

FINAL

UTILITIES ADVISORY COMMISSION MINUTES OF AUGUST 10, 2009

CALL TO ORDER

Vice Chair Melton called to order at 7:00 p.m. the special meeting of the Utilities Advisory Commission (UAC).

Present: Commissioners Eglash, Foster, Melton, and Waldfoegel, Council Member Yeh
Absent: Commissioner Keller.

ORAL COMMUNICATIONS

None

APPROVAL OF THE MINUTES

The minutes from the June 3, 2009 UAC meeting were unanimously approved.

AGENDA REVIEW

No changes were proposed.

REPORT FROM COMMISSION MEETINGS/EVENTS

No report.

UTILITIES DIRECTOR REPORT

Utilities Director Valerie Fong delivered an oral report on the following items:

1. **Water Supply Conditions:** According to the hydrologic conditions report from the San Francisco Public Utilities Commission for July, the water year for the regional water system is near or above average with the total amount of water in storage as of the end of July 2009 at a nine year high for the end of July. Part of this good news is that customers from all agencies receiving the water have been effectively conserving water use. We congratulate our customers for helping in this regard.
2. **Economic Stimulus Funding Application & Awards:**
 - a. **Energy Efficiency Community Block Grant (EECBG):** We anticipate this award for \$663k to be made in September. Of the \$663,000, the City expects to spend \$458,000 on LED street light project and \$205,000 on Home Energy Reports project.
 - b. **People Power:** People Power Company, a Palo Alto start up, in partnership with Cities of Palo Alto, Santa Clara, Alameda, Acterra, and Ennovation Z applied for stimulus grants to help evaluate the energy savings that could be achieved by customers changing behavior triggered by having in-home real time energy monitoring devices. We expect to know if we qualify for the award in the October time frame

- c. **EV Funding Requests:** The City's application with Better Places for EV charging stations was turned down by DoE. We are still awaiting results on the application through BAAQMD.
3. **Street Light Pilot:** Test LED street lights and Induction street lights have been installed around City Hall and along Colorado and Amarillo Avenue. With technical assistance from Pacific Northwest National Labs (PNL) we have taken lighting measurement and now in the process of analyzing the data and seeking community input.
4. **Smart Grid Evaluation:** Following up on the May 11th joint Council/UAC study session, staff is developing a Request for Proposals (RFP) to retain a consultant to help develop a long term Smart Grid Strategic Plan and do a cost-benefit analysis related to smart meter deployment. The RFP will be issued in early September and a consultant is expected to be on board in late Fall. The timeline for the evaluation is yet to be determined.
5. **Renewable Electric Supplies:** On August 3, Council approved two long-term power purchase agreements for renewable electricity. One is with Ameresco for a landfill gas to energy plant in Johnson Canyon (in Gonzales, California), which will provide about 1.1% of the City's electric needs with rights to any expansion plants built at the landfill. The other was to amend the contract for a higher price for the Western GeoPower geothermal power and to increase Palo Alto's potential maximum participation level to provide about 6% of the City's electric needs.

Both contracts are for power at near the Market Price Referent, a benchmark price for renewable power established by the California Public Utilities Commission. Other proposals received in the City's RFP for renewable power (besides the Ameresco Johnson Canyon proposal) are also around or above the Market Price Referent. Discussion at the Council Finance Committee on July 21 when it reviewed the Ameresco Johnson Canyon contract, and at the Council on August 3 when it approved the Western GeoPower contract amendment, noted that staff should ensure that energy efficiency programs reflect the marginal cost of renewable power when determining cost-effectiveness.

6. **Biomethane RFP:** Palo Alto issued an RFP for pipeline-quality biomethane supplies and expects to have results back in mid-August. The biomethane is intended to serve gas customers who voluntarily opt for a non-fossil fuel gas supply.

UNFINISHED BUSINESS

None.

NEW BUSINESS

ITEM 1: ACTION ITEM: Election of Officers

ACTION: Commissioner Eglash nominated Commissioner Melton to be the Chair of the UAC. The motion was seconded by Commissioner Foster. The motion carried unanimously (4-0).

ACTION: Commissioner Foster nominated Commissioner Waldfoegel to be the Vice Chair of the UAC. The motion was seconded by Commissioner Eglash. The motion carried unanimously (4-0).

ITEM 2: ACTION ITEM: Designate Spokeperson(s) for FY 2010

ACTION: Commissioner Foster nominated Chair Melton to be the UAC's spokesperson for Fiscal Year 2010 and the Vice Chair Waldfogel to be the alternate. The motion was seconded by Commissioner Eglash. The motion carried unanimously (4-0).

Commissioner Waldfogel commented that designating the Chair and Vice Chair as spokesperson and alternate, respectively, could be something that would go into the UAC bylaws.

ITEM 3: Intentionally Omitted

ITEM 4: INFORMATION ITEM: City of Palo Alto's Energy Risk Management Report for the Third Quarter, Fiscal Year 2009

Energy Risk Manager Karl Van Orsdol provided a presentation on this report to the UAC as there are new commissioners who are not familiar with the informational report that he provides to the Council and UAC on a quarterly basis.

In summary, Van Orsdol stated that, for the third quarter of FY 2009:

- All transactions were complete within limits – there were no exceptions to report.
- The 36-month Mark-to-Market value of Electric contracts is negative \$1.5 million.
- The 36-month Mark-to-Market value of Gas contracts is negative \$10.6 million.
- The prompt 12-month Mark-to-Market value of renewable energy is negative \$8.3 million compared to wholesale "brown" market.
- The prompt 12-month Mark-to-Market value of the Western Base Resource hydro contract is \$1.2 million and that for the Calaveras hydroelectric project is negative \$5.7 million.
- All counterparties with whom Palo Alto actively trades maintain excellent credit rating.

Van Orsdol described the electric portfolio as consisting of hydroelectric power that is generated primarily in the spring and summer months with lower production in the winter months. Renewable resources such as landfill gas generation and geothermal power produce the same generation monthly, but wind generation also has a seasonal generation profile, producing the most in the summer. Purchases from the market are used to fill in resources to meet the City's relatively flat load. The gas load, on the other hand, is seasonal in nature and purchases from the market are layered in according to the City's laddering strategy over the next 36 months.

Van Orsdol defined Mark-to-Market (MTM) as equal to the market value of an asset or contract less the cost of the asset or contract so that a positive MTM means that the resource is more valuable than its cost while a negative MTM indicates that the resource costs more than it's currently worth in the market.

Commissioner Eglash asked how renewable contracts are marked to market – is the value compared to renewable market prices or market prices for brown power. Van Orsdol explained that in the past, the MTM for renewable resources were based on the brown market value, but in the future, they will be marked to the forward curve for renewable power. The proxy for this renewable forward curve is the "Market Price Referent" that has been established by the California Public Utilities Commission.

Van Orsdol noted that MTM valuations figure into credit risk calculations as the City could stand to lose if a supplier defaulted on a contract that had a positive MTM. Credit risk is calculated by multiplying MTM by the Expected Default Frequency (EDF), which is a measure of the likelihood that particular supplier will default within a 12-month time period. Calculation of the EDF for rated entities is done by a proprietary model from Moody's KMV. EDF is estimated for unrated entities, or private firms, using KMV's RiskCalc and Risk Analyst algorithms based on confidential financial information.

The counterparties with which the City has negotiated Electric and/or Gas Master Agreements (EMAs and GMAs), like many other businesses, have had significant declines in credit worthiness over the past 12 months. Even so, the electric suppliers with whom the City is currently transacting are rated no lower than A- and, due to the currently negative MTM for most contracts, the expected loss (MTM times EDF) is very low.

Van Orsdol noted that the reserves are evaluated on a quarterly basis to determine if they are sufficient to cover risks. As of the end of FY 2009, the electric and gas supply rate stabilization reserves were well funded and above portfolio risks for the next 12 months.

ITEM 5: ACTION ITEM: Energy Risk Management Policy

Energy Risk Manager Karl Van Orsdol provided a presentation on the updated Energy Risk Management Policy. He provided an overview of the three sets of documents involved in risk management: 1) Risk Management Policy – the highest level document is approved by City Council outlines the City's approach to managing risks associated with the purchasing of electricity and gas commodities; 2) Risk Management Guidelines approved by the UROCC to provide more detailed information on establishing rate limits, transacting authority limits, credit limits and overall risk management techniques; and 3) Risk Management Procedures which provide step by step instructions on carrying out key risk management activities.

Van Orsdol noted that the key changes in the updated policy from the existing policy were:

- Specific listing of all approved products (Page 9-10)
- Inclusion of financial instruments in the approved products limited solely to (Page 10):
 - nomination, purchasing and selling of Congestion Revenue Rights
- Specifically noting that the UROCC is the body to resolve conflicts related to the managing three risk management objectives (page 3):
 - Retail rate stability
 - Supply Cost Advantage
 - Efficient and Cost Effective Business Processes
- Strengthens priority of reserve fund adequacy (page 2)
- Greater detail on Front Office roles and responsibilities (Page 4)
- Inclusion of Public Works Director in UROCC (Page 4)
- Replacement of Risk Oversight Committee (ROC) with Utilities Risk Oversight and Coordinating Committee (UROCC) to reflect the expanded scope of the committee (Page 4)
- Strengthened applicability wording to include all staff involved directly or indirectly as needing to be aware of Energy Risk Management Policy (Page 1).
- Revised and Improved Conflict of Interest statement (Page 11, Section XII).
- Role of City Auditor on the UROCC does not impair the Auditor's ability to audit the Utilities Department. (Page 4, Section 4. Paragraph 2).

Commissioner Waldfogel described the policy as a well thought-through document. He asked how the list of approved products (Section XI – Authorized Products Policy) can be expanded, if needed. Van Orsdol explained that the Energy Risk Management Guidelines provide a uniform process for developing and analyzing the benefits and risks of new approved products and presenting that information to the UROCC, the UAC for recommendation to Council and to Council for approval.

Commissioner Waldfogel also questioned the relevance of some parts of Section IX, the Commodity Pricing Policy. Van Orsdol explained that the risks covered are not just on the cost side, but also on the revenue side. Commissioner Waldfogel asked whether all subsections, especially subsections (d) and (e) should be included in the Risk Management Policy. Section IX states: “The commodity pricing policy is composed of the following five principles with the first principle having priority over the remaining four:” a) direct cost recovery; b) risk management; c) indirect cost recovery; d) nondiscrimination; and e) nonsubsidization.

Subsections (d) and (e) in the draft policy are:

d. Nondiscrimination

All customers within a customer class shall be treated in a fair and impartial manner and be entitled to acquire commodities at the same or substantially similar terms and conditions

e. Nonsubsidization

To the extent practicable, costs will be allocated to customers and customer classes according to how those costs are incurred. Thus, commodity rates will not be established in a manner that permits one class of customers to be subsidized by another.

Commissioner Waldfogel expressed concern that these subsections could be out of line with a future Rates Policy as they could be interpreted as being contrary to the encouragement of efficient use of resources.

Commissioner Foster asked about renewable power pricing, noting that the document was silent on the fact that there is a policy on purchasing renewable power, but document talks more about low and equitable rates. Utilities Director Valerie Fong noted that there is not contradiction and that there are other policies, not just the Energy Risk Management Policy. Foster noted that in Section IV – Energy Risk Management Objectives, one goal listed is to preserve a supply cost advantage, but this could be in conflict with the Renewable Portfolio Standard.

Commissioner Foster also wondered if the nondiscrimination and subsidization principles could be called in to question for many new initiatives for efficiency and feed-in tariffs. Commissioner Eglash asked if an example could be provided where some initiative could be contrary to those two principles. Foster responded that one example is if you are encouraging customers to conserve energy and designed a rate structure to charge higher users more per energy unit consumed, then you may be vulnerable to charges that higher users are being discriminated against or are subsidizing other others. Eglash suggested that this situation could be interpreted as being nondiscriminatory since the rate schedule would be available to all users, but it could be viewed as higher use customers are subsidizing lower use customers by covering a larger part of the costs of the system so he considers (e) as more of a problem than (d). Assistant Director Jane Ratchye noted that the intention of nondiscrimination and nonsubsidization sections was so that one customer class (e.g. residential customers) would not bear the costs of another class (e.g.

commercial customers). However, she noted that the way it is written ("costs will be allocated to customers and customer classes according to how those costs are incurred") could indeed be construed to mean that inclining block rates where higher usage amounts were charged at a higher rate would not be appropriate.

Chair Melton recalled an earlier UAC discussion where all fixed costs are not recovered from fixed charges in rates, but a balance needs to be struck between competing objectives such as cost recovery and incenting efficient use of resources.

Commissioner Eglash asked if (d) and/or (e) could be modified to ensure that the intention of supporting efficient use of resources could be clarified so that it would not apply in certain situations. Commissioner Waldfoegel noted that the section did prioritize the first principle (direct cost recovery) over the remaining four.

Commissioner Waldfoegel noted that he wanted to bring this issue up as the UAC will shortly be considering Rates Policies and would prefer that this is an input into rates design coming up. Eglash said that if the UAC in the future makes recommendations that may slightly be in conflict with the policy, then we might wish it had been worded differently or be accused of being inconsistent. He asked if staff had the same conflicts when developing this policy. Ratchye stated that Council adopted the Commodity Pricing Policy over 10 years ago and it was simply incorporated into the Energy Risk Management Policy at this time. Eglash stated that the Utilities Strategic Plan and one of the supporting objectives is to employ balanced environmental solutions so that it's stated there, but not incorporated into this policy only implicitly.

Commissioner Foster suggested that (e) could be changed to say that it does not mean to relate to pricing that encourages efficient pricing. Waldfoegel suggested that maybe a sixth principle on environmental protection could be added.

Chair Melton suggested that a change could be made after the development of the rates for FY 2010 or of a new Rates Policy.

Commissioner Foster would rather modify (e) than delete (d) and (e) since that may be perceived as the UAC not being supportive of the principles of nondiscrimination and nonsubsidization. Commissioner Eglash stated that it may not be the best way to try to wordsmith this complex document at this time. For example, under Section IV we may want to add a new objective related to the acquisition of renewable resources. However, the document has been prepared carefully and he doesn't want to inadvertently create a problem. Foster said that we could approve this unchanged and make adjustments in the future. Eglash asked if the UAC comments will be communicated to Council. Fong ensured that the Commission's comments would be forwarded to the Council. Ratchye added that deleting (d) and (e) would not be a problem for staff, especially since the Rates Policy will be coming forward to the UAC for consideration and they can be added there. Van Orsdol added that these areas are not the focus of this policy, but would advise that these principles should be incorporated into some policy and Utilities practice.

Commissioner Waldfoegel agreed that these principles are important and should be included in some document, but that the Energy Risk Management Policy is not the place. Foster added that the principles could frustrate attempts to encourage efficiency. He asked if the UAC votes to delete these two subsections, can a comment be added to state that the UAC supports these principles, but that they should be found in a document that's more relevant to ratemaking than focused only on risk management. Staff

explained that the commission's discussions would be reflected in the minutes and a summary would be part of the staff report that went to the Council.

Chair Melton said that he saw no reason to make any changes at this time except perhaps to remove the whole commodity pricing policy section if it was replaced in a future Rates Policy.

Commissioner Foster asked that the notes reflect that the UAC does not reject the objectives of nondiscrimination and nonsubsidization, but recognizes that they are not appropriate in this Energy Risk Management Policy. These objectives are more appropriately located in a future Rates Policy, where the UAC will look for them.

ACTION: Commissioner Waldfogel moved the staff recommendation to recommend Council approve the updated Energy Risk Management Policy with the deletion of paragraphs (d) and (e) in Section IX – Commodity Pricing Policy. The motion was seconded by Commissioner Foster. The motion carried by a vote of 3-1, which Chair Melton voting no.

ITEM 6: DISCUSSION ITEM: Selection of Topic(s) to be Agendized for Discussion at Future UAC Meetings

The commission discussed various ideas for topics to be discussed at future meetings, but no recommendation of a specific item was made.

Meeting adjourned at 9:00 p.m.

Respectfully submitted,
Marites Ward
City of Palo Alto Utilities