

FINAL

UTILITIES ADVISORY COMMISSION MINUTES OF FEBRUARY 3, 2010

CALL TO ORDER

Chair Melton called to order at 7:02 p.m. the meeting of the Utilities Advisory Commission (UAC).

Present: Commissioners Ameri, Berry, Eglash, Keller, Melton, and Waldfogel.

Absent: Commissioner Foster

Council Member Yeh arrived following the discussion on Item 1 at about 7:45 p.m.

ORAL COMMUNICATIONS

None.

APPROVAL OF THE MINUTES

The minutes from the January 6, 2010 UAC meeting were unanimously approved.

AGENDA REVIEW

No changes to the agenda were proposed.

REPORTS FROM COMMISSION MEETINGS/EVENTS

Chair Melton reported on meetings he attended, including the NCPA Strategic Issues Workshop on January 26-27 in Sacramento and the CMUA Capitol Day on February 1. He noted that he and staff met with Assembly Member Ruskin, staff of Senator Joe Simitian, Joe Camicia, Chief of Staff to the State's Chief Information Officer. . Melton advised that the state budget will be the primary item for consideration by the legislature, but that Simitian will reintroduce an RPS bill and that agreement between the parties seems to indicate that one will get passed. He also said that the PG&E-sponsored ballot initiative will appear on the June 2010 ballot as Proposition 16 and added that he spoke to Council on February 1 when it agreed with staff and the UAC and took an oppose position to the initiative.

UTILITIES DIRECTOR REPORT

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

1. **Fall 2009 Renewable Power RFP:** Staff plans to take 4 draft power purchase agreements to the Council Finance Committee on March 16 that should be sufficient to meet the Council-approved RPS target of 33% renewables by 2015 without exceeding an upward rate impact of ½ cent per kWh.
2. **Sierra Hydroelectric Update:** As of 2/1/2010 the snowpack was 17% above average to date and the Central Valley Project (CVP) reservoirs were holding about 74% of average water for the date. El Nino conditions are in place and rainfall is forecast above normal for February and March. Watershed groundwater is still being recharged and reservoirs are attempting to refill by hoarding water. Therefore

hydroelectric generation is still forecast to stay below average this year. The exception is the Calaveras project that is forecast to have an average or better generation year.

3. **Landscape Water Efficiency Ordinance:** City staff is currently updating the draft Water Efficient Landscape Ordinance, based on comments from the UAC, community members, other agencies, the City Attorney's office, and other City departmental staff. Staff members have presented Palo Alto's Ordinance development and received feedback at several community meetings including the Association of Professional Landscape Designers, Acterra workshops, and a panel discussion with other water conservation professionals through Wholly H2O, a non-profit organization that educates members of the community about water conservation and efficiency. Staff is also coordinating additional public outreach meetings to engage the landscape community, hosting workshops to address the requirements of the updated landscape ordinance, and publishing press releases and information on the City's website about current requirements and ongoing developments. The revised draft ordinance is planned to return to the UAC in April.
4. **My Utilities Account Launch:**
"My Utilities Account" online service is now available. Utility customers can access their account information from the comforts of their own home. Customers can view timely financial and consumption information and take advantage of the following services: View and pay utilities bill, sign up for paperless billing, access billing history including payments and charges, view historical consumption data, update or add phone number and/or e-mail address, send a secure message about customer account.
5. **Legislative Update:** At last week's NCPA Strategic Issues Workshop and this Monday's CMUA Capitol Day, we heard that the State's budget issues will be all consuming this year. However, we can still expect to see bills introduced on renewable portfolio standards (RPS). We anticipate Senator Simitian will re-introduce his RPS bill this month. Even though the Senator's bill, SB14, was vetoed last year, the general consensus is that the debate will pick up from where we left off last year, where a lot of movement had been made regarding local governance of the RPS program, but deliverability of out-of-state renewables was still to be resolved. Another electric issue we were told to expect legislative action on is energy efficiency.

UNFINISHED BUSINESS

None.

NEW BUSINESS

ITEM 1: DISCUSSION ITEM: Update on Preliminary Analysis of the Ten-Year Electric Efficiency Goals for the Period 2011 to 2020

Resource Planner Christine Tam and Utility Marketing Services Manager Joyce Kinnear provided a presentation reviewing the statutory requirement for an electric energy efficiency (EE) potential to be completed every three years, comparing the results of the 2007 Plan with actual achievements, and then explaining the preliminary recommendations for the 2010 Plan. The 2010 Plan would double the 10-year electric EE goals above the 2007 Plan's recommendations.

Commissioner Eglash asked whether the 2010 Plan uses the current achievements, which are nearly double the goals in the 2007 Plan, as the baseline. Kinnear replied in the affirmative. Eglash then asked

about the reasoning for using supply funds above and beyond public benefit funds to contribute toward the increased funding requirements to achieve these goals. Jane Ratchye, Assistant Director for Utilities, pointed out that state law a few years ago had imposed a loading order for utilities which requires cost-effective energy efficiency to be the first supply resource purchased by a utility. City Council has also requested that the Utilities Department value EE at the same rate as it is willing to purchase renewable power. Finally, Chair Melton attended a meeting last week with Ratchye and Director Fong where Ralph Cavanagh of the National Resources Defense Council had stated that publicly-owned utilities are not spending enough supply funds for efficiency, and that state laws would have to be passed requiring a greater investment from municipal utilities. Eglash responded that he appreciated this view of the funds—that they are not a subsidy for efficiency, but an investment in reducing load that will help everyone in the City.

Commissioner Keller wanted to know if the efficiency programs consider avoiding load such as using insulation to allow a customer to avoid installing an air conditioning system. Kinnear stated that the study considers all economically cost-effective measures and pointed out that rebates for air conditioning are not cost-effective, due to the climate and low requirements for air conditioning in this area. Commissioner Keller stated that if the goal is to keep load down, then we should consider measures that avoid new air conditioning loads. Tam responded that the EE potential model looks at new construction programs separately from retrofits, but that state standards are so high for new construction, that there is little incremental benefit to the utilities department when incenting higher standards. Director Fong pointed out that the Utilities Department does have rebates for new construction and mentioned that a number of these rebates are in the design process.

Commissioner Ameri asked why the department had been able to achieve more savings than were expected in the 2007 Plan. Kinnear said that several third party programs were added, a successful residential compact fluorescent light program was held in two of the years, and that staff had worked exceedingly hard to increase efficiency.

Commissioner Waldfogel wanted to know if the model looks at more than reducing demand when reviewing success and asked if the model looks at what will happen when new technologies, such as plug-in electric vehicles, actually increase load. Tam said that the model does include the current load forecast for the next 20 years in load; however, since these goals are primarily important for the next three years until the next time the EE potential will be calculated, the impact of these technologies are not significant for this Plan. Staff does not believe these new technologies will create much of an impact in the short-term. Commissioner Melton added that the program is trying to reduce existing load. Program goals could be met, but new technology could actually add to system load; however, in this case the programs would still be successful.

Commissioner Melton asked if this model is being used by all NCPA member agencies, and if results can be compared between the utilities. Tam replied in the affirmative. Melton followed up by asking what the California Energy Commission (CEC) does with these reports. Kinnear replied that the CEC reviews all the reports, compares goals with achievements, and prepares a report for the legislature. This report is used by both the legislature and agencies such as NRDC when reviewing what further legislation to push for in regulating utilities.

Commissioner Waldfogel asked whether it would be better to have a lower goal that we know we can achieve or a higher goal that will be more difficult to reach. Ratchye said that setting an appropriate goal is

important, so that staff can request the appropriate expenditures and develop the programs necessary to reach the potential. Chair Melton said that spending supply funds to reduce demand is appropriate.

Commissioner Eglash commented that these are ambitious goals. Each percentage increase in efficiency is more difficult to achieve as the easier technologies are implemented first and more interested customers make changes. He suggested that the plan build in research plans to determine what programs work and what don't work. He suggested that staff investigate what people actually due. Kinnear mentioned that staff completes an annual review of program successes; including both an internal modeling and reporting of achievements and an external Measurement and Verification of program successes. Both of these are reported to the CEC.

ITEM 2: DISCUSSION ITEM: Annual Risk Assessment of Rate Stabilization Reserves

Ratchye stated that staff had no presentation to supplement the written report but that this annual calculation of the risks for each of the Rate Stabilization Reserves (RSRs) was done in compliance with the RSR guidelines.

Chair Melton asked if there was any change in methodology for this year's calculation. Risk Manager Karl van Orsdol replied that the same methodology was used as in past years.

ITEM 3: DISCUSSION ITEM: Annual Calaveras Reserve Stranded Cost Calculation

Senior Resource Planner Monica Padilla provided a presentation on the annual calculation of the short-term and long-term "stranded cost", or above market cost, of the Calaveras hydroelectric project and the California-Oregon Transmission Project (COTP). Padilla first outlined the history of the Calaveras Reserve noting that the current guidelines require this annual calculation of the electric stranded cost. This year's estimate of the FY 2011 stranded cost is \$4.05 million, which the guidelines state will be the minimum transfer from the Calaveras Reserve to the Electric Supply operating budget. The long-term stranded cost estimate for the Calaveras project is \$32.3 million, which is based on a scenario assuming that market prices are the expected case and the long-term generation from the Calaveras hydroelectric project is 90% of normal. The total long-term stranded cost estimate is \$36.8 million, which includes \$4.5 million for COTP contingencies. Padilla presented the estimated ending Calaveras Reserve balance in FY 2011 as \$55.6 million after Council-approved project funding and the minimum transfer to the Electric Supply operating budget. This leaves \$18.8 million for project funding from the Calaveras Reserve.

Public Comment:

Jeff Hoel questioned staff's calculation of \$55.6 million as the FY 2011 ending reserve balance since he thought it was \$64.5 million in the Calaveras Reserve as of the start of FY 2010.

Chair Melton asked what the long-term stranded cost was calculated to be for the last fiscal year (FY 2010). Assistant Director Jane Ratchye stated that it was \$48 million, but was based on a scenario with market prices at 80% of the expected price and hydro generation at 90% of normal.

Commissioner Ameri asked if efficiency programs could be funded from the Calaveras Reserve. Ratchye confirmed that the guidelines allow electric energy efficiency programs to be funded from the reserve as long as Council approves that funding.

Commissioner Berry, noting the description in the report, asked why the treatment of interest was changed. Ratchye explained that before FY 2010, interest earning on all reserves funds accrued at the fund level.

This is for all reserves, including Calaveras Reserve, Emergency Plant Replacement Reserves, Rate Stabilization Reserves, etc. for all funds. However, in FY 2010, just for the Calaveras Reserve, a change was made so that interest earnings accrued back to that Reserve. Staff will reverse that change so that interest earnings accrue at the fund level for the Calaveras Reserve as well.

Chair Melton asked if staff would update the stranded cost before finalizing the budget. Ratchye replied that the stranded cost calculation would not be updated and that it was consistent with all the assumptions that were used in the budget, including market prices and hydro generation estimates. Padilla added that, if the calculation would be repeated today, it would not differ much from the calculation in the report.

Council Member Yeh asked what the "excess" money from the Calaveras Reserve would be used for and what types of projects would be considered. He commented that PG&E had a negative experience with smart meters and wanted to make sure that there would be sufficient outreach to the community on any projects selected for funding. Ratchye reminded that any projects what would be proposed for this funding would require Council approval and that the guidelines require that staff work with the UAC to develop projects for proposed funding from the reserve.

Commissioner Berry asked if we were using two different reserves to cover the same risks. He noted that in the previous item, the risk assessment for the Electric Supply Rate Stabilization Reserve (E-SRSR) covered both hydro generation and market risk and that the Calaveras Reserve also seems to cover those same risks. Ratchye replied that there is no double counting and that the reserves are very differently utilized. The E-SRSR covers risks such as the possibility that market prices could increase more than estimated in the budget or hydroelectric generation could decrease to lower than assumed in the budget. The Calaveras Reserve covers the above market cost of the electric assets given the budget assumptions.

Commissioner Berry noted that the funds for the reserve were collected from earlier customers and to use those funds for projects that will provide a future benefit could be viewed negatively by some. He expressed that this was a murky area and that he had concerns. Chair Melton observed that the guidelines for the Calaveras Reserve were just revisited last year and that he wouldn't recommend making changes this year.

ITEM 4: DISCUSSION ITEM: Long-Term Financial Projections and Revenue Requirements for the Water Fund

Commissioner Ameri announced that he would recuse himself from discussions of this water-related item since he works for a water agency in the East Bay that receives water from the same supplier as Palo Alto. He explained that there was no financial conflict of interest, but since there could be a perception of a conflict, he has chosen to not participate in the discussion.

Senior Resource Planner Ipek Connolly presented the results of the long-term financial projections for the water fund. Connolly began by reviewing the rates and budget process and that these reports and presentations were for the UAC's information and discussion and that action on rate proposals would return to the UAC in March and April. She listed the assumptions used to develop the long-term financial forecasts: FY 2009 actual costs are based on audited financial statements; FY 2010 mid-year budget adjustments are projected and are not final yet; supply cost projections are as of December 2009 and are subject to change; FY 2011 budget requests are not yet finalized; net operating costs are assumed to increase at 1% per year; rent is assumed to increase at 1% per year; and interest rate for interest earnings on reserve funds is assumed to be 4% per year.

Connolly noted that residential customers were about 62% of the total water sales revenue for 2009 and that water use for all customers is higher in the summer months. Water Fund cost projections showed that, excluding bond funded CIP, costs are expected to increase from \$35.7 million in FY 2011 to \$42 million in FY 2015. One of the main trends is that the supply purchase cost is increasing as the water supplier, the San Francisco Public Utilities Commission, has increased its rates from \$1/CCF in FY 2005 to about \$1.70/CCF in FY 2009 and are projected to increase to \$3.35/CCF in FY 2015. The major water Capital Improvement Projects (CIPs) include the \$34 million current emergency water supply and storage project, for which bonds were recently sold and the future recycled water project, that has not yet been approved, but could cost \$26-\$32 million. In addition, the ongoing water main replacement CIP program costs about \$1 to \$2 million per year.

Connolly stated that the long-term projections show a need for a revenue increase of 5% in FY 2011 followed by increases of 5%, 5%, 8%, and 8% in the next four fiscal years. These projections would leave the Water Rate Stabilization Reserve (RSR) at near the minimum guideline level at the end of FY 2015. With that trajectory of revenues and costs, the Water RSR balance would go above the maximum guideline level in FY 2011 and FY 2012, but staff's preliminary recommendation is for a smoothing of rate adjustments over the 5-year planning horizon. Connolly provided a chart showing Palo Alto's current monthly average residential water bill compared to those in Mountain View, Redwood City, Menlo Park and Santa Clara. Palo Alto's average monthly bill of \$72 is the highest of the group.

Commissioner Waldfoegel, noting that a 5% rate increase results in the reserve levels being higher than maximum guideline levels, stated that it would be helpful to see alternate rate profiles that maintain reserve levels within the minimum and maximum guideline levels. Chair Melton agreed that he'd like to see a scenario for no rate change in FY 2011. Director Fong said that staff's preliminary recommendation was an attempt at providing gradual rate adjustments, rather than sharper increases since it's clear that water costs are rising. Commissioner Keller stated that she supported the philosophy of gradual rate changes and argued that that strategy, if communicated to customers, allows customers to plan. She added that she is interested in rate structural changes that encourage conservation.

Commissioner Eglash confirmed that the General Fund transfer stopped for water after FY 2009. He added that he supported the CIP budget as it is best to keep infrastructure in good shape. Eglash also noted that customers do not understand that the water cost is tripling since those costs are not directly translated to customers, but that these cost increases drive the need for water conservation. He added that one of the merits of having a 5% rate increase is that it would communicate that water costs are increasing. Commissioner Berry echoed Eglash's comments, stating that his preference was to raise rates every year consistently rather than having none, then larger increases later.

Commissioner Berry asked why our rates are so much higher than those in the surrounding communities. Connolly replied that it is difficult to get information to compare apples to apples, but in her conversations with staff at the neighboring communities, they seem to be spending less on CIP for infrastructure than Palo Alto has been. Berry asked if the commodity cost portion was the same for the surrounding communities. Ratchye responded that the costs are the same or very similar, even if other cities, such as Santa Clara and Mountain View, purchase water from the Santa Clara Valley Water District. The District's water costs have been very similar to those of the SFPUC's, but will likely be lower in the future. Berry added that he would like to see the relative CIP expenditures of the neighboring cities.

Council Member Yeh asked if the cost of the emergency water supply and storage project could be shared with a neighbor such as Menlo Park. Fong explained that if the project costs were shared, the benefits and output would also need to be shared and Palo Alto needs 100% of the project's benefits. Yeh asked if the forecast includes the 20% by 2020 water savings goal. He also asked that the new rates to be proposed should contain tiers that encourage water conservation.

Commissioner Berry asked if the SFPUC's rate projections were actually being realized. Ratchye replied that they are coming in right about where projected since SFPUC has dramatically geared up to complete the regional water system's Water System Improvement Program.

On the subject of water rate design, Commissioner Waldfogel advised us not to be overzealous in setting punitive rates for high use tiers since water purchase costs are not a huge fraction of the overall water fund costs. This could result in a large rate increase for a small group of customers. Commissioner Berry added that he would be interested in seeing studies on the elasticity of water demand. Waldfogel responded that such studies are not clearly available for water, but that for electricity, studies have shown that usage depends on a customer's "capital portfolio", or group of equipment and appliances that they own, rather than on behavior. If they have purchased energy saving appliances, then they use less energy. Commissioner Keller stated that water use elasticity should be greater than for electricity since customers can change irrigation practices, landscaping, and can purchase low water use toilets.

ITEM 5: DISCUSSION ITEM: Long-Term Financial Projections and Revenue Requirements for the Gas Fund

Commissioner Ameri returned to the room to participate in this item after recusing himself from the prior discussion.

Senior Resource Planner Ipek Connolly presented the results of the long-term financial projections for the gas fund. Connolly stated that residential customers comprise over half (52%) of the total gas sales revenue for 2009 and that gas use for all customers is higher in the winter months. Gas Fund cost projections showed that costs are expected to increase from \$49.3 million in FY 2011 to \$50.7 million in FY 2015. Connolly also provided a chart showing that the gas market price projection used to prepare the budget and financial forecast this year is substantially lower than last year's projection. Although supply purchase costs are not projected to grow much, that cost is highly volatile. The primary gas CIP is the ongoing gas main replacement program, which cost \$3 million to \$6 million per year.

Connolly stated that there was no requirement to make a retail rate adjustment for FY 2011, but that the long-term projections show a need for revenue increase of 6%, 4%, 3%, and 3% in the next four fiscal years. These projections would leave both the Gas Supply and the Gas Distribution RSRs between the minimum and maximum guideline levels through FY 2015. Connolly provided a chart showing Palo Alto's current monthly average residential gas bill compared to those in Mountain View, Redwood City, Menlo Park and Santa Clara, which all receive gas services from PG&E. Palo Alto's average monthly bill of \$99 is the highest of the group.

Commissioner Eglash asked why the system improvement CIP costs were so low in FY 2010 compared to actual CIP costs in FY 2009 and forecasted future CIP costs. Connolly replied that a gas main replacement project was deferred in FY 2010. Eglash asked why projected FY 2010 operations and maintenance costs were higher than actual costs in FY 2009 and higher than budgeted in future years. Connolly explained that it is difficult to compare actuals to budgeted amounts since not all budgeted amounts are always spent,

but we need to have the funds available in the budget in case there are cases, such as the need to hire a consultant to examine an issue or the need to retain experts or legal advisors to help in regulatory cases.

ITEM 6: DISCUSSION ITEM: Long-Term Financial Projections and Revenue Requirements for the Electric Fund

Senior Resource Planner Ipek Connolly presented the results of the long-term financial projections for the electric fund. Connolly stated that residential customers comprise only 21% of the total electric sales revenue for 2009 with business customers comprising 71%. Electric Fund cost projections showed that costs are expected to increase from \$130.7 million in FY 2011 to \$150.7 million in FY 2015 with electric supply purchases costing half of the total. Breaking down the electric supply costs over the forecast period, Connolly showed that the cost of renewable power is increasing over the 5-year period as the City moves to meet the 33% Renewable Portfolio Standard goal by 2015. Connolly provided a chart showing that, as with gas, the electric market price projection used to prepare the budget and financial forecast this year is substantially lower than last year's projection, especially in the next fiscal year. As renewables become a larger fraction of the portfolio, purchases from the market decline, although the cost of those market purchases is very volatile. The primary electric CIP projects include the ongoing system extensions, undergrounding, and system improvement projects, which cost about \$6 million per year. Smart grid projects could add \$3 million per year in the future.

Connolly stated that there was no requirement to make a retail rate adjustment for FY 2011, but that the long-term projections show a need for revenue increase of 8%, 8%, and 4%, in the next three fiscal years. These projections would leave both the Electric Supply and the Electric Distribution RSRs near the minimum guideline levels from FY 2011 through FY 2015. Connolly provided a chart showing Palo Alto's current monthly average residential electric bill compared to those in Mountain View, Redwood City, Menlo Park and Santa Clara. Palo Alto's average bill of \$76 per month is on the low side, with only Santa Clara's bill lower.

Commissioner Keller asked if smart grid expenses are already known now. Connolly replied that the budget amounts are projections, but that we still need to complete the smart grid strategic plan. Fong stated that the contract for the consultant to prepare the strategic plan is going to Council soon and that the draft strategic plan will be reviewed by the UAC.

Commissioner Berry doesn't like the comparison used for rates that includes so many PG&E cities. He said that it would be helpful to include other utilities such as NCPA member agencies such as Alameda Municipal Power. Fong stated that the reason we do this is to develop total bill comparisons and additional utilities could be added to the comparison for water, but it's somewhat problematic to get bill estimates for all the other utilities (water, gas, and wastewater) for some of the other cities. Connolly noted that additional electric comparisons can be added.

Commissioner Waldfoegel said that although staff did not propose a rate increase for FY 2011, we might want to examine a small (e.g. 2%) rate increase since the reserve levels do go below the minimum guideline levels and it would be good to see a 5-year projection with all reserve levels staying within the minimum and maximum guideline levels. This would allow future rate increases to be smaller.

ITEM 7: ACTION ITEM: Potential Topic(s) for Discussion at Future UAC Meetings

The smart grid strategic plan was mentioned as a possible topic for a future meeting. Director Fong advised that the draft plan would go to the UAC.

Commissioner Berry asked about the timeline for the strategic plan. Fong stated that an ad hoc subcommittee could be named for that project in March.

INFORMATIONAL REPORTS

None.

COMMISSIONER COMMENTS

Commissioner Keller complimented staff on the marketing piece describing the resource efficiency programs.

Council Member Yeh expressed his gratitude to Chair Melton for advocating Council's action to oppose Proposition 16 on February 1. Yeh stated that the Council Policy and Services Committee may convene meetings outside of the City Hall venue and that the UAC may want to hold meetings in the community to discuss Utilities matters in a more accessible way with the public.

Meeting adjourned at 9:45 p.m.

Respectfully submitted,
Marites Ward
City of Palo Alto Utilities