

FINAL

UTILITIES ADVISORY COMMISSION MINUTES OF FEBRUARY 6, 2008

CALL TO ORDER

Chairman Rosenbaum called to order at 7:05 P.M. the scheduled meeting of the Utilities Advisory Commission.

Present: Commissioners Marilyn Keller, John Melton, Dick Rosenbaum, and Council Liaison Yiaway Yeh
Absent: Commissioner George Bechtel

ORAL COMMUNICATIONS

NONE

APPROVAL OF THE MINUTES

The minutes from the January 9, 2008, were unanimously approved.

AGENDA REVIEW

REPORT FROM COMMISSION MEETINGS/EVENTS

Vice Chair Dawes gave a detailed report on the NCPA Strategic Planning workshop that he attended with Chair Rosenbaum and staff members. Vice Chair Dawes particularly noted the increased focus on greenhouse gas emissions and emphasis on greenhouse gas reductions activities. Chair Rosenbaum shared the question he raised at the meeting to CPUC Commissioner John Bohn regarding investor owned utilities' achievement of the 20% mandated renewable portfolio supply standard. He noted his surprise at Commissioner Bohn's answer indicated the likely achievement by the IOUs of the RPS standard.

UTILITIES DIRECTOR REPORT

Utilities Director Valerie Fong gave the following updates:

Compact Florescent Light Bulbs

An update was provided to the Commission in response to a question raised by Commissioner Bechtel at the previous Commission meeting: rebates on approximately 16,000 CFLs were provided to Palo Alto customers in 2007 with an estimated savings of 1,600 MWh/year for an average bulb life of five years installed in relatively high usage sockets. The annual saving of 1,600 MWh is equivalent to 0.16% of City's annual load.

Hydro Conditions

As of 1/29 the Sierra snowpack is at 111% of average. Reservoirs are below average (Trinity 81% of average, Shasta 69%, Folsom 53%, New Melones 107%). All reservoirs have space to fill. Releases are minimized resulting in very little Western Base Resource in January and February. Median precipitation for the rest of the year would result in less than average generation through winter 2009.

COTP Transmission Asset Lay-off

City is exploring the option of laying-off City's share of COTP transmission to other members who may place a greater value on the asset. A successful lay-off of the COTP asset at cost will lower the level of stranded cost reserve requirement. Staff expects to bring a recommendation on the topic to the UAC in the coming months.

Seattle City Light Energy Exchange Contract

City is also making progress in assigning City's share of NCPA's Seattle City Light Exchange Agreement to the City of Santa Clara. The exchange agreement provides energy during the late spring and summer months to Palo Alto, and the obligation to return the energy during the fall/winter months. This exchange arrangement is no longer a good fit to the City's energy portfolio that tends to be flush during the spring/early summer months and short in energy during the fall/winter months.

Western GeoPower Incorporated

NCPA is negotiating a 20 year Power Purchase Agreement with Western GeoPower Incorporated for qualifying renewable energy output from a new 25-33 MW Geysers area geothermal plant. Palo Alto staff finds the output attractive as a resource to help meet the 33% renewable portfolio goal and is pursuing Council approval of participation in a third Phase NCPA agreement to allocate between 10% and 20% of the output to Palo Alto. The output is priced at \$98/MWh with zero escalation and is attractive compared to other renewables after considering capacity benefits. The cost would fit within the Council's goal of acquiring 33% renewables at a cost premium that would not drive retail rates up by more than 0.5 cents/kWh. To meet negotiation time tables staff is seeking Council approval on February 19th.

Upcoming Meetings: Staff is scheduled to provide an informational overview on Utilities Enterprise Funds to the Finance Committee in a study session on February 20th. The presentation will be a combined Utilities and Public Works presentation.

UNFINISHED BUSINESS

NONE

NEW BUSINESS

ITEM 1: INFORMATION ITEM: Options to Manage the Calaveras Reserve:

Shiva Swaminathan, Sr. Resource Planner, discussed the relative merits of the 6 options identified to manage the Calaveras Reserve on a going forward basis beginning with a recap of the Commission discussion at the December meeting, where staff's initial estimates showed that the reserve was potentially over funded by approximately \$20 million.

Commissioner Dawes reiterated his belief that staff needs to continue to look at opportunities to invest surplus cash on long term capital projects such as local cogeneration. Staff assured the Commissioner that it is being looked at closely. Commissioner Rosenbaum complemented staff for analyzing the option he identified at the December meeting, to utilize surplus cash create a new reserve to manage hydro risk, and urged staff to look at the option closely. Commissioners Melton and Dawes asked for the impact of laying-off City's share of the California-Oregon Transmission project (COTP). Staff responded that the COTP lay-off would result in additional surplus in reserve.

ITEM 2: DISCUSSION ITEM: Cost Trends & Drivers for Utilities' Five-Year Financial Forecasts

ITEM 3: DISCUSSION ITEM: Annual Risk Assessment of Rate Stabilization Reserves

ITEM 4: DISCUSSION ITEM: Discussion of Five-Year Financial Projections

Items 2, 3 and 4 were discussed all together. Jane Ratchye, Assistant Director for Resource Management, presented the Five-Year Financial Projections for the Electric, Gas, Water and Wastewater Funds. Ratchye stated that the objective of the meeting was to provide information to the Commission and to obtain feedback on utilities cost and revenue projections and resulting reserve levels. Staff did not make any recommendations but presented one scenario each for the gas, water and wastewater fund, and three scenarios for the electric funds for discussion purposes. Ratchye stated that the feedback from the Commission would inform staff as it develops recommendations on rates for UAC action at the March meeting.

Gas fund scenario requires a 7.1 percent rate increase in FY 2008-09, a reduction from the 9.1 percent increase in prior years' budget, followed by no rate increases for the next five years given current projection of costs. Ending reserve level for Supply RSR would be at the Risk Assessed Value for FY 2008-09 reserves. Ending reserve level for Distribution RSR is projected to be slightly below the Risk Assessed Value for FY 2008-09, but this situation is eliminated by FY 2009-10.

Commissioner Keller questioned the certainty of the forecasts and why the proposals did not show ranges. Ratchye explained that these were expectations in the long term, not the risk around the long term. Fong explained that the risk for the upcoming year was not that great as a large portion of the gas portfolio has been purchased. Commissioner Dawes showed concern that we were above PG&E's expected bill projections, despite the laddering strategy used for purchasing gas. Fong explained that this was partially an issue of economies of scale, the length of contracts and hedges they are allowed to purchase vs. Palo Alto, as well as storage capacity that PG&E has access to. Ratchye clarified that we cannot project what PG&E's rates will be for the upcoming fiscal year, as they change prices based on the spot market. Commissioner Dawes questioned whether the main replacement projects were coming to a close at the end of FY12-13, as the Capital Improvement Project (CIP) costs are decreasing. Staff promised to provide an update.

Water fund scenario requires an 8.0 percent rate increase in FY 2008-09, followed by rate increases in the 8 – 10 percent every year for the next five years in anticipation of the water rate increases by SFPUC. The water fund is also expected to utilize bond proceeds to finance its Reservoir and Wells replacement CIP. Ending reserve level for Water RSR is above the Risk Assessed Value, as well as the Minimum Guidelines established by the Council for FY 2008-09 reserves, as well as for the next five years.

Commissioner Melton sought clarification that the rates were being set to cover the cost of debt service, not the capital costs. Staff confirmed this. Commissioner Dawes questioned the estimated cost of Reservoir project and the required bond financing. Staff explained that this figure was still currently projected as \$35 million.

Wastewater fund scenario requires no rate increase in FY 2008-09 or FY 2009-10. Based on current projections, the wastewater fund will require rate increases starting in FY 2010-11 through FY 2012-13 in the range of 6 – 10 percent. Ending reserve level for Wastewater RSR is above the Risk Assessed Value, as well as the Minimum Guidelines established by the Council for FY 2008-09 reserves, and for the next five years.

Ratchye presented three scenarios for the electric fund. All scenarios end up with average system rate not to exceed 13.5 c/kWh in the 2012-2013 time period. Scenario 1 meets either the short term risk or long term reserve requirements in all years, Scenario 3 does not exceed 10 % rate increase in any given year and is the same as what was presented during the prior budget process, and Scenario 2 is in the middle of these two.

Rate increases required and ending reserve Electric Supply RSR balance for FY 08-09 were projected to be as follows for each scenario:

- Scenario 1: with a 19% rate increase: \$33.8 M
- Scenario 2: with a 14% rate increase: \$29.4 M
- Scenario 3: with a 10% rate increase: \$26.0 M

Commissioner Dawes sought clarification that these scenarios assumed average hydro years. Ratchye confirmed that FY 08-09 had a slightly lower hydro generation level assumed, but average after that, although there is obviously much uncertainty around these values.

Ratchye presented a slide expanding the components of the electric purchase costs to show how costs are projected to change. Commissioner Rosenbaum thanked staff for this slide, and asked why the debt service was not included. Staff explained it was an accounting issue. Commissioner Dawes requested a cents-per-kilowatt hour assumption placed on the bar chart, and staff agreed that was a good idea.

Ratchye then explained that since the risk-assessment value was \$33.8 M for FY 08-09,

- Scenario 1: with a 19% rate increase, had sufficient reserve balance at year end
- Scenario 2: with a 14% rate increase, had a shortfall of \$4.4 M to meet risk assessment value
- Scenario 3: with a 10% rate increase, had a shortfall of \$7.8 M to meet risk assessment value.

Staff expressed their feeling that Scenario 3 was adequate for FY 08-09, with no transfer of funds from the Calaveras reserve, with the understanding that Staff may come back next year and request Calaveras funds in FY 09-10 and/or 10-11, based on how supply reserve levels pan out in light of future cost uncertainties. Commissioner Dawes asked how much money may be recaptured from the layoff of COTP. Ratchye and Swaminathan stated that the figure might be around \$20 million for all stranded costs (Calaveras, COTP, and Seattle City-light). Staff asked for comments and questions on these scenarios.

Commissioner Keller asked if there were other issues, such as the message to customers, that there was such variability in costs and asked if rate increases could serve to achieve further resource conservation. Fong stated that there is always a balance between rate-shock vs. sending proper price signals. Staff's inclination was to mitigate rate shock and go for a lower electric increase, in light of increases in the other funds as well.

Commissioner Dawes agreed with the thinking of Staff, that cost uncertainties were large enough and reserves were large enough to not go for a Scenario 1 increase. Scenario 3 was a possibility, but perhaps a 12 percent increase would be a better compromise position.

Commissioner Melton stated that this backs up why he desired having a rate increase in February 2007 to avoid a large increase in July. As Council has discussed and determined minimum and maximum reserve guideline levels, a Scenario 1 increase was required to meet those policy objectives, as well as the short term risk assessment values, even though it would be a large sticker shock for customers. Swaminathan explained that those policies did not take into account excess funds in the Calaveras reserve, which was also at issue here.

Commissioner Keller asked how high and low hydro scenarios would affect the reserve projections. Staff showed Table 2 which showed those uncertainties.

Commissioner Rosenbaum felt that Scenario 2 (14% increase) was the clearly the best scenario.

Commissioner Keller asked if the rate was high if that would get customers to conserve more, and how customers would react. Fong stated that it might look like poor planning on the part of the Utilities, and with reserves being so large, customers might balk.

Council liaison Yeh asked how a potential inflow of funds from Calaveras reserve would influence the RSR reserve levels. Staff confirmed that it would present a one-time bump up in levels, but the trends would persist. As a follow up question, would reserves below guideline levels in any particular fund influence our bond ratings. Staff said that the total reserve balances would be looked at, and the debt ratios would still be favorable.

Commissioner Melton stated that if there was a signal from Council that they were willing to use funds from the Calaveras reserve, then the 14% scenario would make a lot of sense. The fact that the short term risk assessment and the long term guidelines show the same values lends validity to the need for that level of funds in the supply reserves. Fong asked whether, as an advisor to the Council, they could take the position that being below the long term min level would be acceptable because there were other funds available, and advise the Council to such an effect. Commissioner Melton agreed, if there were surplus funds, that he would advise to move surplus funds from Calaveras to the supply reserve to get to the minimum level.

Commissioner Rosenbaum stated that, in the financial forecasts, there should be a footnote regarding lines 17 and 12 about the CVP loan advance funding.

Commissioner Keller stated that she was leaning toward the 14% rate increase scenario, provided the future increase percentages were modifiable and flexible. Commissioner Melton stated that, save for certain commercial customers, in general people don't look at the five year planning horizon, only the upcoming year.

Commissioner Melton stated that three were in favor of the 14% scenario. Commissioner Rosenbaum asked if there had been enough input on the rate scenarios, and staff confirmed that there had been.

The next scheduled meeting March 5, Keller not being able to attend.

Meeting adjourned at 8:50 P.M.

Respectfully submitted,
Marites Ward
City of Palo Alto Utilities