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RECOMMENDATIONS

Recommendation 7. Determine if the current state of union/management relations is equitable and not favorable to one side at the expense of the other.

LADWP management personnel can only accomplish what they try to accomplish. If they continue to allow the Union to “win” the majority of issues, they only have themselves to blame for future problems.

Elected officials should strongly consider an effort to reduce continuing union involvement in the management of the Department, other than through normal channels. Of course, this may impact the level of support and money provided to the elected officials but efficient and effective management of the Department should be the overwhelming goal. The ratepayer should be the primary concern.

Recommendation 8. Immediately develop a confidential strike preparation plan and ensure that cross-training and documentation of essential functions is included in the process and plan.

It is incumbent on management to ensure that operations continue under a variety of circumstances, including a work stoppage. Additional attention from management to the possible contingency of a work action is warranted and ratepayers need to be assured that the Department management is looking out for their interests.

III. CITY TRANSFER AND ECAF ISSUES

SUMMARY

The City has benefited substantially from the transfer of “surplus” funds from the DWP. However, it was the “Transfer Issue” in the spring of 2010 that caused substantial concern among City politicians, DWP officials and the public. Over the past twelve (12) years, the City has received over \$2.2 billion from the LADWP based on the City Transfer. The transfers of money from the Department to the City each year are basically required by the City and are based on an amount that has been budgeted by the Department rather than a determination of “surplus” funds.

The discussion of the Transfer Issue also caused many to question the rate setting process within the Council and specifically the components of Departmental rates, especially the Energy cost Adjustment Factor (ECAF) “rate,” and the visibility/transparency of what is included in the various rates among ratepayers. The CGJ finds that the application of the ECAF rate may be convoluted and not a transparent process which, understandably, leads various constituencies to question its accuracy and appropriateness.

BACKGROUND

This section provides general background about the amount of money transferred from the Department to the City (City Transfer), the importance of the Department’s bond rating (Bond Rating) and the cash position at the Department (Cash Position).

City Transfer

The LADWP has a long reputation as a respected provider of Water and Power to the citizens of Los Angeles. Part of this is due to the strong and consistent financial performance of the Department and the fact that the Electric rates provided to the citizens are lower than would be the case for other investor owned and municipal utilities (comparison of rates was provided in Exhibit 1 of this Report.)

The largest revenue transfer to the City of Los Angeles’ General Fund comes from the Power revenue of the LADWP. Charter Section 344 allows the Council, with the consent of the Board of Water and Power Commissioners, to direct by ordinance the transfer of surplus revenue to the General Fund. Historically, this transfer has equaled approximately 5% of the total operating revenue of the Power revenue fund in the preceding fiscal year. This transfer was increased to 7% beginning in 2002-03 and to 8% in 2010. Transfers from the Water Department stopped in 2006.

It is not unusual for municipal utilities to provide money to the cities in which they operate. **Exhibit 15. Monetary Transfers at Other Municipal Utilities Surveyed** summarizes City payments made by the survey participants.

Exhibit 15
Monetary Transfers at Other Municipal Utilities Surveyed

Utility	Transfer/City Contribution
LADWP	8% of electric revenues
CPS Energy	13%-14% of gross revenues
SMUD	None – stand alone agency
MLGW	Effectively 2 ½%-3% of revenues
JEA	About 6% to 7% of budget – included in customer bill in the Electric or usage charge
Austin Energy	9% transfer
CSU	Payment-in-lieu of taxes of about 3% of CSU's budget, which is recovered in base rates.

However, recently the Department has been challenged (as have all California utilities) by a series of issues including access to capital for significant capital projects, maintaining a good Bond Rating, increased scrutiny from rating agencies and other stakeholders, responding to price volatility, unfunded pension liabilities, meeting RPS goals (as established by the Mayor in LA), reducing dependence on current low cost coal generation in advance of AB 32 (California's Global Warming Solutions Act of 2006) and implementing energy efficiency targets as outlined in AB 2021. Meeting these requirements will require substantial additional money and, most likely, significant increases in the rates charged to residential and commercial customers in the future.

It is this affordability issue that was the key issue that arose last year around the LADWP transfer to the City of an expected amount of money and the ability of the Department to make that transfer, given current and expected financial obligations. This section looks at some of the issues that arose from that experience and makes recommendations to reduce future public relations, financial and transparency issues.

Bond Rating

It should be noted that the bond ratings of several other California municipal utilities have recently been downgraded or are on a watch list for downgrade. This is primarily because they refused to raise rates in response to significant financial pressures, some within their control and some external to their control. But it is important that a department the size of LADWP, and facing the substantial RPS goals and other challenges, keep a strong Bond Rating for the purpose of keeping borrowing costs under control and not having excess interest costs which would contribute to further rate increases.

To avoid a possible downgrade issue similar to other utilities, the Department established and communicated a variety of financial targets to the rating agencies and the City, including maintaining a Debt Service ratio of 2.25X, an unrestricted cash balance of \$300 million (increased from the previous \$150 million), and a capitalization ratio of no more than 60% debt. It was felt that the \$300 million liquidity level would be adequate to cover short-term costs incurred due to fluctuating fuel prices or unit outages.

While maintaining LADWP's financial target ratios are important criteria for maintaining the strong (AA) Bond Rating, other risk factors could cause a possible downgrade. Specifically, exposure to fuel price volatility, increasing costs under an aggressive RPS program, and possible costs associated with California's AB 32 initiative could cause actual values to fall below forecasts. With some key financial targets near historical lows and ratings agency

medians, LADWP would no longer have an additional financial cushion to help compensate for these risks. It was essential that the Department's willingness to address any changes would be an important element in maintaining the AA rating.

Cash Position

Although LADWP had sufficient cash to make the transfer payment, the cash was already identified for other uses. The Department has a Debt Reduction Trust Fund with about \$547 million in it to provide for the payment of principal and interest on long-term debt obligations and purchased Power obligations. Those funds are restricted as additional insurance against a potential debt default.

According to both LADWP financial advisors and Council Consulting Firm (CCF), a company hired by the City Council to review the transfer and rate issues, the \$300 million, if taken alone, is a relatively low liquidity position that corresponds to slightly less than fifty (50) days of cash given projected 2010 expenses. This can be compared to a median in excess of twice that level of coverage for peers reviewed by CCF. However, when taken together, the \$547 million and the \$300 million bring LADWP's minimum targeted liquidity levels to "well over" one hundred (100) days, more in line with comparable peers. (This liquidity level is not meant to address longer term changes in cost structure, which can be measured via the Debt Service Coverage ratio. The Department felt these measures would assure the continued strong Bond Rating.)

The Department has made annual transfers to the City of "surplus funds" based on net income for each year in recent history:

1. The City depends on that transfer for its own purposes, keeping its own Bond Rating stable. This balance between the financial needs of LADWP and the City is a difficult and ongoing process.
2. The Department uses an ECAF rate that consists of many items that are not typically included in an energy adjustment factor, which causes confusion and perceived lack of transparency to the rate oversight personnel and the public. A discussion of this rate is important since it was the under collection of that rate that caused the Department to reject the transfer of funds to the City.
 - i. There is a current cap of 0.1 cents per kWh on quarterly rate changes which is a potential liability that limits the ECAF from adequately serving its function.
 - ii. The Department had not requested nor received increases in the ECAF rate leading to a substantial under collection of monies to be used for operation.
 - iii. That under collection, along with other issues, was a financial concern to the Department and to the rating agencies that rate the Department's bonds for future bond sales.
3. Keeping a strong Bond Rating is extremely important for the Department to ensure adequate access to working capital at a rate that would allow for "reasonable" interest costs and, therefore, a reduction of interest payments and potentially a reduced cost requirement for repayment. With plans to issue over \$3 billion in long-term debt over the next five (5) years, a downgrade could have a substantial and increasing impact on

LADWP's cash position and could impact the perception of the Department as a desirable project partner. In general, it was estimated that a downgrade would cumulatively cost the Department and its customers in the range of \$200-\$300 million in the next five (5) years.

4. Rating agencies place several burdens (such as reserves and additional cash on hand) on utilities and others to increase their comfort level to ensure bonds are safe for repayment within the proper time.

METHODS AND PROCEDURES

Many Department management personnel were interviewed as well as representatives from City Council and the Controller's Office. Additionally, various consultant reports and letters from Department and City personnel were reviewed and analyzed. A survey of transfers from other large municipal utilities to the cities in which they operate was conducted and the results analyzed.

FINDINGS

13. The Department has provided substantial funds to the City of Los Angeles in the form of Power and Water transfers for many years.

The Power system alone has provided over \$2 billion to the City in the last twelve (12) years with another \$204 million from the Water system (up to the time the transfer was stopped by the Courts). **Exhibit 16. Summary of Power and Water Transfer Amounts** shows the money received by the City of Los Angeles for the last twelve (12) years.

Exhibit 16

Summary of Power and Water Transfer Amounts

Year	Power Transfer	% of Operating Revenues	Water Transfer	% of Operating Revenues
1998-1999	\$108,145,800	5	\$16,252,500	5
1999-2000	\$112,000,000	5	\$22,200,000	5
2000-2001	\$119,800,000	5	\$25,500,000	5
2001-2002	\$179,153,000	5	\$27,247,000	5
2002-2003	\$185,358,000	7	\$27,523,000	5
2003-2004	\$210,214,000	7	\$27,649,000	5
2004-2005	\$160,166,700	7	\$29,815,100	5
2005-2006	\$157,894,300	7	\$27,914,300	5
2006-2007	\$174,747,200	7	0	0
2007-2008	\$182,003,900	7	0	0
2008-2009	\$222,505,900	7	0	0
2009-2010	\$220,475,000	8	0	0
TOTAL	\$2,032,463,800		\$204,100,900	

Source: LADWP Summary of City Transfer Declarations for Fiscal Years 1999-2010

14. Although the Department had numerous reasons for not wanting to make the transfer without a rate increase, the Department felt it deserved, holding the City “hostage” under these circumstances was inappropriate. The Department had the cash to make the transfer, stating they had it reserved for other uses.

The Department said it could not afford the transfer. This caused a substantial argument from the Council on their need for the money and a public relations nightmare with the public, who was told that the Department was unreasonable by requiring a rate increase before making the transfer. In reality, the money had previously been budgeted for the transfer. But since the Department had doubled its unrestricted cash balance to \$300 million, it felt that it could no longer afford to make the scheduled transfer to the City without rate relief. Saying they did not have the cash was inappropriate and set off a series of events and negative public and Council perceptions that will take many years to correct.

What is uncertain is whether the doubling of the amount of cash (from \$150 million to \$300 million) was “overkill” and whether or not a smaller increase to \$225 million, for example would have satisfied the bond agencies and still have money left for the almost \$75 million transfer. What is known is that by refusing to make the transfer, the Department’s credibility and reputation as a good “citizen” was in jeopardy. The real question is whether a cash position of \$225 million (which would have been the \$300 million less the transfer) in addition to the \$547 million would have sufficed for the rating agencies, since that would also have brought LADWP’s minimum targeted liquidity levels to over one hundred (100) days, also in line with comparable peers. That difference would potentially have allowed the transfer without the ensuing problems. That will never be known for sure.

Newspaper articles were relentless on the “greed” of the LADWP management. In reality, the Department was only trying to protect themselves and the ratepayer; but they had a poor way of explaining that to the satisfaction of the public. What then transpired was a battle between the Mayor, the Council and the Controller (all publicly elected officials) on who would be the greater

friend of the public. The Department was caught in the middle of a situation that should never have gotten that far.

RECOMMENDATIONS

Recommendation 9. Take steps to ensure that this transfer problem doesn't recur. Some steps to be taken include:

- a. Develop an earlier budgeting process so Council will know what transfer funds to expect ahead of any grandstanding.
- b. Provide a presentation of the budget to the Council in clear and concise terms that are not "technical engineering oriented".
- c. Conduct a proactive review of RPS and capital project alternatives including goal extension or reduction.
- d. Develop long-term projections of costs associated with RPS and major projects to ascertain if additional transfers will impact consumer costs.

BACKGROUND

ECAF Issue

In general, utilities meet their revenue needs through the application of base rates and additional "cost adjustment" charges. Base rates are derived to cover fixed operating and capital costs (mostly controllable costs), while cost adjustment charges are applied to cover special programs and/or more volatile costs. Typically, all cost adjustment charges are separated from the cost component included in the base rates, with the goal of making the cost of certain special programs and/or the most volatile and variable costs (including fuel costs) distinct and transparent from the base rates. Increased transparency into the charges that comprise a customer's bill, in combination with the ability to smooth the impact of volatile charges to the customer, make cost adjustment mechanisms commonplace among utilities. (A comparison with other municipals will be discussed later.)

An important element is demonstrating the willingness of rate makers to support appropriate revenue increases if required to maintain key ratios. One mechanism in demonstrating the ability to meet financial targets should be the ECAF. Automatic changes in the ECAF can play an important role in mitigating the risks associated with volatile and unpredictable fuel pricing and in lending confidence that financial targets will be met. However, the current cap of 0.1 cents per kWh on a quarterly rate is a potential liability limiting the ECAF from adequately serving that function.

The most likely source of volatility to the cash forecast is a sharp increase in purchased power or fuel costs, either due to commodity price increases or an unexpected outage at one of LADWP's low-cost coal or nuclear facilities. This fuel cost increase poses a risk due to delays and caps in passing through short-term increases.

The report prepared by the consulting firm hired by the City Council (previously referred to as CCF) describes the history of ECAF at LADWP:

“As of 1997, the ECAF was designed to pass through the cost of fuel, purchased power and energy conservation. In 1998, the existing ECAF was frozen at 1997 levels in an attempt to prepare for deregulation.....

The ECAF remained frozen for the following eight years. During that time, the Department absorbed fluctuations in actual ECAF costs from year to year while keeping the ECAF rate fixed. However, in 2006 the ECAF was unfrozen to “stabilize LADWP finances in the face of a highly volatile natural gas market.” It was noted that continuing to absorb ECAF fluctuations would “potentially contribute to an erosion of the financial integrity of LADWP.”

“At the same time that the ECAF was unfrozen, several other new categories of charges were introduced to the ECAF account. Most notable was the inclusion of renewable energy costs.....Inclusion of renewable energy is also consistent with the 2003 City Council action conceptually approving a pass-through for renewable energy expense.”

Explanation of Fuel Adjustment Charges Used Elsewhere

Fuel adjustment charges are widely used throughout the Electric and Gas utilities industry. “Most states with traditional retail electric markets (i.e., states in which retail service is provided by a regulated electric utility with an exclusive franchise service area) regulate the price of electric utility services using mechanisms that separate the review, approval, and recovery of certain frequently changing costs, such as fuel and purchased power costs, from the corresponding scrutiny of the more fixed and predictable capital and operating costs associated with financing and maintaining the assets of the utility. The more variable, unpredictable costs are recovered in rate components that are allowed to change periodically—at least every year and in many cases more frequently—without the need for a full rate case that reviews all of a utility’s cost of service. Instead, these rate components are allowed to change roughly contemporaneously with changes in the utility’s underlying related costs. The remaining fixed or more predictable costs are recovered in “base rates” that are typically modified only every few years in formal rate cases.” (Source: Electric Utility Automatic Adjustment Clauses: Benefits and Design Considerations”, Edison Electric Institute, November 2006)

The California Investor Owned Utilities (IOUs): Pacific Gas and Electric (PG&E), Southern California Edison (SCE) and San Diego Gas & Electric (SDG&E), have a very complex mechanism for recovering variable fuel and purchased power costs; however, like LADWP, each IOU’s tariff allows for the inclusion of a variety of other costs. The California IOUs all use an Energy Resource Recovery Account (ERRA) which was established by the California Public Utilities Commission (CPUC) in Decision 02-10-062. This decision also required the Electric utilities to establish a fuel and purchased power revenue requirement forecast, a trigger mechanism, and a schedule for semi-annual ERRA proceedings. The first semi-annual proceeding (the forecast application) consists of an application by the utility to establish annual fuel and purchased power forecasts for the upcoming twelve (12) months. During the second semi-annual proceeding, a compliance review of the utility’s prior period energy resource contract administration, least cost dispatch, and ERRA balancing account is conducted. An IOU must request a rate adjustment when the balance in the ERRA balancing account exceeds 5% of the electrical corporation’s actual recorded generation revenues for the prior calendar year. The 5% may be an over collection or an under collection. In general, California ERRAs included over a dozen cost categories and over two dozen utility-specific costs.

In contrast, the municipally owned utilities surveyed generally have a less complex accounting structure. **Exhibit 17. Comparison of Municipal Fuel Adjustment Clauses** provides information on the fuel adjustment clauses of the municipally owned utilities.

Exhibit 17

Comparison of Municipal Fuel Adjustment Clauses

Utility	Clause	Components
CPS Energy San Antonio	Unit Fuel Cost Factor	Difference between the current month's unit fuel cost factor and a base cost of \$0.01416 per kWh. The unit fuel cost factor includes: fuel costs, any offsetting credits or additions resulting from judicial orders or settlement proceedings affecting fuel costs incl. taxes and transportations costs, recovery of energy efficiency and conservation program dollars spent above those in base rates and taxes
SMUD Sacramento	No traditional fuel adjustment clause, but something conceptually similar.	SMUD's largest resource is hydro power from the Sierra Nevadas. They have a factor which adjusts rates up and down based on rainfall. In a dry year SMUD will have to buy purchased power. In a wet year, they will have excess production and rates will drop.
MLGW Memphis	TVA's Fuel Cost Adjustor	MLGW is required by federal law to purchase all of its electric power from TVA and passes TVA's FCA on to its customers. The FCA reflects TVA's cost of fuel for electricity generation and purchased power costs
JEA Jacksonville	N/A	N/A
Austin Energy	Fuel Adjustment Clause	Fuel costs and related expenses including Independent System Operator (ISO) charges
CSU Colorado Springs	Energy Cost Adjustment (ECA)	Fuel and related expenses, purchased power, off-system sales

FINDINGS

15. The ECAF as currently constituted at LADWP contains several elements that typically would not be found in a cost adjustment factor.

The CCF report does an excellent job of discussing the ECAF at LADWP, as follows:

The ECAF operates as a 'pass-through' of renewable energy costs, fuel/natural gas costs, purchased power costs and energy conservation costs as well as providing rate stabilization requirements. Fuel costs and purchased power costs represent the traditional Fuel Cost Adjustment (FCA). These costs are dependent on market prices. While a utility can follow best-practice procurement and hedging plans, it cannot completely control the market price of fuel and purchased power.

Some renewable energy costs are also dependent on market prices (long-term renewable Power contracts whose prices are indexed to gas prices or power prices) but others, such as long term fixed-price Purchase Power Agreement costs, prepaid energy costs, transmission costs or the capital costs of LADWP-built renewable resources, are not dependent on market prices and, therefore, would not typically be part of an FCA.

Energy conservation costs such as the costs of energy efficiency programs are also not part of the typical FCA. On the other hand, revenue losses due to Demand Side Management (DSM) are often considered unpredictable and out of the utility's control. Therefore, in many cases, including that of the California IOUs, these losses are passed through by an adjustment mechanism (revenue decoupling) similar to an FCA.

The ECAF also contains a separate element that accounts for the City Transfer payments that are made as a percentage of total revenues. This adds 8% to all other ECAF costs such that the Department is essentially kept whole on the 8% of ECAF revenues that are transferred to the City as ECAF costs rise and fall. While this makes sense given the way City Transfer payments are calculated today, the fact that City Transfer payments are tied to volatile ECAF revenues at all introduces additional volatility both to customers and to the City, as well as adding additional complexity to the ECAF balancing account.

The ECAF is intended to limit the speed at which rates grow. Cost increases in excess of the cap are accumulated in the ECAF account and deferred until the quarterly cost increase would otherwise be less than the cap. While this provides a limited amount of rate stabilization, it is at cross purposes with the role of the ECAF in enabling a quick response to uncontrollable cost increases. During times when the cap prevents revenues from increasing as quickly as costs, an under collection of ECAF costs accumulates. This under collection must be financed by the Department, negatively impacting cash levels as well as debt- coverage ratios. A well designed rate stabilization plan usually includes a method to amortize under collections within a defined time horizon; the ECAF cap can prevent timely amortization.

In addition to renewable energy costs, a decoupling mechanism for energy efficiency improvements was introduced that incorporated into ECAF a charge for revenues lost due to energy efficiency improvements. This allowed LADWP to maintain base revenue levels while reducing overall electricity demand. Additional language changes created a small rate stabilization fund, updated language to reflect a 7% City Transfer (now 8%), expanded decommissioning costs from nuclear facilities to all generation facilities, and specifically included emissions fees, interest expense above 4%, uncollectible bills, asset write-offs, and extraordinary expenses.

The ECAF rate is calculated on a quarterly basis by estimating the following twelve (12) months of costs, described above, adding any previous under or over collection of ECAF, and dividing by the estimated energy demand for the following twelve months. From this rate, an amount of 1.25 cents/kWh is subtracted to yield the ECAF rate to be charged to customers over the next quarter. This 1.25 cents is meant to reflect a portion of the ECAF charge that is included in base rates, implying that current base rates are higher than needed to cover base operations. In FY 2009, costs booked to the ECAF account totaled slightly over \$1.3 billion.

In summary, there are now six (6) distinct categories of expenses currently included in the ECAF rate:

- a. Fuel - Includes all costs associated with natural gas, coal, and nuclear fuel procurement, including emissions, greenhouse gas reduction and retirement costs
- b. Purchased Power - Includes all purchased power costs, including associated transmission, short-term energy market purchases as well as long-term purchased Power
- c. RPS costs - Includes all charges associated with renewable resource energy, capacity, RPS related prepayment expense, operations and maintenance, depreciation, and interest expenses for generation and transmission
- d. DSM expenses - Includes qualified DSM costs, defined as costs incurred for the acquisition and installation of devices and systems, including incentive payments, audit costs related to DSM, and administrative costs, which are part of those programs or projects designed to lower and control power system demand or consumption (limited to 10% of three (3) items above)
- e. DSM Revenue Loss Recovery - Includes lost revenue due to the implementation of DSM programs, helping to preserve LADWP's rate base as demand is reduced through energy efficiency
- f. City Transfer - Includes a factor of 8% added to all ECAF expenses to cover the portion of the City Transfer associated with ECAF revenues. (This does not include the City Transfer component associated with base rate revenues, which is built into the existing base rate structure.)

In effect, only a few of these costs are considered "uncontrollable" and, therefore, should be included in ECAF: fuel, some renewable costs tied to fuel and DSM revenue losses.

16. The current ECAF design does not provide for adequate oversight and transparency into long-term commitments made by the Department, particularly with respect to Renewable Portfolio Standard (RPS) and Demand Side Management (DSM).

The presence of so many elements into a single cost adjustment factor reduces transparency into the cost drivers behind ECAF increases. Understanding the causes of ECAF increases today requires a detailed decomposition and analysis that is difficult for policy makers and customers to understand.

The act of bundling market-driven elements with less volatile costs that lie within the Department's control can limit overall transparency and potentially lead to a lack of accountability for those costs. Under the current system, ECAF increases are passed through to customers automatically without detailed rate review.

Long-term commitments have predictable costs and, as such, they can be made with specific consideration for their impact on costs. Under the current structure, commitments that are both predictable and within the Department's control can be passed through to ratepayers without review. This includes major capital project commitments that represent strategic (and therefore changeable and not operational) decisions.

Finally, rate responses to volatile fuel and purchased power costs should not be constrained by the presence of a very tight cap on ECAF changes. Exposure to market prices should be passed through uncapped to the ratepayer to avoid the potential for financial distress.

CCF concluded that the costs associated with ECAF are set to increase rapidly over the next two (2) years. Without a significant increase in the ECAF rates, this will put significant pressure on LADWP's debt ratios, with the potential that ratios in 2011 will be well under target levels.

At the same time, a cap on market-based drivers presents a significant risk to the Department in the event of a market price shock, providing support for the argument that the ECAF should be decomposed into separate elements with their own individual mechanisms for rate review. Any effort to reconstitute the ECAF won't be simple. Any effort to promote transparency must not be at the expense of expediency, and care must be taken to prevent disproportionate impacts on individual classes of ratepayers.

RECOMMENDATIONS

Recommendation 10. The CGJ agrees with the CCF recommendation that a "new proposal for rate restructuring should be drafted and analyzed. One aspect of this proposal would be to split the current ECAF into several separate rate components. This will provide the Council (and the public) with greater visibility of LADWP's cost structure and of the justification for any rate increases."

CCF goes on to state that:

- a. Costs that are clearly out of LADWP control should remain in the ECAF.
- b. At an appropriate frequency, Council should approve an LADWP procurement plan. As long as procurement has been in accord with the plan, ECAF cost recovery should be a pure, uncapped pass through.
- c. Costs that are predictable, such as long-term contract costs or energy efficiency costs, should be removed from the ECAF.
- d. Revenue losses attributable to DSM should be passed through without a cap but as a separate bill component in addition to ECAF.
- e. The City Transfer should not be tied to fluctuating ECAF revenues but rather entirely to more stable base rate revenues. This will create greater certainty of City Transfer payments and remove elements of the City Transfer from the current ECAF structure.

While such a change means that the City Transfer will fluctuate as a percentage of total revenue as ECAF revenues change, it will result in lower volatility in rates as well as in payments to the City.

- f. The Council should separately define a rate stabilization program that will mitigate or spread out rate increases. Rate stabilization has the effect of financing a cost increase and its impact on City finances and LADWP capital adequacy should be explicitly considered.
- g. Develop a clearer, more pure, definition of the ECAF rate (for review by Council and the public).
- h. An automatic rate change based on a pure ECAF rate should be approved.

It should be pointed out that the Department has received this type of recommendation previous to the CCF Report. In July of 2007, a Revenue Requirements Study prepared for the Chief Legislative Analyst and the City Administrative Officer states, "Energy Services has bundled several different cost recovery elements in the ECAF.....neither the Board nor management are presented the ECAF budgeted revenues by element." The recommendation made in that report was to "Unbundle the ECAF into its elements for presentation to management and to the Board." In their response to the report, LADWP agreed that all future presentations to management and the Board would unbundle the ECAF elements.

Recommendation 11. Increase the transparency of the cost of each current ECAF item by showing the item and amount on the ratepayer's monthly bill.

The CGJ suggests following the CCF recommendation with an additional recommendation intended to provide transparency, not just to Council but to the public at large. Print on each residential bill a statement indicating the costs associated with any "controllable" large expenditure that was previously in the ECAF. A statement showing the cost to the consumer for the RPS program, DSM program and the City Transfer (separately) should be clearly available to the public for their review and ultimate approval. Statements might read as follows:

"The portion of your bill collected by LADWP for the City of Los Angeles to support government services not related to LADWP (City Transfer) is \$XXX or XXX%. The City contribution shown here reflects the amount of your bill that goes toward government transfers. However, on your actual bill, this charge is included in the Electric or usage charge."

In addition to City transfer costs, the Department should also present similar information for "Renewable Program Charges" or "DSM charges" to the ratepayer. This provides the ultimate level of transparency to the public and allows for discussion of each element at the Board and Council meetings.

IV. RATEPAYER ADVOCATE ISSUES

SUMMARY

The strength of the ratepayer advocate measure is more a function of the future actions of the City Council, rather than the passage and implementation of the proposed measure. As important to what the ratepayer advocate will do are the issues that the ratepayer advocate should not do. It is not reasonable to assume that the existence of the ratepayer advocate will solve all of the various management, political or personnel deficiencies in existence at the Department. It can and should, however, shine a light on current and projected future costs for programs proposed by the Department and/or political entities, and ensure that the rates being charged to the public are fair, prudent and affordable under existing economic conditions.

BACKGROUND

Partially as a result of the “City transfer” issue from the spring of 2010 and a number of other concerns about LADWP management by various LADWP critics, a proposal to approve a Charter amendment to hire a Ratepayer Advocate was placed on the ballot for March 8, 2011. This ballot measure passed with a large majority.

Charter Amendment I creates an Office of Public Accountability at the LADWP. Backers of that measure say a Ratepayer Advocate will be needed as the Department carries out a plan for spending billions of dollars on system upgrades and environmental initiatives. At least one City Council supporter points out that, although the City Council reviews rate increase requests, “there is no guarantee you will have a City Council that will be vigilant and aggressive in making sure that information regarding rate increases is fully vetted on the public record.” Several City Council members said they did not know whether the spring 2010 rate increase was permanent or temporary. Greater attention to cost details or rate changes is warranted.

Some business leaders (and others) disagree, saying a new oversight office would be expensive and redundant, at a minimum \$1 million per year. They point out that LADWP’s actions are already reviewed by a Board of Commissioners appointed by the Mayor to oversee the Department, the City Council, and the City Controller. They continue their argument by pointing out that the Council is capable of performing their role by refusing to support three (3) of four (4) rate hikes sought last year by the Mayor. The thought is that another level of bureaucracy would be just that - bureaucratic - without any tangible benefits.

As it stands now, the Council is charged with filling in most of the details of this measure later, such as who appoints the advocate and to whom he or she reports. Apparently, the Council plans to empower local residents by involving voluntary Neighborhood Councils in the decisions. The Mayor, along with the Council, would also be charged with confirming the nominee for Ratepayer Advocate.

One recent editorial (LA Times, February 18, 2011) summed up a feeling that may be common within the City. “We hope the Council will also help ensure that the advocate selected is a well-regarded professional with deep expertise in utility operations; voters and lawmakers need solid advice on balancing the LADWP’s need to invest in clean power with its need to keep rates under control, not a populist interested solely in blocking rate hikes. We have misgivings about whether a ratepayer advocate can do much to fix the LADWP. The advocate would be charged with examining proposed rate increases and reporting back to the utility’s board, the City

Council and neighborhood Councils about their fiscal necessity. But it is unclear whether the advocate would be more successful in opening up the LADWP's impenetrable finances and practices than past auditors and consultants have been.....Measure I, if properly implemented, might bring a degree of transparency to the utility's operations that could build public trust."

The Ratepayer Advocate would be part of a newly proposed Office of Accountability and would act as a watchdog for the public with respect to utility rates and would also include an Executive Director and an Inspector General. According to the Chief Legislative Analyst, the role for the Office of Accountability would not exist solely for the purpose of lower rates, "but shall be to provide expert advice on rate actions and strategies which most economically accomplish the city's policy goals and the LADWP's long-term interests." At least one Councilmember also voiced support for an Inspector General position that would not just look at proposed rate increases but also identify waste and fraud within the agency.

Department Efforts

Supporters of the Ratepayer Advocate say it has been part of the public debate since 2008, when the Mayor's appointees at the LADWP Commission killed a proposal to create the post. However, events from the spring of 2010 (dealing with the City transfer and proposed rate increases in the Council) apparently caused the Board to reconsider their opposition.

On June 10, 2010, the Board of Water and Power Commissioners approved the establishment of an independent Ratepayer Advocate and recommended the formation of an expert panel to provide input and recommendations on how the position should be structured to ensure maximum effectiveness and neutrality. The Advisory Group was comprised of five (5) personnel from consumer advocate organizations: Natural Resources Defense Council (NRDC), Neighborhood Councils and various business and civic leaders.

The group was charged with defining the specifics of the Ratepayer Advocate's office and function, including structure, role and responsibility as well as how the office will be funded and staffed as well as where it should be located to ensure complete neutrality. The group agreed that the central responsibility of a Ratepayer Advocate is to review, analyze and provide expert independent advice to policy makers regarding utility rates and proposed rate changes and provide ongoing review and analysis regarding rate-related and budgetary issues.

During initial meetings, there was some debate over exactly what a Ratepayer Advocate's role and responsibilities should be. The Consumer Advocate representing the NRDC believed that "a pure ratepayer advocate, with a mandate to focus narrowly on cents per kilowatt-hour rates, instead of what is in the best interests of the customer, could be a waste of money and a distraction from the important decisions LADWP has to make in the next few years. What LADWP customers need is a 'Customer Advocate," with a clear mission to ensure that the customer has an independent voice at the table advocating for lower bills and better service.....A ratepayer advocate may fight to keep rates down even if that means LA remains dependent on dirty coal.....In order to continue that progress (getting off coal), LADWP has to keep investing in clean energy technologies. This is something that you may care about. This is not something, however, that an advocate focused exclusively on short-term rate impacts will care about, which may put them at odds with LADWP's efforts to move towards a new clean energy future." This same Consumer Advocate continues by saying "A ratepayer advocate won't care about creating new job opportunities in LA and stimulating our struggling local economy. Investing in clean energy, including energy efficiency and rooftop solar, creates good jobs, right here in LA. That might be something that you, a customer of LADWP and resident of LA care about, but a pure ratepayer advocate would not." She concludes with "If LADWP is

going to spend your money to pay for an advocate, that advocate's mandate should be to represent you, the customer."

While the CGJ completely understands the point made by the Consumer Advocate and firmly believes that a party should be responsible for looking out for the consumer's best long-term interest in areas such as clean environment, new jobs, etc., the CGJ believes that party should be the elected representatives of the City. It should not be the job of a Ratepayer Advocate who will have sufficient responsibilities to perform without debating the "policy" issues.

METHODS AND PROCEDURES

The ballot measure, as well as previous iterations, was reviewed. Additionally, many Department managers, City staff and IBEW management were interviewed. Consumer Advocate input was solicited. Substantial internet searches provided various reports and news articles on the pros and cons of the position. Finally, a survey was conducted of other large municipalities to ascertain their involvement with Ratepayer Advocate positions.

FINDINGS

17. The implementation of a Ratepayer Advocate at LADWP would be unusual in the municipal utility industry.

While the majority of states have Ratepayer Advocate positions or groups, those organizations monitor rates imposed by IOUs, not for publicly owned utilities. The concept is that public utilities are owned by the people, and the people's representatives (the elected City Council) would ensure that the people were protected and would do what the people want.

However, in many locations including Los Angeles, Council members have complained that they could not get the information that they needed from the utility and that, at times, the information was not consistent, informative or transparent. There is also concern in many jurisdictions, including many in Los Angeles, that special interest groups, such as unions (who have substantial political power due to their monetary contributions) have greater input into the reviews and decisions of elected representatives than they have in the public at large. For example, it might be in the City's best interest and the utility's best interest to have an immediate focus on solar or wind power, but a Ratepayer Advocate could provide a transparency on the cost of such proposal and present alternatives in terms of focus or timing that might benefit the consumer.

As shown in **Exhibit 18. Ratepayer Advocate Organizations at Surveyed Municipal Utilities**, there are very few "official" Ratepayer Advocate organizations in other municipal utilities that could be found.

Exhibit 18

Ratepayer Advocate Organizations at Surveyed Municipal Utilities

Utility	Ratepayer Advocate Organizations
LADWP	Office of Public Accountability recently passed during the municipal Election
CPS Energy	No indication of Ratepayer Advocate. They have a newly formed Citizens Ratepayer coalition but it is not independent or government (it is non-profit). They ask for donations to help with legal costs on the website.
SMUD	No indication of Ratepayer Advocate function.
MLGW	No indication of Ratepayer Advocate function.
JEA	No indication of Ratepayer Advocate function.
Austin Energy	No indication of Ratepayer Advocate function.
CSU	No indication of Ratepayer Advocate function.

18. Some people believe that the impact of the Ratepayer Advocate ballot measure is minimized because other proposed Charter amendments were not approved for the same ballot.

As the deadline for the March 8, 2011 ballot measure drew closer, there were competing proposals from public advocates and Council members. At one point, the Council voted for three (3) supposed LADWP reforms:

- a. Creating an Office of Public Accountability with a Ratepayer Advocate
- b. Requiring LADWP's budget to be submitted earlier with a guarantee that "surplus" funds will come to the City of LA for General Fund uses
- c. Granting the City Council the authority to remove the LADWP's General Manager or LADWP Commissioners with a two-thirds Council vote. The Council could also override the Mayor's removal of the General Manager or Commissioners with a two-thirds vote.

Only the first two (2) items were on the March 8, 2011 ballot (and both passed with large majorities), with the third being vetoed by Mayor Villaraigosa so that it would not go before the voters. The Mayor's obvious goal was to ensure that he kept control over the appointment and removal of Department management and governance. There were seven (7) votes from the Council to override the Mayor's veto, which was insufficient by one (1). The thought by some of the people who proposed these changes was that as long as the Mayor controlled the appointments of LADWP Commissioners and General Managers, any attempt at serious Ratepayer Advocacy would be minimized.

The end result is that the Office of Public Accountability will be limited to the review of Water and Power rates and will rely on the City Council and Mayor to pass ordinances to ensure the thorough review and analysis of LADWP's strategic plan, operations, finances and management.

As one consumer activist stated, "...the establishment of a Ratepayers Advocate supported by the Office of Public Accountability is a hollow and symbolic gesture unless they are supported by subsequent ballot measures that reform the Commission process and establish a City

Prosecutor.....The last thing LA needs now is oversight reform that consists of more audits and advice with no authority or mandate to enforce the law.....it is important to remember that oversight and accountability mean little, if anything at all, without enforcement authority and a mandate for prosecution.”

19. Although the final wording of the Ratepayer Advocate ballot measure may be interpreted as being effective, the implementation of the measure, and therefore its strength, is up to Council ordinance.

There was an original version of the Ratepayer Advocate position which declared “the role of the OPA shall be to (1) promote efficiency and effectiveness of the Department; (2) provide centralized focus on ratepayer protection and consumer complaints; and (3) provide independent analysis of Department actions, particularly as they relate to Water and Electricity rate actions. The OPA shall advocate against excessive rates and shall provide expert advice on rate actions and strategies which most economically accomplish the City’s policy goals and protect the Department’s long-term interests.”

The final wording of the proposed ballot measure indicates that the proposed focus will be on determining if rates are too high, not if LADWP is using revenues to overhaul infrastructure and move towards green energy and a sustainable, local water supply. The issues are if the Ratepayer Advocate should be expected to question whether, for example, the use of wind power (which is substantially higher generation cost compared to any other RPS item) is appropriate or whether, given the decision to go with wind, the rates are minimized and accurate. It is a subtle but very important distinction that will have huge impacts to both the work load of the Ratepayer Advocate and to his/her overall impact and effectiveness.

After numerous motions from various Council members on the wording of a Ratepayer Advocate ballot measure, and after considering a higher level of funding (0.1% rather than 0.025% of annual revenues), the following was the actual wording decided upon and the wording that went to the public for voting on March 8, 2011.

Section 683. Office of Public Accountability

- (a) The role of the Office of Public Accountability (OPA) shall be to provide public independent analysis of Department actions as they relate to water and electricity rates.
- (b) The OPA shall be headed by an Executive Director, who shall be exempt from civil service. The Executive Director shall be appointed by a citizens committee to a five-year term, subject in appointment to confirmation by the Council and Mayor. The Council shall by ordinance provide for the removal of the Executive Director in a procedure similar to that set forth in City Charter Section 575 (e), and only for the reasons provided by ordinance. The Council by ordinance shall prescribe the composition and manner of selection of the citizens committee.
- (c) The Executive Director shall (1) report directly to, but shall not be instructed by, the board; (2) have full charge and control of all work of the OPA; (3) be responsible for the proper administration of its affairs; (4) appoint, discharge, suspend, or transfer all of its employees, subject to the civil service provision of the Charter; (5) issue instructions to OPA employees in the line of their duties, subject to the civil service provisions of the Charter; (6) prior to the beginning of each fiscal year and in accordance with a schedule prescribed by ordinance, submit to the City