SMUD rate action 2021

June 18, 2021

Directors of SMUD and staff,

Last night during the Board of Directors meeting I raised the issue that the proposed rates violate Article XIII C of the California Constitution on taxes by local government. I asked you to each review the information I sent you on this in 2019, including the video and transcript of the hearing on June 4 and the June 4 and 24, 2019 meetings. I also asked you to review everything I am going to send you in the current rate action, which began last night. The reason I mentioned the 2019 rate action is that the issue is the same this year.

Materials (slides and transcript) from my presentation at the 2019 rate hearing

You can find the 2019 and 2021 CEO and GM Reports on the SMUD website.

I am sending you in this message “2018 Residential Time-of-Use Rate (RT02) Design Study,” a 16 page document, that provided the factual / evidentiary basis for the current time of day rates adopted in June, 2019. This was the only cost justification SMUD provided for the 2020 and 2021 rates. The 2019 CEO and GM Report, Appendix I, was a letter from NERA Economic Consulting that referred to this Rate Design Study. That letter was pages 109 – 112 of the Report. .

I am sending you in this message my Comments and alternative to the SMUD proposed rates for
2020 and 2021. This is a slide presentation and the title of it is “SMUD hearing June 4 2019 rev MG June 4.pptx”. This is the slide presentation that showed to the Board during the June 4, 2019 rate hearing. The issues are the same today except with new numbers because SMUD failed to fix the problem as I recommended by backing the 9.2% scalar out of the then current rates before raising them in 2020 and 2021. These slides accompany the transcript of the hearing.

I am sending you in this message the transcript of the hearing on June 4, 2019. My presentation is on pages 16 – 21. Staff responses are on pages 40 – 43.

SMUD proposed rates for 2022 and 2023 violate the California Constitution

The key question is whether the proposed rates violate the limitation on local government taxes in Article XIII C of the California Constitution. SMUD may not impose, extend or increase a special tax without voter approval. According to the California Constitution, Article XIII C, section 2.d, “(d) No local government may impose, extend, or increase any special tax unless and until that tax is submitted to the electorate and approved by a two-thirds vote.”

A tax is extended when an agency lengthens the time period during which it applies. *Gov. Code, § 53750, subd. (e)*. A tax is increased when an agency revises its methodology for calculating a tax and the revision results in increased taxes being levied on any person or parcel. *§ 53750, subd. (h)(1)*.

*Webb v. City of Riverside,* 23 Cal. App. 5th 244, 258.

The CEO and GM report recommends a rate increase of 1.5% on March 1, 2022 and 2.0% on January 1, 2023. (Volume 1, page 38) The current rates are the result of the original TOD rates plus the four rate increases from the 2019 rate action. Those rate increases kept and did not back out the illegal (unconstitutional) scalar of 9.2%. As a result the current rates are slightly more than 9.2% too high. They are a special tax as defined in the California Constitution, Article XIII C:

“(d) “Special tax” means any tax imposed for specific purposes, including a tax imposed for specific purposes, which is placed into a general fund.

(e) As used in this article, “tax” means any levy, charge, or exaction of any kind imposed by a local government, except the following:

(Section 1)

SMUD imposed the special tax in June, 2017 when it first created the time of day rates. You extended and increased them in 2019 when you raised rates. According to your current CEO and GM Report and Recommendation on Rates and Services and Exhibit to Agenda Item #9 from the Board meeting last night you are planning to extend and increase them again this year. This is unconstitutional.

There are 7 exceptions to the definition of a tax. The only one that even plausibly applies to SMUD rates and charges is (e)(2):

(2) A charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.

In other words SMUD must show its reasonable costs of providing electricity service.

SMUD’s rates were not cost justified in 2017 or 2019 and still aren’t in 2021

The current (2020 and 2021) rates are from a Resolution 19-6-13 that the Board adopted on June 24, 2019. This was the end of the 2019 rate process. SMUD had published a CEO and GM Report and Recommendation on Rates and Services for that rate process. That Report said, on the subject of its proposed rates,

“SMUD follows the marginal cost approach from NERA and industry best practice rate principles to determine how much it costs to provide service to customers. Once costs are identified, they are then assigned to either the monthly SIFC, a demand charge, or the energy rate. NERA performed a review of SMUD’s marginal cost and recommended rate components for all commercial classes. For details, please see Appendix 1 in this document.”

(Page 28)

Appendix I to the CEO and GM Report was a letter dated December 6, 2016 from NERA Economic Consulting addressed to SMUD’s Resource Planning and Pricing Department (RP&P).

The subject of the letter was NERA’s independent review of SMUD’s 2016 Marginal Cost of Service (MCS) Study and its proposed residential Time of Use (TOU) rates for the period 2017 – 2019. That letter was pages 109 – 112 of the Report.

There is only one document, to date, that presents and quantifies SMUD’s reasonable costs of providing electricity service and the components thereof. That document is “2018 Residential Time-of-Use Rate (RT02) Design Study,” a 16 page document, that provided the factual / evidentiary basis for the current time of day rates adopted in June, 2019.

This Rate Design Study was all about SMUD’s marginal costs. It said,

“SMUD’s proposed rate structure as defined by the Chief Executive Officer & General Manager’s Report and Recommendation on Rates and Services is based on by SMUD’s Marginal Cost of service. Marginal costs are the additional costs SMUD incurs to provide electric service to a new customer, a new load or the savings expected from not serving that customer or load. These costs vary by the voltage at which electricity is delivered to the customer.”

(page 2)

This is the key document because it introduced the “scalar” of 9.2%. (Tables L and M, page 14). Here are those tables.



As you can see SMUD’s explanation of this scalar, right in between Tables L and M, is:
“The proposed time-of-use energy rate is completed by setting proposed rate revenues equal
to rate revenues for the budget year. The reconciliation of marginal costs to rate revenues is
accomplished through increasing final marginal cost energy charges by a scalar of 9.2%.”

The Rate Design Study also said, “The reconciliation of marginal costs to rate revenues is accomplished through increasing final marginal cost energy charges by a scalar.” (page 3) But there is no justification for that in the California Constitution and in fact that is prohibited – unless the voters approve such rates in advance.

SMUD’s Total Energy Marginal Cost, shown in the last column of Table L, is SMUD’s reasonable cost of providing electricity service. The Rate Design Study presented the marginal cost components. SMUD’s Marginal cost components were:

* Generation
* Capacity
* RPS
* Transmission
* Subtransmission
* Distribution
* Distribution Facilities
* Meter; and
* Services.

(page 3 of the Rate Design Study, Table A: Classification of Marginal Cost Components)

That analysis of SMUD’s reasonable cost of providing service was complete. Up to and including Table L SMUD had accounted for all of its reasonable costs of providing electricity service through its rates. The scalar is not one of your costs. SMUD may wish to take in a certain amount of money and may write a projected / proposed / actual budget with that expected / hoped for revenue. That is not enough. That is not sufficient to comply with California law.

Rates must be based on SMUD’s reasonable costs, not on its budget wishes, according to the California Court of Appeal.

“However, if a local government body chooses to impose tiered rates unilaterally without a vote, those tiers must be based on cost of service for the incremental level of usage, not pre-determined budgets.”

(CAPISTRANO TAXPAYERS ASSOCIATION, INC., v. CITY OF SAN JUAN CAPISTRANO, G048969, COURT OF APPEAL OF THE STATE OF CALIFORNIA, FOURTH APPELLATE DISTRICT, DIVISION THREE, (Super. Ct. No. 30-2012-00594579, Order modifying opinion; no change in judgment, dated May 19, 2015.)

Even though SMUD’s electricity rates do not involve tiers they do involve “pre-determined budgets”and that is the relevance of that opinion to your proposed rates.

SMUD’s rates and charges must comply with Article XIII C

SMUD’s current CEO and GM Report, volume 1, has a section on “Compliance” on page 92. The statement that SMUD’s rates are voluntary and not “imposed” one of the three (3) terms used in Article XIII C, with the other two being “extended” and “increased” is incorrect. It has already been rejected by an appeals court.

“A tax does not lose its revenue-generating character because there is a theoretical but
unrealistic way to escape from the tax’s purview.”
*CITIZENS FOR FAIR REU RATES et al., v. CITY OF REDDING et al.*, (2015), C071906, (Super. Ct. Nos. 171377, 172960), (reversed on other grounds), page 13

The analysis I presented to this Board in 2019, which is still true today, shows that your proposed rates for 2022 and 2023, like the rates for 2020 and 2021, are not cost justified. Therefore section 1, subdivisions (e)(1) and (e)(2), do not exempt these rates in the California Constitution, article XIII C, from the limitations on local government taxes requiring a prior vote and approval by the electorate.

SMUD also claims that, “to the extent to which they exceed cost is the result of legacy pre-existing rate-making legislative choices that predate Proposition 26, which the measure does not disturb.” This is similar to the City of Redding’s argument in the above cited case. The court rejected that argument because the annual budget includes new rates. Here you are presented with a rate resolution, which the Board can adopt, amend, or reject. This is a new action. That resolution contains NEW rate making legislative choices. Such choices are not exempted or grandfathered and SMUD must comply with Article XIII C and Proposition 26.

Please ask me questions about this. I can answer all of them. Please be genuinely interested in doing the right thing.

SMUD dodged the issue and falsely responded to it during the 2019 rate hearing

The message is please do a better job this time. It is your job as a Director.

You will see, on page 40, where General Counsel Laura Lewis actively dodged my claim that Proposition 26 covers SMUD rates and charges. All she did was refer to the CEO and GM Report’s section on “Compliance” and said, “That section speaks for itself, and, as I've explained to Mr. [G], no further explanation is required.” Ms. Lewis was mistaken. I had explained in my presentation why that section on compliance was wrong. It deserved a response. Every Director let Ms. Lewis get away with it, which was a very poor decision by each and every Director. Please do better this time. Please ask for specific responses to my specific claims.

Jennifer Davidson’s response to my presentation said a few things. She said, “The CPUC has recently accepted some recent rate cases using that methodology.” But as Ms. Davidson knew or should have known CPUC rulings and opinions have no bearing on SMUD rates because CPUC regulates the investor owned utilities (IOUs) and SMUD is not an IOU. SMUD is a municipal utility district.

Ms. Davidson also said,

“So it is true that right now the marginal cost is less than the embedded cost, so we needed to figure out what is the right way to correctly allocate costs in the cost study from the marginal cost to the embedded cost, and we also want to make sure that we allocate those costs accurately and equitably, and so we do apply a math formula or a percentage to all the components to appropriately scale, hence the name "scalar," between the cost of adding one more customer and all actual total costs of our system.”

Ms. Davidson had apparently not read the definition of a “tax” and the exceptions to it even though I had presented this information to SMUD on slides (visually, for each Director to read during the hearing) and I had provided my slides to SMUD prior to the date of the hearing.

A tax is “any levy, charge, or exaction of any kind imposed by a local government, except” for 7 exceptions. The only exception that is plausibly relevant to SMUD rates is Section 1 (e)(2), which says:

 “(2) A charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.”

SMUD is not allowed, as Ms. Davidson claimed, to “correctly allocate costs in the cost study from the marginal cost to the embedded cost.” It is supposed to make its rates from its reasonable costs. If, after carefully accounting for each component of SMUD’s marginal costs and adding them up, as the Rate Design Study did, SMUD finds that its marginal cost is less than the amount of revenue that the Board wants to receive during the next two years SMUD is supposed to set its rates based on the marginal costs. Adding 9.2% is not reasonable. It gives you rates that are NOT reasonably based on your cost of providing electricity service. There would be no purpose for an actual rate design study if, when you complete the study, you could simply add in whatever percentage you want to make your projected revenues match the amount of money you want to receive, and call it a “scalar.” If you could then there is no limit to the scalar and no limit to the rates you could charge. If you could then you could easily add a 25% “scalar” and point to the same excuses that Ms. Davidson gave here. A 25% scalar is not cost justified because it has nothing to do with your reasonable cost of providing service. Same is true of a 9.2% scalar.

Her explanation here is missing a key link and that is the justification for the scalar. All she has told you is that the marginal cost, very carefully described and quantified by component in the Rate Design Study, was less (by about 9.2%) than the amount of money SMUD wanted to receive in revenues in 2020 and 2021. Ms. Davidson is using the term “embedded cost” to express the amount of money SMUD wanted to receive in revenues in 2020 and 2021. We already knew that from reading the Rate Design Study. That doesn’t mean the rates are justified.

Following a waffling and rambling explanation (which was more of an excuse) on page 43 of the transcript Director Tamayo posed a straight forward, although loaded, question to Ms. Davidson.

BOARD MEMBER DAVE TAMAYO: But there's not an

18 equivalence between the marginal costs of energy and

19 the reasonable cost of supplying the energy to the

20 customers; is that correct?

21 JENNIFER DAVIDSON: That is correct.

That was not correct. That was incorrect. The entire Rate Design Study was about the marginal cost and each of the marginal cost components **because** that’s what SMUD rates are based on. Ms. Davidson’s statement here is contradicted by the quotations provided earlier from the 2019 CEO and GM Report, “SMUD follows the marginal cost approach from NERA and industry best practice rate principles to determine how much it costs to provide service to customers.” (page 28) and from the Rate Design Study, which was referred to by the letter from NERA Economic Consulting to SMUD, which was Appendix I of the 2019 CEO and GM Report, ““SMUD’s proposed rate structure as defined by the Chief Executive Officer & General Manager’s Report and Recommendation on Rates and Services is based on by SMUD’s Marginal Cost of service. Marginal costs are the additional costs SMUD incurs to provide electric service to a new customer, a new load or the savings expected from not serving that customer or load.” (page 2) Unfortunately Ms. Davidson was unwilling to admit her lack of knowledge of these documents and this subject. Equally unfortunate was that Director Tamayo had framed a question that was clearly intended to elicit a “yes” response that would appear to give the Board an excuse for disregarding my entire presentation and argument.

Increasing the SIFC by 1.5% and 2.0% is unconstitional too

This is for very similar reasons as increasing your electricity rates is unconstitutional. But such an increase also violates this:

California Constitution, Article XIII C, Section 1:

“The local government bears the burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor’s burdens on, or benefits received from, the governmental activity.”

(Emphasis added.)

I explained this in the 2019 rate hearing. It’s in my slides and the transcript. The issue today remains the same.

Directors should be fully conversant and familiar with my argument and ask specific questions

Now that I have shown you how the Board was deceived by staff during the 2019 rate hearing you should be very familiar with it. You should not let it happen again. You have the evidence, the quotations from the relevant documents and the California Constitution and the Rate Design Study showing the scalar of 9.2%, which is still lurking in the current rates. Please don’t be fooled again. Please be curious.

Every Director should be fully conversant and familiar with this issue when you walk into the meeting room for the hearing and, separately, the Board meeting when you will vote to rubber stamp the new rates. With my argument and the supporting evidence and legal basis. With the excuses that SMUD provided at the June 4, 2019 hearing on the new rates and why those were just excuses. With what it would take to actually show that the rates (any electricity rates and charges) are cost justified. With the concept and use of a “scalar” of 9.2% in the 2017 rate action, which was kept in the 2019 rate action and is also kept in the current rate action.

Last night I said that the Board President in 2019 was Rob Kerth, which was a mistake. It was Dave Tamayo. As I said he was not interested in learning or understanding the issue at the time, only in finding a fast and dirty way to dismiss (disregard) my entire presentation and argument. I don’t think he understood the issue at the time. That’s exactly the wrong approach for a Director to take, especially the President. There are 7 Directors. All 7 Directors should be interested in this issue and fully conversant and familiar with it.

Conclusion

Ignoring this issue is not going to serve SMUD. You can run away from your customers, your “customer-owners” and the issue but you cannot run away from your obligations as a Director, from the Board’s obligations, and from the California Constitution, Article XIII C.

There is no point doing a Rate Design Study if you add to your marginal cost a 9.2% “scalar” in order to “set[] proposed rate revenues equal to rate revenues for the budget year”. That defeats the purpose of the Rate Design Study.

SMUD should:

1. Remove the 9.2% “scalar” that SMUD added when it created the TOD rates in June, 2017 and then raise rates by whatever percentage is actually cost justified, not including the unconstitutional scalar, for the next two years.

2. Eliminate the System Infrastructure Fixed Charge.

Will you acknowledge your receipt ot this message?

Sincerely,

Mark G.