

EUGENE WATER & ELECTRIC BOARD
BUDGET PLANNING SESSION
VALLEY RIVER INN – ROGUE ROOM
1000 VALLEY RIVER WAY
JULY 24, 2007
9:00 A.M.

Commissioners present: Mel Menegat, John Simpson, Patrick Lanning, Ron Farmer, and John Brown.

Others present: Randy Berggren, Jim Wiley, Tom Buckhouse, Marty Douglass, Dick Helgeson, Dick Varner, Mel Damewood, Dean Ahlsten, Patty Boyle, Jay Bozievich, and Krista Hince of the EWEB staff; Ruth Atcherson, City of Eugene minutes recorder.

President Menegat convened the Budget Planning Session of the Eugene Water & Electric Board (EWEB).

INTRODUCTORY REMARKS

General Manager Randy Berggren provided an overview of the agenda.

Commissioner Farmer remarked that the Board had a lot of material to digest. He said it would be helpful to see a simplified comprehensive look at all of the rate impacts in such a way that a “layman ratepayer” could understand the increases and how they related to the work that was needed on the water and electric infrastructure.

Commissioner Lanning noted that he would have to leave after two hours because of a job-related obligation.

WATER CAPITAL IMPROVEMENT PLAN

Water Engineering Manager Mel Damewood reviewed the recent findings and how they had affected the capital improvement plan (CIP). He stated that the first five years of the CIP were “pretty well cast.” He said the projects were identified and the cost estimates were fairly solid. He related that the division still did not know how it would approach finding a second source. This was the reason the numbers for the outlying five years were far less detailed.

Mr. Damewood reported that the division had held several workshops that resulted in a list of 67 projects, reflected in the CIP. He said they also had identified a plant expansion at a cost of \$10.9 million as well as a new chemical feed building. He stated that the change in scope on the expansion added nearly \$9 million within the particular project, with \$3 million in the out years as a placeholder for future renewal and replacement on the plant.

Vice President Simpson asked what the metropolitan interconnect project on Game Farm Road was and why it was necessary. Mr. Damewood replied that it consisted of a 24 inch line going up old Coburg Road and Game Farm Road and included a large pump station that could exchange

approximately 10 million gallons per day between utilities. He underscored that EWEB was seeking to get three major inter-tie points with the Springfield Utility Board (SUB) and the Rainbow Water District. He said the utility would be completing the Moe Hill inter-tie and was looking to put another inter-tie in the Glenwood area in order to provide the hydraulics needed to shunt water back and forth between utilities in an emergency situation.

Mr. Damewood reported that the pump station projects were “pretty well set” for the next five years. He did not believe there would be a huge capital impact for pump stations in the out years. He felt the capital plan also addressed the utility’s reservoirs adequately. He stated that the city had not provided EWEB with design information so far regarding what pipes needed to be replaced in coordination with street maintenance and preservation. He said the estimates in the CIP were based on the most the known projects could cost the utility and the estimates would become refined as more information became available.

Mr. Damewood noted that the recent gas tax passed by the city would mean a ramp up of road projects. He said EWEB would work to get the correct information from them sooner to give the utility a 15-month lead for planning purposes.

Mr. Damewood related that the utility had not conducted a thorough inspection of its transmission lines. He stressed the importance of investigating it, beginning with a study in 2008. He noted that there were reports of concrete cylinder pipe exploding in California. He said EWEB had approximately five miles of this type of pipe in its system, the most key piece being 3.5 miles of 36 inch pipe under the Beltline Road.

Mr. Damewood said \$1 million had been added to the CIP to update the instrumentation and control systems, particularly the Supervisory Control and Data Acquisition (SCADA) system.

In conclusion, Mr. Damewood stated that the CIP had been increased from \$118 million to approximately \$128 million. He said they would spend \$59.4 million in the first five years of the CIP and \$68.4 million in the outlying five years. He believed the highest area of cost risks to be in the second source development, transmission line rehabilitation, and in main relocations resulting from city street repair and replacements.

Commissioner Brown asked why the Laurel Hill Reservoir was not in the spreadsheet. Mr. Damewood replied that it was being bid out in the next week. He said it was in the 2007 budget, but the division would likely have to rollover money because there would be some carryover into 2008. Given that it was rollover money from the present year it would have no impact on rates.

Commissioner Brown asked if, given that the reservoir work was for new development, the Systems Development Charges (SDCs) would pay for it. Mr. Damewood replied that SDCs would pay for 50 percent of the work because only half would serve new development.

Commissioner Farmer noted that the backgrounder had indicated that engineering had relaxed

the reservoir reconstruction schedule and asked what the logic was in that. Mr. Damewood responded that the water division had completed reconstructing the City View Reservoir, which had been thought to be the worst reservoir. He said the recommendation from the consulting engineer had indicated that as long as there was a good maintenance program and the division continued to monitor the reservoirs that the utility could reconstruct the rest of the eight reservoirs at a rate of one every three years as opposed to one every two years.

Commissioner Farmer recalled that EWEB had chosen not to build the intake because of a study. He commented that he was “gun shy” about fish issues relative to studies after EWEB’s experience with the fish ladder. He asked how confident staff was that the study would satisfy the groups who worked on behalf of endangered fish species. Mr. Damewood assured him that staff was very confident. He related that the City of Corvallis had recently installed a fish screen and had worked with all of the fish agencies regarding screening issues. He said EWEB had hired the engineer who designed that fish screen. The engineer indicated that EWEB could add a fish screen that would meet the fish agency criteria and would also meet demand needs to 2050.

In response to a follow-up question from Commissioner Farmer, Mr. Damewood affirmed that staff was confident that there would not be a great deal of protest over the fish screen because it had not happened in Corvallis. He noted that the fish screen had the “blessing” of the ACOE and the Oregon Department of Fish and Wildlife (ODFW).

Commissioner Farmer asked how county road construction would affect water facility replacement. Mr. Damewood responded that most of the work done with the County was in the River Road/Santa Clara area and there was a shared cost with those entities. He added that the County did not do as much work because of resource issues.

Vice President Simpson asked whether the intent of building two raw water intakes at the Hayden Bridge facility was to have both operating at the same time. He wondered why EWEB wanted to build two of them. Mr. Damewood replied that two were being considered because EWEB did not know if it could have a new screen configuration that could meet the velocity criteria. He said having the second intake had been thought to be the solution to address the need for additional screen area. He stated that since then the engineers implemented a study on it and the study indicated that they did not need to build the second intake.

Vice President Simpson expressed some concern that the water division was not synchronizing the roll out of Automatic Meter Reading (AMR) with the electric division. He asked why the water division was not being aggressive in this endeavor. Water & Steam Division Director Tom Buckhouse replied that the water division had been working on the pricing scenarios for the water division. He related that the division had come to understand that EWEB would lose money if it deployed AMR for both divisions within the next 20 years, with the largest part of it coming on the water side. He explained that AMR was not cost effective for the water division. Mr. Berggren added that a task force had been working on it for six to ten months. He noted that one of the reasons it was not cost effective was that water was cheap. He suspected that at some point the economics

would change such that it would be more beneficial to move forward with implementing AMR for the water division.

Treasurer Jim Origliosso remarked that he expected that something would “cross over” and it would be reasonable to believe that the utility would move forward with AMR.

Employee, Customer & Community Services Director Debra Smith believed there would be Board discussions on AMR. She observed that at present AMR for the electric division was still “unattractive” on a combined basis, given that it would not save money in meter reading. She said in going forward they would be looking at how water meters were read and the frequency at which they were read. Mr. Berggren commented that the utility could ultimately look into reading water meters bimonthly.

Commissioner Farmer asked if once a bond measure to cover costs had been paid for whether AMR would become economical for the water division. Senior Rates/Financial Analyst Patty Boyle replied that when it came to the water meters, the meters themselves would last but the utility would have to replace the batteries and possibly the electronics. She predicted that the replacement expense would happen between 10 and 20 years out. Ms. Smith added that because of the length of time these types of systems had been out, there was not an adequate amount of support data for a change.

Ms. Boyle noted that the lack of information was especially detrimental to the water side of the equation. She said there were not a lot of water utilities that were equal in size to EWEB.

Commissioner Brown asked how the wastewater charges would be treated if EWEB went to reading water meters every other month. Mr. Berggren replied that the question was as yet unanswered.

Mr. Varner reported that he had begun a preliminary discussion with the city to get them to think about the value of monthly meter reading to them. His intent was to get the city to consider what its meter reading needs were and whether a change in the pattern would be acceptable. He noted that the city did not pay for the meter reading at this point.

Vice President Simpson averred that it made sense to him to put in AMR when the utility did new installs and repairs. He asked if something like that was reflected in the 10-year CIP. Ms. Boyle responded that staff had discussed it in regard to large developments but it was a very high level discussion at this point.

Mr. Damewood noted that the CIP included \$50,000 per year on average for meter replacements.

Vice President Simpson asked if that included meters with the new technology. Mr. Damewood replied that the answer was uncertain at this point.

Mr. Berggren stated that he did not have enough confidence that the new technology could be utilized within a reasonable time period and would not become obsolete. He pointed out that the battery powered technology could change.

In response to a question from Vice President Simpson, Ms. Smith clarified that AMI stood for Advanced Meter Infrastructure.

10-YEAR WATER FINANCIAL PLAN

Ms. Boyle stated that there were no real changes from the previous review of the 10-year financial plan for the water division, with the exception that it had been aligned with the staff proposal for the Roosevelt Boulevard project. She explained that she had aligned the AMR line to reflect that the electric division would continue to explore that option while the water utility would not. She said this effectively lowered costs in the plan because \$500,000 to \$1 million per year had been freed up, starting in 2008. She related that she had also aligned it with the capital plan, which moved costs forward and increased what would be spent for SDCs. She stated that when it came to rates she had been able to increase the amount of bonding in the first years and decrease it in the last two years and had freed up money from the AMR and Roosevelt projects. She said this kept the same rate structure for 2008 and increased it by a “high single digit” percentage in 2009 followed by increases of 4.5 percent over the 10-year timeframe. She explained that this was how the financial plan resulted in an additional \$10 million.

Commissioner Brown asked where the sale of the Roosevelt came back into the plan. Ms. Boyle replied that it “came back in” 2013 under the Roosevelt lease payments.

Commissioner Brown asked if there was no amortization; would the water utility own its share of the facility when the bond was done? Fiscal Services Supervisor Dick Varner responded that the assumption was that the electric utility would buy the facility, the water utility would have a 25-year lease, and the principal interest would be amortized on the purchase of the utility. He said they would set a lease payment equal to a proportionate share of the ongoing operations and management costs at the facility. He stated that after 25 years the water utility would pick up a 30 percent share of the cost.

In response to a follow-up question from Commissioner Brown, Mr. Berggren affirmed that the water utility would have an equity position after the 25-year lease.

Commissioner Farmer observed that in the construction phase all of the costs would be loaded onto the electric division.

Mr. Varner clarified that the utility would have to write a specific inter-utility agreement on which the Board would have to sign off. He noted that when the headquarters building had been constructed in 1986 through 1989 the Electric Division had paid all of the costs and owned all of the

facilities that were built in the old master plan. He underscored that the electric utility received all of the proceeds even though the Water Division had been paying a *pro rata* share of those costs.

Commissioner Brown asked if it was a fair assumption that the Water Division was paying for operation through the water budget and at the end of it would have nothing. He opined that this was not a fair division. Ms. Boyle affirmed that it would not be a Water Division asset.

Mr. Buckhouse commented that it would be possible to restructure the agreement so that water could come out of it with an equity position.

Ms. Smith stated that Roosevelt Project Manager Ken Beeson, Mr. Varner, and Ms. Boyle had primarily come up with this strategy but there was opportunity to discuss a change in it.

Commissioner Farmer said it appeared from the memorandum that the latest assumption on the return in value had increased from \$20 million to \$30 million. He did not believe this had been discussed at the Board level.

Mr. Berggren agreed that it should be a topic of discussion.

Mr. Damewood ascertained from the Board that there was support to move forward with the CIP and financial plan as presented.

Commissioner Farmer indicated his discomfort at the \$5 million that was slated for the cost of a second water source. He asked if any risk analysis had been conducted around the need for a second source.

Mr. Berggren stated that there had been pieces of work done on it. He said there was risk assessment. He believed a disaster of magnitude was highly unlikely, but he emphasized that more accidents were occurring on the highway.

Commissioner Farmer asked what effect an oil tanker truck going into the river would have. Mr. Berggren replied that staff could compile a risk assessment that was more specific for the Board. Mr. Damewood added that Water Resource and System Engineer Brad Taylor would be providing a presentation about the current status of the second water source plan in August.

Mr. Berggren shared his worst case scenario, one in which a toxic spill in the river permeated the alluvial layers and polluted the water source for years to come.

Senior Water Engineer Jay Bozievich reiterated that the EWEB system stored enough water for one day. He added that EWEB was the largest utility with only one water source.

BREAK

The Board took a 15-minute break at 10 a.m. Commissioner Lanning left the meeting.

ELECTRIC CAPITAL IMPROVEMENT PLAN

Systems Engineering and Substation Reliability Manager Dean Ahlsten reviewed the *Electric Utility 2008-2012 Capital Improvement Plan*. Regarding the *Work Category Summary*, he explained that 40 percent of the rate revenues went into aging infrastructure.

In response to a question from Commissioner Brown, Mr. Varner stated that the numbers for the Roosevelt Boulevard project were all “going forward” costs. Mr. Berggren pointed out that the money spent on the original design was not in the plan because it had been spent.

Commissioner Farmer asked why it said \$82 million. Ms. Smith replied that a certain amount of the money was going forward in the design costs. Mr. Varner added that right now it was estimated that the utility would issue \$78 million in new money from bonds.

Vice President Simpson asked what Configuration Management consisted of. Mr. Ahlsten replied that it was a separate program that managed the design basis standards across the division for operating procedures. Mr. Wiley elaborated, explaining that it consisted of work management systems, integrated work schedules, and some of the efficiency improvements. He said it also included the work to write down operating procedures and update safety manuals.

In response to a question from Commissioner Farmer, Mr. Varner clarified that staff was looking toward earmarking \$1.5 million per year for what the utility would spend each year until it obtained the license. He said this year the utility had set aside \$2.2 million from rates to pay for the relicensing costs. He planned to do the same thing in succeeding years.

Mr. Berggren said arguably this could be refunded from bonds.

Mr. Varner stated that at this point he was not looking at including this in the bonding issue.

In response to a question from Commissioner Farmer, Mr. Varner affirmed that no other projects would be reduced to generate the income needed.

Commissioner Farmer asked if there would be a rate decrease after the Carmen-Smith facility was relicensed. Mr. Varner replied that at that point the utility would be paying part of the debt service on the \$98 million paid for the bonds.

Commissioner Farmer asked if there was a Board action related to approving the rate increase. Mr. Varner responded that this was use of some of the surplus contribution margin. Mr. Berggren clarified that there was no formal Board action that specifically allocated the surplus contribution margin.

President Menegat asked if there was an assumption for a surplus in every year. Mr. Varner replied that there was.

Vice President Simpson asked when the project to rewind the Leaburg Generator #2 was scheduled. Mr. Ahlsten replied that it was planned for 2010.

Vice President Simpson asked if the potential for a feeder addition on Ayres Road was included. Mr. Ahlsten replied that it was not included for funding at this time. He said there was potential for it given the possibility that a hospital could be built in the area.

Mr. Ahlsten continued his review of the plan. He noted that the Public Utility Commission (PUC) had required the Delta-System conversion, so it was included in the plan though it was uncertain what it would actually cost.

Vice President Simpson asked if the project to upgrade the Energy Trading and Risk Management (ETRM) system had arisen from the auditor's report. Mr. Berggren replied that the auditor's report always had issues with the ETRM program because the software did not support all of the functionality. He said EWEB was hoping the upgrade would resolve some of the concerns regarding the outstanding spreadsheets.

Commissioner Farmer asked if there were any projects in the list that could not be done without alternative funding. Mr. Berggren replied that the boat landing was a unique project in that it would require some alternative funding; the other projects were funded.

Commissioner Farmer asked how much debt service the AMR would require. Mr. Varner replied that ultimately it would be \$1.8 to \$1.9 million. Commissioner Farmer surmised that the utility would gain approximately \$1 million. Mr. Varner stated that AMR on the electric side would be a break even proposition for the first 10 years and then the savings would begin to accrue in the next 10 years.

Mr. Ahlsten reviewed the list of projects on the *Risk Assessment of Unfunded Work*. He noted that the Bethel Substation Transformer would be overloaded in 2010 to 2011. He also related that if the McKenzie-Willamette Hospital was built in the Delta Highway area the Delta-Ridge Substation would need to be upgraded.

Mr. Varner remarked that there was precedence in the Delta-Ridge area for the customer to pay for improvements.

Commissioner Farmer asked if some of the unfunded work was in the alternate plan. Mr. Berggren affirmed that it was.

Commissioner Farmer asked if everything that was unfunded should be put into the alternative plan. Mr. Ahlsten responded that the list was his effort to get a sense of some of the projects and what they consisted of.

Commissioner Farmer called out the \$1.7 million Smith Dam power and communication cables and observed that though it was on the alternative plan it was not on the risk assessment list. He questioned why this would be. Mr. Ahlsten replied that it was in the largest spreadsheet but it presented a timing issue. He explained that it would need to occur before the utility was able to get the license for the project. He said it had been pulled out and put into rates and he underscored that it was a priority.

Commissioner Farmer asked for an explanation of the risk involved in that project. Mr. Ahlsten responded that in 1996 there had been a lot of flooding that had washed out the roadway to the dam and had taken the power and communications cable out. At that time EWEB, with the help of Federal Emergency Management Agency (FEMA) money, had run cable from the powerhouse up the side of the mountain and over the ridge to where the dam is. He stated that the steel conduit had been run over the ground and was anchored on top of the ridge. He said recently the utility had experienced more blow-downs that had lifted some of the cable runs up and kinked them.

Mr. Berggren asked what would happen if the cable run was lost. Mr. Ahlsten replied that EWEB would lose communications and would fall back on failsafe measures such as emergency generators. He stated that the project would reroute the cable, bury it, and take it along the roadway.

Mr. Berggren asked if the PCB-contaminated distribution transformers had been more recent discoveries. Mr. Ahlsten replied that it was his assumption that it was legacy. Electric Division Director Jim Wiley added that it was a higher concentration of PCBs but had not reached contamination level. Mr. Berggren said he thought EWEB had gotten all of the PCB containing transformers off the system. He ascertained from Mr. Wiley that the levels were less than 50 parts per million.

In response to a question from Vice President Simpson, Mr. Berggren explained that the original application for PCB containing transformers was for flame-retardant purposes. He said there was now insulating media that was not flammable and did not contain PCBs.

Commissioner Brown observed that EWEB paid for the diminution of property values when the utility installed power poles and other structures. He asked if EWEB ever received any offset to the cost when removing such facilities. Mr. Berggren responded that it did not. Mr. Ahlsten added that EWEB did not normally pay for this. Commissioner Brown cited payment made to the property owners on Country Club Road as an example. Mr. Berggren clarified that they were paid for acquisition of right of way.

Mr. Ahlsten noted that the Waltham fish return improvements could now be a “moot point.” Mr. Wiley said the \$600,000 project for the current year was to put a shut-off at the mouth of the fish return channel, ordered by the Army Corps Of Engineers (ACOE). He stated that there was more to do.

In response to a question from Commissioner Brown, Mr. Wiley clarified that the Tailrace Barrier would still be in place. He said the problem with getting fish into the return channel had to do with the lack of water coming down the channel. He explained that it was shallow and the fish became “skittish” in it and turned around.

Commissioner Brown asked if EWEB just needed to deepen the channel. Mr. Wiley responded that it needed deepening but it was a complex process. Mr. Ahlsten added that EWEB had experienced difficulty in obtaining the county permit to get the shut-off gate in place.

Among risk management issues, Mr. Ahlsten noted that there could be power quality impacts on sensitive customer loads. Vice President Simpson ascertained from Mr. Wiley that the new equipment would react much faster to cover an outage so that larger customers such as Hynix Semiconductor Incorporated would not have power interrupted.

In response to a question from Vice President Simpson, Mr. Berggren stated that Weyerhaeuser was also considered to be a sensitive customer load, as were several others. He added that it would cost Weyerhaeuser \$600,000 just to start back up after a momentary outage.

Vice President Simpson asked at what point the responsibility for such costs fell to the customer. Ms. Smith responded that EWEB typically did not pick up the cost for damages. Power Resources Division Director Dick Helgeson added that EWEB agreed contractually to not be negligent, though it did not guarantee that outages would not occur. He said they agreed to follow a standard and prudent practice.

Mr. Ahlsten stated that the electric utility had 40 to 50 year old equipment. He said the onus was on the utility to keep up with technology. He noted that Hynix had put approximately \$7 million into Dynamic Voltage Restoration (DVR) equipment for its own use.

Mr. Wiley related, in regard to risk management associated with non-compliance with regulations, that the “big fish study” that had been mandated was important. He said if it did not work or if something was found to be not right staff would be back before the Board seeking approval for more money.

Mr. Ahlsten reviewed the *Alternate Capital Program Proposal to Mitigate Risk*. He projected that the Electric Division would end up, even with the additional work, with \$11.6 million in the capital fund at the end of five years. He stressed that additional funding for the utility would benefit the system.

In response to a question from Commissioner Farmer, Mr. Wiley said how EWEB had treated changes in the cost assumptions was that the utility had just done less work.

Commissioner Farmer remarked that from a “proper planning perspective” the utility should project costs and then build around them. Mr. Berggren pointed out that this was possible only if the cost escalation was known.

Commissioner Farmer asked how much escalation had cost in projects not done in the last year. Mr. Ahlsten replied that the River Avenue and Hawkins Hill projects had increased by 60 to 70 percent. He said he would try to quantify it for the Board. He noted that the cost of transformers had increased by 110 percent over the course of a year.

Mr. Wiley related that the price for the Leaburg generator had been inflated to what staff predicted it would be.

Mr. Berggren averred that a person would have to go to every piece of material and price it out to have a real sense of cost escalation.

10-YEAR ELECTRIC FINANCIAL PLAN

Mr. Varner called the Carmen-Smith relicensing process and the Roosevelt building project the “gorillas in the room.” He stated that the rough estimate of cost for the Carmen-Smith process was \$118 million. He noted that the two big items were the fish screen and the ladder trail. He said the utility was planning on using current revenues to finance the improvements and all of the expenditures until the license was issued. At that point the utility would go out for financing, but he was not assuming that they would try to recapture.

Mr. Varner reported that the financial plan was based on the Board decision to authorize an \$84 million project at the Roosevelt building site to be completed in 2010. He said the utility would issue 25-year bonds with a “five year call” and that any proceeds from the property sale would be used to call those bonds. He noted that the utility would pay only interest in the first five years and then would pay the principle.

Vice President Simpson asked why the utility would pay interest only in the first five years. Mr. Varner replied that this was so that debt service costs did not have a huge increase and then a big decrease when the utility called the bonds.

In response to a question from Commissioner Brown, Mr. Varner stated that the assumption was that the project would cost the full budget.

Mr. Origliosso emphasized the importance of the utility not shorting itself on the initial bonding authority.

Mr. Varner related that staff was not sure of the level of contingencies that would be needed by Carmen-Smith. Mr. Berggren agreed that it could vary from the estimate.

Mr. Varner continued his review of the 10-year electric financial plan. He said the initial target was \$15 million but it would adjust to whatever depreciation the utility would go forward with. He stated that they had the flexibility to go plus or minus \$5 million on the reserve as the utility built its plans. He explained that the utility would remain between the \$10 and \$20 million range on a planning basis for the capital reserve.

Commissioner Farmer asked why this was so. Mr. Varner responded that there would be variability from year to year in capital expenditures.

Commissioner Farmer asked if this meant the target was flexible. Mr. Varner replied that the target would be fixed in the plan but in any year the utility would be “floating around” the target.

Commissioner Farmer questioned why staff would not just come to the Board to change the target if it needed to be changed. Mr. Berggren responded that staff would show a capital plan with all of the variability’s and a budget that the Board would approve of and in each year there would be a proposed balance on the capital improvement reserve. He stressed that it had variability because of the nature of the sequence of projects. He said it would not be different from the procedure to date.

Mr. Varner reviewed the assumptions, which he considered to be fairly conservative, associated with the different scenarios possible with the end of the current contract with the BPA in 2011.

Mr. Helgeson reported that the BPA had made it clear that the region would look balanced in 2012. He related that the BPA was not happy with the contracts that had been “cut” five to six years earlier that had allowed utilities to keep and sell power. He predicted that EWEB would not be holding a firm surplus on the BPA. He noted that at present EWEB carried a 40 MW surplus.

Commissioner Farmer asked what the 40 MW change would mean to the utility. Mr. Varner replied that it would be a \$12 to \$13 million loss in net revenue. He said it was why the rates would have to be increased in 2011 and 2012.

Mr. Varner observed that the biggest variable lay in the hydro assumption. He attributed the increase in reserves to the average hydro year that the area had experienced in the face of having based the budget on an assumption of an 85 percent hydro year.

Mr. Varner stated that increases in retail load did not necessarily translate into increases in bottom line net revenue. He explained that the average rate across all of the customer classes was about equal to the wholesale revenue. He reminded the Board that the city received a 6 percent share of retail revenue and a 5 percent cut taken from increased revenue was “pushed” toward conservation programs. He reiterated that selling more electricity to retail customers would not likely push the “bottom line.”

In response to a question from Mr. Berggren, Mr. Helgeson said they had not yet lined up the conservation potential and the current funding level versus increased funding levels with the rate action proposals. He stated that generally speaking he did not anticipate ramping the work up prior to 2012.

Mr. Varner asked if Mr. Helgeson was thinking of moving away from the five percent construct to something that was more akin to a five or ten year plan. Mr. Helgeson affirmed that this was what they were looking into. He was uncertain whether this would be more or less than the current 5 percent.

Continuing, Mr. Varner reported that EWEB would have “weak” financial ratios due to the change in the BPA contract and the loss of the Weyerhaeuser Co-Gen project, which was slated to go off line. He said in order to get ratios better EWEB would have to exact another rate increase from its customers.

Mr. Varner stated that there was a “little more” hedging work to do for 2008 and 2009. He explained that there was some downside with a market drop; in 2008 hedges that were “deep in the money” primarily drove it. He said prices could fall “a fair amount” before the hedges came in. He related that the utility was not fully hedged for 2009 and had some work to do to help “lock in” the expected contribution margin. He noted that 2009 was a little over three-quarters hedged.

Mr. Varner had provided two versions of the ten year plan, one that included an increase in the spring of 2008 for escalation of internal costs and another version that would defer the increase.

LUNCH

President Menegat called for a break for lunch at noon. He reconvened the Budget Planning Session at 12:49 p.m.

BONNEVILLE POWER ADMINISTRATION'S RULES

Mr. Helgeson reported that the BPA had just ended a five-year rate period in October. He said the BPA had another rate case, setting the rates for 2007 through 2009. He averred that EWEB had much better prospects with the rates and was not anticipating any "surprises" from the BPA. He did not anticipate any "true-ups" of significant magnitude. He stated that there were two remaining adjustment clauses in the rates but he did not expect them to trigger in the year. He related that one was a revenue redistribution clause. He explained that the BPA had a target in its reserves of \$300 to \$800 million and had started the year at the lower end of the range. He said if the target dropped below the \$300 million mark it would trigger a surcharge and if it exceeded \$800 million it would trigger a rebate.

Mr. Helgeson recalled the pass through of the rate decrease that the Board had enacted earlier in the year. He felt the BPA was having a good year. He thought there might be a modest "flow through" of excess revenue. He commented that the Board might consider approval of another modest pass through.

Mr. Helgeson said there was an emergency clause that declared that should fish related costs come in higher the BPA had the ability to recover them at any time. He did not believe this would happen in the present year.

Continuing, Mr. Helgeson did not anticipate a Slice true-up in the coming year. He related that another item that weighed in the favorable side of the rates ledger was that the BPA had suspended payments for the residential exchange. He explained that there was approximately \$300 million on average built into the BPA rates annually on the assumption that the level of payments would continue. He thought the BPA might show the incremental revenue as deferred revenue and would set it as some deferred obligation on the books. He believed it could be a three to five percent retail rate benefit if the utility could "secure the politics of the situation."

Mr. Helgeson believed EWEB would see a power budget that was fairly comparable to the previous year's budget from the BPA. He noted that the only wild card was the proposal from the White House Office of Management and Budget (OMB). He said between the pull back of the exchange payments and the better revenue performance the BPA could end up with a cash balance of over \$1 billion. He observed that this was a lucrative target for the OMB, which had previously proposed to "skim off the top." He felt that with the recent shift in party majority there was less interest on the part of Congress in pursuing it.

Vice President Simpson asked if the BPA had any large expenditures on its “horizon.” Mr. Helgeson responded that the only uncertainty in the budget at this time were fish-related expenditures. He said it could cause additional foregone generation or additional investments in infrastructure and/or habitat, but it was tied up in court at present.

Vice President Simpson asked if the BPA planned for any significant transmission projects. Mr. Helgeson affirmed that the BPA was making some significant transmission investments. He said the BPA had paid down some of its federal debt and had increased its borrowing capability to finance those investments. He explained that it had been factored into the current rate level for transmission.

Commissioner Farmer asked if the money from the Investor Owned Utilities (IOUs) had been placed into escrow. Mr. Helgeson replied that the money had come from the public utilities. He said the BPA did not have a formal accounting structure that would allow money to go into escrow. He explained that the money was not segregated from the cash balance.

Commissioner Farmer asked if the BPA could get into a position wherein it would not pass through the surplus to anyone, rather they would just “sit on it.” He wondered if that would create more stability for the BPA or for EWEB. Mr. Helgeson said he would make a distinction between firm power and the market rates and the secondary issue. He believed that to the extent the BPA had a surplus in the present it would be selling more of it at the “PF Tier 1” rate and would not be getting the margins like EWEB had been experiencing on the surplus sales market. He did not think this had been the source of instability on “the firm side;” the real issue had been on the “secondary.” He felt they were facing some reduction in revenue credits in that timeframe against the rates that EWEB paid, but the benefit was that EWEB received the Tier 1 rate and did not pay market rates.

COMPARATIVE RATE STUDY

Senior Rates/Financial Analyst Patty Boyle introduced the item. She said this was the second step after the initial work session held in April. She reviewed the *Comparative Rate Study – Electric Utilities*. She explained that staff had surveyed all of the utilities they thought could be comparators and had selected a set to compare EWEB with for both the water and electric utilities. She related that staff could not find a perfectly aligned comparison for either utility. She noted that the Springfield Utility Board (SUB) had not been included because she had sought utilities with similar rates.

Ms. Boyle observed that only the Medford water utility had lower water rates than EWEB. She explained that this was due to an abundant source and lower treatment cost.

Ms. Boyle asked the Board to give her a sense of whether there was agreement that the appropriate comparator utilities had been selected and staff should conduct a more detailed study of them.

In response to a question from Commissioner Farmer, Ms. Boyle said Seattle City Light had not returned the survey. She related that the utility had called to say they did not know how to respond or who to respond to. Her sense was that the utility would not make a good partner to provide useful information. She noted that demographically Seattle City Light was a larger utility.

Mr. Berggren commented that he had observed that there was a growing dissonance between where the work was headed relative to what the Board had seemed to want. He felt the utility should look nationally for comparators. He recalled that EWEB had done three to four years of this type of work in the 1990s. He had found the quality of the information to be low and extremely subject to accounting standards. He did not believe there was a perfect comparator nor did he believe an electric utility that came even close existed. He did not believe that Clark Public Utilities or Snohomish Public Utility District (SnoPUD) were good comparators for EWEB. He expressed concern about the tremendous amount of staff time this type of work could create.

Commissioner Farmer observed that this seemed like an internal staff debate. He reiterated that he had sought to see that the organization was cost competitive for the people the utility might want to attract as customers.

Ms. Smith recalled that this was an initiative that had arisen from the strategic plan that sought to manage the increasing tension between rates and rate competitiveness and escalating operating expenses. She said a lot of it had been driven by benefits and staffing issues. Staff's original thought was to "get the Board to be clear" about where EWEB should be from a rate competitiveness standpoint.

Commissioner Brown observed that EWEB customers did not have a choice. He said the Board should remain aware of how the decisions made would affect the community and whether the community was willing to pay "that price for that product or that service or that conservation."

Mr. Berggren said he tended to think about it as finding ways to save money but it would come down to EWEB's value proposition within its community. He did not believe that EWEB would compare itself to other utilities and find opportunities to save money that would come back as a lower rate comparison target. He thought this could be a "long tedious road" with a minimal return. He felt EWEB could get more value from a higher level of assessment and then establishing where EWEB wanted to be regarding rates. He stressed the importance of doing the work that was most important and letting go of the work that was no longer so important.

Commissioner Farmer believed that the farther one moved away from Eugene, Oregon, the harder it would be to utilize something as a comparator. He averred that a large part of the EWEB mission was the provision of cost-effective services. He did not think EWEB wanted to be the low cost provider because it had values in the organization that prevented the utility from serving as such. He did not want to be the highest cost provider either.

Vice President Simpson averred that EWEB had a larger value to offer customers as it sold more than electricity, water, and steam. He thought unless EWEB marketed its added value people could think EWEB was not managed well or was spending money extravagantly. He believed that EWEB delivered its products and services at the best and most reasonable cost.

Mr. Helgeson observed that part of the quandary was whether rates were simply the outcome of the values context.

Mr. Berggren said EWEB actively managed its rates within the culture and priorities of Eugene. His discomfort lay in going inside the utility to get a discreet assessment of activities for the purpose of changing them.

President Menegat recalled that when the discussion of a rate comparison had been initiated the Board was not trying to get at best practices so much as trying to get at what EWEB did that other utilities also did or did not do. He was uncertain whether EWEB would get a lot out of such a study. He did not know if he wanted to commit to a certain quartile for rates. He felt the Board had wanted a general idea of where it stood in comparison to other utilities.

Mr. Berggren averred that staff had done a “fair amount of work” for the Board on the context of national and regional competitiveness at all of the rate levels.

Ms. Smith recalled that staff had undertaken a detailed analysis of SUB at one point that had been a “huge piece of work.”

Commissioner Farmer said it was important to look at best practices. He felt any entity had to be in the “ballpark price-wise.” He averred that EWEB had a lack of empirical data on rates. He commented that he had run into trouble before by misreading what people were actually willing to pay.

Mr. Berggren suggested that he take the item back to staff and reposition it and return with a proposal that would serve the spirit of the Board’s intent.

ELECTRIC RATES/RESERVES

Mr. Varner explained that EWEB had a significant probable contribution margin surplus in 2007 and planned surpluses in 2008, 2009, and possibly 2010. He asked the Board how the funds should be deployed against the potential uses. He referred to a list of uses included in a memorandum entitled *Contribution Margin, Reserves, and Rate Actions* dated July 19, 2007. He recalled that the original direction from the Board was to have 20 percent of the final capital cost in the reserve for the Carmen-Smith relicensing process. He registered his concern at this point that the costs were escalating at a pace that the reserve fund could not keep up with. He pointed out that EWEB would also lose approximately \$20 million in revenue during the Carmen-Smith construction outage.

Commissioner Farmer asked if the money for the Carmen-Smith outage would come from the power operating reserve fund. Mr. Varner replied that he would keep it dedicated to the Carmen-Smith project, possibly creating another reserve fund. He said one approach would be to defer some of the revenue realized in the present to a future point.

Mr. Varner continued reviewing the list of potential uses for the surplus, which included using it to reduce the level of borrowing for the Roosevelt building project, funding the unfunded actuarial liabilities associated with retiree benefits, deferring a 2008 rate increase, development of a power supplier reserve to cushion potential vagaries in the financial situations of power supplier contracts, and an increase in the power operating reserve.

Mr. Varner provided an overview of the table in the memorandum that delineated the current *EWEB Utility Reserves and Targets*.

In response to a question from Commissioner Farmer, Mr. Varner attributed the drop in the capital improvement reserve to \$1.5 million to budget amendments and negative variances for 2007.

Ms. Smith underscored that it was not all due to negative variances; some were due to timing issues. She explained that the utility had ended 2006 with a much higher balance than had been anticipated because some projects had not been completed.

Mr. Varner reiterated that staff's recommendation was to transfer at least \$10 million to the reserve.

Commissioner Farmer asked if EWEB would be at approximately \$10 million below its total reserve target with an 85 percent "hydro year." Mr. Varner clarified that an 85 percent hydro year would generate \$10 to \$12 million in positive cash flow at the end of 2008, depending on whether there was an operations and management increase or not.

In response to a follow-up question from Commissioner Farmer, Mr. Varner said EWEB would have to be down to a water year similar to what had been experienced in 2001, i.e. a 75 to 80 percent water year, to break even.

In response to a question from President Menegat, Mr. Varner stated that the Board had two "decision points" each year regarding reserves. He explained that in the summer time the Board was presented with an estimate of what the year end total would be and a decision on how much of it should be committed. Then after the audit was completed the Board was given a recommendation for what to do with any revenue that was not committed.

Mr. Berggren projected a high likelihood that three years of better than 85 percent water would generate \$20 to \$30 million.

Mr. Varner stated that based on historical rain patterns the utility had a one in six chance to have a year that was below 85 percent.

In response to a question from Vice President Simpson, Mr. Varner stated that the utility would have another \$15 million to address at the end of 2008 should there be a 100 percent water year.

Vice President Simpson asked how many years of rain in a row at the break even point of 70 percent it would take to impact the utility's financial health. Mr. Varner responded that there had not been two years in a row to date at that rain level. He said there was enough money in the power operating reserve to get through one year like that.

Mr. Origliosso stressed that it was the Board's choice where to put the surplus contribution margin.

Vice President Simpson said he wanted to "sock away" enough money but not too much money.

In response to a follow-up question from Vice President Simpson, Mr. Varner stated that the Board had 100 percent discretion to move money from one reserve fund to another.

Ms. Smith observed that there were several items that included significant risk, specifically the Carmen-Smith relicensing process and the retirees' lawsuit. She noted that the Roosevelt building project did not include as much risk.

Vice President Simpson was inclined to increase the equity position for the Carmen-Smith relicensing project. He was uncertain whether he could suggest boosting the equity position in the face of the potential retiree medical costs. Mr. Berggren offered to have staff bring more information on those two items for another meeting.

Commissioner Farmer remarked that there probably was not an item on the list that someone could not convince him to allocate surplus contribution margin to. He supported reducing debt as a priority. He felt that finding comparable utilities would better inform these types of decisions. He added that he would not support changing the hydro assumption at this time. He suggested that the utility wait until after the audit to move surplus revenue from one place to another.

Commissioner Brown said his first goal for surplus contribution margin would be to dedicate it to the unfunded actuarial liabilities involved with the Public Employees Retirement System (PERS) and retiree medical benefits. He asked what the spread was between the "cost of money" and EWEB's opportunity to put money away. Mr. Varner replied that if the reference was to PERS the interest earning capability was 5 to 5.5 percent. Mr. Origliosso clarified that if EWEB gave it to PERS the return was 8 percent, if EWEB invested the money itself the rate was 5.5 percent, and if EWEB borrowed the money it would cost approximately 6.5 percent in the present market.

Commissioner Brown asked why EWEB would not then give the money to PERS. Mr. Berggren affirmed that there was some economic sense in that option. Commissioner Brown averred that he would not want to strap future generations with the unfunded liability.

Vice President Simpson expressed a preference for buying down debt.

Commissioner Brown said he would not “not raise rates” in 2008. He felt the costs would have to be paid some day and that it was easier to absorb a \$5 rate increase than a \$20 rate increase. He observed that the surplus was not really a surplus, it was money that had not been dedicated to a specific need at this point.

President Menegat ascertained from Mr. Varner that the proposal to transfer money from the power operating reserve to the capital improvement reserve was for at least \$10 million and as much as \$13.5 million. Mr. Varner added that approximately \$800,000 was proposed to be moved from the power operating reserve to the non-power operations and maintenance reserve fund.

In response to a follow-up question from President Menegat, Mr. Varner affirmed that the transfers would utilize the entire surplus from 2007.

Vice President Simpson observed that the target for the Carmen-Smith reserve fund was \$20 million but the project end-of-year balance would be \$21 million. He did not understand how the reserve could exceed its target without authorization from the Board. Mr. Varner clarified that the \$1 million was from interest income.

Commissioner Farmer said he would not make an immediate decision to fund unfunded liabilities until he understood the utility’s position on current generation versus future generation.

Mr. Helgeson underscored that the choice to base the budget on an 85 percent hydro assumption had been a risk management policy decision. He said it was a way to balance things so that EWEB could balance its reserve funds. He related that EWEB had indicated that the strategy was oriented toward risk management when signing its contracts with large customers i.e. the University of Oregon, Hynix Semiconductor, and Weyerhaeuser. He stated that the contracts had been structured so that those customers were not contributing to the excess cash production; they were based on a 100 percent hydro assumption. He underscored that the 85 percent assumption had not been intended to be a cash flow strategy once reserves were filled. He said one concern would be whether it was equitable to utilize the strategy to pay down future liabilities, given that the large industrials were not participating in the generation of the surplus.

Vice President Simpson observed that the rate change that followed adoption of the 85 percent hydro assumption had only affected the rate and not the delivery charge. He felt that EWEB was making the energy charge a “moot point.” It had been his understanding that the money was being held aside for power operating.

Mr. Berggren stated that for a number of years the distribution system had supported the power supply. He felt it might be theoretical and not pragmatic to draw a hard line between the two.

Ms. Smith stressed that it was one entity. She explained that at the time it had been split on the bill it had been in anticipation of the ramifications of deregulation.

Commissioner Brown asked if any of the current expenditures were coming out of the Carmen-Smith reserve fund. Mr. Varner replied that the next piece of work for Carmen-Smith was to get a year-end estimate in order to look at whether a budget amendment would be needed. He added that the funding choices would be either surplus contribution margin or interest earnings on the reserve fund.

2008 BUDGET ASSUMPTIONS

Ms. Boyle asked the Board if EWEB staff should build a budget based on the assumptions that had been articulated. She said in water it would be building it with a 20 percent rate increase and the expectation that the utility would seek the authority to issue bonds over the 2008 to 2010 time period for about \$15 million and about \$25 million over the ten-year time period. Regarding the electric utility, she asked if the Commissioners wanted to consider a rate increase of 1.8 percent and whether the utility should seek approval for bonds associated with the Roosevelt building project.

Mr. Varner asked also for Commissioners to indicate support for either Plan 1 or Plan 2 for the Capital Plan for the electric utility.

Commissioner Brown indicated his support for the 20 percent rate increase, Plan 2 for the Capital Plan, and a 1.8 percent increase in the spring for the electric utility.

Commissioner Farmer agreed with Commissioner Brown with the exception of the 1.8 percent increase. He preferred to go with Alternative 2 without the increase.

Vice President Simpson concurred with Commissioner Farmer.

President Menegat also concurred with Commissioner Farmer.

Ms. Boyle asked if the Board wanted a budget built with the rate increase in it. Mr. Varner pointed out that it was easier to build a budget with the increase in and then take it out.

Commissioner Farmer asked to be able to review a five-year view of the actual percentages of revenues and expenditures in order to observe any trends.

WRAP-UP

Mr. Berggren summarized the direction received at the budget session, as follows:

- Staff will provide an end of session summary of all-in cost increases as per Commissioner Farmer's request.
- Staff will provide some of the historical risk assessment associated with the second source of water.
- Some Commissioners had expressed a desire to further discuss the potential of the water utility having an equity position at the Roosevelt building project. This will be scheduled for a future work session.
- Staff will provide more background to the information on the most recent revenue estimate for the sale of the riverfront property.
- Staff will take back work on the comparative rate position and will try to determine where to go next and the "sequence of opportunities" would be.
- EWEB will keep the 85 percent hydro assumption as it proceeds.
- There was work to do on who benefited from how the money was utilized in regard to ratepayers and large customer contracts.

Vice President Simpson asked if staff would return with recommended reserve levels. Mr. Berggren replied that they would bring the recommendation as well as the equity issue to be considered from a cost of service perspective.

ADJOURN

President Menegat adjourned the Budget Planning Session at 2:48 p.m.

Assistant Secretary

President