

EUGENE WATER & ELECTRIC BOARD
WORK SESSION
EWEB BOARD ROOM
DECEMBER 6, 2011- Amended
5:30 P.M.

Commissioners Present: John Simpson, Vice President; Bob Cassidy, Joann Ernst and Rich Cunningham, Commissioners.

Others Present: General Manager Roger Gray, Debra Smith, Clay Norris, Roger Kline, Mark Freeman, Cathy Bloom, Sheila Crawford, Jason Heuser, Wendi Schultz-Kerns, Dawne Howard, Lance Robertson, Tom Buckhouse, Bill Welch, Susan Eicher, Gail Murray, Quentin Furrow, Cindy McLaren, Flo Hoskinson, Ramie Alkire, Tracy Davis, Cheryl Golbek, Carla Aguilar, Sarah Gorsegner, Jill Hoyenga, Adam Rue, Michelle Martin, Edward Yan, Claire Elliker-Vaagsberg, Taryn Johnson of the EWEB staff; and Vicki Maxon, recorder.

Vice President Simpson convened the Work Session of the Eugene Water & Electric Board (EWEB) at 5:30 p.m. He noted that President Brown will arrive later in tonight's meeting.

2011 AUDIT PLANNING

With the aid of overheads, Debra Smith, Customer & Shared Services Division Director; Cathy Bloom, Financial Services Manager, and Julie Desimone, partner in Moss-Adams, presented the 2011 audit planning process. Ms. Bloom noted that this presentation constitutes the annual planning meeting required by Board policy, and follows the Board's standard process for audit planning.

Ms. Desimone explained the standard process for EWEB's audit planning and said she and staff will be asking for the Board's thoughts tonight in order to set the stage for the new audit planning process.

Commissioner Ernst asked how Moss-Adams prevents the yearly audit from becoming static. Ms. Desimone replied that Moss-Adams requires a mandatory rotation of audit staff each year in order for there to be a new set of eyes. She explained that each year the previous year's audit is discarded and the auditors start with a clean slate and discuss risks that EWEB is facing, the different procedures and reporting standards, and whether or not there are any specialists needed to fill any gaps. An example of this would be if EWEB had any changes in information technology structure, an information technology specialist would be brought into the audit staff.

Commissioner Ernst then asked how any carryover items fit into that scenario. Ms. Desimone replied that those are looked at in the planning stage now (i.e., tonight's presentation) instead of later to see whether or not (and how efficiently) they've been addressed.

Ms. Smith asked Ms. Desimone to clarify the difference between the auditors' opinion and the items which are raised in the management letter. Ms. Desimone explained that the management letter states whether the auditors have done enough analysis to determine whether all items are materially correct and, in the course of doing that, auditing staff uses a lot of different procedures and get into a lot of different controls and areas in order to make sure the numbers are correct. She noted that the auditors are required to tell the Board if they find material weakness of internal controls of financial reporting (which will sink the ship quickly if they are not taken care of) and also to report significant deficiencies in internal controls (small holes that could quickly become big ones).

Ms. Smith clarified that those are often items that are helpful for management to know but not an indication that EWEB's financials are in any way deficient. Ms. Desimone noted that audit standards in general have changed significantly over the last 15 years regarding how risk is looked at, etc.

Commissioner Cunningham recalled that a construction audit was done on the Roosevelt Operations Center (ROC) and he wondered if there will be a construction audit done on the Carmen-Smith upgrade.

Ms. Desimone replied that that falls outside the area of Moss-Adams' audit process but that they do look at: 1) whether what happened was accurately reported; and 2) a comparison between what did occur vs. what could have occurred. She added that the auditing staff did audit the ROC for a considerable amount of time to make sure expenditures were appropriate, minimum standards were met, contract law sufficiently followed, etc., but that an audit regarding past decision-making is outside their scope.

General Manager Gray added that some of the Peter Roberts audit recommendations have been implemented and some have not, and that those were operational (management) audit items. He noted that one key financial aspect that hasn't been done is to put additional staff resources on a project ahead of time to help the project manager manage the throughput of contracts and invoices. He added that the Board will receive an update previous to any Carmen-Smith expenditures.

Further discussion ensued regarding the audit process.

Vice President Simpson commented that he is interested in electronic bill payments being accurately accounted for and that credit card payments, for example, don't linger in an expired state for too long, and that he would like to see a paragraph or two in the audit regarding the health of that system. He asked Ms. Desimone if audit staff will be reviewing the Board financial control policies for applicability to the current business environment.

Ms. Desimone said that they will if they see something happening outside of what the Board does, but that they generally don't unless they see a gaping hole.

Vice President Simpson told Ms. Desimone that the Board invites recommendations for making its financial control policies more sound and in line with today's business practices.

Further questions were asked and answered by Ms. Desimone.

Ms. Smith explained the titles and responsibilities of Ms. Bloom, Susan Fahey, Fiscal Services Manager; and Susan Eicher, General Accounting and Treasury Supervisor, and how they interact with auditing staff.

Commissioner Cunningham asked if auditing staff will be involved with EWEB taking on additional risk on the power trading floor.

Ms. Bloom verified that that item will be part of next year's audit. General Manager Gray commented that staff is looking at the power trading risk policies with no action yet, but that it may be good to run that process by EWEB's internal auditor in terms of controls put in place and improvement, i.e., and that he wouldn't consider it "taking on additional risk," but trying to mitigate risk. He added that he likes to separate consulting from auditing and to make sure that separation is respected.

Vice President Simpson said he would like Ms. Desimone to assess whether the format of EWEB's official audit is proper compared to EWEB's competitors.

Vice President Simpson thanked staff and Ms. Desimone for the presentation.

2012 LEGISLATIVE AGENDA

Jason Heuser, Legislative Representative, discussed the character of the 2011 legislative session and recalled the history of Oregon's legislative process from 2002 to the present regarding length of session and policy expectations.

He noted that there are two issues that staff continues to push:

1) the Energy Supplier Assessment (percentage of revenue from gas and oil to the State to help with energy siting), which is now funded more heavily through fees and was redirected to help cover the Department of Energy (DOE) budget. He explained that the key issue for EWEB is that there is no knowledge of how the money is spent and really no sideboards regarding the ability of the DOE director to increase that assessment, and that currently the hit can be raised by the stroke of the DOE director's pen without any legislative involvement. He noted that EWEB's assessment has doubled from five years ago, and that it is not known whether that money is being spent on activities in the DOE or elsewhere in State government.

Mr. Heuser noted that Portland General Electric (PGE) has a legislative concept on that, and that he strongly believes EWEB should join PGE and a coalition of utilities to try to get transparency on what the money is used for and to create some sideboards.

Commissioner Ernst asked if the percentage is the same for public utilities as independently-owned utilities (IOUs). Mr. Heuser replied that natural gas might have different rates but all electric utilities pay 0.07% of retail revenue.

Vice President Simpson agreed that EWEB needs to know where the money is going.

Mr. Heuser continued with the second item of interest to EWEB, high water/high wind events. He explained that for almost three months, due to high flows on the Columbia River, BPA has put limitations on how much water they can spill over the dams, which has put them out of compliance with the Clean Water Act and Endangered Species Act. He added that there was a lot of generation in the area and BPA was forced to employ an environmental re-dispatch policy to curtail generation, with thermal generators being first, and that thermal generators are content to take free hydro power from BPA as it saves them fuel costs. Unlike wind, thermal generators are not dependent on projects like production tax credit as well as value of energy credits. He noted that while EWEB does not want to see BPA in a negative crisis, EWEB has wind projects that are subject to curtailment, even with only one project having partial impact because it was funded by a different mechanism. Nonetheless we had impact.

He added that the solution is that economic damages that are suffered from those who are curtailed are relocated to benefits granted by State and federal law, renewable energy credits (RECs), and tax credits. He said that those benefits that cause economic damages are also in a position to amend policies in order to earn benefits when they are curtailed, in order to help BPA stay within the Endangered Species Act guidelines, so EWEB desires legislation to grant replacement RECs.

Commissioner Cassidy expressed concern about the incentives that the State has given for wind generation, as the State has made wind generators an offer they can't refuse to achieve 20 years' revenue in 10 years' time. He said it seems that EWEB should support something where incentives are drawn back for wind generation and that EWEB should favor BPA on this one.

Mr. Heuser replied that: 1) the business energy tax credit has been ratcheted down to nil already and has been taken out of the equation due to the relative success of wind energy in the Northwest; and 2) EWEB doesn't need to necessarily choose one or the other, as EWEB is not taking either side, but rather wanting to find a solution to the problem. He added that EWEB is unique in Oregon because it is the only consumer-owned utility who has its own generation, and that is not the case in the state of Washington. He said he believes EWEB has done a good job of wearing two hats and advocating for a possible solution to get more utility revenue and getting others to join in, and that even if EWEB gets replacement RECs at the State level, more economic damages occur on the tax credit side.

Further discussion ensued regarding the possibility of a legal challenge on the part of wind generators and RECs, and how to solve the above issue.

Commissioner Ernst asked if EWEB would be a part of a payout if a lawsuit was filed. Clay Norris, Director of Power Resources, clarified that they would by virtue of their access to BPA, but that it would really be a BPA vs. wind industry lawsuit, and as a wind project owner, EWEB would not sue BPA. Mr. Heuser added that EWEB has more to lose by being a BPA customer than by being on the wind generator side.

General Manager Gray added that just because EWEB has not intervened and sued BPA doesn't mean EWEB couldn't make claims against them, and that there are two kinds of practicality: 1) 25% of EWEB's power comes from them and suing wouldn't be practical; and 2) the RECs EWEB is losing are extremely low-value in market EWEB is in currently, so there is a lot more to lose on the BPA side right now if BPA loses the lawsuit. He added that he supports Mr. Heuser regarding taking long-term interest in both camps to see that this problem is solved, and that this will be only part of an overall solution, not the key piece.

Vice President Simpson thanked General Manager Gray for his explanation.

Vice President Simpson then asked if EWEB's new wind contracts will be coded differently and if rewriting them carefully would be a way to slowly correct this problem. Mr. Heuser said the short answer is yes, and General Manager Gray added that with BPA is trying to clean up this exposure with its new interconnection agreements.

Vice President Simpson said he believes EWEB favors wind generators being able to gain access to RECs in times of environmental re-dispatch based upon predictions of what they would have generated during that shutdown period. He wondered if that is correct and if EWEB sees that as a middle of the road type position.

Mr. Heuser agreed, and added that the expectation that the legislature will have time to address these two issues in a short session is low.

Commissioner Ernst commented that she didn't recall the Board passing a resolution for the above. Ms. Smith replied that staff had given Mr. Heuser an example for wording of a resolution, and also some general statements for how EWEB will deal with the legislation.

Vice President Simpson encouraged the Board to pass Resolution 1145 later in tonight's meeting. He then recommended moving agenda item #12 (approval of Resolution 1145) ahead to item #1 in tonight's Regular Session so that Mr. Heuser could return to Salem as soon as possible in light of tonight's inclement weather. The Board agreed.

THIRD QUARTER FINANCIAL STATEMENTS

Using overheads, Susan Eicher, General Accounting and Treasury Supervisor, reviewed the third quarter financial statements, and summarized that the trend has been good for the electric side but no so good for the water side.

She addressed comments and questions from the Board regarding decreasing revenue on the water side. Ms. Smith explained scenarios for withdrawing from reserves in times of decreased revenue.

President Brown asked for clarification of the difference between operating and net revenue, and a discussion ensued regarding the disparity between the two. He wondered how he will explain to his constituents how a rate increase is being proposed when net income is up 35%.

General Manager Gray replied that the big driver is wholesale power sales, which is driven by the water year, and that residential and commercial industrial rates are driven by weather and economics. He said that rate changes within the retail class can be explained, and that the windfall coming from wholesale revenue cannot be counted on every year, i.e., in an 85% water year, that income will evaporate.

Ms. Smith and Ms. Eicher further explained this scenario, and Ms. Eicher reminded the Board about drawing from Carmen-Smith reserves (which is spread out throughout the year and has now slowed down).

President Brown reminded staff that EWEB is heading for a water year and a change in the BPA contract that staff hasn't seen the impact of yet.

Further discussion ensued regarding the need for a rate increase. Commissioner Ernst agreed with President Brown, and said that it seems like the Board needs the financial information from fourth quarter 2011 before they make a rate decision.

Ms. Smith reminded the Board that they are not taking rate action at tonight's meeting, and re-clarified the previous rate process and discussion that had been going on for months.

Commissioner Cunningham said he can move forward with budget approval tonight, but that he will have a problem if that budget guarantees a rate increase, and that he is concerned about putting the cart before the horse. He added that he is willing to give staff the benefit of the doubt and see where the rate increase plugs in if staff is willing to give the Board the benefit of the doubt to be able to "sell" the rate increase to them, but that presently that sale will be difficult.

Ms. Smith reminded the Board that one choice the Board had previously made was to not move the rate action up and go with a rate increase in May. She said there is an opportunity to complete the audit and understand from Moss-Adams how the year ends. She noted that she is not interested in selling the Board on a rate action, and that staff had previously brought the Board a series of decisions that could have resulted in a different rate action, but that the budget was built on direction staff received from a majority of the Board at a previous meeting. She added that if the Board wishes to give staff a different direction, adjustments will be attempted.

Commissioner Cunningham gave kudos to Ms. Smith and the financial staff for an outstanding job on a new product that has changed the budget process, and said he believes it will take a while for the Board to get used to the new way of budgeting.

Commissioner Cassidy commented that he has no problem with the budget as it is but that he hopes that future financial presentations can be done differently and made easier to follow. He asked for clarification of the budget summary the Board received in their packet.

Ms. Eicher clarified Commissioner Cassidy's questions.

General Manager Gray noted that the Consent Calendar in tonight's regular session contains a budget amendment for a financial control policy requiring that major capital projects get reported separately and for adding funding for a specific project in order to complete the work.

Vice President Simpson adjourned the Work Session at 7:16 p.m.

Assistant Secretary

President