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MEMORANDUM

TO: Mayor and Council Members

CC: Spencer Cronk, City Manager

FROM: Jackie A. Sargent, General Manager *JAS*

DATE: September 21, 2022

SUBJECT: Adjustment to Austin Energy's Power Supply Adjustment Rate and Other Pass-through Charges for Fiscal Year 2023

The purpose of this memo is to update the City Council on proposed adjustments to Austin Energy pass-through charges: the Power Supply Adjustment (PSA), Regulatory Charge, and Community Benefit Charge (CBC). Adjustments to these charges occur annually to reflect actual costs. The Fiscal Year (FY) 2023 pass-through rates will come before City Council for consideration next week at its September 29 meeting.

Changes to the pass-through rates are separate from the pending base rate review. As discussed below, the current PSA and Regulatory Charge is insufficient to meet rising costs, and Austin Energy has been depleting working capital to meet these financial obligations. Higher energy costs are occurring both nationally and globally, and are impacting Austin Energy as well.

Most significantly, the proposed adjustments include a 71% increase in the PSA charge on customer utility bills starting November 1, 2022. The PSA is the largest pass-through component of the bill, and the increase is due to adjusting the rate after the return of a significant over-recovery in wholesale power supply revenues associated with Winter Storm Uri in February 2021, which had resulted in lowering the PSA below cost, as well as increased market costs due to regulatory changes associated with the ERCOT market. Specifically, these increased costs are a direct result of higher congestion costs seen within the ERCOT system, exacerbated by the highest natural gas prices since 2008. In addition to the PSA adjustment, the smaller Regulatory Charge will increase by 24%. The increase to the Regulatory Charge is a result of prior under recovery.

The net impact of these changes to the PSA and Regulatory Charge will be a monthly increase of \$20, or 24%, to a typical residential bill (860 kWh). Impacts to commercial and industrial customers will vary depending on consumption patterns, but can be up to twice the percentage increase on a typical residential customer.

I. Power Supply Adjustment

Policy

The PSA tariff requires that the rate be determined as part of the City of Austin's annual budgeting process, including a public hearing. The tariff also provides that the PSA rate may be adjusted during the year to eliminate any over- or under-recovery. To enact a PSA adjustment, the City Manager must report to the City Council the underlying calculations for the PSA, both pre- and post-adjustment, by customer class within 30 days of any adjustment of the PSA.

In compliance with the adopted tariff, this memorandum serves as the City Manager's public report to the City Council. Public notice of the PSA adjustment is provided through the issuance of this memo. Due to the accelerated timing of the annual budgeting process, Austin Energy sets the PSA annually effective November 1 to capture summer energy usage.

Background

The PSA is a dollar-for-dollar cost pass-through to electric utility customers for the recovery and crediting of ERCOT settlements, fuel costs, and net purchased power agreement costs, with an adjustment for the over- or under-recovery balance for the period preceding the adjustment of the PSA. There is no monetary gain or general fund transfer assessed on PSA charges.

Effective with November 2022 electric bills, the PSA on residential bills will increase from the current 2.877 cents to 4.917 cents per kilowatt-hour (kWh), which represents a 71% increase. The PSA component of a typical residential customer bill of 860 kWh per month will increase by \$17.55 per month, or 21%. Austin Energy's residential and commercial Business Cents and Energizer customers who subscribe to GreenChoice® will also see an increase.

Drivers of Adjustment to the PSA

The PSA rate for FY 2023 will increase due to five major factors.

First, the current PSA rate of 2.877 cents was deliberately set below cost by roughly 0.6 cents to pass through an over-recovery from extraordinary generation revenue during Winter Storm Uri. That over-recovery was passed through to customers in FY 2022 in the form of a PSA reduction, which now requires the adjusted rate to reflect current costs.

Second, Austin Energy incurred significantly higher transmission congestion costs than in any previous year. Congestion costs occur when the flow of energy on the ERCOT electric grid is limited due to certain constraints such as changes in power flows, transmission outages, the proximity of load to generating resources and the finite capacity of transmission lines within ERCOT. Increased load surrounding Austin Energy's load zone, decreased local generation, and increased generation in less populated areas have led to an increased potential for significant congestion across the ERCOT region, and this potential was realized in 2022 in the form of higher costs for many market participants, including Austin Energy.

Third, natural gas prices this FY were higher than in any previous FY since 2008. The August 31, 2022, average gas price of \$8.93/MMBtu was 106% higher than the August 2021 price of \$4.33/MMBtu, and

288% higher than the August 2020 price of \$2.30/MMBtu. Not only do these natural gas prices impact Austin Energy’s fuel costs, but they drive ERCOT market prices overall. For example, historical ERCOT market prices per MWh have averaged \$22 for FY 2020 and \$33 for FY 2021 (excluding Uri) for the Austin Energy load zone. Whereas, in FY 2022, prices have averaged \$62.

Fourth, with growing reliability concerns resulting from ERCOT performance during Winter Storm Uri, ERCOT has taken a conservative operating posture leading to increased costs across the ERCOT system. These costs are estimated at over \$1.5 billion through the first two-thirds of FY 2022, by the Independent Market Monitor. These costs are recovered through all ERCOT customers in the form of higher rates.

Fifth, because the current PSA rate was set below cost at a time when significant increases in natural gas prices and congestion occurred in the market, the PSA is estimated to be under-recovered by \$77 million through October 2022. The proposed 2023 rate reflects this under-recovery in addition to a \$27 million net receivable owed from ERCOT related to Winter Storm Uri.

Underlying Calculations for the PSA

Austin Energy utilizes a standard formula to develop the PSA average system rate, as shown below:

$$\left(\frac{\text{(Over) or Under Recovery}}{\text{Normalized GWh Forecast}} \right) + \left(\frac{\text{Historical Costs}}{\text{Historical GWh}} \right)$$

Historical costs and load (GWh or kWh) and the over- or under-recovery amount may be adjusted to reflect known and measurable changes to account for one-time events, abnormal weather, abnormal operating conditions, or other events not reflected or improperly reflected in the historical numbers. The current PSA average system rate, developed in September 2022, utilized adjusted historical costs and an over-recovery balance as of August 31, 2021, a forecast of over- or under-recovery for September 1 through October 31, 2021, and a normalized load forecast for the period of November 1, 2021, through October 31, 2022. The result was an average system rate of 2.862 cents per kWh, calculated as shown below (in millions of dollars and GWh):

$$\left(\frac{-\$51.0\text{M}}{12,038 \text{ GWh}} \right) + \left(\frac{\$401.9\text{M}}{12,230 \text{ GWh}} \right)$$

The proposed 2023 PSA average system rate utilizes adjusted historical costs as of August 31, 2022, the forecasted under-recovery amount as of October 31, 2022, and a normalized load forecast for the period of November 1, 2022, through October 31, 2023. The result is an average system rate of 4.893 cents per kWh, calculated as shown below (in millions of dollars and GWh):

$$\left(\frac{\$104.2\text{M}}{12,548 \text{ GWh}} \right) + \left(\frac{\$535.0\text{M}}{13,167 \text{ GWh}} \right)$$

Adjustment for Customer Classes

Austin Energy adjusts the average system rates based upon the level of voltage in which the customer receives electricity. Customers served at primary and transmission level voltage install and maintain their

own transformer(s) and related equipment at their site as needed to step down the voltage before the power enters their facility. Electricity delivered at higher voltages results in lower line losses between the point of generation and delivery to the customer. As a result, primary and transmission customers pay a slightly lower PSA charge. Residential and most business customers receive secondary service. All customers will receive a 71% increase in their PSA rate. The total impact of this increase on a customer’s bill is dependent upon their voltage level, consumption, and usage pattern.

The following table indicates the proposed PSA rates per kWh by voltage level on bills beginning November 1, 2022.

Voltage Level	Adjustment Factor	Power Supply Rate (\$/kWh)
<i>System Average</i>	1.0000	\$0.04893
<i>Secondary</i>	1.0049	\$0.04917
<i>Primary</i>	0.9821	\$0.04806
<i>Transmission</i>	0.9696	\$0.04745

II. Other Pass-Through Adjustments

In addition to the PSA, the Regulatory Charge and CBC are reviewed annually and adjusted as needed to recover their respective costs and prior period over- or under-recovery. All pass-throughs are accounted for under “GASB 62: Regulated Operations,” which requires that rates set to recover costs can be charged and collected from customers.

Regulatory Charge

The Regulatory Charge recovers (1) Electric Reliability Council of Texas (ERCOT) transmission service charges and credits; (2) North American Electric Reliability Corporation (NERC) and Texas Reliability Entity, Inc. (Texas RE) regulatory fees and penalties; (3) ERCOT administrative fees; and (4) other material regulatory fees or penalties specific to the electric industry.

The FY 2020 Regulatory Charge was intentionally set below cost to pass back a prior period over-recovery. In response to the pandemic, Austin Energy provided additional interim bill relief by further reducing the Regulatory Charge by 32% beginning in April 2020 to accelerate this refund of the over-recovery. While the lower Regulatory Charge provided the intended relief to our customers, those rates have since proved inadequate to recover rising wholesale transmission costs.

The current Regulatory Charge is estimated to result in an under-recovery of approximately \$20 million by the end of this FY and to under-recover annual expenses by approximately \$30 million a year in FY 2023. To mitigate this under-recovery, Austin Energy proposes to increase the Regulatory Charge by 24% and raise annual regulatory revenue to an amount equal to the expected annual expense. This increase is part of a three-year funding plan that is projected to fully recover regulatory costs and any under-recovery by FY 2024.

For FY 2023, the estimated bill impact of the Regulatory Charge to a residential customer using 860 kWh is \$2.45 monthly.

Community Benefit Charge

The CBC recovers certain costs incurred by the utility on behalf of Austin Energy's customers and the greater community and includes three specific programs and services provided to customers. This memo does not address FY 2023 changes to the CBC as any changes will be implemented concurrent with the finalization of the pending base rate review.

III. Conclusion

With the material changes to the PSA and Regulatory Charge effective November 1, 2022, Austin Energy will analyze alternative options to future rate setting processes that could stabilize customer bills and reduce volatility, including setting the PSA on a more frequent basis.

If you have any questions, please contact me or Mark Dombroski, Austin Energy's Deputy General Manager, Chief Financial and Administrative Officer.

xc: Ed Van Eenoo, Chief Financial Officer, City of Austin