

UTILITIES ADVISORY COMMISSION

MINUTES OF DECEMBER 6, 2006

CALL TO ORDER

Chairperson Melton opened up the Utilities Advisory Commission Meeting for December 6, 2006 at 7:00pm.

All five members: Melton, Rosenbaum, Dexter, Bechtel, Keller were present. Beecham Absent.

ORAL COMMUNICATIONS

None

APPROVAL OF THE MINUTES

There was no meeting in November. Bechtel moved, seconded by Rosenbaum, to approve the minutes of the UAC meeting held October 4, 2006. Motion passed unanimously. Dawes said he was not present but he did watch the meeting on his VCR.

AGENDA REVIEW

.Melton requested to rotate Item 1 and 2. No use keeping the public waiting. Val responded that it would be fine to switch.

REPORT FROM COMMISSION MEETINGS/EVENTS

.Dedication of the Shiloh Wind Farm. Bechtel mentioned that Palo Alto had a nice dedication. Council member Drekmeier spoke at the dedication. Palo Alto has done a great thing to be a part of this project. Pacific Power Market did an excellent job in putting this event together. It is huge tower with modern technology incorporated in the design of the wind generator itself. Linda Clerkson did a great job in the publicity and Karl Knapp was a big part of the build-up.

UTILITIES DIRECTOR REPORT

Melton publicly welcomed Valerie Fong, Director of Utilities and her first Utility Director Report. Val thanked Commissioner Melton.

at 7:15 tomorrow (Dec. 7th) we have at Lubberly, our first All Hands Meeting, and the entire Utility Department where I would be able to introduce myself to the entire team. It would be her first

communication to the entire group. The managers will cover budget process overview, financial goals and rates, talk about environmental initiatives, give an update on infrastructure and capital improvement projects, and cover safety statistics.

Second Item: California Municipal Utilities Assn. completed the statewide Residential Electric Customer Survey. The results indicate that the municipal customer satisfaction response is higher than it was in 2004.

Upcoming Council Items – The Mayor’s green Ribbon Task Force will present their recommendations to the City Council on December 18. The Council will also consider at that meeting a resolution to join ICLEI (International Council for Local Environmental Initiatives). The focus is climate protection and a pledge to undertake five milestones that have been identified by the campaign all geared toward reducing local emissions that contribute to global warming. At the same Council meeting we are going to submit a request for Budget Amendment to move \$750,000 from the electric supply reserves to be used to fund higher than anticipated customer response for solar photovoltaic rebates. There will also be a special order of the day – Recognition for the Palo Alto Green Program. On November 22nd the Planning & Transportation Commission held their meeting to consider the Draft Environmental Impact Report on the Emergency Water Supply and Storage Project. Jean McCowen OF Stanford made public comments and reminded the Planning Commission to include the comments that she had submitted earlier related to the specific project sites on Stanford Owned Land.

NCPA Strategic Planning Workshop will be held on Jan. 25th and 26th. Budget is available for two Utility Advisory Commissioners to attend and let Jennie know by December 28th. We will be attending the CMUA Capitol Day on Feb. 5th. That concludes my report. Thank you for the ‘Welcome’. I am very glad to be here.

UNFINISHED BUSINESS

None.

NEW BUSINESS

ITEM 2: ACTION ITEM: (SWITCHED ITEM 1 & 2 BECAUSE OF THE PUBLIC – NO WAITING)

The Draft EIR – Emergency Water Supply and Storage Project. Planning Commission had its first meeting a week or so ago. We are officially in the Public Comment Period.

Tomm Marshall said we are here tonight to take comments and try to transcribe them to be included in the comments for the EIR.

The Environmental Scoping Meeting was held by the Commissioners on March 8, 2006. Draft EIR was completed on November 8, 2006, then started the 45 day comment period, following Public Hearing on November 29, 2006 at the Planning Commission. Comments could be in writing or show up at the Final Feb. 14, 2007 meeting. At this meeting we will hear on the adequacy of the project and the recommendation as a whole whether it should move forward. It will follow with City Manager's Report making staff recommendation as well as the Planning Commission Recommendation to the Council who will then determine whether to make the EIR official.

Tomm mentioned that it may be premature to have a discussion before the Planning Commission determines what they are going to do. The Planning Department who is putting the comments from the public and other agencies will put this together through a contracting agency and prepare the last final document. City itself is doing its own environmental review.

Dawes mentioned that this that though this is essentially a utilities issue a large capital expenditure which requires an Environmental Impact Report the person or the entities that are responsible for creating the final report which is I guess is the final recommendations is it the Planning Commission rather than the Utility Department? Tomm responded that in terms of the EIR that is correct. They are certifying the Environmental Report. The Council just approves the group of alternatives and then staff will go back to get the final recommendations on what exactly the project will be, where the well sites and reservoirs are located.

Bechtel said that this would have a major bearing on the final recommendation. After the draft of the final report is approved there is another phase which says Okay we know what the

environmental impact is - here is what the Council says where we want to spend 15 million bucks or whatever the deal is and the schedule is this the second step? Tomm said that this is correct. Tomm informed the Commissioners that they could submit their comments in writing or could address them to the Planning Commission.

Melton noted that the UAC February 7th meeting occurs before the Feb. 14th where the Planning Commission will send their recommendation to the Council. We need to decide whether we want to make a recommendation directly to the Council or send our recommendation to the Planning Commission to perhaps influence their recommendation and get both Commissions speak in one voice. Dawes questioned if UAC would have an opportunity to comment on the specific final recommendations. The cost and the schedule is very important in terms of one of the considerations and he would think it is very appropriate if the UAC could look at what the alternatives are in terms of the practical implementation. Tomm responded that certainly cannot see why it couldn't be brought back for the Commission to look at. Melton said those all come after the Final EIR has been approved by the Council. The Utilities Department then gets in the decision making process out of all the alternatives spelled out in the document which ones we should select.

Tomm responded that it has not been decided which site it would be right now and we do not know what the Planning Commission is going to recommend. We will study all the alternatives but some of the issues are going to be lease issues and that is going to determine possibly where the reservoir ends up. One of the issues we have is Stanford as several properties are Stanford land. At the last meeting they said they preferred to have it on Park Land as opposed to other alternatives. Dexter questioned if it is Stanford Park Land versus Stanford Parking Lots? Tomm answered Parking Lots.

Bechtel expressed concerns about costs. EIR is not an engineering report presenting alternatives. If we have personal preference and that preferred preference site is rejected because of environmental reason that would concern us. As long as the alternatives are presented, the EIR is certified; we come down to the nitty-gritty of judging which site is perhaps the most cost-effective. It appears reading the report nothing that has been discussed in the past has been rejected as

having an environmental problem. Tomm mentioned that there are some places where there are few significant impacts. Bechtel further commented that there are some things in the report that are missing where some figures are reversed and some pages missing at least in his report and wanted to know if he should write and send them to him. Tomm agreed about the reversed figures.

Keller mentioned that she had not been on the UAC when the background report was created. Roger Cwiak gave a brief overview of the project and the CEQA process for the project. Alto receives its water from Hetch Hetchy 100% of that through SFPUC system and we use our reservoirs to meet our peak demands during the day. We have a system of five standby wells that we don't normally operate. The graph compares Palo Alto Emergency Water Supply level of service with other local utilities that are equal or larger in size. It is almost ten years since the Health Department made a recommendation on their trying to get the maximum number of demand days of eight hour supplied in all utilities. Since that time some utilities have decided that it is not good enough for them and others including Palo Alto and even others that do not have any storage or any type of backup are still struggling trying to meet the red vertical line there which is the DHS recommendation to water utilities. Palo Alto currently has approximately about a third of that supply and this gap between really provides the project purpose for the work we want to do and that is to provide enough water to meet the normal and emergency demand if the SFPUC system is shut down what is the benefit to Palo Alto. We end up with an Emergency Water Supply. The project objectives are to be provided an eight hour emergency water supply based on the DHS recommendation, to provide facilities that would allow for drought years supplementation that is from the wells design facilities to meet the fire flow requirements under emergency water supply condition, implement cost-effective capital improvements to meet the above objectives and to reduce and minimize the environment effects to the degree feasible. The water well study was completed in 1999 and that recommended that the city develop two and a half million gallons of storage, develop eleven thousand gallons per minute reliable well capacity, construct three new wells and rehabilitate the five existing wells and rebuilt the Mayfield Pump Station. The CEQA project description included one reservoir at four potential sites, three new wells at ten potential sites, rehabilitating five existing wells and rehabilitating one pump station. After we construct the three new wells, if we get a high volume of water out of these wells like 1500 to 2000 gallons a minute then we may not have to rehabilitate all the other five wells. We may eliminate some of the

existing wells afterwards through the process of building the three new wells. It will be a long process in actually trying to build a well. There will be the public crying against the well at a particular location. Roger also informed that if it turned out that when the well is being developed it really produces 3,000 gallons a minute, then could we eliminate one of the wells being built....he said probably 'Not'.

The map shows the existing well locations – the red dots and then we have the potential reservoir sites that are the parking lots, downtown and California Avenue, the El Camino Park, Stanford Shopping Center parking lot and the temporary parking lot at Stanford next to the Quarry substation. The environmental issues that were discussed in the CEQA documents are these and at the Planning and Transportation Committee Meeting. The construction will require park closure if we use El Camino Park land, but there is going to be no permanent loss to the park land. The mitigations are that we would use public notice, web posting, mailing and signage to inform the public about the projects and we would coordinate with the Community Services Department to reschedule park activities in the construction so that we could minimize that impact on the park use. We have visual quality potential impacts – are construction related visual impacts, permanent site alterations and new sources of light and glare. The mitigation measures identified in the Draft EIR are that the construction areas would be screened when possible, sites would be maintained orderly and neat we would have signs explaining what is going on for the public. We would use extensive site restoration and landscaping with native vegetation, night time construction lighting would be directed downward and not visible to neighboring areas, permanent light fixtures would be low intensity and non reflective building materials and use of vegetation to screen the buildings. This nighttime lighting will come with, if we drill a well it is a process which would last ten days to two weeks and it goes on 24 hours a day. We would have to mitigate the sound and noise that we would make during the night. Ground water level that could be potential impacts of increase groundwater recovery to meet emergency demands or drought demands could result in ground water levels below historic levels. New wells could interfere with existing well efficiency and the mitigation measures that we have identified to make these impacts less than significant are that we perform accurate testing, limitations of the emergency pumping to 1500 acre feet in one year and restricted production until groundwater levels recover. Locate new wells more than 500 feet from production wells. We may have a historic property at one well site and we have some potential

impacts if any alteration to the pump house building could reduce its eligibility for the national registry. That mitigation measures reduce impact to less than significant any work we would do would be reviewed by the Historic Resources Board and compliance with the State, with the Secretary of the Interior Standards and Guidelines relating to the rehabilitation of historic buildings.

Melton mentioned that the previous work on the building may have destroyed the historic standards already and so no longer qualify has that been determined? Roger said that he does not think that it has been completely determined. We know the exterior of the building was rebuilt in the early 1980's and anybody that worked on the project no longer works for the city now. So we are having a hard time actually trying to find out what was actually done. Melton said this becomes a non concern because it does not qualify anymore. Roger said that the Planning Department is thinking that it may still have historic significance and we may not lose this designation. There is potential impact of permanent reduction of existing parking spaces for well sites and reservoir sites and depending on which location the number of spaces and then the mitigation measures for those to make them less than significant we would pay fees for the parking lot sites and possibly California site could be re-stripped to have the same number of spaces if we did decide to site a well in that parking lot. There will be concerns about noise and vibration. Impacts could be from the construction and vibration and operational noise. One of the mitigation measure was to use a 100 foot set back where possible include sound walls and blankets, public notification. Pump house and well enclosures would be designed for minimum noise, design assisted by 24 hour noise survey, sound attenuation housing for emergency generators and silencers for the exhaust flow. Conclusions in the DEIR that some of these are significant and unavoidable. The 24 hour drilling activities. If we drill a well we have to complete it once we start and work continuously. The well drilling equipment noise at the site except for Stanford Shopping Center, these sites would be near houses or other persons would be impacted by the noise and then the other construction equipment noise affects at all sites except the downtown parking lots, El Camino Park, Stanford and Town and Country Shopping sites. These sites are fairly noisy and there may not be as much impact when we work on those sites that have a higher ambient noise levels. We reviewed the interconnection with the Santa Clara Valley Water District – it doesn't meet the project objectives that have the greatest land disturbance and a very high cost and it does not help the city meet its fire flow objectives. We looked at the desalination plant. It does meet the project objectives. It has

regulatory water constraints, water quality constraints, greater land disturbance and greater impacts across all areas. It could also meet the project objectives.

Bechtel asked Roger how we meet the fire fighting requirement with the desalination plant. Would it be located in the pressure area one? Roger said that it would be our water supply and we would have our normal system just supplied by that plant. How do we participate? You could give comments in writing to the site address up there or give us the comments this evening. You could attend the public meeting on February 14th.

Keller had a question about objectives. The city objectives are to support minimum of eight hours of normal water use, four hours of fire suppression, and capable of providing water supply up to 30 days what does this mean? Roger responded that if we develop a system that can meet our maximum day demand for eight hours, at the end of eight hours if we are reusing our wells those could also supply water for a long period of time. Either we have to solve this problem of trying to have a large reservoir of water that could supply for a long time or you do it with smaller reservoirs and wells and that is what Palo Alto this project is trying to do as Palo Alto's solution – it looks like it would end up we do not have a place to put a very large reservoir that could hold enough water to supply us over a long period of time. But just to meet the eight hours of maximum day demand we can use wells and reservoirs and then we have the fire fighting capability that we need to be able to do also. That is hard to meet from wells because you can get about 1000 gallons a minute for your average well. We have a demand of 6000 gallons a minute in one part of town that we are trying to meet and we cannot site six wells in that small area. We need a reservoir with a pump so that we could pump that large volume of water over a short period of time. We have looked at the ground water table around Palo Alto it looks like we could pump in one year 15 acre feet which turns out to be a 30 day supply on a level about equal to our winter day demand. If we reduce that through conservation, it could last a little longer. But if we pumped about 1500 acre feet out of the ground a year then we would be able to keep the water elevation above the ground water elevation above where it had been before when Palo Alto used to use only wells for its water supply. Keller asked would that be enough for a typical daily demand. Roger said for winter demand. If we were in a situation where we had no water supply, then we would have other efforts for conservation. So if this project was successful as planned, we could be independent for a year if we cut back on our

water is that how I could interpret? In an emergency situation where people are motivated? Roger said if they were motivated to use three or four gallons a day then we might last a year. 30 days at about 12 million gallons a day is pretty realistic. Melton said that the reservoir is to meet the peak demand; it could be the fire fighting demand. If we were cut of from Hetch Hetchy what we are counting on is the eight wells are going to produce enough drinking water for the city for the 30 to 60 days that we are supposed to plan for SFPUC to get Hetch Hetchy back in service. Roger agreed.

Keller wanted to know how quickly the wells or the water supply be activated if we have to go and get the chemicals to treat the water to use. If there is a huge earthquake and the road are collapsing and everything else how long does it take to actually get the chemicals and bring them back and get the system going. Is it quite a delay and where are the chemicals stored? Roger responded that we have a contract with a company in Fremont that stores water treatment chemicals so how long it takes to drive there and come back and connect it to our pump so probably within four hours we could have the wells turned on and have ammonia and chlorine fed into the system. Keller also wanted to know how the well sites were selected. Is it on hydrological criteria or areas that are possible? Roger said that they did test borings and test pumping of those holes to determine locations in the city where siting a well would work and would produce water and some of them are historic sites that we have used as wells and we know that they were good producers in the past.

Keller asked if there is lots of confidence that these sites are good possibilities. Roger confirmed that they are good possibilities. Keller wanted to know why the reservoir sizes on Table II -2 are different. Is it just the dimensions of the sites? (Page 237) Roger said that there has to be roads built In and Out on the tight sites and so there is more excavation made to work the smaller sites. Keller continued that it sounds like the wells will be build one at a time rather than the same time, the concern is here that it is five years down the road if something happens before that what we do. I could see some of the cost benefits staggering up is it a trade of between staggering them and doing them all at once? Roger responded that if we could do them all at once we will. It is a long drawn process when we actually get it. If we could get an agreement and public support building the sites that are chosen for wells and if there is not a lot of opposition to that they could probably

be build all at one time. It would be efficient to have the same contractor come here and work for nine months and build three wells. It is not likely that they would all be built at once. Physically – yes – it could happen but the reality is that we would probably have a battle every place that we would go and therefore we would be building one at a time. If we get through and we have one site to build, we will work on that site built but the likelihood of all the sites that get selected to be an open door to go build on is very remote. Most likely scenario is described here as them being staggered.

Keller pointed out that Page 3.2.17 it describes how the mitigation is to reschedule the park usage what does that mean to the teams that are scheduled to play soccer? Do they have other places to go or do they have fewer people that come and play. What is the reality of rescheduling park usage? Roger replied that the reality that they will be rescheduled. Exactly how that will occur he does not know yet but will work with Community Services Department.

Keller asked about transportation. On 3.8-10 it describes terms for transportation that she did not understand. Melton said that transportation rates intersections from A to F depending on congestion. A is good and F is bad. Keller's other concern was dependence on pumps for the reservoir in an emergency. What happens if there is no power? Do we have standby generators? Are they 100% reliable. The answer was 'Yes'.

When you clean out the reservoir how long you are out of a reservoir for maintenance? It is usually about three to four days to drain the water in the system, to clean it, sanitize it, fill it with water run a test on that make sure that the water is portable. Keller was also concerned about sound walls. Roger explained that they would measure the noise against ambient if we are in violation of a city ordinance that we would do everything on the site to eliminate that violation and it would come down to having relocate this has been done in the past.

Keller – 311011 contaminated fumes. Would it possible to include a map showing those fumes in case these wells are used more than we planned to now. It seems that could be clog contamination if there are fumes migrating towards the wells. How can you count for not pulling up non contaminated water? Roger replied that most of the contaminated water is in the upper

aquifer. We would construct a well; we would seal the well according to the Santa Clara Valley Water District standards which require sealing the first top 100 feet so we would not draw any water. If we were going to site a well near an area that was contaminated, we would know the geology and we would construct the well so that it would only draw groundwater from zones below where the contaminated fumes were not.

Keller said she was quite impressed by the document and appreciated his (Roger) answers.

Dexter made a quick comment that UAC approved the capital expenditure after the Corollo Report was done many years ago and the recommendation then and he finally supports now to go forward with it, that he finds the environmental impact to be tolerable and correctable and it certainly looks like the El Camino Park location seems to be the best site. A bond was floated in 2000 or 2001 or 1999 (Girish may be you remember) of 15 million dollars to accommodate this capital expenditure which was approved in the budget and I believe funded and it is not the time to get into that issue today but I certainly believe that UAC would want to follow the money from that bond issue and understand where the finances went. I understand those are fundable money and they go into the capex pool and they kind of go out and I think the public and the UAC rightfully concern and want to understand that if bonds were floated for the purpose of funding this capital expenditure and quotes spend on other things how that whole thing works – that would be the subject for the implementation part.

Rosenbaum had a comment on what Dexter said. An equivalent amount of money is sitting aside in the capital improvement fund. The money is there. It was in the summer of 2000 where I met with you Roger to discuss where this reservoir was going to go and it seems pretty obvious that it has to go in the El Camino Park and in the intervening years my reaction to this project is varied from impatience to loss of interest. That latter option not being available to you. It seems to me that at the end of the year 2006 the best location for that reservoir is still El Camino Park. Jean McCown on behalf of Stanford sent a letter to City Council saying that the city staff had certain sites they wanted El Camino Park but Stanford preferred another site. Stanford suggested that their particular site be evaluated specifically in the EIR we chose to look at all of El Camino Park in the EIR without any site specific reference. Is this going to be resolved? Stanford owns the land.

Have there have been recent discussions, is there some resolution to the issue as to where in El Camino Park this might go? If any of this is in appropriate at this time you could tell me that but I just want to take advantage of the opportunity that you folks are here.

Tomm responded that there has been no resolution. We have talked to them about the options in the Park but they still have a preference but we have not made the decision as yet where we are going to place that in the Park at this point. We have been looking at issues with the money and land lease and other issues are still to be discussed and how much land we are going to need. These issues are still on the table. Rosenbaum continued that even if an approved DEIR we are going to be here for another six years. Roger may be gone by then but the project will still be here with us. This all sounds discouraging to me and it does not seem to me that we are rapidly approaching closure here. These are my comments.

Tomm said that we made some progress. We got through the EIR that is a great accomplishment. Melton said that he is very pleased that we finally have this document at the table in front of us. He has not reached the point of loss of interest. I really want to move it forward expeditiously. Unless any one has comments or questions, I think we are through with this topic and if there is anything and what we have asked or said that you want to forward to the Planning Commission please draft it up and let us take a look at it.

ITEM 2: QUARTELY REPORT:

WATER

Jane said she is here to answer any questions on the Quarterly Report. Melton said he has a question not on the Quarterly Report, it is a follow-up on something we talked about at the last meeting in October on the Recycled Water Project. New buildings and dual plumbing systems for new buildings, you were going to a meeting with the Planning Department to discuss the subject about the ability to use wastewater for flushing toilets in new construction. What came out of that discussion? Jane responded that it was a meeting to set-up a multi-departmental group to work on the Ahwahnee Water Principles. That group meets for the first time next week. We are talking with Planning already and they have incorporated many ideas from the Ahwahnee Water principles in their zoning ordinance. There are some other areas including potentials to possibly require dual plumbing in large projects, but such a decision would be decided by the Council.

Dexter talked about the WSIP PEIR and it certainly seems that growth is going to be the hot button here. Who make the decision between the alternatives; does BAWSCA get a chance to weigh in on these recommendations? Should Palo Alto or can Palo Alto make recommendations to BAWSCA concerning which recommendations we prefer in the PEIR?

Jane answered that there is not going to be a decision made in that document. The PEIR describes the environmental impacts of all the different alternatives. The decision about which way to go, BAWSCA will participate but it is the City of San Francisco system that will certainly weigh in. Palo Alto can weigh in as well. This may be an issue that is addressed in the new water supply service contract. SFPUC sent the project objectives to its Planning Department in advance of preparing the Program EIR and one of the objectives was to meet all of the customer demands to 20/30. So if they chose an alternative that did not meet the objectives that would be interesting. They would have to justify that. From that perspective, BAWSCA would certainly be involved in making sure that those objectives did happen. One objective that BAWSCA was not happy with and did go forward into this document is the amount of water that would be available in a drought. The PEIR will look at both 20 percent cut back system wide and a 10 percent cut back system wide but SFPUC's level of service goal is a 20 percent cutback.

Dexter asked about residential per capital water use. If Palo Alto has the fourth highest per capital water usage for single-family residential customers, and the highest per capital water usage for multi-family. Multi-family does not have any yards so is there anything specific about our multi-units. Jane responded that she does not know why Palo Alto is higher than others. Bechtel asked if it is an opportunity for us to go in with some conservation issues. Jane said it is, and that it pointed more towards landscaping. Bechtel also had a question on the reliability impact measures. Everything is within one hour or four hours. When you fix something, it might take 2.8 hours or so. Are we just plugging numbers in here just to get the chart done? There is too much coincidence. Tom Auzenne responded – it may be just a human error. In answering that if it is less than 2 hour or less than 4 hours or less he would check on that and get back to them.

GAS

Dexter said there was a calamity in September/October when the Calgary Speculator crashed and prices came down quite a lot. I hope we are filling our 06-07 contracts that we haven't yet firmed up to 100% and now see that we still have 10-15% unpurchased for this winter season and it seems like that was a heck of a good time to top of. Girish responded we still have some more to buy hopefully in April – June period and our load is also relatively low as you conceive from the chart. The prices went down in that one month to about \$4.80 it wasn't just because the trade, it had to be with the hurricane season that was anticipated not actually showing up record levels of storage. It is the highest level of storage going into the winter season in the last six years or so and a drop of in industrial demand nationwide. That knocked it down. However, next month it went up 73%. This is just for the bid week. The prices out into the future were not showing the kinds of changes that prompt month were showing. Dexter wanted to know if it is our policy to save like 10% of our expected use in any particular month to buy just spots so that we are not over-committed. Girish said that the target basically between min and max is about 82% where we tried to be pulse or minus. There is some spot market exposure that we take and right around this time within the next couple of months we looks at the next year's budget and depending on what our next revenue risk is over there would probably come back to the management.

ELECTRIC & FIBER

Melton referred to Page 5 and wanted the update on the NCPA RFP. Girish responded with a brief overview. Responses were received totaling about 17 proposes for a total of about 770 megawatts and the majority of the power was from Wind proposes, we even had 5 megawatts a proposal for tidal energy, few solar proposals and a couple of bio-mass proposals. A couple of member representatives from each of the cities on the power pool are working to evaluate it right now and we have one of our staff members on that team also. So as the proposal get vetted they will be brought forward to the NCPA Commission and prior to that we have done our analysis here so that we can provide information to our NCPA Commissioner.

Bechtel had a further question: We are having a number of new housing units built in Palo Alto over the next couple of years. Are we doing anything to push renewables, like solar? Tom Auzenne answered. We work fairly closely with the Planning Department and we make

available to them the programs we have in place. One of the things we are looking forward to is the greater emphasis on new construction programs with probably higher levels of incentives. Everybody goes through a budget; we have no mandate or legislative solutions for requiring them to install renewables. Valerie added while my recollection may or may not be accurate, I believe that these \$750,000 additional rebates for solar photovoltaic installations the increase in the request is partly due to new development. Tom Auzenne referred to page 9 of the Attachment C quarterly electric/fiber issues SB 1 deals specifically with solar and we are in internal conversations about how best to implement the provisions to go forward. Bechtel said that on Page 10 SB1 implies that it prohibits using PB funds for PV and I think that's were we had funded our photovoltaic subsidies before is that correct? And is that the reason why we need the \$750,000 request out of the regular reserves in to in effect the PB fund pot and is this a one deal or is it going to be every year we are going to be nipping away at our electric reserve and having to subsidize solar panels out of our regular reserves. Tom Auzenne said one of the provisions of SB1 is that you cannot take away from your current efficiency efforts. When you have competing legislations because the electric PB funds was enacted in 1998-90 so that had a renewables component to it. This is another renewables mandate from the State that will be stacked on the top of it. We are looking at cost-effective renewables as an offset to supply purchases now. This is another piece of legislation that Girish could talk about. State legislature has been very busy. Valerie added that Commissioner Dawes is absolutely correct to know that by design Senate Bill 1 does specifically preclude us from using PB monies and as Tom Auzenne said in working with Girish here we will be building that into our portfolio costs. Bechtel said there has been a state mandate to set aside like nine tenths – one percent of revenues into the PB funds this in effect is saying you got to increase that somehow. Valerie continued we have 3 million dollars across the state and we will have our share of that amount of monies that we will be in essence expected to spend for solar. Rosenbaum made a comment that city can put in as much money as it wants but it is only a small part of the total costs. There has to be a private party that is willing to put up the rest of the money if that private party does not exist by then our monies will go unspent. Valerie said that it is absolutely correct. But the intent is certainly there.

Dexter referred to bottom of Page 1 it talks about the potential exposure four and a half million dollars a year – it is the requirement to buy additional capacity to conform to CASIO's addiction to

good reliability has this been built into our long range financial plans before? Girish said 'yes' It may not have had this particular label. The specific label of local capacity but these costs essentially have shown up pretty much the same kind of magnitude in either a label which we would call reliability service charge or congestion costs.

Val said that if you own a generating unit you have debt service behind it is because you built it. You made a capital investment in it. On an on-going basis you will buy fuel, you will pay to own and operate it and you will recover that as you generate because you are either selling it or you are using it and there is an intrinsic value in the fact that you are running that plant. Now that the fact that the plant exist – that is kind of your equivalent of capacity and in the past there was no market here, no liquid market in California for this concept of capacity. People built into their energy bills. Now they are separating the two and plant owners obviously want to make sure that they are recovering all the cost but the running cost to actually generate the kilowatt hour and to own that plant. We now as the purchaser in the market have to pay for both those types of units for purchasing in the market and the ISO is determining the rules which determine the amount that we need to purchase or have locally. That is really going on here. Girish if I have misspoken you will step in. Dexter said that we are also a generator ourselves, so by virtue of Calaveras – we are receiving payments of this nature as well. Girish said that Arma units are designated units that ISO selects. So they do studies every year of the system all of California and then they designate specific units and enter into negotiations to sign a contract with the unit owner.

Attachment D: Financials.

A. Electric.

Bechtel said that we had a meeting three months ago or so in which we had discussions over the sources of these numbers. With Mr. Yeats being in charge for the numbers for the city, he brought some points of SAP. Table II for example the source of these numbers through the official numbers generators or are these like old days where you to satisfy our needs to have a financial picture calculated some numbers can you give me any insights into this?

Tom Auzenne said that these are real official numbers. These Accounting Department numbers match, Carl and Van Orsdol numbers have all been reconciled. We all agree on the numbers. To

that extent the numbers you see are consistent and accurate. Some of the accounting audits we discovered when you get to the gas you will see that in Carl's report there is a potential negative impact on the gas reserve with a minus 1.8 million dollars. The reason for that is from the accounting standpoint they booked all the encumbrances and everything else at the beginning of the year but they don't book all the revenues at the beginning of the year so that minus 1.8 million dollars will probably turn in positive by the next quarterly report that you see. It is an audit that we are trying to work internally to address it, to make it more understandable for you. Bechtel said in Table III I see that you have estimated FY2000-07 you are taking into account anything? Tomm responded to make it a little more understandable it is rolled in the embedded numbers.

Bechtel looked at Table III.

I see here you have estimated FY 2006-07 ending balance this is on reserves balances. You are taking into account anything that is booked at the beginning of the year that might make any particular month or quarter look bad but still what you are expecting at this point for us to end up at the end of the year for example 63 million for 86 compared to the supply rate stabilization reserve 569930 is that right. You are projecting the year end if everything rolls along the way we expected during the year.

Tom Auzenne said at the snap shot in time it is 'Yes'. Bechtel said this is an official number. In the end Carl will agree that this is how he would expect it to be from the Budget Department. Tom Auzenne said that Carl would agree that it is as good a number as it is possible because one of the other things we do in there is that we throw in our guess estimates under projected activities. Today to the extent that our estimate is correct, he would say that the final number is correct because if you subtract one from the other. As far as the projected activity, this could change. Melton said as time goes on you got more actual and less projected. Tom Auzenne said one of the things that he should also point out is that he would probably get questions on a little bit later but he might as well address it now. Now in the front page of Attachment 'D' it also says significant changes may take place to the balances because of what we don't know. One of the things that Carl brought to your attention maybe three months ago if memory serves was retiree medical cost. At that time we did not know the potential impacts because they were still working with the internal city auditor, external financial auditors, and the **actuaries** to sit out there and work it out, they finally got that worked out. The net impact will be an impact on utilities over a three year period to catch

up to where we should be and then after that it is maintenance mode. They are going through the process now to close the books on FY05-06. The first year of that retiree medical impact will be FY05-06. We have already taken essentially a two year hit out of functionally the reserves. The Adopted Budget beginning balances on these reserves have been restated from whatever you saw last quarter to reflect the hit from FY05-06. The hit for FY06-07 will be on the back end of this or they may have taken out already. Over all utilities that represented about an 8 million dollar hit. One of the problems we had with the gas reserves, going back to KVO's number in the negative 1.8 million dollar is essentially we had two year retiree medical hit on what was a reasonably healthy balance. We are not quite broke yet, we have absorbed that cost and we will go forward. Tom said he has full confidence in what you are seeing before you.

Rosenbaum said to Tom that it appears that Utilities have been asked to essentially make up unfunded liability over a three year period? Tom responded that he is not exactly sure. On a prorated FTE basis, the utilities portion of the unfunded retiree medical plan will be made over a three year period and then we will be contributing our portion going forward from there. Valerie said that for clarification the same holds for the general fund. It is the same standard being across the board. Rosenbaum said that the General Fund Department cannot afford a hit of this sort and he assumed that they would attempt to pay off this liability may be over 20 years is somebody sure that the budget for the next year for the General Fund will be out of balance if it is 4 million a year for the utilities how much would be for the rest of the city, and the city is not in a position to take it out of the budget that is why I was curious why the utilities numbers are so high as they seem to be. Tom said that his understanding is that the way the monies were working, is that we were actually behind the general fund on contributions. Everybody is going to be in lock step after this three year period. The three year is just a catch up whatever was in the rears in the past.

Dexter assumes that this is recognizing a liability which had not been recognized here for us. There is no cash impact here it is simply a reclassification on the right hand side of the balance sheet and the liability site between equity or reserves in our case to a long term liability so that cash wise we are not talking about any difference here. Tom said we are out of pocket 8 million dollars. Dawes said that this amount is actually funded; we write checks for amounts that won't be due for 20 or 25 years? Tom said it goes into escrow account. Dawes said it is unusual to have it

funded if that's the way the city does it that is fine. Valerie said that San Diego had problems because they did not fund it. I think this is a standard. All cities have been required to do this. In fact we had some bankruptcies because it wasn't being done. Tom said that there were changes to GASB 43 and 45 that required all of this. I think that there is a city on the Peninsula with an unfunded liability probably pushing billion of dollars. So it changes from the standards vote.

Dawes I also said that in Table I net retail sales you combine both. You combine supply and distribution retail sales and the retail purchase cost is only the commodity cost. So basically you are adding the sale dollars and no cost to Table I and I do not see any reasons to have Table I because when you add together the distribution and commodity sales and only deduct commodity purchases, net margin doesn't mean a whole lot because you do not have any cost involved with the distribution side. I think Table II addresses that we separate out the electric net sales, the distribution net sales, and then you apply the cost for each of the ones and come up with a equal total I call the margin after all of the cost which shows the electric supply instead of having an 8 million dollar margin as a 4 million dollar loss it is quite a different picture. My suggestion is to omit Table I. It does not add anything to it. Tom said the original rationale for Table I is to sit there and separate out the retail side of the business versus the entire business because on Table II there is surplus energy cost, surplus energy revenues and those are reflected in the wholesale market. So what we are trying to do is to give the total picture of utility business here in Palo Alto. We can certainly revisit that and take another look at it. Bechtel said just disregard the operating margin calculation because that is really not an operating margin but the other numbers are useful just don't do the arithmetic and show that as an operating margin and include the 4 line items above it that is useful information for status. Tom said if that is the sense of the Commission it is done.

Melton had a question on Table VI. I am wondering if it is a labeling problem. I do not remember. The bottom line is where the number is 6266 is labeled as the maximum guideline. If that it is the maximum guideline given that the estimated ending balance is well under that my question is what is the minimum guideline? Tom said it is 50% of that number. One reason is lower gas sales in the beginning of this year and in some of the data you will see that they have only recorded three months from the first quarter of the revenues which is causing us a little problem we will address that. The other part was the two year worth of hit on retiree medical that was a significant impact

on the gas distribution reserve particularly. Melton said one of the things coming down the pipeline is a mid year adjustment in the water rate and that has been...Lucie said we are not projecting the water rate adjustment in mid year this year. We are re-evaluating the gas revenue in the mid year. We are not going to change rates in January. Melton said we were discussing a mid year adjustment for the water rate but it got held up because of this Big Horn decision. My question is as a result of all of these factors and given what is going on in the gas reserves has there been anything in the adjustment on gas rate. Dawes said that the UAC recommends to the Council that a rate adjustment be made in the gas for this year and I certainly think that there is plenty of precedence for that in the past mostly driven by exchanges in supply cost rather than by volume as it appears to be as much volume driven 10% percent less volume through the system as anything but it is equally valid reason for doing so but we would be delighted to hear the reasoning of staff saying 'No' it is not the right thing to do. Tom said it is because there is a gas supply reserve and gas distribution reserve. Gas supply reserve is sitting somewhere around 6 million bucks which covers our risk exposure to market prices. There is only 60 percent of the minimum however. It appears to cover whatever potential exposure is given. The last time I looked at it the prices was 80 86 cents per....that appears to be comfortable. The Risk Manager will probably will have an issue with the gas distribution reserve but given the likelihood of a significant event on the gas distribution requiring a significant inclusion of cash we do not see if there are other options to. The other options are we can borrow from other sources. Dawes said that every fund stood on its own and any cost subsidization is absolutely not allowed. That is true Tom said but we can borrow from the general fund and pay them back. I am not thrilled but I am not sweating.

Water: Tom said what we originally anticipated doing was to do the mid year budget adjustment which just changes our budget projections, mid year projections to be in line with current reality. We are still flogging a little bit through the Big Horn decision and the immediate impact deals with the process rather than financial. It is going to be notifications and calendar issues. No water rate increase is anticipated at this time.

Fiber: Dexter said Fiber is doing great. Business should be expanded. I talked about this many times in the past. It is obvious to me that it has paid back the initial advance that paid for the initial system. Projected profits of 400 hundred thousand dollars and I would love to see a plan to

expand this into a fiber program. I do not expect any answers to that but it is an editorial comment. We have an expert on communications program sponsored by cities some good some bad but at least a wonderful expert at our end I do not commend that this little business is a nice start to doing something.

Tom said we are making some significant progress in fiber. We are coming out with new marketing materials; we are expanding the sales force functionally by about 400 percent. We are working closely with the City's Attorney's office to shorten the 2 ½ pound contract and we are making a good progress there. We are coming with new back office processes, procedures. We have clarified and simplified our rate and pricing structure. I hear your enthusiasm for this. Give us about 12 – 18 months. Rosenbaum said that he seems to have different recollections on a number of topics this evening. The last time the Fiber Manager was here I think with some discussions we agreed that the budget looks good as it did because we hadn't paid of the initial capital investment and I do not know how this shows up on this Table. Tom said that the repayment schedule has been amortized over X number of years. I do not recall what it is now but we are making payments to that effect out of our gross revenues. So it is a viable growing concern. Dexter says he was talking about the size of the reserves fund approximating our investment. You have reserves to the size equal to investment that is my interpretation.

Tom said that there are number of things that we are investigating going forward now. One is the reinstatement of a minimum monthly charge to take care of the distribution cost on water. That would probably change the overall pricing of the commodity and probably result in fewer sales. The other thing we are considering is adding another tier to the pricing not necessarily to make it punitive but to sit there and send accurate price signals because with the anticipated changes with the San Francisco Public Utilities Commission (SFPUC), we are going to have higher prices anyways. There are some pricing initiatives under study.

Melton wanted to know what kind of a tier arrangement Tom is thinking about. Tom said just adding another tier for very large water users to increase the cost to them. We did not have to do with electricity because of the nature of the wholesale cost but going forward with water if we could sit there and install a fixed month recharge it will take care of our distribution cost. Because low

water users are being subsidized by high water users. So that might be one of the effects that leaves us at the highest category in another section among BASWCA and BASWCA users because there is no incentive for there is limited incentives I should say for conservation even with our high prices.

Last page of the financial is CIP Reserve balances and I note that those reserve balances going to decline from a couple of years ago when they first came to our attention and we started asking questions why they were so high and I see it making good progress in bringing them down. There is money in the water CIP reserve balances that since we have set aside for that but are totally inadequate for what we are now facing and it seems to me that one of the issues that we have to address is not only the technical choices of how to do that project soon as we move forward on it but how we are going to pay for it. I am sure that it is something staff of the city has been thinking about and I would be delighted to hear your thoughts. We have 10 or 12 million dollars in the bank for this project and the current estimate because of the passage of all this time we have been flexing around with this thing it is now up to 20 million dollars or better and we don't even know yet what the land lease is going to cost us. We have to think about some pretty substantial change here. Tom said because of the final recommendation, we do not know which set of recommendation and at what cost we will be coming forward part of that is going to be financial plan.

Tom Marshall said some kind of bond measure something will have to be done for the reservoir. I think at least 10 million dollars will be needed. I think there are only about 3 or 4 million dollars actually in the CIP which is accumulation of bunch of different projects that have been approved by the Council. Funding for the Reservoir itself was not approved by Council and so there are no funds set aside. Valerie said we will bring this all back when we know a bit more.

Meeting reconvened after a brief recess.

Next Item:

Quarterly Risk Management Report:

Basically in summary you will see from the report you will see they are all within credit limits there are no exceptions to report. Our total net market value for all contracts is now about 23.3 million

dollars for the next 12 months. The month to month value of our fixed electricity contracts is down from 15 million to 11 million. Credit exposures continue to fall as a result of the decline in size both electricity and gas prices during the quarter. In fact for gas prices this is the third quarter in a row we had a decrease in prices and the value of the risk of unpurchased portion of our portfolio having higher cost because of increase in prices. Prices remain very low for electricity and it is gone down significantly for gas. It is still above 10 percent of the supply reserve benchmark for gas but it is moving in the correct direction. Supply reserves as you see are doing very well for electricity. They are below the established policy reserves for gas but are essentially sufficient for the next 12 months for risk exposure. We have had over the course of the last couple of years a continuing decline in the gas supply reserve and at this quarter it has finally turned around. We reached the bottom of the end of the fiscal year in June when we went down to 2 million. We now see it moving up in the direction that allows us to cover the risk. To summarize the reserve assessment, currently reserve balance is 61 million. Required minimum reserve under the current policy is 29 million so stock doubled. 12 month risk exposure is estimated about 24 million dollars that is all the risk market current hydro legislative regulatory risk. On the gas side we have current reserves for 3.9 million almost doubled the 2 million that we had at the end of last quarter. Under the current policy guidelines the minimum required is about 10 million so we are still significantly below it. But a 12 month risk exposure is currently low now in part because we purchase quite a lot out in the future prices are down. So our 12 month risk exposure is the lowest it has been in quite a while that is 1.7 million dollar. As you will hear after me from Jane that the middle office, front office are working together and have come up with new guidelines for setting targets each year for the reserves based on risk. We will continue to do these quarterly monitoring instead of using just a straight number we will actually set up a target for each year. This is end of my presentation.

Bechtel said that in figure 2 forward purchases. It looks like our long term contract is going to be with Coral. The other Sempra and BP are going away any specific reasons for that? How many total suppliers do we have? Because I know we buy spot market as well. KVO answered that the Coral forward purchases are the result of one purchase that was made in 2003 going forward until 2009. There have been no other long term purchases. That was purchase made at 35 dollars megawatt hour; that is significantly below market. Currently as you can see from Fig. 2 you only

have three counter parties that are bidding actively on purchases most of it is taken by Coral contract. As you remember we had Duke in the market for quite a while but they of course pulled out of the market. We are currently in the process of negotiating a new round of energy master agreements and gas master agreements which should result in at least doubling number of counter parties for both gas and electricity. Gas will be coming to the City Council in January and Electric in February. Bechtel wanted to know if KVO in the risk assessment if he include the supplier base in terms of number of suppliers particularly in industries that he has been associated with, always like to have multiple suppliers not necessarily because of pricing although that was 80 percent of it. One of the suppliers he was sole sourcing and they had a problem, you were in trouble and I think that would be part of your risk assessment although I do not know how you would quantify it. KVO answered that he looks at the base of different counter parties. When he assess what the credit risk is I take the largest mark to market exposure for any one counter party especially when it is so diversified. We had one very large counter party exposure and two small ones and he takes a 50 percent of that market exposure as a credit risk. Because in any default you will find you get 50 percent fixed on a dollar back. It is extremely conservative approach. But most of others I talk to in other industries, Monte Carlo Simulation, they look at more than one category going to defaulting because the risk of our counter parties defaulting is so very low. Coral has a default rate of about 2 ½ thousand in the next 12 months. It is the best to take the largest one. He continues to look at Coral Energy very closely on a very continual basis and they remain financially strong. I would like to see greater diversity as we are moving towards that with the new master agreements.

Dawes said that he was having trouble between figure 2 and Table II. Table II shows Sempra going out to 2010 and Coral going out in 2009. Sempra stops in Jan 2008. KVO answered that Figure 2 is electricity and Table II is gas. If you turn to Page 10 on my report figure 7 you will see that both Sempra and Coral do alike. Dawes said that Shiloh project shows negative on MTM his recollection is that the city has said that it would pay up to half a cent more up to market for environment power like wind power and I assume that this is your conventional mark to the regular electricity mark without any bearing that it is green power and we sell green power more than we do regular power but this is just marked to the regular power. KVO said it is marked to brown power. Dexter said we were under water when we signed the contract because we paid more then the market at that time. KVO explained that we have to realize that high winds the first project is

109 thousand dollars as a positive mark to market. We had a better price for that. As there is an increasing demand for renewable energy in California we are forced to pay slightly higher prices and I would expect that trend to continue as there is a greater demand for renewable power. In some above market rate we are paying for all this power is 11 thousand dollars which is well within the half percent.

Rosenbaum referred to Page 4 the first sentence says that the total current value for the City's electricity and gas contracts that is total mark to market? KVO replied it is but because we have limitations on Western on selling Western if you will it is not probably appropriate to call a straight mark to market like you would for a Coral contract. If we could sell our Western power for 21 million dollars I would have just called it Market value. For that and for Calaveras is taking out the cost that we pay. It is revenue minus our cost to the two organizations for that power. Rosenbaum wanted to know if we have included Calaveras and Western in the past or is that new? KVO said that the whole table is new. He wanted to put up front an overall view of the portfolio probably a little more simplified terms when we have in the first two tables. He put up the overall value but now he is including the cost associated with those resources as well. Rosenbaum said when we talk about risk we understand the risk with the long term contract and Coral promised to sell us at 36 mils and we have to go out and buy it at 60 or 70 so that is a risk. KVO said that he pretty much historically talked about fixed price contracts. Clearly as we diversify more he wanted to put together Table that summarizes where we stand in relationship essentially all our counter parties just not fixed price counter parties but Seattle, Shiloh, Calaveras and the others. Not really talk about risk but talk about the value of the portfolio. Rosenbaum said he has trouble considering Western and Calaveras as counter parties in the usual sense. KVO said whether they are counter parties it is different in that Western is definitely a govt. agency but we need to pay fees to get that power and that power has a value. Valerie asked Rosenbaum if he had any suggestions how we would represent this differently. Rosenbaum said that was confused how you might do. Calaveras we own and if there was a large earthquake we wouldn't get any energy from it that would be a problem. I expect we have to continue making the bond payments. Valerie said it might be a bad hydro year another scenario. KVO said we of course take that into consideration when we look at the hydro risk.

Dawes said that he has a suggestion – think about it amount by which our resources are above or below market and Western is a resource that is below market cost us less than market price. The gas contracts work very slightly above market so rather than calling it mark to market call it the sum of the cost of our resources versus the market price given at any given time. Is the Calaveras 10.7 million dollar cost inclusive or exclusive of the amount we take out of the reserve KVO? The 10.7 million we give to Calaveras is not included in the hydro risk reserve estimate.

Jane Ratchye's presentation followed the staff report. – In September, the Finance Committee directed staff to work with the UAC on the Utilities Emergency Plant Replacement Reserves (EPRRs) and the Rate Stabilization Reserves (RSRs). The EPRRs were set-up by City Charter with the stipulation that the maximum level of those reserves cannot be more than five percent of the net book value of the fixed assets for that fund. In 1988, Council added directives that: 1) the annual funding to those reserves should be about five percent to the annual increase in the net book value and 2) the balance of those reserves should be able to cover the cost of the most expensive item in that utility that, if taken out of service, would result in a loss in utility service. The City's insurance policies also cover some disasters. The City's liability insurance has a one million dollar deductible currently. The City Charter sets the maximum for these reserves. All of these reserves are under that maximum so we are in line with the City Charter. Staff is recommending that these reserves have a minimum level equal to the greater of: 1) the deductible for the city's liability insurance; or 2) an amount that would cover the cost of the most expensive piece of equipment that would need to be repaired in order to return utility service forthwith. Under staff's recommendation, the Wastewater Collection Emergency Plant Replacement Reserve would need to be funded to meet that one million dollar minimum. Do you want to pause here and have any questions on the EPRRs?

Commissioner Dawes asked about overlap between the EPRRs and the distribution reserves. Ratchye noted that the EPRRs are meant for something where the money is needed right now because something just broke that needs to be replaced. Most of the reserves are significantly below the maximum levels from the City Charter since Utilities does have distribution rate stabilization reserves in all the funds. The RSRs did not exist at the time of the City Charter.

Commissioner Melton noted that for the Wastewater Collection EPRR, the most expensive item could cost five million dollars to replace, but the staff report says that the cost would only be one million dollars.

Ratchye noted that staff struggled with this because it is hard to imagine that somehow the entire 42-inch section that would cost five million dollars to replace would disappear without being caused by an earthquake, that is covered by FEMA, or there being a liability issue that would be covered by our liability insurance, or something covered by our property insurance. Staff could not come up with something that was reasonable, so we estimated that a reasonable number for repair would be the one million dollars.

Ratchye then discussed the six Utilities rates stabilization reserves (RSRs). The RSRs were established in 1993 and they are to finance extraordinary one time contingencies to cover increased operating costs in short run and they are supposed to allow rates to gradually increase over a reasonable period and that is how you have seen them being used over the time you have been on the Commission I am sure. They are not to solve long term financial problems or to cover major catastrophic disasters. The reserves should be allowed to flow up or down with levels generally between the minimum and the maximum guideline based on the assessment of the financial risks of facing the whole Utility. The intent when these reserves were established is to review their adequacy annually. Staff is not recommending major changes in the minimum and maximum guidelines for any of the rate stabilization reserves. The new element is to require an annual risk assessment for each fund as part of the annual budget and retail rate setting process. The risk assessment would be used to develop the target level should be for the RSRs. The ranges for minimum and maximum that we have now should capture the risks that we expect to see. Risks assessments have been done in the past, but not necessarily annually and the results have not necessarily been made public.

Commissioner Bechtel commented that, from a practical point of view, the maximum is not as important as the minimum because the minimum is the one you really feel, bottom line, you should have that money in reserve. We should not be quibbling about too much maximums.

Commissioner Melton observed that the annual risk assessment should lie between the minimum and the maximum levels, but in the past, the reserve levels have gone below the minimums.

Girish Balachandran, Assistant Director for Resource Management noted that the risks need to be looked at for the long-term. For example, given our hedging strategy, we tend to end up being lower than minimum for the prompt 12 months. But, for the second and third years the risk exposure is substantially more. The annual risk assessment is the time when we get the dialogue going on rates and that connection happens and so the timing of this is right. We do not have a hard and fast rule as to how much we are going to hedge. It seems that the common sense approach would be to look at the real risk exposure for the rate period in question and calculate rates based on that.

Commissioner Melton agreed with this approach, but noted a certain degree of tension and uncomfortableness if that annual risk assessment is below the minimum guideline and we are not setting rates to at least keep our reserves at the minimum guidelines.

Ratchye noted that these are guidelines and not policy. Even if reserves have been lower than the minimum for a single year, you will see the levels in the longer-term view climbing up above the minimum.

Commissioner Dawes agreed with Chair Melton. He also is concerned when reserve levels are below the guideline minimums. In addition, the risks on the electric side are highly dependent on hydro availability, which is not known with any certainty at the time of budget development.

Balachandran noted that this is what's been done for last several years. For electric, we look at two hydro years for coverage on our reserves in an attempt to accommodate the volatility of that key assumption. On the gas side, the laddering strategy for the first eighteen months has a minimum of 60 percent hedged and a maximum of 100 percent. In the last few years we are hedged at 80 percent or so. That is why the risk exposure that you see has been below the guideline. But we could actually be hedged at 60 percent so the risk exposure could be much higher.

Karl Van Orsdol, Energy Risk Manager, stated that the first time this is done, we will do it with a lot of detail and a lot of explanation as to why we have chosen the risk approaches that we have. As Girish said we need to do two years for hydro, you are using the prompt 12 months for which there is actual data and then using the model for the following twelve months. It is much more conservative approach then doing it for a twelve month period.

Commissioner Rosenbaum commented that the section from the City Charter was interesting. The Charter does not seem to contemplate the rate stabilization reserves we now have.

Ratchye noted that not everything we do emanates from the Charter. Balachandran noted that there are other reserves established by the Council which are not written into the Charter.

Commissioner Dawes stated that he is comfortable with the proposed guidelines. If we come up to real changes in the risk assessment, we may have to adjust the reserves, but not the guidelines. So we really have to adjust the dollars and not worry about tweaking guidelines.

Commissioner Dawes move that the UAC recommends the staff recommendation in Table II for revision of guidelines with the exception that when the target reserve is below the minimum guidelines that the assumption used are the most conservative available to the particular utility.

After discussion, Commissioner Dawes agreed to change "most conservative available: to "an appropriately conservative set of assumptions."

The motion died for a lack of a second.

Commissioner Rosenbaum moved staff recommendation. Commissioner Bechtel seconded the motion.

Commissioner Bechtel noted that the risk assessment means more than the minimum and maximum guideline levels. In the budget process, we can discuss the risk assessment.

Commissioner Dawes indicated that he supports the motion as he has great confidence in staff to envision circumstances in the market.

Commissioner Melton was still not comfortable with the Emergency Plant Replacement Reserves since it doesn't cover the cost of the most expensive item for the Wastewater Collection fund.

Motion passes unanimously.

Respectfully submitted,

Jennie Castelino

City of Palo Alto Utilities