

Appropriate Recovery of Power Costs – A Key to Financial Health

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Power Costs Dwarfing All Others

- By far the largest portion of operating expense; for most cooperatives, in the range of 65% to 80%
- Growing fast; many cooperatives could see power cost doubling in the next 10 years or so
- Many are experiencing wide fluctuations due to fuel prices

3 Key Financial Health Issues

- Fully recovering power cost, since under-recovery could threaten financial stability
- Recovery from customers reflecting cost causation improves both cost recovery and rate fairness
- Review and revise recovery methods as external pressures change

Full Cost Recovery

- **Fluctuating costs may merit a new approach to avoid year-end surprises**
 - Fuel cost variations from budget
 - Usage-driven changes in cost
- **For some distribution cooperatives, the wholesale supplier carries variances for true-up later**
- **Power cost adjustments are often good preventive medicine**

Power Cost Adjustments

- Power cost adjustments provide recovery of changing power costs without frequent base rate changes but . . .
- There are multiple ways of implementing, with tradeoffs
 - Infrequent changes provide stability but add risk to recovery
 - Monthly changes improve recovery but reduce stability
- Watch out for late-year surprises!

Reflecting Cost Causation

- **Cost causation is a function of wholesale supply**
 - Structure of pricing in wholesale power contract
 - Drivers of cost for directly owned generation assets
- **Rate components should reflect wholesale cost components**
 - Capacity costs in demand charges
 - Variable costs in energy charges

Simplicity vs. Safety Tradeoffs

- Utilities have historically deviated from cost causation for customer, administration & technology reasons
 - Residential and small GS customers not billed based on demand
 - Larger customers not billed for demand when cooperative peaks
 - Few customers billed based on time of day cost variations
- We could do these, though

Safer But Still Simple

- Seasonal energy charges provide recovery of costs in periods incurred
- Billing larger customers based on same demand each month provides revenue stability
- Smaller rate classes based on similar characteristics provides fairness with simplicity
- Long-standing rate discounts may no longer be cost justified

A Future of Greater Complexity

- Political and member calls for energy reduction programs
- Power costs may continue shift from capacity to energy
 - Less construction will mean average capacity falls with depreciation
 - Emissions regulation will drive energy cost upward on top of fuel increases
- Rate innovation likely needed to change member usage behaviors

Future Complexity Can be Good

- Pressures for innovation will lead to greater cost causation in rates
 - TOU rates to encourage efficiency will better link revenue with cost
 - Critical Peak Pricing will pass along peak cost to customers
- Providing more information on cost to members should lead to lower costs and member bills

Periodic Review Essential

- Pricing tactics to meet current needs may not support future strategies
 - New laws will result in new costs
 - Legal mandates will lead to new cooperative strategies
 - Members' needs will change
- Rates, both levels and structures, need periodic review to assure alignment with cooperatives' needs