RATES ADVISORY COMMITTEE

Tuesday, September 22 2009
2:00-4:00 p.m., City Hall room L280

Committee Members Attending:

Eric Hausman
Rod Kauffman
Ellen Monrad
Joe Simpson
Debbie Tarry
Andrea Caupain

Also Attending:

Dan Eder, Leg. staff
Cameron Keyes, DOF staff
Michael Jerrett, CM Harrell staff
Jennifer Samuels, CM Harrell staff
Tony Kilduf, Council central staff
Corey Knutsen, SCL
Sung Yang, SCL
Phil Leiber, SCL
Paula Laschober, SCL
Roberto Bonaccorso, SCL

The session began with the election of a chair. Mr. Joe Simpson nominated Mr. Rod Kauffman, who accepted, stipulating that he still would like to be able to voice his opinion. The committee elected Mr. Kauffman without opposition.

A presentation on Revenue Requirements was next. Mr. Corey Knutsen started the presentation with a summary of the utility's vision and the five long-term strategic priorities:

1) **To recruit and retain top talent:** City Light's workforce is approaching retirement age, and it had to make investments to retain and bring in talent. He said the current economy has slowed down the turnover and retirement of employees
2) **Protect the environment:** City Light has a history of being environmentally sensitive; in recent years there has been increasing emphasis on green house gas reduction..
3) **Strengthen infrastructure**: Equipment needs to be replaced, as made evident by catastrophic storms. We are investing in asset management and outage management systems. We are also looking at Smart Grid technologies, with subsidies from the federal stimulus bill, with a proposal for $204 million investment in new technology.

4) **Develop an efficient resource portfolio:** Our conservation plan had to be tempered because of funding issues. We hope to increase funding in the future and we are required by I-937 to increase our proportion of renewable resources.
5) **Ensure financial resilience:** This rate adjustment activity is part of this priority. What revenue/fiscal policies/expense reductions should the City consider? Mr. Knutsen asked the committee to think about that they would like the utility to do in this regard.

Mr. Kaufman asked for clarification on Smart Grid technologies, and Mr. Knutsen explained how we are planning to invest in automated meters, smart distribution sensors and switches.

Mr. Phil Leiber led a presentation on the steps to rate making: revenue requirements analysis; cost allocation, and; rate design issues. Mr. Leiber said there are choices to be made when talking about what it takes to run the utility.

At root, he said, we have to achieve a careful balance to provide customers with the services they want, while recognizing that they may have to pay higher rates during a tough economy. A key part of the discussion is looking at financial policies that have been in place for more than 30 years.

Some of the current financial policies date to the supply crisis if 2001, when City Light was forced to buy power at inflated rates. This experience set up the current policy of resource planning, where City Light buys more supply than it needs.

Mr. Kaufman asked about the coverage ratio. Mr. Leiber explained that we should set rates to be two times the cost of servicing our bonds, but that we are currently at 1.3 ratio. The surplus goes to pay capital expenses. Mr. Leiber said this is a deliberate choice to provide a debt cushion to offset future borrowing costs, and to better our rating with credit agencies. The debt coverage ratio was set high to deal with the volatility of power markets, since we depend on power sales for revenue. To a degree, we've come to rely on power sales, so much that $70 million of the current revenue shortfall is from low energy prices.

Mr. Leiber said City policies require us to have 95 percent confidence that at least $1 of operating cash will go to cover capital costs. We will have a current debt capitalization of 60 percent by the end of 2010.

Ms. Paula Laschober explained that these polices assure us that we will have adequate revenues in 19 of 20, as opposed to setting rates so high that you will never have a deficit.

Mr. Eric Hausman asked if the current RAC resolution applies to 2009-10, and if the committee will continue to meet. Mr. Leiber explained that the RAC resolution does have a sunset, and that it will need to be modified to allow the RAC to continue in 2010 to review the effectiveness of rate policies.

The committee then discussed some of the implications of current debt capitalization policies, and what the industry standards are (50 percent to 60 percent is considered good).

Mr. Leiber explained that City Light also has a policy to keep 30 million in cash balance per month, with a $25 million emergency reserve with strict restrictions on when it can be tapped.

Mr. Leiber said these polices have served the utility well by improving our credit rating. But in 2009, it was a challenge to provide services and meet policies.

The committee then discussed some of the implications of low credit ratings, and lower rate ratios. They asked whether credit boards have become aware of our latest figures.

Mr. Leiber explained that the current financial policies have helped insulate us from some volatility. But the main problem has been that expenses have climbed to unsustainable levels under current rates. He said the original assumptions called for higher rates.

Mr. Tony Kilduf then interjected to explain the City budgeting process. He said that for most general fund departments, a city budget offers the authority to spend money. But revenue generating departments like City Light have a separate process to collect revenue. For City Light, those revenue sources are rates and surplus power sales. Rates are a stable source amounting to almost $600 million a year. The other side is power sales in the wholesale market, which can swing wildly. In the past, no City department has had to deal with this kind of volatility in revenue.

As a result, the spending plan and the revenue plans haven't agreed, allowing the utility to spend more than is sustainable. Mr. Kilduf said the City didn't spot this problem until recently. And the City needs to change the revenue and spending plans so they don't go out of synch.

Mr. Kauffman said the two plans used to be in synch. Mr. Kilduf said the revenue plan is not connected to the rates. And part of the problem is that the share of revenue from power sales has grown since 2001, when they utility began to get a surplus of power.

Mr. Kauffman said the utility sometimes can't control what the Council will do. He asked about the sale of the Centralia plant. The discussion then changed to an explanation of the sale of Seattle's interest in a coal-fueled generating plant in Centralia in 2000, where the owners collectively decided to sell rather than invest in costly environmental upgrades

Mr. Kilduf then explained that City Light began to own more power than it needed after the renegotiation of the BPA contract. Because of that, City Light is now more reliant on power sales. Part of the rates setting process could be a mechanism to flex rates with wholesale market conditions.

Mr. Leiber brought the conversation back to the reasons for spending increases at City Light. He said about half of the increases were in discretionary funds. Some programs that raised costs included labor, FERC/NERC regulation, safety, the expanded apprenticeship programs, all programs that had been vetted and discussed in the budgets.

Ms. Laschober then began a detailed look at the 2010 endorsed budget, financial forecast, differences in the 2007 and 2008 forecasts, operating expenses and how to close the gap between revenue and expenses (see handouts for specifics). She described the bottom line as a gap between forecasts and spending that resulted in $135 million in deficit. The presentation included lots of questions and discussion by committee and staff about the validity of forecasts and the potential amounts for a rate increase that could level the differences.

Ms. Laschober said all the analyses show that we need a rate increase to be able to meet services and current financial policies.

Mr. Joe Simpson asked why electrical load was down. Mr. Kauffmann and Ms. Laschober said the recession has caused business demand to drop, which led into a discussion about whether conservation is leading to lost revenue (it's not, the saved power is then sold in the wholesale market, Ms. Laschober said), the current conditions of the wholesale market, and the role of California in driving prices.

Mr. Leiber and Mr. Kilduf said we don't have transmission capacity to sell directly to California, and that it's not a big market for our power.

Ms. Laschober then explained the $61 million operating expense budget, referring the committee to the handouts, rather than explain line by line the expenses. She and Mr. Leiber explained that most of the capital projects described were not recurring expenses.

Mr. Kaufman then asked staff to define the committee's charge, now that the Mayor has proposed a rate increase in his budget.

Mr. Sung Yang said the RAC's charge will be take the mayor's request into consideration, along with all the other information being provided, so that the committee can make its own rate recommendations. Ultimately, Mr. Yang said, the charge is the revenue requirements at the utility.

Mr. Kaufman and Mr. Simpson asked to receive copies of the proposed budget when it's ready. Mr. Yang said the budget will include a rate increase.

Mr. Yang, following questions from committee members, said the Mayor's proposal will include rate triggers for rate adjustments. The proposal covers only one year and the RAC could come back to look at rate design as well as revenue requirements.

Mr. Kaufman asked if a new Mayor will have the right to appoint a new RAC.

Mr. Yang said the ordinance says the RAC is dissolved upon adoption of new rates. Since the situation has changed, it will require new Council action. Previously, we thought the RAC would be a two part process. Mr. Leiber said the original plan called for 180 days before the rates could be changed.

Mr. Kilduf said the original assumption was to work with a place holder budget that would be re-opened to make it consistent with new rates. Because the new budget proposal includes a rate increase, we need to amend the City ordinance to remove the 180 day clock. He said it would still be the assumption that the RAC could reconvene to look at rates design.

Mr. Simpson asked whether the Mayor and Council usually propose new rates with a budget.

Mr. Kilduf said that they do not always look at rates, and that has thrown City Light out of cycle with expenses. The usual practice is to look at rates on budget off years. That practice doesn't affect SPU, since its revenue is more stable.

Mr. Kaufman asked if a new Council could revise committee assignments.

Mr. Kilduf said that's one of the reasons why it makes sense to tackle rates right now. He said it would not be fair to give this assignment to a new Council committee chair.

Mr. Kaufman asked to provide meeting documents to all the absent members of the RAC, and that he would call and update them.

The committee agreed to keep future meetings at the same length, with about a half hour of flexibility if needed.