually, the strategic plan—all adopted by the City Council.

There are two core *financial policies*:

1. City Light's electric rates must be set at levels sufficient to achieve a debt service coverage ratio of 1.8.
2. City Light must manage its capital improvement program so that on average over any given six-year capital improvement program it will fund 40% of the expenditures with cash from operations.

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\* The limits on RSA surcharges that can be added without Council action are increments of 1.5% up to a total of 4.5%. The level of the surcharge authorized depends on the level of funds in the RSA (which in turn is dependent on quarterly net wholesale revenue received by City Light).

Section 4. Role of the Panel

(e) in its second year or earlier, and at least once every three years thereafter, **assess City Light’s rate design** to ensure that rates send the appropriate signals to customers to **use electricity efficiently**; and

What does this mean?

*Rate design* means the way City Light structures its rates to recover costs from customers in accordance with adopted rate policies. Assessing rate design means examining both the rate policies and the more detailed decisions that are made to implement these policies. The focus of this requested review is on promoting *efficient use of energy/conservation*.

For example, one of the Council’s rate policies (as previously approved and reflected in current residential rates) says that rates should be designed on the basis of ascending charges for increasing amounts, or *blocks*, of energy where blocks are feasible. This rate design policy is intended to send price signals that encourage conservation. To implement this policy, the City has a variety of rate design options, including:

- Which *rate schedules* (also called “tariffs”) should incorporate pricing by energy blocks?
- How many blocks of energy should be established?
- How big should each block be?
- How much should rates increase from block to block?

The most common price elements in electric rate schedules are:

- “*energy charges*” --prices per kilowatt-hour used
- “*demand charges*” --prices per kilowatt for the *maximum level* of energy consumed during a fixed period of time (for example, during a billing month); and
- “*base service charges*” or “*customer charges*”-- prices per day or month that do not vary with consumption

Current elements of City Light’s rate design that send conservation price signals are the first and second block structure of residential rates, and the peak and off-peak structure of large commercial/industrial customer rates. Other types of rates that might send similar signals include interruptible rates (which might help the utility limit the amount of infrastructure it must install to meet demand), or baseline rates where a customer is allowed to use a set amount of energy at “normal” rates and additional energy use carries a very high price.

Section 4. Role of the Panel

(f) in its second year or earlier, and at least every three years thereafter, **assess City Light’s implementation of marginal cost allocation among customer classes** to ensure that it provides a fair allocation of costs among customer classes and takes account of changes in costs and consumption.

What does this mean?

The Review Panel is being asked to consider how *fairly* the *marginal cost allocation* approach used by City Light is working.

Every electric utility needs to establish a “*revenue requirement*,” i.e., what customers need to pay in order for it to cover its authorized expenditures. One goal of the strategic plan is that it will help map out this revenue requirement over the planning period. The revenue requirement needs to be spread out in some way to customers. All utilities divide their customers up into groups called “*customer classes*.” These groups have some consumption characteristics in common which distinguish them from members of other groups. Differences include when they use the most energy, how much equipment it takes to provide that energy to them, and the cost of the meter that measures their use. These differences affect the cost to provide service. The goal is for the cost allocation to reflect these differences.

“*Fair allocation of costs*” among customer classes is something of an art in the utility industry; everyone does it slightly differently. Again, generally speaking, the goal is to allocate the revenue requirement among customer classes based on the costs of providing service to those customer classes. City Light uses a “*marginal cost allocation*” approach for cost spreading. Marginal costs measure how a utility’s cost picture changes when new load is added or new customers join the system. Per Council direction, City Light has used a marginal cost of service study as the basis for apportioning the revenue requirement to customer classes since 1980. The intent behind this approach is to send the appropriate cost signals to users to be efficient in the use of the resources. City Light calculates marginal costs for all customer classes and allocates the revenue requirement to them by percentage shares of marginal costs. For example, if a given customer class is responsible for 20% of marginal energy costs, it will be allocated 20% of the revenue requirement related to energy.

*Taking account of changes in costs and consumption* means that the utility should perform a cost of service study at least every few years. City Light last did a cost of service study in 2006.

#### Section 6. Rate Setting.

The Council will not adopt rate changes proposed by the Mayor for at least sixty days after the Council Bill authorizing the rate change has been referred by the Council to the relevant standing Committee to allow the Panel sufficient time to review the proposed change and sufficient opportunity for the public to provide input to both the Panel and the Council. However, this restriction does not apply to rate changes initiated by the Council to address emergent issues or to protect the financial integrity of the utility.

#### What does this mean?

The Council expects the Review Panel to provide input on proposed rate changes, unless there is an emergency.

The *sixty day* waiting period is a new requirement adopted to give more time for rate review and to highlight the Review Panel’s role in this process, making sure there is sufficient time to receive public comment. The Review Panel will, of course, have its own calendar of activities and will begin considering any new rate proposals long before they get to the Council’s designated committee.

When City Light wants to change rates, it first discusses them with the Mayor and the Mayor makes the actual proposal to the Council's Energy, Technology and Civil Rights committee (ETCR). This committee reviews and discusses the proposals with City Light, sometimes making minor changes and other times proposing significant alternatives. The Full Council considers the alternatives and adopts one after providing hearings in which the public can comment.

Occasionally, the Council adopts City Light rate changes without allowing much time for public review. This happened, for example, during the 2001 energy crisis, when power costs were increasing exponentially from one day to the next and the utility could not continue to provide energy to customers without more revenue to cover the cost.