

EUGENE WATER & ELECTRIC BOARD
BUDGET WORK SESSION
EWEB BOARD ROOM
OCTOBER 17, 2006
5:30 P.M.

Commissioners present: Sandra Bishop, Mel Menegat, John Simpson, and Ron Farmer. Commissioner Patrick Lanning was excused.

Others present: Randy Berggren, Dick Varner, Tom Buckhouse, Marty Douglass, Jason Heuser, Jim Origliosso, Dick Helgeson, Jim Wiley, Roseanna McArthur, Debra Smith, Patty Boyle, Lance Robertson, and Krista Hince of the EWEB staff; John Brown, Commissioner-elect; Ruth Atcherson, City of Eugene Minutes Recorder.

President Bishop convened the Budget Work Session of the Eugene Water & Electric Board (EWEB).

AGENDA CHECK

There were no changes to the agenda.

2007 STRATEGIC PLAN REVIEW

Assistant to the General Manager Debra Smith reviewed the *2007 Strategic Plan Summary*.

President Bishop asked what aspects of the Integrated Energy Resource Portfolio (IERP) were included in *Initiative 1.2* under *Goal 1*. Ms. Smith responded that the goal was to develop an environmental impact measurement system for EWEB's energy resource projects and to develop a systematic reporting mechanism with the findings to come back to the Executive Management Team (EMT) and eventually the Board. She noted that it was not an ambitious piece of work as currently scoped because EWEB did not have the resources.

President Bishop stressed the importance of developing measurements.

Commissioner Farmer advocated for development of some kind of prioritization of the goals. He thought the budget might not be the right way to do this. Ms. Smith agreed that it was not just a dollars issue.

Commissioner Simpson favored the development of performance standards with the goal of being compliant with regulatory standards.

Commissioner Farmer asked, regarding *Initiative 1.1*, what the definition of a value-added product was. Ms. Smith replied that one way to think of it was to look at how EWEB's rates compare with other utilities. There were things that EWEB funded that the utility believed the community validated, such as the environmental stewardship, the conservation load, the low income energy assistance, and the education grants, that were not as simple as the pure delivery of water and

electricity. She said one of the things that had been discussed was how to increase the customers' understanding of the rate impact. She added that they were talking about the delivery of services, too. She noted that EWEB was still working on fine-tuning the benchmark survey.

Commissioner Farmer thought the *Deliverables* focused primarily on the value-added products. He added that he thought 75 percent was not a high enough rating to aim for.

Commissioner Simpson said EWEB was going in the right direction with *Goal 1*. He commented that "increase organizational awareness" detracted from the main impetus, which was to increase customer awareness of the value-added products. He advocated for emphasizing an increase in customer awareness. He suggested creating a statement, brochure, or facts and figures that could be easily communicated to a customer who felt rates were high.

Commissioner Farmer said *Initiatives 2.1* and *2.3* sound like strategic ongoing issues that should be in the charge of the Human Resources Department. He did not believe that having a goal of two additional diversity trainings should reach the Board level. He agreed, however, that *Initiative 2.2* should be under the purview of the Board, as it had to do with labor relations with the International Brotherhood of Electrical Workers (IBEW). While he did not disagree that cultural competency was important, he did not believe it was a strategic approach.

General Manager Randy Berggren said the training that had been used was powerful, but the person who took charge of it had left EWEB and had not been replaced. He thought it very important to EWEB to demonstrate that the utility was actively trying to change the culture in the workforce.

While he did not disagree that cultural competency was important, Commissioner Farmer did not believe it was a strategic approach, especially given that the cost of the program was \$20,000 out of a budget of more than \$2 million. Mr. Berggren replied that the behavior and action might be more strategic than the money expenditure.

Ms. Smith stated that *Goal 3* consisted largely of existing projects.

Commissioner Farmer felt there were things missing from *Goal 3*. He averred that the most strategic thing to worry about at present was the financial ramification of fish going over the Carmen-Smith dams. He underscored that there were "huge unknowns" regarding how this would be mitigated.

Mr. Berggren stated that there would be a discussion on this at the next meeting. He thought it certainly could be included in the strategic plan.

The other thing Commissioner Farmer thought was missing from the initiatives was something, possibly in line with *Initiative 2.2*, was some strategic development around how EWEB would continue to work with the Union.

Ms. Smith suggested that *Initiative 2.2* could be modified.

Commissioner Simpson thought *Initiative 3.4* would be clearer if the objective was stated, as follows:

“To increase communication between the City Council and the City and EWEB.” He said a process did not need to be developed as all that really had to happen was for people to “pick up the phone and call.”

Mr. Berggren related that EWEB had been trying to establish better communication with the City but had met with several delays on both sides.

Ms. Smith reviewed *Goal 4*.

Commissioner Simpson asked if the work scheduling software had been rolled per *Initiative 4.1*. Ms. Smith replied that staff had tried some “home-grown” solutions. Mr. Berggren elaborated, explaining that they had conducted a pilot program and were still rolling it out.

President Bishop expressed appreciation for the *2007 Strategic Plan Summary* chart that Energy Resource Planning Analyst Brenda Sirois had created. She found it helpful to know which staff people were assuming responsibility for coordinating the initiatives. She observed that it appeared that the responsibility for the initiatives was being spread out.

President Bishop called for a ten-minute break at 6:43 p.m.

2006 GENERAL BUDGET ASSUMPTIONS/ELECTRIC 10-YEAR FINANCIAL FORECAST/2007 ELECTRIC O & M AND CAPITAL BUDGET

- GASB 45 Implementation
- O&M Cost Escalation
- Labor & Benefits, etc.

Fiscal Services Supervisor Dick Varner stated that staffing levels were relatively even for 2006-2007. It looked like wages would increase by three-and-a-half percent on average. He said the good news was that benefits would only increase by six percent, down from the prediction of an 11 to 13 percent increase.

Mr. Berggren noted that this was the first year that EWEB was utilizing the 20 percent co-payment and the “stop loss” policy.

Mr. Varner thought EWEB staff was being conservative in assuming the Public Employee Retirement System (PERS) rates. He stated that at present EWEB paid approximately 23 percent with a six percent "pick up." Also included in that category was the amortization of the borrowing EWEB had done to buy down its unfunded actuarial liability (UAL). He reported that EWEB had been told to expect a two- to five-percent increase in the rates, but would know more after December.

Regarding Operations and Maintenance (O&M) costs, Mr. Varner reported that EWEB staff had calculated in a three and a half percent escalation of O&M expenses as a target for managers and supervisors. He related that they had been told that if they had other large projects coming in cuts would have to happen in other projects in order to pay for them.

Mr. Varner stated that there were changes in how things were accounted for. He said the \$90,000 allocated for incentives for photovoltaic (PV) energy installation would be handled more like the Energy Trust program, which provided financial incentive per kilowatt (KW) of installed capacity.

In response to a question from President Bishop, Mr. Varner explained that EWEB paid Tier 3 rates for energy returned to EWEB through PV panel-generated power. He added that the PV incentives had to be moved into the operations budget for accounting purposes.

Commissioner Farmer asked why sick leave was projected to increase by 25 to 30 percent. Mr. Varner explained that staff was assuming that the Voluntary Employees Benefit Association (VEBA) vote will happen as it did in 2006 and EWEB would be funding approximately \$300,000 worth of sick leave buy-back to go into employees' medical accounts. He likened it to paying for sick leave now rather than later.

Mr. Varner reported that EWEB was required to undergo Federal Energy Regulatory Commission (FERC) Part 12 Period Dam Inspections every five years at a cost of \$100,000. He remarked that staff needed to make an effort to get these "smaller" items into the budget forecast.

Mr. Varner related that some of the electric utility's projects had utilized less labor and it had "migrated" to the O&M side, adding approximately \$250,000 to that budget in labor and vehicles.

General Manager Randy Berggren noted that materials costs were soaring. Electric Division Director Jim Wiley suggested the Commissioners have a conversation regarding escalating materials costs and how to address it.

Mr. Varner related that Lane Electric Cooperative was receiving eight percent of the revenue from the Hynix contract until 2009, approximately \$900,000.

Mr. Varner reviewed the accounting changes required by the Government Accounting Standards Board (GASB) 45. Treasurer Jim Origliosso noted that the next meeting would feature a session on the implications of GASB 45. The EWEB actuary was slated to present a more detailed report on the ruling.

Commissioner Farmer commented that the change was significant but not monumental. He related that he had read that as many as 20 percent of cities could be bankrupted by it. He wondered why it was lower for EWEB. Treasurer Jim Origliosso replied that EWEB had been preparing for this for years and adding revenue into the reserve. He thought EWEB was in a better position to meet the GASB 45 requirements, noting that some cities were not prepared at all. He said the Commissioners had acted responsibly in allocating extra funds into the reserves.

Mr. Varner reviewed the conservation accounting. He reiterated that it did not make sense to defer and amortize the expenditures, per the advice of the auditors earlier in the year. He underscored that the change in accounting did not reflect a change in cash flow.

Commissioner Simpson observed that there was an increase in transmission and distribution costs and wondered what that could be attributed to. Mr. Varner explained that \$250,000 could be attributed to materials and vehicles, payments to Hynix were circa \$200,000, there was a normal escalation in the non-labor costs, and the balance was attributable to both the normal escalation of capital costs and the added cost of crews doing more work on the O&M "side."

Commissioner Farmer said the number that "jumped out" at him was a nearly 42 percent increase in wholesale sales revenue. Mr. Varner replied that there was also a nearly corresponding increase in purchase power and "wheeling." He said staff was budgeting for higher wholesale prices and for additional generation coming from the Weyerhaeuser unit, which produced revenue at a very low cost for EWEB. He also pointed out that EWEB had options purchased at very high prices so that the strike prices were very high. He commented that those options were "deep in the money" and a lot of the 42 percent had to do with the hedging that EWEB had done.

Commissioner Farmer requested a memorandum that would assure him that this was a conservative projection. He wondered why the Contribution in Lieu of Taxes (CILT) did not go up correspondingly. Mr. Varner replied that the gross was increasing but the net was calculated against forward market prices. Mr. Berggren added that this was the way EWEB had structured its agreement with the City.

In response to a question from Commissioner Simpson, Mr. Varner explained that in order to provide shelter under sections 5(b) and 9(c) of the Northwest Power Act, a utility had to show that it was not selling federal power forward. He said EWEB bought power at "index" and sold it forward

at a fixed price and then when it was time to deliver the power; it was provided with EWEB's own power sources which could then be sold into market at index. This wiped out the index purchase for the index sale and then EWEB had locked in what the value was for its own generation and the portion of the Slice product that was surplus to EWEB's needs.

In response to a question from Commissioner Farmer, Mr. Varner said the firm surpluses for 2007 were 95 percent sold. He added that the secondary power at the 85 percent level was nearly completely protected by put options that put floors underneath it. He offered to provide some sensitivity analysis to what a price drop would be or a load loss in order to give a sense of how conservative staff's analysis was.

Mr. Varner reviewed the electric capital budget. He stated that the budget comports with the capital plan that the Board had approved in September.

Commissioner Farmer commented that he struggled with having some labor costs listed in the capital budget. He asked if bonding financing would flow into the O&M budget for that labor. Mr. Berggren replied that some labor was embedded and as such it was a capital expenditure and fully bondable.

Mr. Origliosso pointed out that the capital plan would be brought back before the Board two more times and the second time it would reflect the actual experience.

Mr. Varner highlighted the budgetary implications of the Roosevelt Project. He said once the design was finalized, staff would conduct some real analysis of what portion of the building should be paid for by the water utility and what should be paid for by the electric utility. He noted that Rea; Property Manager Mark Oberle was reviewing "who owns what" of the current O&M yard, so that if a piece of the property was sold the correct utility would be paid for it.

Mr. Varner delineated the current reserves and the projected targets. He stated that if he had "every dollar in every reserve that [he] wanted" there would be over \$104 million in reserves. He noted that the current target for the working reserve was 30 days. He said if it was moved to a 45-day working reserve EWEB would add \$7 million to that amount.

Mr. Varner said the target for the capital reserve was \$15 million. This amount would likely need to be increased in three or four years given inflation. He thought some discussion was warranted on what the minimum amount in the reserve should be.

The power operating reserve target was set at \$15 million, based on one bad water year, and Mr. Varner felt this was adequate. He reported it was fully funded. He noted that some things to be concerned about were high prices and a poor water year. He related that the Bonneville Power

Administration (BPA) had more flexibility in its Cost Recovery Adjustment Clauses (CRACs). He said there could be an immediate fish CRAC should Judge Redden's ruling cause a financial impact to the BPA. He did not think BPA Slice true-ups would be a big issue in the near term. He thought the Board might want to discuss how fast it wants to pass through BPA rate actions.

President Bishop asked if the BPA could retroactively collect a rate increase. Mr. Varner replied that the Slice true-up was a retroactive rate action. He explained that after the BPA's audit was completed they came to the utilities to balance their costs. In response to a follow-up question from President Bishop, Mr. Varner stated that two-thirds of EWEB's power from the BPA consisted of the Slice product.

President Bishop asked how higher than average or lower than average temperatures would affect EWEB. Mr. Varner assured her that half to two-thirds of the load was not sensitive to temperature.

CARMEN-SMITH RELICENSING FINANCING

Treasurer Jim Origliosso reported that if everything remained on schedule EWEB would get its license approval in 2008 and then would be in a position to seek bonding authorization for the Phase II costs and any Phase I costs that had not been recovered. He suggested that EWEB might not be able to meet this schedule. He said the relicensing processes were fraught with complications. He predicted that for every month EWEB was not able to determine what the Phase II costs would be, another month of cost early in the process "gets uncovered." He said now with the higher costs of Phase I it appeared that EWEB would run out of the bond money it currently had on hand in March.

Mr. Origliosso related that staff now had "a notion" of an equity account. He thought it could be at least partially funded at the end of the next year and could become the source of funding for some of the pre-license costs.

Mr. Berggren thought there could potentially be years that would be uncovered. He recommended having a "serious conversation" about using an equity fund and putting \$25 to \$27 million in it.

Mr. Origliosso stated that EWEB intended to fully recover the application costs and was prepared to spend at least some of the reserves if necessary.

Mr. Varner advocated for seriously considering an increase in the target amount from \$20 million to \$25 to \$35 million to address the potential for delay.

Mr. Origliosso said another alternative would be to maintain the idea that it would be fully funded and then go back to the council asking for another authorization to at least get the utility to the application. He noted that staff did not have a great deal of clarity on what that number would be at this point.

Commissioner Farmer asked if the “800 pound elephant” was the fish issue. Mr. Berggren replied that he thought it was a combination of many things including environmental mitigation and potential litigation about issues. Commissioner Farmer expressed concern about the level of what was unknown at this point.

Mr. Wiley said staff was looking at the best and worst case scenarios. He averred this was the best that could be done at present.

Mr. Varner related that there was a chance that EWEB would not be able to continue operating the Carmen-Smith facility under the current license during the licensing process without some mitigation.

Mr. Berggren underscored that the main point was that EWEB was not in charge of this process.

President Bishop asked where “the tipping point” was. Mr. Berggren responded that it was unlikely that EWEB would get to a point where the relicensing process was so cost-prohibitive that it would not be worth it. Mr. Wiley added that the facility was worth at least \$250 million.

Mr. Varner said one issue that would likely come up as accounting policies were being discussed would be how firm of a commitment the Board would make as to “where money goes.” He said the Board might want to defer revenue to a future year that it would be spent in. He explained that revenue recognized in the future year it would be utilized would be placed in a reserve account until then. Mr. Berggren added that not accounting in this manner could affect bond ratings.

President Bishop called for a 10- minute break at 8:20 p.m.

WATER 10-YEAR FINANCIAL FORECAST/2007 WATER O & M AND CAPITAL BUDGET

Senior Financial/Rate Analyst Patty Boyle said the 2007 forecast reflected a small amount of growth, though EWEB had lost the Williams Bakery water load and also no longer provided water service to the Springfield Utility Board (SUB) for Glenwood.

Ms. Boyle reviewed the O&M expenses. She explained that the labor increase of \$60,000 was due to two employees retiring and the need to overlap hiring for continuity.

President Bishop noted the increase in cost for water chemicals and wondered if other methods of water purification were as affordable. Mr. Buckhouse replied that the other methods were “orders of magnitude” greater in expense.

Ms. Boyle discussed water capital planning, noting that the Board had passed the capital plan in September.

Commissioner Farmer asked how short-term the loan from the electric utility to the water utility would be. Ms. Boyle replied that it would be repaid within one year.

In response to a question from Commissioner Farmer, Mr. Buckhouse stated that the borrowing came from the electric utility as opposed to another source and was approved by the Board to be added to the Capital Plan.

Commissioner Simpson asked how much drawing on the reserve funds would diminish the fund and how it would be replenished. Mr. Buckhouse replied that it would be contingent upon the coming year. Ms. Boyle added that the water utility was expected to have \$3 million in reserve by the end of 2007; the draw on it would not severely impact it.

Commissioner Farmer asked what the debt service requirements were for the existing debt and when it would run out. Mr. Origliosso responded that generally debt was issued for 20 years. He said the largest chunk of the current debt was spent in 2003 and there were about 15 more years. He added that the bond was “low coupon.”

Commissioner Farmer said the thing he worried about the most was the long-term picture. He questioned how well the customers would tolerate a sizable rate increase “year after year.” Ms. Boyle responded that while the overall rate increase had been 9.3 percent, the increase to residential customers had been 7.3 percent. She said the water districts took the highest rate increase because of “peaking behavior.”

Ms. Boyle stated that she, Water Engineering Manager Mel Damewood, and Water & Steam Division Director Tom Buckhouse would be back before the Board in February, April, and May with the Water Capital Plan.

President Bishop noted that the desired level for the working cash reserve minimum was \$1.5 million and asked what the real desired level would be. Ms. Boyle replied that \$2 million in a working cash reserve would be ideal.

Mr. Buckhouse remarked that though staff was not entirely comfortable with the current numbers in the water utility, the numbers had improved from last year.

Ms. Boyle stated, in conclusion, that staff continued to see the need for increased revenue for the water utility. She said the budget looked a lot like what had been projected.

PUBLIC INPUT TO BUDGET PROCESS

External Communications Coordinator Lance Robertson said it seemed there was some interest in how to address the issue of rate assumptions that were built into the budget. He recalled that some concern had been expressed that a budget was approved late in the year that included those assumptions. He suggested that the Public Affairs division provide more information to the public and the media regarding the rate assumptions. He said staff recognized there was a need to increase the profile of those assumptions and toward that end, they intended to include those assumptions as part of the outreach related to the budget. He noted that they had started to do this with project-specific issues such as Carmen-Smith, noting in any news releases that the relicensing project would ultimately have a rate impact.

Commissioner Farmer questioned how much concern there was among the general public. He pointed out that for the most part the same people testified “time after time.” He wondered if there were another tool, aside from the public hearing, to measure the concern of the general public that would not testify. Mr. Robertson responded that there were other ways to gain input, such as the back of the bill comments and going out with the Speakers Bureau. He said the sense of public sentiment was largely anecdotal.

Mr. Robertson sensed that there was a low connection between the budget that was approved and the rates that were approved in the public’s mind.

Commissioner Simpson asked if the customers were ever asked whether they felt EWEB was charging a fair price. Mr. Robertson replied that it was hard to ask that question without biasing the answer. He said they did ask value questions, but asking if something was fair seen to be subjective. It would be difficult to discern what the respondent meant by the answer.

Commissioner Simpson observed that EWEB was the sole provider of electricity in the area. He was aware that some people were distinctly cognizant that EWEB provided a high value. He commented that to generate the power to run a washing machine with a peddle-operated generator would be more expensive in the long run than EWEB’s power. He averred that this should be the value-added message. Mr. Robertson agreed that this was worth exploring.

Commissioner Farmer observed that when you ask people if they want better roads they say ‘yes’ but when you ask them if they want to pay for better roads they say ‘no.’ He recommended that survey questions be asked in a “dynamic tension mode.”

Commissioner Simpson agreed, adding that customers needed to be asked if they were willing to pay for ‘A’ to get ‘B.’

President Bishop said there was an education piece to it. She felt EWEB needed to find a way to raise the public's awareness of the reason why rates were affected.

Mr. Berggren asked if the concept of being very overt regarding the rate assumption meet the Board's threshold. Commissioner Farmer replied that the newspaper needed to be educated first because the newspaper did not tend to report on a rate increase until it was passed.

Mr. Robertson agreed that a good way to get customers interested in the budget would be to tie the rate increases to the actual rate assumptions.

Commissioner Farmer opined that even if EWEB went out to raise awareness about the reasons behind rate actions people would not come out.

President Bishop noted that a new Commissioner was coming on in January. She suggested that it would be a good idea to do a little outreach to Commissioner-elect Brown regarding what the Public Affairs Division of EWEB did. Mr. Berggren said there was a whole orientation that Commissioner-elect Brown would undergo.

NEXT STEPS & WRAP UP – BUDGET PROCESS

Ms. Boyle reviewed the timeline. She said a public hearing was scheduled for November 21 and the second public hearing and budget approval was scheduled for December 5. She stated that she and Mr. Varner would get the budgets for electric, water, and steam "all tied up" and ready to present to the public and the Board. They would work with Mr. Robertson to get the information to the public as best they can.

Commissioner Simpson and President Bishop thanked staff for their work on the presentation.

President Bishop adjourned the meeting at 9:15 p.m.

Assistant Secretary

President