Rate Design and Cost of Service Issues for Large Energy Users

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City Light Review Panel

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SCL Class COS Issue #1

Allocation of Net Wholesale Revenues

- SCL's Net Wholesale Revenues (NWRs) play an important role in offsetting part of the cost of serving SCL's retail customers.
- Up until the 2007/2008 rate period, SCL appropriately assigned NWRs to the "Energy Function" and allocated these revenues to each class consistent with the allocation of "Energy Function" costs. This treatment properly allocates the benefits from these revenues in the same manner as the allocation of costs of the facilities that make these benefits possible. This is standard utility practice across the country, including other regional utilities such as PacifiCorp (UT, OR, WA and WY), Idaho Power, PGE, and PSE.

Current SCL Cost of Service Method: MIC Concerns

- In the 2007/2008 rate period, the assignment and allocation of NWRs was changed.
  - NWRs were essentially assigned to both the Energy Function plus the "Retail Service Function" and allocated based on the combined costs in these two functions. The Retail Service Function includes all distribution costs – which are unrelated to the production of NWRs.
  - This change to the allocation of NWRs unfairly diluted the NWRs allocable to Small, Medium, Large, and High Demand classes, representing a loss of 1/6 of the NWR credit for these classes - $10 million annually at the 2007/2008 NWR level.

Recommendation: The 2007/2008 allocation method for NWRs unreasonably disadvantages large energy users. NWRs are properly assigned only to the energy function and should be allocated in the same manner as energy production costs.

Current SCL Cost of Service Method: MIC Concerns

SCL Class COS Issue #2

Allocation of Franchise Contract Revenues

- The allocation of franchise contract revenues from Tukwila and other suburbs served by SCL improperly disadvantages non-residential customers.
- In the 2007/2008 COS report, the utility noted that its financial agreements resulted in an additional $13 million of revenue.
- SCL notes in its report that the franchise contract revenue was “credited to those (customers) considered to be the owners of the Department’s assets, i.e. Seattle residential customers.”
- ALL customers, not just residential customers, contribute to paying for the assets of the utility: i.e. generation, transmission, distribution, etc, and therefore should share the benefit of the franchise contract revenue allocation.

Current SCL Cost of Service Method: MIC Concerns

- **Recommendation: The current method for allocating franchise fees unfairly disadvantages non-residential energy users. In the 2007/2008 rate period, $1.27 million of additional costs were allocated to Non-Residential customers due to this method.**

  All customers pay for the utility assets; therefore, the franchise agreement revenue should be equitably shared by all the classes by allocating the franchise agreement revenue on the basis of each class's share of the total revenue requirement.

Current SCL Cost of Service Method: MIC Concerns

SCL Class COS Issue #3

Allocation of Generation Capacity Costs

- The Northwest region has historically been a winter-peaking system. However, the Sixth Northwest Conservation and Electric Power Plan indicates that the summer peaks are expected to grow faster than the winter peaks. That means that SCL must now purchase excess capacity it may not need at other times of the year in the summer in order to serve the peak load driven by residential customers.
- In an August 2011 handout, SCL notes that “rates should be structured so that customers face price incentives to conserve energy and reduce peak capacity requirements.”

Recommendation: SCL’s marginal cost study lacks any recognition of the cost of generation capacity necessary to serve customers. The marginal cost of service study should be modified to include a demand-related generation component to derive the marginal costs shares by customer class for the Energy Function.

Rate Design: MIC Concerns

Resolution 31351

- MIC strongly opposes "higher rates for high consumption (blocks of energy)" for non-residential customers.
- The distinctions that are used to justify inclining block rates for residential customers (e.g., "essential" usage versus discretionary usage) are entirely inappropriate for non-residential customers: non-residential usage is driven by business-specific requirements, not consumption preferences.
- Establishing inclining block rates for non-residential customers would be arbitrary and would unfairly punish or reward businesses purely on the basis of size or energy process requirements.
- Inclining block rates for non-residential customers would penalize customers for economic growth.

Recommendation: Reject the concept of inclining block rates for non-residential customers.

Setting Rates for the Upcoming Rate Period

Updated Cost of Service Study (July 11, 2012)

- The updated cost of service study indicates that High Demand rates should be reduced 3.5% overall to reflect costs under the current methodology.

Recommendation: Use the updated cost of service study (July 11, 2012) to guide ratemaking for the upcoming rate period. Apply the cost-based decrease derived in the updated study for High Demand customers.

Summary of Recommendations

Class Cost of Service Method

- NWRs should be allocated in the same manner as energy production costs, consistent with the allocation method that was used prior to the 2007/2008 rate year.
- Allocate Tukwila and other suburb franchise contract revenues on the basis of each rate class' share of the total revenue requirement rather than restricting this credit to the residential rate class.
- Modify the marginal cost of service study to include a demand-related generation component to derive the marginal costs shares by customer class for the Energy Function.

Rate Design

- Reject the concept of inclining block rates for non-residential customers.

Setting Rates for the Upcoming Rate Period

- Use the updated cost of service study (July 11, 2012) to guide ratemaking for the upcoming rate period. Apply the cost-based decrease derived in the updated study for High Demand customers.

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