



# MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

*Rely on us.*

TO: Commissioners McRae, Barofsky, Schlossberg, Brown, and Carlson

FROM: Frank Lawson, General Manager; Deborah Hart, Assistant General Manager/CFO; Adam Rue, Rates Manager

DATE: July 31, 2024 (August 6, 2024, Board Meeting)

SUBJECT: Review of Ratemaking Principles

OBJECTIVE: Rate Design Directional Discussion

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## Issue

The Eugene Water & Electric Board is developing a Rate Design Plan. This presentation seeks Board direction and feedback on key strategic questions related to rate design and revisits Rate Design Principles to guide those efforts. Staff is presenting current and proposed changes to rate making principles and overview of 5-year rate planning process.

## Background

The 2024 EWEB Organizational Goals update include the development of a 5-Year Rate Design Plan. Primary elements of the Rate Design Plan will include at least the four components listed below.

- a) Cost of Service Analysis
- b) Customer and internal stakeholder engagement.
- c) Assessment of current and required systems to enable advanced rates.
- d) Option rate and payment choices to match customer preference and support beneficial behavior such as smart electrification.

These plan requirements have been considered in the Climate Action Plan 2.0, section 2.6.4 EWEB Rate Design Principles. These principles allow EWEB to meet organizational goals and align with values while conforming to its legal obligations. Utility rates have a legal requirement to be rates that are “reasonable” and not “unduly discriminatory” and EWEB has closely aligned its rate making principles with industry accepted principles that provide the basis for meeting legal standards and best practices in rates making.

## EWEB Rate Making Principles:

- Sufficiency
- Affordability
- Efficiency
- Cost Basis
- Equity
- Gradualism

EWEB ratemaking principles are codified in several different Board policies and the reference to these policies can be found in Attachment 1.

The development of the Rate Design Plan holds interdependencies with other 2024 Organizational Goals. The SAP Finance and Customer Systems “Go Live” will be a key system required to enable advanced rates. Additionally, the 2023 Integrated Resource Plan “Actions” of BPA product selection and completion of Demand-Side Management potential assessment actions will inform value and customer benefit of the Rate Design Plan.

**Discussion for Rate Making Principles**

EWEB ratemaking principles are codified in several different Board policies. This update modifies SD9 Rate Setting Policy to provide additional context to reference the Rate Design Principles more explicitly into a single section of Board Policy. Therefore, the Rate Design Principles are proposed to be consolidated into a single section of Board Policy. There are also substantive clarifications/edits recommended below for Board consideration.

The proposed edits to SD9 Rate Setting Policy, which incorporates the changes outlined below can be found in Attachment 2.

Sufficiency

Sufficiency is the principle that provides investor-owned utilities with the ability to recover costs and a reasonable rate of return to attract capital and continue to invest in the system on behalf of customers. For a municipal utility like EWEB, sufficiency is a principle supported by Board Policy SD6, Financial Policies, and SD9 Rate Setting Policy.

Principle	Current	Consideration(s)
Sufficiency	EWEB policies provide guidance on sound financial management.	No substantive change to SD6 or SD9 is recommended but Rate Sufficiency incorporated into SD9 and listed under Rate Design Principles as well.

**Rate Design Plan impact:** reserves strategy and financial management metrics provide framework for borrowing and funding large capital projects. The ability to mitigate risks through more closely aligning supply and demand is intended to improve sufficiency metrics within a given overall rate level (i.e. time of use rates leading to shift from high-cost periods to reduce overall cost pressure).

Affordability

Affordability is included in Board policy SD1, Mission, Vision, Values & Legacy. “Affordable” is listed as one of the utility’s five values.

Principle	Current	Consideration(s)
Affordability	EWEB SD1 highlights the value of Affordability as a key value for EWEB.	No substantive change but includes Affordability in SD9.

SD1 states that EWEB values and respects our customer’s financial resources by making wise investments and controlling costs and rates. This value is supported by EWEB’s limited-income programs and long-standing budgeting practices.

**Rate Design Plan impact:** reduce long-term investment needs by better aligning supply and demand to reduce capital needs for a given overall consumption level (i.e. flat loads are cheaper to serve than peaking loads)

Efficiency

Efficiency in ratemaking refers to the concept that electricity prices should be set at an economically efficient level. The prices should reflect, as closely as possible, the true cost of providing reliable electric services to each customer class and should not inadvertently distort the market. Setting an electricity price that does not align with costs has significant consequences for utilities.

Principle	Current	Consideration(s)
Efficiency	EWEB has referenced Efficiency in its Board presentations on ratemaking principles but has not codified in Board policies.	Efficiency is defined as a counter to traditional cost basis by viewing economic efficient pricing in terms of long-term marginal costs including externalities.

Additionally, efficiency can also be used to describe the customers’ understanding and interpreting the utility prices, rates, and tariffs.

**Rate Design Plan impact:** aligning costs and rates is a fundamental element of the Rate Design Plan. This principle is most closely aligned with the strategic objective of aligning and synchronizing supply and demand.

Cost Basis

The principle of cost basis typically refers to the results of the budget process and cost allocation in the Cost-of-Service Analysis (COSA). EWEB currently utilized COSA based analysis for many of its retail rates and prices. However, some instances, such as retail power supply agreements and direct generation pricing utilize different terms and pricing than direct COSA allocation.

Principle	Current	Consideration(s)
Cost Basis	Traditional Cost Basis is typically represented in a budget based annual COSA methodology.	Behavioral Cost Basis is defined more broadly to include a variety of factors including traditional COSA but also short and long-term marginal costs and externalities, such as carbon cost.

The cost-of-service models are the basis for meeting the standard of cost based rates for EWEB customers. The costs are based on the Board approved budget annually and projected in three-year periods for multi-year cost of service review.

Rate Design Plan impact: the use of embedded and/or marginal cost is most directly related to the principle of cost basis. Pricing at embedded cost ensures sufficiency and pricing at long-term marginal cost aligns with efficiency. The two principles can be in conflict at times, but the definition of cost basis can provide helpful insight.

**Equity**

Equity is in reference to the legal standard of rates that are “fair and reasonable” and “not unduly discriminatory” and is met by applying an industry standard cost of service approach to cost allocation among various customer classes and by employing standard rates and policies for customers within the respective customer classes. This ratemaking principle is aligned with Board policy SD9 Rate Setting Policy and SD23 EWEB’s Diversity, Equity, and Inclusion policy, especially within the focus area of equitable “access to products and services”.

<b>Principle</b>	<b>Current</b>	<b>Consideration(s)</b>
Equity	Provides the legal standards for rate setting in SD9	No substantive change and still included in SD9

Rate Design Plan impact: Equity discussions are at the forefront of electrification and rate design. Questions such as how much demand is embedded in each residential service and is it equivalent across the community are highly relevant to ensuring adequate infrastructure to meet demands of electric vehicles and other electrification.

**Gradualism**

Gradualism (Bill Stability) refers to the need to ensure that electricity tariffs remain relatively stable over time. The cost of electricity can vary hour to hour and the principle of stability reflects the utilities’ role in managing that volatility and insulating customers from the impact of the volatility. EWEB develops a 10-year financial plan and manages its financial plans to mitigate rate shock and volatility in retail rates and prices.

<b>Principle</b>	<b>Current</b>	<b>Consideration(s)</b>
Gradualism	Not directly identified in Board Policy.	Includes Gradualism in SD9.

The intent of these revisions/clarifications to rate design principles is to align EWEB rate development processes with the legal framework and utilizing industry standard practices of establishing its revenue requirement and cost allocation, while providing the Board of Commissioners adequate discretion within these principles to meet competing objectives, organizational goals, and community values.

Rate Design Plan impact: ultimately, the transition to new rate design will incur change and, where appropriate, the changes should employ the principle of gradualism to mitigate customer impacts. The ability of customers to change behavior and/or make investments will require planning and gradualism to improve engagement and acceptance within the customer base.

## **Rate Design Questions (Work Session-Style Discussion)**

The plan requirements will be informed by key strategic questions that the Board can consider and use to provide feedback and direction to staff. Some key considerations and questions include:

1. What costs/investments should EWEB socialize across all rates?
2. Are there specific costs/investments that should only be socialized within customer classes (i.e., residential, commercial, industrial)?
3. What costs should be borne by specific customers?
4. How should EWEB reward customers who can modify consumption for the benefit of all, and how much of this benefit should be shared?
5. Does customer-specific profile (i.e., income level, customer class, location, etc.) or consumption purpose (i.e., restaurant vs. brewery vs. senior center) matter when it comes to utility pricing/rates? How/when?
6. Should rates be based on present costs to service, or should rates be geared to drive behavior that reduces future costs?

Understanding the Board's perspective on these broad issues/questions can aid with more specific rate-design elements, such as:

- a. Is an uprived rate appropriate?
- b. Should today's pricing structure more strictly align with costs-of-service (e.g. ratio between fixed and variable/marginal costs)?
- c. How might a residential demand charge be implemented?
- d. How can Time-of-Use pricing create beneficial behavior? How are the benefits realized?
- e. How might demand-response participation and conservation benefits be distributed?

## **Next Steps**

The Rate Design Plan will be presented to the Board at the October Board meeting. The initial draft presentation will incorporate analysis of the three-year cost of service for water and electric utilities and provide recommendations for rate trajectory in that timeframe. The recommendations will then be finalized to incorporate any Board feedback and will be presented in the November and December price proposals.

The Rate Design Plan that is referenced in the 2024 EWEB Organizational Goals will be incorporated into the October Board discussion. The Rate Design Plan addresses key interdependencies of rate design with other organizational initiatives, including customer and stakeholder engagement, demand potential assessment, electric resource planning, distribution system planning, BPA product selections, SAP Finance, Customer Systems, and meter data management.

## **Requested Board Action**

Feedback on the Rate Design Principles and Rate Design Questions posed above, for further investigation and potential incorporation into the Rate Design Plan for preliminary review in October.

**Links and Relevant Resources:** EWEB Board Policies including Strategic Direction Policies SD 1, SD 3, SD 6, SD 9, and SD23 referenced in this section.

## Attachment 1

EWEB ratemaking principles are codified in several different Board policies.

Sufficiency is the principle that provides investor-owned utilities with the ability to recover costs and a reasonable rate of return to attract capital and continue to invest in the system on behalf of customers. For a municipal utility like EWEB, sufficiency is a principle supported by Board Policy SD6 Financial Policies and SD9 Rate Setting Policy.

SD6 states “Rate Sufficiency Policy: 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. (FP 1.1) “

SD9 states “set rates at a level sufficient to recover ongoing costs of utility operation.”

Affordability is included in Board policy SD1, Mission, Vision, Values & Legacy. “Affordable” is listed as one of the utility’s five values.

SD1 states that EWEB values and respects our customer’s financial resources by making wise investments and controlling costs and rates. This value is supported by EWEB’s limited-income programs and long-standing budgeting practices.

Efficiency in ratemaking refers to the concept that electricity prices should be set at an economically efficient level. The prices should reflect, as closely as possible, the true cost of providing reliable electric services to each customer class and should not inadvertently distort the market. Setting an electricity price that does not align with costs has significant consequences for utilities. Additionally, efficiency can also be used to describe the customers’ understanding and interpreting the utility prices, rates, and tariffs.

Cost Basis has two components that align with the Board policies SD3 Customer Service Policy and SD9 Rate Setting Policy.

SD3 states that “rates will be uniform to all consumers within various service classifications; and that pricing for utility service and products will be cost based...”

SD9 states EWEB’s elected Board of Commissioners has complete authority to “approve rates which are cost-based, nondiscriminatory, and in concert with the needs of EWEB’s customers.”

The cost-of-service models are the basis for meeting the standard of cost-based rates for EWEB customers. The -costs are based on the Board approved budget annually and projected in three-year periods for multi-year cost of service review.

Equity is in reference to the legal standard of rates that are “fair and reasonable” and “not unduly discriminatory” and is met by applying an industry standard cost of service approach to cost allocation among various customer classes and by employing standard rates and policies for customers within the respective customer classes. This ratemaking principle is aligned with Board policy SD9 Rate Setting Policy and SD23 EWEB’s Diversity, Equity, and Inclusion policy, especially within the focus area of equitable “access to products and services”.

SD9 requires that “rates and charges for utility service be fair and nondiscriminatory” and are considered nondiscriminatory when “customers receiving like and contemporaneous service under similar circumstances are treated equally in the development and application of specific rates.”

SD23 authorizes, delegates, and directs EWEB’s General Manager to ensure that the Community we serve has Equitable Access to Products and Services.

Gradualism (Bill Stability) refers to the need to ensure that electricity tariffs remain relatively stable over time. The cost of electricity can vary hour to hour and the principle of stability reflects the utilities’ role in managing that volatility and insulating customers from the impact of the volatility. EWEB develops a 10-year financial plan and manages its financial plans to mitigate rate shock and volatility in retail rates and prices.

EWEB Board policy SD6 Financial Policies 1.2 supports the principle of gradualism.

SD6 FP 1.2 states “certain funds will be held in reserve for the purpose of mitigating the customer rate impact of unanticipated events.” EWEB annually reviews and updates its Rate Stabilization Fund.

The intent of these established rate design principles is to align EWEB rate development processes with the legal framework and utilizing industry standard practices of establishing its revenue requirement and cost allocation, while providing the Board of Commissioners adequate discretion within these principles to meet competing objectives, organizational goals, and community values.

Links and Relevant Resources: · EWEB Board of Commissioner Policies. Includes Strategic Direction Policies SD 1, SD 3, SD 6, SD 9, and SD23 referenced in this section.

## **Attachment 2**

### **Strategic Direction Policies (SD Policies)**

**SD9**                                      **Rate Setting Policy**  
**Effective Date**                      **October 4, 2007**

The EWEB Board has exclusive jurisdiction to approve annual operating budgets and establish rates for electric service. Although EWEB's electric rates are not subject to regulatory review by any federal or state utility commission or similar agency, the Board must comply with the requirements of applicable state and federal statutes as they pertain to the development of rates and the general conduct of utility business. Current statutes and related case law provide two general standards and the first two rate design principles concerning the establishment of retail electric rates.

**RATE SUFFICIENCY PRINCIPLE:** Rates and charges will be adequate recover the ongoing costs of utility operations and to provide revenues sufficient to maintain a degree of financial soundness over and above requirements for compliance with existing bond covenants. 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.

**EQUITY PRINCIPLE:** Rates will conform with the legal 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.

**EFFICIENCY PRINCIPLE:** Rates, fee, and prices will be set at an economically efficient level. The prices should reflect, as closely as possible, the true cost of providing reliable electric services to each customer class and should not inadvertently distort the market. This may include consideration of embedded average costs, market-based pricing, short-term and long-term marginal costs, or other behavioral cost-based pricing. Setting an electricity price that does not align with costs has significant consequences for utilities.

**COST BASIS PRINCIPLE:** Cost allocation and rate design are cost based in accordance with all applicable federal, state, and local laws and regulations. The Cost Base will be established by utilizing COSA, short- or long-term marginal costs, market-based pricing, behavioral cost basis, or other reasonable cost-based pricing mechanism.

**AFFORDABILITY PRINCIPLE:** Rate affordability is included in Board policy SD1, Mission, Vision, Values & Legacy. "Affordable" is listed as one of the utility's five values.

**GRADUALISM PRINCIPLE:** Rate and customer bill Gradualism refers to the need to ensure that electricity tariffs remain relatively stable over time. The cost of electricity can vary hour to hour and



large capital projects can produce significant volatility and cost. Gradualism provides a framework for insulating customers from the impact of the volatility. EWEB develops a 10-year financial plan and manages its financial plans to mitigate rate shock and volatility in retail rates and prices.

The above standards, and approved policies allow EWEB to maintain rates at the lowest possible level consistent with sound financial principles and traditional utility ratemaking practice. They also give EWEB's elected Board of Commissioners complete authority to approve rates which are cost-based, nondiscriminatory, and in concert with the needs of EWEB's customers.