

UTILITIES ADVISORY COMMISSION

MEETING MINUTES

July 7, 2004

I. ROLL CALL

Commissioner Rosenbaum called the meeting to order at 7:05 p.m. in the Chambers, 250 Hamilton Avenue, Palo Alto, California.

Present: Dick Rosenbaum, Elizabeth Dahlen, George Bechtel, Dexter Dawes, Mayor Beecham and John Melton

II. ORAL COMMUNICATIONS

None

III. APPROVAL OF MINUTES

Motion: Commissioner Bechtel moved that the minutes from June 2, 2004 with the correction made that the reference on page one to the "New Dawn Pedro Dam" should be Don and not Dawn . John Melton seconded.

Motion Passed: 4-0 Dawes Abstained as he was not present at June meeting. Dawes asked about beginning sense minutes and mentioned that this may be on a future agenda.

IV. AGENDA REVIEW AND REVISIONS

No changes to agenda.

V. REPORTS FROM COMMISSIONER MEETINGS/EVENTS

None.

VI. DIRECTOR OF UTILITIES REPORT

City Council approved the budget including rate increases in gas, water and electric. The overall effect to the average customer is about 8.4% including the refuse cost that went up. Normal \$200 bill will go up to around \$15-\$17 increases to each customer.

Council approved electric to be effective January 1st.

Execution of Council approval of energy block purchases. As of June 30th, staff 360 giga watt hrs at \$51.76 megawatt hour. Will give update at quarterly meeting.

Tariff bill for services from PG&E, we've been protesting. 1998 April-Aug 2002 – we lost decision at FERC – now obligated to pay \$8.5 million for past services. We will be paying about \$700,000 a month next 12 month period. We will be depositing money into an escrow account and will be parceled out after we've completed further litigation. This is currently being discussed with our external auditors.

Council approved the feasibility study for local alternatives. Interdepartmental training is being developed to have a good understanding of legal and environmental requirements before we look at sites. We're also developing public outreach plan.

Dawes asked about PG&E, FERC decision. Free to discuss any appeals or is it confidential? Ulrich explained the escrow account; expect to have appeal through NCPA through FERC, which may result in court.

VII. UNFINISHED BUSINESS

None.

VIII. NEW BUSINESS

1. UAC Elections

Motion: George Bechtel made the nomination of the Vice Chair, Dexter Dawes as Chairman for this upcoming year. Seconded by Elizabeth Dahlen.

Motion Approved: Unanimously.

Motion: Chairman Dawes asked for nominations for Vice Chairman for the Commission. Rosenbaum nominated George Bechtel, seconded by Dawes.

Motion Approved: Unanimously.

2. Fiber To The Home

Ulrich introduced Joe Saccio who as the leader of looking into financing options. Blake Heitzman was also at the table to answer any questions. John stated it is important to come back with the latest news on financing options. Utilities has attempted to answer questions the UAC had and also sent questions some City Council members asked at the last Council meeting and through emails we've received.

Joe Saccio explained highlights of information to summarize additional information we did on finance options. Looking at other communities. State staff recommendations on what to do from here. Option A: don't have a lot of information to compliment what we had last time, legal constraints prohibit us from pursuing revenue bond backed by Utility. Couldn't use rate payer assistance to back subsidies. Option B is discussed in the CMR which appears too costly. Option C appears to be not viable and revenue certificates of participation with private placement would be too costly. Financing (Option A) through Utility Revenue Bonds backed by the Electric Fund is not viable since ratepayers would be paying for a benefit they may not receive. Private Placement (Option B) is too costly and does not provide required funding. Certificates of Participation (Option C) backing of General Fund is not viable and Revenue Certificates of Participation with private placement is too costly.

FTTH Financing in other jurisdictions – number of municipal jurisdictions have implemented or are currently implementing FTTH project financing. These include Truckee-Donner PUD, Alameda, Lompoc, Utopia Consortium, Provo, and Tacoma. Approaches for these projects are summarized here. We've been looking at how to come up with a viable financing method. There are no cookie cutter approaches. We've heard that there is a city on the verge of getting help but we don't know what city that is and there is no track record there.

We came to the conclusion that doing a bond financing would not yield the \$32 million in capital costs or provide for \$8 million initial operating costs. BAN's could range anywhere between 7 and 15 percent. Will be based on different variables on what their interest rate would actually be.

Conservative approach to financing, we believe that some of the assumptions we've used are very reasonable. Palo Alto has always taken a very prudent approach to financing. We take conservative approaches when we do Capital Projects. City has a low debt ratio. Looking at more conservative numbers where we do have more questions, we are not recommending moving forward at this time. We recommend sitting back for a while and monitoring other jurisdictions and continue FTTH trial for 12 more months with Council review.

Commissioner Dawes stated questions from Commissioners would be addressed.

Melton asked why continue FTTH for an additional 12 months? He thought we had achieved everything we needed to know which were mostly technical not financial. What more would we learn by continuing for another 12 months?

Heitzman said we are in the position of council having approved indefinitely until we decide if we are going to go through with FTTH citywide, so moving to a one year time line is more conservative. On an annual operating cost basis, the trial is paying for itself. This does not include the initial construction costs, trial fees will never pay that back. There is much value in additional information we can learn (i.e. testing and incorporating different types of equipment) and there are other bits of information to learn about, test, try. There is value in the research.

Dahlen asked if the trial had met the objectives that it was intended to meet?

Heitzman stated that one objective is to learn technique for setting equipment which is constantly changing so we've met that objective, but we are constantly increasing our knowledge base by having the installation to work with.

Rosenbaum wanted to know if participation is continuing at the original level or if we've lost any from the original trial members.

Heitzman responded that this has to be cash flow positive to continue operating. If at any time we do not have enough subscribers we would have to go to Council, with a decommission plan. We've lost a few but we haven't hooked anyone else up not knowing if the trial will go forward. He also stated that our annual operating expenses must be lower than our annual income.

Bechtel asked Joe if staff or Council has ever received a legal written statement about the option pay is not to do.

Ulrich answered 'yes'.

Bechtel stated the Commission has asked for that information over the last year, can it be shared with the Commission and the public so everyone can understand the legal basis of the staff recommendation.

Ulrich explained that we have been trying to embed this information into the report. The legal review is a confidential document and has been reviewed with Council as appropriate.

Bechtel noticed emerging relationships on FTTH – consultants met with – interviewed, so on. Some people seem eager to work with us. So eager they came and pleaded on bended knees to work with us. If we held off, would CPAU talk with these people?

Heitzman had deferred a lot of financial issues to Finance. He noted that many people were eager to work with us but all had strings attached. Some had actual financial rates there were pretty high and would be prohibitive. Until we see something better in reality, these are prohibitive rates. As you close one parameter you narrow the others. Higher interest rates mean you will need higher penetrations, and have less room to lower prices. The plan becomes more risky with a higher interest rate.

Saccio commented Eagle Broadband and Dynamic were eager to partner with the City. That would be a deviation from the basic business model as you'd have partners hoping to profit in the long term. We need to be serious about moving forward with the project. When you enter into those discussions, your understanding about interest rates and discounts may be different. Joe's sense was some consultants were interested in being part of the marketing process in the community. There may be investors out there but no one could be certain and we don't know what the interest rates would be from the private section. If we wait, we may gain knowledge from other cities.

Bechtel asked about continuing talking with them. Staff's recommendation says halt consideration about what we've talked about to date. How could we move forward?

Ulrich assured him that we would be glad to sit down and listen if a deal looked very financially viable. We believe this is what we've found... if someone else is going to come in with a better plan it would pencil out our plan but we still think the business model is sound. We think it is prudent at this point to make our recommendation on what we've found, constraints given. If you want to give

different constraints we will be glad to take to the public. No longer able to continue taking money from the public enterprise funds. Can't keep spending more money and staff time.

Dahlen stated that she expected more clarity on when we would be moving forward. What time frame are we looking at? How will we know when to open up the discussion again?

Ulrich said "when we see it, we'll know it". We are interested in seeing Truckee/Donner financing plan. We'd have a real number, see revenues, costs they have. Something to look at. Every month APPA report says over 600 public entities that have gone into some form of telecommunications, we know it can be done but for California, all points have not come together.

Dahlen questioned if there are few cities in California you want to keep monitoring? We're looking for a clear path to move forward or not move forward.

Ulrich is willing to listen to any ideas the Commission has. Closure of this project is a different set of recommendations. We are trying to leave the door open, it's premature to say let's not look at it any more. If we see a viable solution, we'd be the first ones back to discuss.

Heitzman says once we get a real model we'll have real numbers to put in instead of the estimates we now have.

Dahlen asked when will we terminate the FTTH build out? What stepping stones are involved in that process? Trial tied to city-wide build out is still on the table. What information do we need to say we are going to terminate the city-wide build-out?

Ulrich said if we see Truckee comes out, we plug the numbers in, don't see anything better coming along, that would be the point to say enough is enough. He asked Elizabeth to explain what is the driving force she is looking for to say no?

Dawes stated when we make a motion it should have open-ended clause or when to end.

Dahlen questioned if Donner/Truckee would be a critical decision point for us.

Ulrich said it would be one of them, it's not exactly like Palo Alto so you would have to go in and put in other factors. It would be important point but not the one and only.

Dawes observed investment bankers are very intelligent when filling customers needs, as Santa Clara is trying to finance a project right now for a symphony hall. Have we ever - get a DO in place, these people are willing to spend a fair amount of time - have we thought of inviting in teams or a team of investment bankers saying here's our need, find a way to fill it and come back. "We're not giving you retainer fees, we're not hiring you but we will hire if you come back with a way to accomplish this?"

Saccio stated they only have been told there may be investors out there willing to finance. They probably do have access to bond councils. We'd exercise discretion in choosing bond councils. Such talks could occur in this situation. We'd use great scrutiny in looking at what would be offered. We find figures increase as the talks go along. We have not really gone to the point that Dawes mentioned.

Dawes thinks it is a very fertile resource to find out how to accomplish our needs by listing what our requirements are. Slide 6 says 'not been pledged only by revenues'. Is that by law? Is this illegal under Muni-finance?

Saccio says it is legal but we found nothing in the official language or illusion to that in the consultant report in the early Truckee report or Alameda report.

Dawes asked if we can pledge revenues and assets itself, we'll give title to it? Who ever succeeds to ownership of the assets. Value is in the eye of the beholder. We financed our municipal garages with that process. The revenues of them are no greater assurity than municipal communication system. That's his observation and belief, any other assets pledged?

Saccio replied that you're pledging full faith and credit of the City. City Hall could be leased. General Fund pledging resources to pay for that.

Rosenbaum – garages was funded by assessment districts.

Saccio stated that assessments are the revenue stream for which we pay for the garages.

Dawes recommends to staff and ASD to get creative types in to see if they rise to the bait to see if they come up with a plan we can live with.

Commissioner Dawes asked for comments from the Public.

Art Kraemer expressed his belief that there is no doubt services on fiber optics will be part of most homes. Palo Alto has an important piece as the City owns right of ways and can control who uses it. City can deny other power or telephone companies to compete. Comcast needs city approval to replace (assume) Palo Alto could use it's ownership of the right of way to gain some control. Part ownership in the company, Palo Alto could follow similar model for fiber optics. For a piece of the action, some degree of control and a share of the profits. To invest in business to provide income to the city without gambling. He hopes we can find a reasonable way.

Robert Smith stated that the staff report is very reasonable but conclusive enough. He stated that there are significant events that foreshadow greater competition and greater complexity. Will be a different world if we wait 12 months. He is not recommending go forward or stop but if we believe in it go with it or shut it down. Tremendous competition brewing – no one quite knows what is going to happen. It will be a very different place in a year from now. His recommendation : do it whole hog find a way to do it or shut it down.

Bob Moss spoke. Palo Alto should show everyone else the way. He's heard that we can't bond because 100% of the people won't be having fiber to the home. Didn't matter with the other utilities. Electric utilities used bonds and it took more than 20 years before everyone had the service. That doesn't automatically disqualify us from using revenue bonds. There is a prevalence of fiber: no lack of fiber in the right-of-ways. Fiber to the home to the final user is what we're lacking. SBC is planning on investing money but not one cent to existing homes, just new homes. Muni utilities are the only entity putting fiber to the home. The only way we'll get it is if we do it.

Mr. Moss agreed that Commissioner Dawes is correct, when you borrow money you pledge the assets. They gave money back to the community, to MCMC. There is money out there to be made. The business plan kisses off VIOP. Mr. Moss predicts within 10 years it will have entire market for phone service. If we do the job right, we can finance and pay it off. Would like to see us go forward, not go back. Find a way to finance it and build it.

Stanford Forte spoke. Business model are much too taunt – things will get more complex but the City can leverage complexity to their advantage. Leverage an asset, it's a good idea but if we're talking about municipal assets it's not a good idea. If the FTTH trial continues, we will have necessary time to discover specific usage goals community wants to have. Once all the goals are discovered they should be embedded in the strategy. Gain consensus that results will be understood in a way that creates immunity. He spoke of the private capital in the community. Local investor opportunities could be introduced. Private placement options are too institutionally driven. Find a way to include institutional goals. Payback scenarios should be instituted. How can additional services be incorporated into the big three. VIOP will be given away free in the next year or two. Look at the social return on investment modeling showing real revenue gain and real opportunity loss. CPAU should not employ outside consultants. We have enough knowledge and resources to here to accomplish our goals. Looking for community goals – ubiquitous all kinds of choices that would be complimentary – wireless hot spots all over town, everyone understands the goals making it more supported.

Herb Borock had two suggestions for the UAC to take to the City Council. First, recommend council release legal opinion that is the basis for staff's conclusion that you can't use revenue bonds. Council should release that report. Second suggestion is that any equity invested should be a

public entity. Consultants hired by utilities in states that prohibit retail services for Fiber to the Home systems conclude that wholesale Fiber to the Home systems are financially viable for those utilities. The same consultants when hired by utilities in states that permit retail services for Fiber to the Home systems conclude that wholesale Fiber to the Home systems are not financially viable for those utilities, while retail systems are viable.

Mike Le Bright said the analysis looks very difficult so it has to look further to give the City more options if something comes in. He stated that he is not one of the trial people, but wishes he were. Allow other people that could be added, be allowed to join. He likes the concept "I'm in control," through the City, "of my own content." The benefits are not that it's cheaper but that we can get content, support and service we need City-wide.

Dawes asked for a motion. Discussion was held on several revisions to the former recommendation.

Dahlen was concerned that the motions were more open than what staff is asking for. She asked the other Commissioners if that was what they had in mind. And what is the time frame these activities should take place, what steps necessary to initiate discussions?

Rosenbaum said he has no time frame in mind, if Council directs, staff will do. There is the feeling that the investment banking community has not been consulted with enough up to this point. There should be no time horizon in mind.

Dahlen – staff will continue with efforts that they have been doing and we're not giving them any other direction other than looking at investment banking.

Melton wanted clarification of motion.

Ulrich drew attention back to the staff recommendation. Halt consideration means we're not going to go out and actively pound on doors. The key word is monitor what is happening in other locations. Halt means we are not going tomorrow to actively spend money to look for people to come forward. We feel we've done enough of that.

Bechtel asked to speak to comments. He expressed his concern that we have not educated the Council or the public enough about what is going on. We have a long way to go. He strongly urged the proponents of this project to get out and talk it up... they will have to do the work, city will not do your work, get busy!

Dahlen mentioned again that the proposed motion doesn't address ending the FTTH trial. Will vote for that motion.

Dawes: second part of recommendation.....

Dahlen wanted a motion that the FTTH trial met objective intended for, looking to cease or slow down. Recommend ceasing operation of the trial.

Melton seconded.

Rosenbaum said that given the consideration of all effort put in by so many people it would be too final to just cut it off. Depending on staff's assurance that the trial is meeting expenses he said he is happy to see the trial continue for a year and would oppose any motion to end the trial.

Bechtel expressed his opposition to a motion to end the trial. Dick is on track. The system has paid for itself now. It's an asset and by continuing the trial we would provide further support for any further financing that might occur. We would lose the opportunity to demonstrate it is a viable business. He thinks proponents of system need this as a demonstration of what can be done. By demonstrating with 70 homes we have, we could demonstrate benefits we haven't had before.

Ulrich intercepted with the comment that before the Commission votes, he is very surprised in any interest in shutting down since we've made the recommendation to continue and we are making more revenue. We've invested more than \$600,000. If we end the trial, are you expecting we will keep this in benign neglect or go out and remove and pay for the cost of doing that? Benefits of taking it down verses just turning it off. John stated that he'd appreciate the opportunity to allow us to continue doing this.

Dawes asked for a motion.

Rosenbaum revised the previous UAC motion as follows:

Motion:

1. Do not place advisory vote on the November ballot.
2. Halt consideration on further action on FTTH until a viable financial option emerges. Direct staff, over the next 6 months, to seek guidance from the investment banking community about possible financing options and continue to monitor the progress of other California cities in securing financing.

Motion Approved 3-2, Dahlen and Melton opposed.

Bechtel moved to add the Motion:

Motion: Continuing with the FTTH trial for one year with an evaluation on whether to continue the trial at that time.

Seconded by Rosenbaum.

Motion approved 3-2, Dahlen and Melton opposed.

Dahlen asked how much it will cost to shut down the trial.

Ulrich said once it is turned off decisions will need to be made regarding facilities on poles or on ground, equipment, and cost of labor to remove.

Dahlen stated that the intention of a trial is to demonstrate certain objectives, they were met. Since she was not on the Commission when this project began she asked for an explanation of what they had in mind when you started trial with end point and closure.

Bechtel was not on the Commission when Council authorized it.

Heitzman said the trial was approved by Council on November 13, 2000. Objectives are in that report. He offered to make the report available to the Commission. He said it listed various objectives and to the extent we foresaw what we could really do, those have been met. Some of the marketing objectives were un-fulfillable.

Dawes was on commission. He stated the objectives were a demonstration of feasibility and customer satisfaction. Still is a project that could come to life. Absolutely very highly desirable to have continuing users who can attest to its viability while it's cash positive and it serves as a successful endeavor if a full implementation does come to pass.

Melton asked about Ulrich's earlier statement that some of our equipment used in the trial is on loan. Email from the public that indicated that under the loan arrangement we are approaching a time we had to purchase that equipment. Is that accurate?

Heitzman replied that the agreement is open ended. If the company feels we are continuing to lend they can continue to lend to us. It is possible that they could pull it out in September. Or find alternative equipment. Installed for free by their technicians. It is highly unlikely they would ask us to do that at this point.

3. **Renewable Energy Supply Implementation Plan: Energy Contracts Summary**

Ulrich shared that our experts are here to answer any questions. Any questions by the Commissioners?

Rosenbaum mentioned prices are stated in an odd manner (page 3 of attachment). PPM will provide a fixed price. He'd been thinking in terms of 5 cents, what does less than 7 cents mean?

Knapp stated he has signed confidentiality agreements and cannot give specifics yet, but the details would be included in the contract when presented to Council for their consideration.

Bechtel asked that we chose 20 mg share, could that go up? What options do we have for increasing the share? Are any of these possible with wind.

Knapp said that this is the last 20. We tried to get more but were unsuccessful.

Dawes was perplexed 3rd paragraph – please explain.

Knapp said wind doesn't get any capacity credit in the proposed market design for resource adequacy planning. Wind produces a lot of energy but you don't get any capacity credit.

Dawes asked could CPUC push us to have more resources in respect to our needs because part of it's wind and not hydro?

Knapp replied that potentially that could be true. You could get more reserves to make up for the fact.

Dawes was fascinated by the seasonality how it plays. To have a resource that fits so well with our requirements and it's a peak hour resource, have we done cost trade-offs to pay more and have it make more sense to us as it comes on at a high peak time?

Balachandran answered we did do that analysis. How we got our percentage recommendation about 20%. Entire portfolio, diversified, we need resources we can control during peak hours, don't know with wind. LEAP portfolio recommends thermal. Need to have a plan to actually implement but opportunities to revisit percentages of wind and thermal, etc. We will revisit the entire resource plan in feasibility study.

Bechtel asked about green power. Is that right that green power is a different product?

Knapp said that is accomplished using tradable renewable certificates. Advantages of green power program, green pricing programs are a good match for green tags.

Bechtel asked if we purchase this could it have an impact on the green power program?

Knapp thinks yes, we should be able to lower the premium because you don't have to purchase as many tags.

Dahlen asked for a time frame PUCP will come to any resolution?

Balachandran was not sure but replied we are monitoring and tracking to see if we have capacity reserves.

Dawes asked for further comments and hearing none moved to next item.

4. **Western 2005-2024 Base Resource Percentage Assignment to NCPA**

Ulrich said staff does not have a formal presentation. Expect the best way to cover this information is by the Commissioners asking questions. The agreement has the provision for us to get out with

short notice so we can get out at any time to hold the contract the way we do now. Benefits are rather significant and we appreciate your concurrence.

Melton asked if initiative is driven by Western's rules and regulations. We didn't choose to do but need to do. What is the background of why this exists.

Kabat said yes, Western has allowed pooling of resources for past 20 years and is now changing provisions that to qualify to pool resources you must assign your base resource percentage to a resource pooling entity.

Balachandran added that Western

Dawes asked about several years ago when we had the hydro blow-off and CPAU was selling power to other powers. Is this in any way related to that issue or different? Could be sold outside of the Muni-fraternity?

Balachandran – its' not related.

A commissioner asked if this represents new savings that we do not already achieve.

Kabat- This is to try to maintain the status quo of saving money by pooling, about \$650,000 a year going forward. If we don't pool, we would have to pay more. Assigning to continue pooling can be viewed as either avoiding a future cost or continuing current savings.

Motion: Rosenbaum moved to accept staff recommendation. Bechtel second.

Motion Approved: 5-0 Unanimous.

IX. ADJOURNMENT

Regular business completed.

Ulrich asked about the next meeting in August. We have one item, the Utilities quarterly report. He asked if we want to have a meeting in August. Docket will be based on how many questions you have on the quarterly report. Last time we provided to you and asked for your comments at the next meeting.

Motion: Dawes made the motion to cancel the August meeting. Rosenbaum second.

Motion Approved: 5-0 Unanimous.

Melton asked staff to provide the quarterly report in advance of meeting. Dahlen added the desire to have the Energy Risk Management report as well. UAC asked for an early distribution of the September packet.

All in favor: unanimous

Meeting adjourned at 9:36 p.m.

Respectfully submitted,

Dee Zichowic, Administrative Assistant
City of Palo Alto Utilities