UTILITY COMMITTEE

The Utility Committee Meeting was held on March 23, 2015 at 5:21 p.m. with Chairwoman Williams presiding. Members present were Mr. Perza, and Mr. Snaman. Mr. Slavin and Mr. Blakeman were absent. Councilmen Dixon and Hutchison were also present.

AGENDA ADDITIONS/DELETIONS

Mr. Snaman moved for approval of the agenda, seconded by Mr. Perza and unanimously carried (Slavin absent).

Power Supply Update - Discussion Only

Mr. Scott Koenig, City Manager, advised members that the City's electric utility is probably one (1) of the most complex organizational issues that is discussed, with a lot of moving parts and money that is spent running the utility. He stated that the utility has been very good to the City over many years and has helped fund the General Fund and other activities. Mr. Koenig stated that the City is under constraints in the PJM with rising prices, complexity, and regulation, as well as the retirement of generation and the building of new generation. At the staffing level, the City has had difficulty filling some positions, is trying to reevaluate staffing needs, and will probably be doing some nationwide recruiting to fill a couple of key positions in the utility.

Mr. Koenig stated that, going back to last year's budget, the transfer from the Electric Fund was increased from $8M to $10M. That extra $2M was transferred from the Rate Stabilization Fund, and the concern is that the rates are under a lot of pressure. During the Utility Committee meeting held on March 9, 2015, members considered a proposal to perform a review and update of the electric system financial model, complete cost of service analysis, and develop proposed rate adjustments. The Committee recommended acceptance of the Burns & McDonnell Group proposal, as recommended by staff. Mr. Koenig expressed his hope that Council would adopt this recommendation during their meeting scheduled for later in the evening so that it would be possible to see where the City stands with respect to rates and revenues going forward. From Mr. Koenig's standpoint, the expectation is that those things are going to go up as the City moves into the future.

Mr. Koenig stated that the City has been very competitive with electric rates for residential users, and the most recent figures indicated that the City was as economical as the second lowest in the State of Delaware. He expressed his belief that in the winter the City runs around the fifth lowest; however, the City is not as competitive as it may want to be in the electric rates related to businesses and is probably in the top third in a number of business classifications. From a business standpoint, the City is expensive in the electric industry.

Mr. Koenig stated that Mr. Harry Maloney, Electric Director, would address a number of the issues that the City would be wrestling with over the next 12 months, and in some cases three (3) to five (5) years and perhaps beyond.

Mr. Maloney stated that he would be discussing: 1) where the City stands with Calpine; 2) what is happening with rates and where the City should be going with rates; 3) the budget, including some budget ideas to be presented that members had never seen before; and 4) an update on Playtex's new load and how staff plans to service it.

In regard to Calpine, Mr. Maloney stated that he and Mr. Kirk Betts, the City's utility attorney, were in discussion with Calpine about buying capacity, probably starting in 2018. There was no need for capacity starting in June of 2017 because that market had already cleared PJM at a known price of about $120 per megawatt-day. Mr. Maloney indicated that the City was short 34 MW at a cost of about $1.5M. He stated that in the budget that will be presented, the cost goes up in 2018 because the City will have to replace retired capacity.

In response to Mrs. Williams, Mr. Maloney confirmed that Unit 1 and Unit 2 will be retired in 2017 and, because these units would not be operational, there would be a need to increase capacity and pay someone else to cover the load. The market for June 1, 2017 cleared at $120 per megawatt-day. He explained that the market clears three (3) years in advance and expressed his belief that in mid-to-late May 2015 the price for June 2018 would be known. Mr. Maloney reiterated that the City already has the load covered for the first year of retirement at a decent price of $120, but the City was paying very little to keep Units 1 and 2 around since overhauls, etc., were cancelled and the price was just some labor, operations, and maintenance, which was very light.

Mr. Maloney stated that the City was now dealing with Calpine on a future deal for three (3) to eight (8) years. He advised members that the City had also been engaged in open discussions with Calpine on a dispatchable energy deal, where the City could phone Calpine and request energy for the next week, with the gas price based on Calpine's local unit. Mr. Maloney indicated that this would be a very simple deal and would be combined with the City's capacity to purchase to get the best dollar for the energy. It would be based upon a gas rate at the New York Mercantile Exchange (NYMEX) and the heat rate of the unit, and a little would be added for the transmission of gas, etc. He felt that this would result in a decent price that the City would try to fit into the purchases it had been doing. Just as the City now starts its own units up and down, purchases could be made during hot weeks and would not be needed during cool weeks.

Mrs. Williams questioned if energy would be similarly priced at $120 per load. Responding, Mr. Maloney indicated that this was the fixed charge and the energy price would be a lot less. He stated that, based on the heat rate and a gas price of $2 to $3, it would be a good rate.

Mrs. Williams asked if Mr. Maloney was looking for flexibility for the daily demand if needed. Mr. Maloney stated that he was, adding that this was called a "call option" in today's marketplace. He noted that it may be just on paper, or they may actually turn the unit off and on; however, he felt that they would want to run this combined cycle unit and would not want to keep shutting it up and down since this would tear the unit apart. Mr. Maloney stated that the desire would be to keep it hot and keep it on.

Mrs. Williams asked if Calpine would stay up if something happened on the grid and if this would be a redundant supply for the City. Responding, Mr. Maloney explained that stability analysis modeling, costing millions of dollars, is run to see what is stable. He stated that no one knows what would happen with the grid, and it was unknown what the circumstances would be. Mr. Maloney explained that it would take 10% of power, or approximately 30 MW, for Calpine to do a cold startup and then they would have to energize. He felt that there were plans to get Calpine back online since they are located on the peninsula where there is less generation, noting that Indian River

is being phased out over time. He stated that there were small, 300 MW, generators in the area if a problem did occur; however, there were a lot of variables, such as whether there was enough load connected and if the decision would be made to put it on. He reiterated that PJM does a lot of planning for this.

Mrs. Williams asked if something did happen and Dover had to depend on itself, how many customers could be served. Responding, Mr. Maloney stated that on a typical day, Dover would be fine. However, on extremely hot days, the City was probably at 100% of its 149 MW generating capacity. He indicated that the City could cover almost 90% of its load on a hot peak day and at least a 10% reserve was needed for flexibility. Mr. Maloney advised members that this would include residential and business customers.

Mr. Maloney advised members that the City's contract with North American Energy Services (NAES) would automatically renew on July 1, 2015 and that he and Mr. Betts were trying to complete the new contract for signature and approval before that time. Mr. Maloney indicated that new language would be included in the contract because Units 1 and 2 would be retiring.

Mr. Maloney advised members that another factor with capacity was the changing PJM rules. He noted that in January 2014, there was a big cold snap and a lot of generation was not available, so PJM developed new rules and a new policy called, "Capacity Performance" (CP). The new rules state that you must have firm fuel supply, and if you have a duel fuel unit like the City's, you must either have three (3) days of fuel on your property or fixed gas contracts with a fixed absolute supply. Mr. Maloney explained that the City is on an interruptible rate and has spot gas, not firm gas, but does have oil capacity. He stated that PJM will still have the old capacity for the next three (3) or four (4) years; however, that will eventually be phased out and then new requirements must be met. Units that do not meet the requirements cannot be bid into the capacity model. Mr. Maloney stated that the City was following the rules and that this matter was now being considered at the federal level, having been filed through the Federal Energy Regulatory Commission (FERC), and he anticipated that there would be protests but ultimately it would lead to higher costs. A firm gas contract would be required or oil could be used; however, oil would have to sit in reserve and there would be a cost for this. In addition, he noted that if the oil were kept and the City was asked to run on a hot or cold day and failed to run, the penalties would go up. The City would have to give back the money that would have been received for that day and there would be an additional penalty; therefore, the City would lose this money plus pay a penalty of 100%. Mr. Maloney explained that there are caps and, if the City were out for six (6) months, there would be a significant financial penalty if the City does not have the unit available when called upon. Mr. Maloney advised members that these rules affect Calpine and those rules are coming into effect when the City needs to buy more capacity.

Mrs. Williams questioned what the consequence would be if there were a delay and more penalties, and asked if the City could charge Calpine for water, since they have to use water to make steam. In response, Mr. Maloney recommended a firm, set deal with Calpine on paper. If they run or fail to run, the City would still get its deal for 30 or 40 MW and Calpine would pay the PJM price because they have to replace energy and the City would be insulated from this. He said that Capacity Performance would raise the price to buy more capacity and raise the City's internal price to maintain oil on the property and make sure that its two (2) units will run.

Mrs. Williams asked if the City could obtain funds through the water rates if more money were needed. Responding, Mr. Maloney stated that the City sets its own rates in its service area; however, he indicated that water and sewer were outside his area of responsibility.

Mrs. Williams noted that water was needed by Calpine to make steam. In response, Mr. Maloney stated that the City received notice that Calpine would be filling its cooling tower shortly and that drawing water may cause brown water complaints.

Mrs. Williams indicated that she would like to see the good relationship that Dover has had with the American power market remain, even if the City has to switch utilities a bit to readjust and ensure that the City still gets sizable revenues for utilities. She said that revenues may be from water in the next millennium and might have been from electricity in the last, noting that it did not matter to her as long as the City gets the right price.

Mr. Maloney stated that Mr. Betts was reminding Calpine on a daily basis that the City did a lot of infrastructure improvements to help them get here. Mrs. Williams stated that these improvements amounted to $16M. Responding, Mr. Maloney advised members that the trouble was that the individual with whom the City was now negotiating was not the person that was physically here when the process began.

Mr. Maloney informed members that President Obama was trying to push through a clean power act. Although it was uncertain how far that would go with the change in the Senate and Congress, many were saying that the government wanted to shut down coal plants; therefore, there was less coal generation and everyone now wants gas.

With respect to rates, Mr. Maloney stated that Mrs. Donna Mitchell, Controller/Treasurer, planned to work with Burns & McDonnell regarding rates, noting that the City would be looking at a four (4) or five (5) year deal. He reiterated that in FY18 the City would have a spike in costs as a result of having to buy capacity in the approximate range of $1.5M, which would be a cost increase that the City was not incurring before. Mr. Maloney said that as staff does the rates, they are looking at the structure. He stated that as efficiency improves, for example, as you get better light bulbs, consumption goes down. Mr. Maloney noted that there is still a basic cost of service, but a lot of the City's basic cost of service is in the kWh rate. As the City sells less kWh, it would not be recovering basic costs. Mr. Maloney stated that the move now is to lower the kWh and raise the basic customer service charge. Even though the customer uses less energy, the customer service charge would climb and the City would still recover the basic costs of service as efficiency improves. He noted that everybody wants efficiency; however, there is still a basic service and cost for the wires, transformers, etc. Mr. Maloney felt that the City probably would not build more substations but would still have a flat load going out. If the City lowers the kWh and raises the customer charge, the average customer would not see a net effect, and the City would still have a guarantee of revenue to cover costs.

In response to Mrs. Williams, Mr. Maloney explained that he was referring to kWh consumption, noting that a lot of the basic cost of services are in the kWh of consumption billing. Some of it is in demand, but all of the residential is in the consumption. He indicated that there is more solar penetration, which is being ramped up in the State, and revenue would be lost through solar.

Mr. Maloney stated that as the State ramps up the requirements there will be more and more solar energy applications, noting that he had a couple on his desk. He stated that there were some limits; however, this would "creep up" and cause lost revenue because the City still has to supply all of the wires, etc. for solar customers to utilize on cloudy days. The customer may net out close to zero (0) for a year, but the City may only get $5 for the basic charge, which would not cover the wire or basic generation charges. Mr. Maloney indicated that rate changes would be phased in over time and the City would look to see what that impact is going forward. If this is not done, there would not be enough revenue and those who cannot afford solar or more efficient units would "pay through the nose" for electricity. He explained that this is a nationwide movement happening today, not just a City of Dover issue. Mr. Maloney stated that although everybody thinks the rates are just going up, the City tries to make them revenue neutral so the average consumer does not get hurt by it.

In regard to Playtex, Mr. Maloney stated that Playtex advised the City last year that they plan to double their load and may increase the load to a little more than double. He explained that the existing circuits that feed Playtex cannot handle it. Based upon the existing infrastructure of two (2) substations with spare breakers and the retired 22,000 volt line that runs along the railroad tracks and approximately $300,000 worth of improvements and some other wire, the City is going to build two (2) new circuits that can feed Playtex. Mr. Maloney advised members that the existing circuits have only a 400-amp rating and the new ones need a 600 amp rating. He said that staff was working with Playtex and hoped to have the work done by summer. It was hoped that over the next two (2) years there would be load growth there. Mr. Maloney indicated that the only positive load growth that the City has is with Playtex and the City would provide them two (2) good redundant supplies. He explained that Playtex cannot sustain long outages, which hurt production greatly, noting that Playtex had always had double feeds, so this would be continued at a larger size.

In reference to the budget, Mr. Maloney indicated that the "New Developments" line item in the budget would be raised significantly to more than $2M from approximately $600,000. He indicated that Mrs. Mitchell had said that the budget could not be raised by that much; however, he explained that whenever a new development is done, such as a new underground development or a new service to commercial, 100% of the cost will be billed. When that revenue comes in, it will offset the costs going out. If a developer hands him a $100,000 check, Mr. Maloney would pull $100,000 of new materials, and the City would be even without affecting the rate payer. Mr. Maloney stated that he wanted to have sufficient funds in case developers tell them in May that they want to build 100 homes starting in the fall. He indicated that his recommended approach would provide flexibility to enable the City to proceed with providing material and installing the necessary services. Mr. Maloney cautioned that this money could not be spent on anything else since it would be earmarked for new developments that pay cash for the City's charges. He stated that this would not affect rates but would be revenue neutral because he would have to have the check in hand before going to the warehouse to pull the equipment.

In relation to personnel, Mr. Maloney stated that, when being interviewed for his job, he asked who the City's representative at the power plant was. Although there is a contractor there, normally a company has a person watching a plant all day long, noting that the City has $200M worth of assets there that should be observed. He advised members that Mrs. Mitchell and Mr. Koenig had worked

with him and planned to budget for an Assistant Superintendent of Generation or Assistant Generation Manager, to have a representative on the property. In addition, this individual would be a project manager as the City plans its generation. Mr. Maloney stated that when the City starts new generation, this individual would be the seed. The City would begin to build, get consultants and layout, and everything would come through this employee, including the financials, project management, etc. The employee would also serve as a backup for Mr. Maloney and would be present when Mr. Maloney is not. Mr. Maloney stated that it would take a team to build the City's own generation since the City would be looking at a $60M - $80M expenditure, depending on its size, and someone would be needed to work on starting the process. He stated the intention to present this in the budget discussions.

Mrs. Williams asked if $4M - $6M was needed for the things Mr. Maloney had mentioned, including the revolving account for the new developments. Responding, Mr. Maloney stated his belief that it would be a little over $2M; however, rates revenue would not be needed for this. He reminded members that if a check were not received from a developer the money would not be spent.

Mrs. Williams stated that she understood this; however, it would be necessary to buy the materials before the check would be received. Mr. Maloney explained that the inventory account is outside the budget. He stated that staff normally stocks enough to get going and the rest of the material can be here in eight (8) to 12 weeks. The funds needed for all the things he had talked about would mainly go toward salaries and would amount to a few hundred thousand dollars.

Mr. Koenig advised members that the information presented provided an update on the challenges that the City faced. He stated that the baseline cost would go up by an additional $1.5M to pay for capacity. The City would have to raise these funds, and that cost has to be added into the rates and the future projections. Mr. Koenig indicated that Mr. Maloney was recommending the potential hiring of an Assistant Generation Manager, which is an expensive position and could cost $100,000 plus per year in the operating budget. Mr. Koenig indicated that this person would be the main focus of oversight of the City's existing generation, help manage the contract with NAES, and would potentially serve a dual role if the City decides to build a new piece of generation instead of buying 34 additional MW in power supply. If a new plant were built, this person would be the focal point for identifying the best technology and location, and taking it through construction and startup.

In regard to the budget increase for new developments, Mr. Koenig stated that staff had experienced difficulty in getting all of the dollars to line up in the correct line item in the budget, especially when the budget is an estimate of annual spending and about two-thirds of the service territory is outside the City limits. He advised members that the City has a pretty good handle on where development projects are within the City; however, the County operates differently. Mr. Koenig explained that developers come in and out, and projects sometimes move slower or faster than anticipated. He stated that the $2.5M for new developments is essentially an earmark in the budget. It is not part of the rate calculation because the City would not spend that $2.5M unless $2.5M had been received from developers in revenue for those new features, whether they are transformers, lines, or something else. Mr. Koenig indicated that $2.5M may be spent in some years, while only $1.5M may be spent in other years; it would be completely driven by the number of new connections or transformers going into the system for new service.

Mr. Koenig stated that the big challenge for the City is the expected flat loads, other than Playtex and potentially some additional loads coming online at Garrison Oak Technical Park in the future. He informed members that the national trend for load seems to be downward as people replace equipment with more efficient equipment. Mr. Koenig stated that if the City does nothing, people continue to install more efficient equipment, and no new customers are added, the City's load will go down over time, noting that base costs are going up. He explained that personnel and benefit costs, as well as the cost of replacement parts, etc., are increasing; therefore, many things are putting pressure on the need to make good business decisions for the utility going into the future.

In response to Mrs. Williams regarding the total costs, Mr. Koenig stated that he would be remiss in saying that costs would be going up 5% or 8%. He stated that this would not be known until the rate study comes back in four (4) to six (6) weeks with more information about the rate design. He stated his hope that the increase would be more manageable than double digits and may be something that could be phased in. Mr. Koenig indicated that the rate would be in the best interest of the utility as well as the customers.

In response to Mr. Hutchison regarding what was in place to protect the City's customer base, both within and outside the City, and to make sure the City keeps those customers, Mr. Maloney stated that this is called a key account person or program and the City had none. Mr. Koenig explained that the State has issued an electric franchise and the City's franchise territory is pretty much fixed at the State level; therefore, Delmarva Power cannot just come in and take customers, or take a portion of them. He stated that, currently, true electric choice is not available; therefore, the City does not have to worry about Delmarva taking its customers. Mr. Koenig advised members that the State can consider this in the future, but there would be big ramifications. He indicated that there are some protections, explaining that even if Delmarva took a customer, they would have to cross City lines to get to that customer, and the City would be entitled to some rate of exchange. He stated that because the City is a municipal provider, it has been granted a certificate, and although the City is not completely a monopoly, it operates like a monopoly. Mr. Koenig informed members that one (1) of the biggest issues which was raised by the Governor several years ago, is that if the State decides they are not happy with the municipal electric utilities, transfers, and rates, they can send the municipal electric utility to the Public Service Commission (PSC) to be regulated as a public utility, like Delmarva Power. Mr. Koenig explained that you can spend a lot of money with attorneys and accountants to present your rate case at the PSC, go through all of the hoops and discussions, and come out with an approved specific rate of return. If the City were to do that, the result could potentially be higher than its current rate because of the guaranteed rate of return. He reiterated that the City has some protections because the City was granted a certificate.

Mr. Hutchison stated that the Governor's office, as well as membership of the General Assembly, had brought this issue up and he expressed the need to make sure the City of Dover is staying ahead of that curve and making sure to protect what we have.

Mr. Koenig reminded members that the City offers an entire bundle of services that intertwine at times. He stated that the City is not like the Delaware Electric Co-Op that only runs an electric utility, or like Delmarva Power that is interstate and has a number of different interests related to electric power.

Mr. Hutchison stated that in the last meeting with the Governor and the local leadership in the General Assembly, Senator Colin Bonini brought up an issue regarding rates and asked if Mr. Koenig and the Mayor responded to this. In response, Mr. Koenig indicated that he had only heard about this secondhand. He explained that he had talked to Senator Bonini a number of times over the years about this issue and had a somewhat different philosophical view than Senator Bonini. Mr. Koenig stated that, in regard to rates, the City's Achilles heel is some of the commercial electric rates. When looking at the rate design, he felt it would be necessary to decide whether the City favors business development over low residential electric rates, noting that Senator Bonini's issue is related to the commercial rates rather than residential rates.

Mr. Koenig stated that Calpine started a notice of flow earlier in the day, so the City is beginning to receive sanitary flow from the Calpine project to the new infrastructure in the Garrison Oak Technical Park. He advised members that there would be an adjustment period for the water system. Calpine had put the City on notice that they are beginning to test out the systems and the new energy center. Mr. Koenig stated that they would be filling up the large holding tank on the site with approximately one-half million gallons over the next couple of days. Within a few weeks, they were going to start ramping up the system check at Calpine and were expected to begin some type of production operation with the next month or so. Water quality complaints were expected as the system adjusts and staff would be putting out Facebook posts, public notices, etc.

Responding to Mrs. Williams, Mr. Koenig stated that the system would not run dry; however, when flushing the water system, brown water can be stirred up and the hydrants would be open, pulling brown water out. As Calpine comes up, the flow in the system will change because of a different demand point at Calpine. Where there may have been very low flow in the mains in White Oak/Towne Point, the pressure in houses would not be affected; however, the velocity outside in the mains would be affected. Mr. Koenig stated that the flow may have been running north-south, but with the Calpine project it may reverse and run south-north, which creates scouring in the pipe. Until the system adjusts to that flow reversal, there will potentially be plumes of brown water, water quality complaints, and perhaps laundry complaints, and staff is gearing up for this. He informed members that during the month of April staff would also be flushing the water system and they are trying to time it so as the water system is being flushed, the system adjusts and there would be a reduced amount of complaints. Staff will be remediating these things as they are happening as much as possible.

Mr. Snaman moved for adjournment, seconded by Mr. Dixon and unanimously carried.

Meeting adjourned at 6:04 p.m.

Beverly C. Williams
Chairwoman

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