

FINAL

UTILITIES ADVISORY COMMISSION MINUTES OF FEBRUARY 4, 2009

CALL TO ORDER

Chair Dawes called to order at 7:00 P.M. the scheduled meeting of the Utilities Advisory Commission (UAC).

Present: Commissioners Dexter Dawes, Marilyn Keller, John Melton, Dick Rosenbaum, Asher Waldfogel and Council Member Yiaway Yeh

ORAL COMMUNICATIONS

NONE

APPROVAL OF THE MINUTES

The minutes from the January 7, 2009 UAC meeting were unanimously approved.

AGENDA REVIEW

Commissioner Waldfogel requested that the Calaveras Reserve item be moved to after the financial projections. Staff noted that the Calaveras Reserve discussion was purposely before since the financial projections which assume that the Calaveras Reserve recommendations are approved. Waldfogel asked that the presentation be made first as in the prepared agenda order, but that the action taken be moved to after the financial projections. Staff agreed to this change.

REPORT FROM COMMISSION MEETINGS/EVENTS

Commissioner Melton reported attending three Northern California Power Agency (NCPA) events in January. On January 14, the special meeting of the Legislative and Regulatory Committee met to discuss the different legislative proposals for the Renewable Portfolio Standard (RPS). On January 21-22, he attended the NCPA strategic issues and Commission meetings. On January 26, he attended the California Municipal Utilities Association (CMUA) Capitol Day. Melton noted that there are two RPS bills under discussion in the legislature. Senator Simitian's bill, SB14, gives some command and control authority to the CEC over municipal utilities. Assembly Member Krekorian's Assembly bill leaves more authority in local hands. Discussions continue on how to include hydro resources into the bills. Melton reported that Assembly Member Ruskin is carrying a bill sponsored by NCPA to streamline reporting requirements.

Council Member Yeh noted that at NCPA's strategic issues meeting, he attended a meeting with the California Air Resources Board (CARB) staff, which allowed for CARB staff to see the differences between members' situations.

UTILITIES DIRECTOR REPORT

Director Valerie Fong provided the following oral report:

1. **Hydro Conditions:** As of January 26, Northern Sierra rainfall is 70% of average to date and Sierra snow water content is 60% of average to date, Stream run off is about 50% of normal, Reservoir levels are about 50% of average. If precipitation returns to median levels for the balance of the water year we

would get to nearly 80% of annual precipitation onto very dry watersheds that would produce low (60-70% of average) runoff into very low reservoirs. Reservoirs would be operated at minimum releases in an attempt to retain water. Hydro generation is forecast to be low for a wide range of upcoming precipitation levels.

For the Hetch Hetchy system, snowpack is somewhat healthier in the Tuolumne River watershed than in other parts of the state as of February 1, but it is still below average. A water supply shortage could be called in March or April and is likely unless additional precipitation occurs in February and March. The Santa Clara Valley Water District may announce mandatory rationing even sooner if conditions do not improve.

2. **Utilities – Customer Demand and Revenues:** FY 2009 results for July 08- Jan 09 for commodity use indicate that demand remains close to projections for electricity and lower than projected for gas and water. In terms of sales revenues, due to billing adjustments, both electric and water sales are higher than budgeted, while gas sales revenues are lower than budgeted. Although electricity use was 0.2% below budget, electric sales revenues are 4.4% higher than budgeted. Gas use was 4.1% below budget while gas sales revenues are 6.4% lower than budgeted. Water use was 2.6% below budget, but water sales revenues are 6.9% higher than budgeted.
3. **Utilities Bill “Sticker Shock”:** The effects of the natural gas rate increase approved in July 2008, coupled with December’s cold weather are being felt by customers as evidenced by an unusually high number of residential customer complaints about high gas bills. Even those customers whose December 2008 consumption is less than, or similar to, their December 2007 usage are questioning meter reading accuracy and meter calibration. We are also seeing the effects of the downturn in the economy in the strong reaction of our customers to their bills. Staff works with customers to help them understand the cold weather impacts and also directs customers to our efficiency programs.
4. **COTP Assignment:** the contracts for the 15-year assignment of the rights and responsibilities for the use of the California-Oregon Transmission Project were fully executed with a start date of February 1, 2009. The short-term assignment that was in place for the prior 6 months resulted in savings to Palo Alto of approximately \$800,000.
5. **Hetch Hetchy Tour:** the Water Education Foundation is tentatively offering a tour of the Hetch Hetchy system in July. Please let us know if you want to attend this 3-day educational tour of the entire system from the SFPUC facilities on the Peninsula and the East Bay to Yosemite. The Water Education Foundation has stated that it will offer the tour if it can fill all seats on the bus.
6. **MRTU:** CAISO’s long awaited transmission market redesign, MRTU, is expected to go live on April 1st. The City has already modified a number of is working on a few other modifications to be in place under MRTU. Under the new market design, the City’s transmission costs are expected to go up, but the extent of increase is still highly uncertain. We will be keeping the UAC apprised of the cost impacts and cost mitigation strategies staff will be pursuing as we begin operating under the new market.
7. **UMS:** Classic Residency by Hyatt is the newest PaloAltoGreen member. They have signed up for the equivalent of a ½ wind turbine. Maintenance on the City’s PV systems at the MSC, Cubberley, and Baylands is still in process. The monitoring equipment has been ordered and the information signs have been installed. The tracking system at the MSC is still having difficulties. The contractor is working with Facilities staff on getting this system in working order
8. **Council Adoption of the Legislative Policy Guidelines:** On Monday night, the Council adopted the Utilities Legislative Policy Guidelines with two changes:
 - a. The first change was to add language to the overarching goals acknowledging the State’s efforts on climate protection through AB32. The Council modified the goal of the preservation of local accountability to include the phrase “*while balancing the statewide climate protection goals.*”
 - b. Additionally, the Council modified the goal to support meaningful climate protection legislation with recognition for early voluntary action to reflect *early adoption* instead of *early voluntary* action.
9. **UAC Calendar:** Rolling calendar of upcoming items for UAC meetings.

UNFINISHED BUSINESS

NONE

NEW BUSINESS

ITEM 1: INFORMATION ITEM: Annual Risk Assessment of Rate Stabilization Reserves

Risk Manager Karl van Orsdol gave a brief introduction to the document, noting that the risks to the supply reserves are not additive, and so the approach of using moderate approaches to assessing each risk does provide in sum, an adequate approach to total reserve levels. He also noted that the reserve levels are taking into account the current hydro conditions and economic and pricing data.

Commissioner Melton asked about why the second year risk levels are so much higher than the one-year risk estimates. Van Orsdol noted that prices were likely to increase next year and the default rates of counterparties are much higher for two years. Utilities Assistant Director Jane Ratchye added that the second year was also higher because of the laddering strategy, with fewer purchases made for year two, meant that the price risk was considerably higher.

Commissioner Keller asked if the assumption that CIP costs could increase only 10% is realistic. Staff said that this was a good assumption for Palo Alto's ongoing CIP work.

ITEM 2: ACTION ITEM: Proposed Changes to the Calaveras Reserve Guidelines

Utilities Director Valerie Fong presented staff's proposed changes to the Calaveras Reserve Target and Guidelines and requested that the UAC recommend to Council the adoption of the proposed changes.

The recommended changes as presented included:

- Eliminate the existing Calaveras Reserve drawdown schedule;
- Require the calculation of the stranded costs for the electric supply portfolio during the annual budget process for the upcoming budget year(s) and set the minimum transfer from the Calaveras Reserve to the Electric Supply Operating Budget equal to this amount;
- Require the calculation of the stranded costs for the long-term of the electric supply portfolio during the annual budget process and ensure that the Calaveras Reserve balance will be sufficient to cover this amount;
- Calculate stranded cost based on the above market cost of the Calaveras Hydroelectric Project and the California Oregon Transmission Project; and
- To the extent that there are funds available in excess of long-term stranded cost needs, staff will work with the UAC to identify and recommend projects for Council consideration and approval. Such projects shall be to the benefit of electric ratepayers.

Fong also presented an update of stranded cost and possible excess Calaveras Reserve funds in a manner consistent with the proposed changes to the guidelines, including:

- Stranded cost equal to minimum transfer requirement for FY 2010 and FY 2011 at \$2.63 and \$1.99 million, respectively based on market value and cost assumed for FY 2010 budget development;

- a range of long-term stranded cost scenarios which are dependent on market price and hydroelectric generation of \$31.5 to \$52.5 million; and
- a potential Calaveras Reserve excess in the range of \$12 to \$33 million, given the range of long-term stranded cost and the projected ending FY 2009 Calaveras Reserve balance of \$64.5 million.

Assistant Utilities Director, Jane Ratchye added that in the event a project is identified for possible funding with excess Calaveras Reserve funds, the long-term stranded cost calculation would be updated prior to expending the funds to ensure adequacy of the Calaveras Reserve. Ratchye also clarified that the stranded cost transfer calculated for FY 2010 is the minimum amount recommended and that it is Council's discretion to approve greater transfers from the Calaveras Reserve.

Commissioner Waldfogel expressed concern that the short-term calculation did not look at contingencies for low hydroelectric output for which Ratchye clarified that such contingencies would be included in the long-term calculation.

Chair Dawes expressed his desire to annually true-up the transfer from the Calaveras Reserve based on actual performance of the stranded assets, however none of the other commissioners expressed their support for this idea as it would not add to rate stability and could be administratively burdensome.

Commissioner Melton asked what staff would do if the Calaveras Reserve is used to fund projects and stranded cost increases above the amount available in the Calaveras Reserve. Fong explained that staff's response would depend on whether or not Direct Access was available to customers and that any recommendation would be provided in the context of overall rates.

Action on this item was deferred until after Item Number 6 – Long-Term Financial Projections and Revenue Adjustment Targets for the Electric Fund.

ITEMS 3-6: DISCUSSION ITEM: Long Term Financial Projections and Revenue Adjustment Targets

Commissioner Rosenbaum made a general comment on all the long-term projection items with respect to the General Fund Transfer as he noted that the reports assume that the General Fund Transfer from the Water Fund would be discontinued in FY 2010 and that the transfers from the Electric and Gas Funds would be dramatically increased by \$7 million. He asked whether a recommendation on the change in policy on the General Fund Transfer would be reviewed by the UAC prior to action by the Finance Committee. He noted that this was the case in the past. He warned that when the City takes such a political action, you can never be sure what will spark citizen outrage. He said that under the circumstances of the economic downturn and collapsing energy prices, the increases proposed for the Electric Fund are completely unreasonable.

Senior Resource Planner Ipek Connolly presented a review of the budget and rate setting process and noted that the objectives of tonight's presentation were to provide information to and get feedback from the UAC on preliminary cost and revenue projections and reserve levels. She reminded the UAC that these items are for information only and that the action items of rates and budget will be presented to the UAC in March (for the rate projections) and May (for the budget). Although these are 5-year projections, the emphasis is on FY 2010.

The assumptions used in the analyses include:

- The FY 2008 actuals are from the City's 2008 Comprehensive Annual Financial Report (CAFR);
- The FY 2009 mid-year budget request is assumed to be approved, although it has not be finalized or requested as yet;
- The FY 2010 and FY 2011 budget request has not be finalized as yet – the figure shown are preliminary; and
- The financial projections shown were prepared in December 2008 and are subject to change. These include the following assumptions:
 - Operating expenses will increase at the rate of inflation, assumed to be 3% per year, or CPI;
 - Population increase of 1%/year;
 - Interest rate of 4%/year assumed for interest earnings on reserves;
 - Rent cost increases of 3%/year;
 - Assumes proposed revisions to the Calaveras Reserve guidelines;
 - Assumes revisions to the minimum guideline levels for the Electric Supply, Gas, Water and Wastewater Collection Rate Stabilization Reserves (RSR); and
 - Preliminary estimates for changes to the General Fund Transfer amounts.

Commissioner Waldfogel stated that the UAC should look at cost savings possibilities for each fund.

ITEM 3: DISCUSSION ITEM: Long Term Financial Projections and Revenue Adjustment Targets for the Water Fund

Senior Resource Planner Ipek Connolly presented the Uses of Funds for the Water Fund, noting that the Emergency Water Supply and Storage Project spikes up the CIP costs and that there are the expected large increases in wholesale water costs from SFPUC. The CIP projects were identified. It was also noted that the transfer to the General Fund from the Water Fund would cease starting in FY 2010. The monthly bill comparison showed that Palo Alto's current water rates are higher than all the neighboring benchmark cities. The 5-year revenue projections show that current revenues are not sufficient to cover costs without rate increases over the 5-year planning period.

Two water rate adjustment scenarios were evaluated. Scenario 1 has no rate increase for FY 2010, but is followed by higher increases in the each of the remaining 4 years. Scenario 2 has a 5% rate increase for FY 2010 followed by moderate, single-digit increases in each of the remaining 4 years. Both scenarios result in RSR balances near the minimum guideline level.

Chair Dawes asked if any of the CIP projects could be deferred. He asked about the seismic water tank value, costing \$800,000. Commissioner Waldfogel asked if the water main replacement program could be deferred. Utilities Director Fong noted that deferring CIP projects may increase operations and maintenance costs and that these projects need to be completed. Council Member Yeh noted that the federal government has a focus on infrastructure projects, including in the federal stimulus package.

Chair Dawes noted that it was not a good time to issue bonds for the Emergency Water Supply and Storage Project. Commissioner Melton asked if the Water Fund could borrow from the Calaveras Reserve to fund the project until the bond market recovered.

Commissioner Waldfogel asked why there was such a huge increase in the operating budget from FY 2008 to FY 2009. Fong noted that the FY 2008 figure was actual expenditures and that the City cannot exceed its budget and must budget for any planned expenditures going forward, such as in FY 2009 and beyond.

Chair Dawes asked for public comment and Herb Borak spoke. Borak agreed with the opinion that the Water Fund cannot make a General Fund Transfer, but wants a historical record, especially since rates are higher than in surrounding cities. He wanted a public document to be released on the transfer issue, not for the decision to be made in a confidential memorandum for the Council only.

Commissioner Melton stated his preference for the 5% increase in FY 2010 scenario as he likes steady smaller increases, rather than double-digit increases. He stated that if rates must increase, that the increases be steady, not lumpy. Chair Dawes agreed with Melton's assessment.

ITEM 4: DISCUSSION ITEM: Long Term Financial Projections and Revenue Adjustment Targets for the Wastewater Collection Fund

Senior Resource Planner Ipek Connolly presented the Uses of Funds for the Wastewater Collection Fund, noting that the treatment costs are the main drivers for cost increases. The CIP projects were identified. The monthly bill comparison showed that Palo Alto's current wastewater rates are higher than Santa Clara's, but the same or lower than the other four neighboring benchmark cities. The 5-year revenue projections show that current revenues are not sufficient to cover costs without rate increases over the 5-year planning period.

Two wastewater rate adjustment scenarios were evaluated. Scenario 1 has no rate increase for FY 2010, but is followed by higher increases in each of the remaining 4 years. Scenario 2 has a 5% rate increase for FY 2010 followed by more moderate increases in each of the remaining 4 years. Both scenarios result in RSR balances near the minimum guideline level.

Chair Dawes asked for public comment and Herb Borak spoke. Borak noted that wastewater treatment costs are shown in the chart, but that this is not in the purview of the UAC.

Chair Dawes and Commissioner Melton echoed their remarks from before that gradual increases are preferred to zig-zag increases, so they generally supported a 5% increase for wastewater collection.

ITEM 5: DISCUSSION ITEM: Long Term Financial Projections and Revenue Adjustment Targets for the Gas Fund

Senior Resource Planner Ipek Connolly presented the Uses of Funds for the Gas Fund, noting that gas supply costs are not projected to increase over the 5-year planning horizon. The transfer to the General Fund from the Gas Fund could increase substantially starting in FY 2010 based on preliminary analysis. The CIP projects were identified and it was noted that one major Gas CIP project was being deferred, which lowered the FY 2010 costs. The monthly bill comparison showed that Palo Alto's current gas rates are higher than in the neighboring benchmark cities that all have service from PG&E. This is due to PG&E's gas purchasing strategy of buying on the short-term market. In times of rising market prices, Palo Alto's gas purchasing strategy results in lower rates, but in time of declining gas prices such as being experienced currently, PG&E's rates are lower than Palo Alto's. The 5-year revenue projections show that current revenues are not sufficient to cover costs without rate increases over the 5-year planning period.

Two gas rate adjustment scenarios were evaluated. Scenario 1 has no rate increase for FY 2010, but is followed by a 9% increase in FY 2011. Scenario 2 has a 2% rate decrease for FY 2010 followed by a 9%

increase in FY 2011 and a 3% increase in FY 2012. Both scenarios result in Gas Supply RSR balances near the minimum guideline level and Gas Distribution RSR balances midway between the minimum and the maximum guideline levels.

Chair Dawes asked if the rent charges in the budget were likely to be the actual numbers. Fong said that this was the case. Dawes wondered if rents would fall to mirror the widespread falling property values. Budget Manager Sharon Bozman said that the appraisals are done annually by an independent appraiser.

Commissioner Waldfogel again noted that the actual FY 2008 numbers are much higher than the budgeted FY 2009 numbers. Chair Dawes noted the substantial increase in General Fund Transfer.

Commissioner Melton stated that the 2% rate reduction was so miniscule as to be meaningless and not worth doing. Commissioner Rosenbaum said that the proposal should be a reduction of at least 10% even if this would result in RSRs being below guideline levels. Commissioner Melton said that a big cut this year would be hard to make up in subsequent years. Commissioner Waldfogel said that Palo Alto's rates should more closely follow market costs and noted that Palo Alto's rate lag PG&E's.

ITEM 6: DISCUSSION ITEM: Long Term Financial Projections and Revenue Adjustment Targets for the Electric Fund

Senior Resource Planner Ipek Connolly presented the Uses of Funds for the Electric Fund, noting that supply costs are the largest single cost item and were projected to increase moderately over the 5-year planning horizon. It was also noted that the transfer to the General Fund from the Electric Fund could increase substantially in FY 2010 based on the preliminary evaluation. The supply costs were broken down into the component parts – Western, Calaveras, local capacity and CAISO costs, NCPA costs, renewable resources and market purchases.

The CIP projects were identified. The monthly bill comparison showed that Palo Alto's current electric rates are slightly higher than Santa Clara, but that PG&E's rates are about 43% higher than Palo Alto's for the other neighboring benchmark cities. The 5-year revenue projections show that current revenues are not sufficient to cover costs without rate increases over the 5-year planning period.

Three electric rate adjustment scenarios were evaluated. Scenario 1 has a 21% increase for FY 2010 followed by a 14% increase in FY 2011. Scenario 2 has 16% increase for FY 2010 followed by a 19% increase in FY 2011. Scenario 3 has 12% increase for FY 2010 followed by a 22% increase in FY 2011. All scenarios result in Electric Supply RSR balances above the minimum guideline level in the long-term with Scenario 3 going below the short-term risk assessment value for FY 2010. scenario 1 takes the minimum amount from the Calaveras Reserve while Scenarios 2 and 3 rely on an increased transfer of \$3 million in FY 2010 from the Calaveras Reserve.

Council Member Yeh asked if local cogeneration plants can reduce costs. He asked if it can compete well with other renewable power sources since the cost of renewable resources is increasing so much. Ratchye explained that local generation and cogeneration has great value to the City – it counts as local capacity, it can be very efficient, it saves on transmission costs and losses. However, cogeneration systems do not count toward the RPS goals for renewable resources as they are driven by natural gas.

Commissioner Waldfogel asked if the demand-side was evaluated in the same way as the supply side. He said that plug-in electric cars could have a large impact on demand for electric power and that the demand

forecast should include that effect since Palo Altans would be earlier adopters than the national or state average.

Chair Dawes asked for public comment and Herb Borak spoke. Borak discussed historically how the General Fund Transfer was set and that it seemed to change with each new City Manager. However, the changes are not communicated to ratepayers. He wanted to know what changes in City services would result from keeping the current General Fund Transfer method.

Commissioner Waldfogel wanted to see a scenario with some rate increases, reduced operating expenses and expense deferrals.

Chair Dawes was more comfortable with single-digit rate increases. In addition, however, he wanted a greater build-up of reserves to protect from dry hydro years. Commissioner Keller was concerned about deferring costs and advised being aware of short-term versus long-term benefits. Regarding the rate increase proposals, Chair Dawes expressed concern for the impact on ratepayers. Keller said she preferred steady increases to large jumps. Melton wanted to see the rate proposals after looking at all budget cuts. Keller noted that there should be a consistent message with respect to cost increases.

RETURN TO ITEM 2 FOR ACTION: Proposed Changes to the Calaveras Reserve Guidelines

Commissioner Melton motioned to recommend to Council the adoption of the changes to the Calaveras Reserve Target and Guidelines as presented by staff. Commissioner Rosenbaum seconded the motion. The motion passed unanimously (5-0).

ITEM 7: ACTION ITEM: Selection of Topic(s) to be Agendized for Discussion at Future UAC Meetings: Review of sections of the Municipal Code and City Charter relevant to the role of the UAC

Commissioner Waldfogel wanted to have a study session to discuss the municipal code and to determine if there are any gaps such as the responsibilities of the UAC with respect to wastewater, recycled water, and fiber optics. Commissioner Melton wants to make sure that the code is up to date. He noted that the City Attorney's office would likely need to be involved.

Fong asked if she should approach the City Attorney's office to request that it give its input to the UAC in a workshop or study session. Commissioner Waldfogel asked if the UAC should appeal to the Council. He noted that the code allows the UAC to establish bylaws, but is unaware if they exist.

Commissioner Waldfogel moved to agendize a study session for discussion of the municipal code with respect to the roles and responsibilities of the UAC and request input from the City Attorney. Commissioner Rosenbaum seconded the motion. The motion passed unanimously (5-0). Council Member Yeh said that the Council supports the general effort to clarify the UAC's role.

Meeting adjourned at 10:00 P.M.

Respectfully submitted,
Marites Ward
City of Palo Alto Utilities