SPECIAL UTILITY COMMITTEE

A Special Utility Committee Meeting was held on July 24, 2014 at 3:05 p.m. with Mr. Blakeman presiding in the absence of Chairwoman Williams. Mr. Snaman was present. Mr. Perza and Mr. Slavin were absent. Councilman Hutchison was also present.

AGENDA ADDITIONS/DELETIONS

Due to the lack of a quorum, no official action could be taken.

Energy Risk Management - Overview and Training

Mr. Scott Koenig, City Manager, indicated that this meeting was scheduled specifically to explain the Hedge Purchase Program that the City uses to stabilize the price of power for residential, business, and industrial customers. He introduced Mr. Rob Trinnear, The Energy Authority (TEA), who serves as the City's expert and would be presenting the information. Mr. Koenig noted that the City receives a lot of support from TEA for all aspects of the Hedging Program.

Mr. Koenig introduced the City's new Electric Director, Mr. Harry Maloney, noting that Mr. Maloney had been in the business for over 30 years; retired from the City of Vineland, New Jersey; and is acquainted with Mr. Kirk Betts, the City's utility attorney, through that career. Mr. Koenig advised members that the City of Vineland's system is very similar to Dover's and is experiencing some of the same challenges and issues as the City of Dover, and that Mr. Maloney was familiar with the Pennsylvania-New Jersey-Maryland (PJM) Interconnection and all its intricacies from working in that environment.

Mr. Maloney confirmed that the City of Vineland faced many challenges, such as being approached by Atlantic Electric for over 100 years regarding the purchase of their system, Council members who felt that they could negotiate (although the City had a strong mayor form of government), etc. He stated that Vineland had a good administrator, who was on the payroll in 1920 and retired in 1970, and that this individual always maintained the utility and continued to build and protect assets, which kept the City whole and allowed Vineland to maintain control of its own rates and destiny, while remaining competitive. In addition, he stated that he had experience with labor negotiations, specifically with the International Brotherhood of Electrical Workers (IBEW).

Mr. Hutchison welcomed Mr. Maloney and stated that members of City Council looked forward to working with him for the betterment of the City's future. He stated that he was looking forward to Mr. Maloney's 30-45 day assessment.

Mr. Blakeman and Mr. Snaman introduced themselves, explaining that they were serving as civilian members of the Utility Committee.

Mr. Snaman requested staff to provide information regarding the cost to produce electricity from the solar plant, not what the company pays. It was his understanding that the federal government subsidized costs and that there were other incentives provided, which should be considered in the calculation. He explained that the City may need to consider the elimination of the tax breaks currently provided and questioned how this would affect the City. Responding, Mr. Koenig indicated that the contract with the solar park is a 20-year contract and that the pricing is fixed; therefore, any action taken regarding the tax credits would not affect what the City would actually

pay, to his knowledge. He felt that the park's revenue stream might be reduced over time but reiterated that this would not change the cost the City will pay since it is a scripted cost that will be paid over the length of the contract (20 years).

Mr. Snaman again explained that his request was for the City's cost. Responding, Mr. Koenig stated that although staff did not have the specific information at this time, some of the information could be obtained and provided at a later time. Elaborating, Mr. Maloney indicated that, often, companies will not disclose certain corporate information.

Mr. Koenig reminded members that the City was one (1) of the first to sign a contract with the solar park and, as such, the City probably does not have the best contract price, explaining that being first in this instance does not equate to a better price.

In regard to Energy Risk Management, Mr. Koenig stated that owning an electric utility requires a multitude of people and a lot of expertise and that today's presentation represented a "snapshot" of what is discussed on a monthly basis in an attempt to provide power at the lowest possible cost. He reminded members that the State was interested in the cost of power that the cities are able to transmit to their business customers. Mr. Koenig stated that the City of Dover currently has the second lowest residential rate in the State, noting that the Lewes Board of Public Works has the lowest. He indicated that the City has not been as competitive on the commercial side (Dover Downs, Energizer, Procter and Gamble, etc.). Mr. Koenig stated that staff was concerned with these issues and was determining how they fit into the "big picture."

Mr. Trinnear reviewed a Presentation - Dover Hedging, July 2014. He advised members that he provides two (2) day seminars on risk management and hedging and that he had, as best as possible, condensed the information to 20 minutes for the presentation this evening.

Mr. Trinnear stated that everyone is subject to some type of risk, such as the risk of being caught in a hurricane or losing a cell phone and that there are three (3) elements that must be considered in regard to risk: 1) the perception that something could happen; 2) the likelihood of something happening; and 3) the consequences of something happening. He advised members that the City of Dover has a power price risk. Mr. Trinnear explained that if prices increased and the City had to purchase power in the market at high rates, this would ultimately result in increases for the City's ratepayers; therefore, a five (5) year hedging program was established to mitigate this risk. He noted that monthly meetings are held with the Risk Management Committee (RMC) to review hedging recommendations and hedging prices, explaining that power prices could be fixed today going out for five (5) years. Mr. Trinnear informed members that there is a market for hedging that can be utilized. He stated that a market that is "liquid" is necessary, one (1) in which transactions can take place and a reasonable price can be obtained. Mr. Trinnear noted that some transactions cannot be hedged, such as PJM fees and extreme events that go outside normal distributions. As a result, the City has a Rate Stabilization Reserve for added protection as well as the power plant portfolio. However, Mr. Trinnear explained that in the winter the City runs on diesel fuel, which means the plant portfolio is very expensive. Since the plant runs only in extreme cases, it is not a true hedge for market prices. He noted that, during the winter of 2014, $240 - $360 per MWh costs were

experienced for the power plant's units; however, with a budget fixed at approximately the $60 - $80 per MWh range, this would created a large gap before reaching $240, where generation would mitigate some of that high-priced power and act as a hedge.

Responding to Mr. Hutchison regarding whether, from an operational perspective, the City could prevent a recurrence of the high costs the City experienced in January 2014. Mr. Trinnear stated that during this period the City experienced much colder than normal weather and that extreme cold conditions would not be factored in the basis risk, since only normal distribution is considered when risk metrics are examined. However, he indicated that some risks could be identified, including the basis risk going from PJM West, where the hedges are, to the City of Dover, and he felt that these risks should be reviewed for possible hedging going forward. Mr. Trinnear felt that action would take place to ensure there would be enough oil, in terms of obtaining suppliers and ensuring their ability to refuel tanks. This would result in the City having more oil in storage than in the past. He stressed that it would be impossible to eliminate all risk.

Mr. Blakeman questioned if the City should consider hedging natural gas purchases rather than electricity so that, in the event that gas prices spike five (5) years out, the City would have a commodity that could be sold for a higher price, which could be used to offset the increases in electricity. Responding, Mr. Trinnear stated that the PJM West market is robust on the power side and power can be sold back to another counterparty. He assured members that if power were not providing a benefit, an alternative, such as gas, would be considered. Generally, he stated that the preference would be to hedge the commodity that has the risk. In the current market, he felt that hedging power made sense; however, if it reached a stage where the market was not robust or some of the counterparties dropped out and a premium was being paid to transact hedges, hedging gas could be considered.

Mr. Blakeman questioned if the City had more commitments for backup generation, whether this would it affect hedging going forward. Responding, Mr. Trinnear stated that this would transfer the risk. If gas were generated, then there would be fuel risk; therefore, the power risk would be reduced and there would be gas risk, which would result in gas hedging. He noted that both the gas market and the PJM West market are robust and as a result, the hedging program can be adapted to whatever it needs to be.

Mr. Blakeman stated his confusion that the budgeted price for hedged kilowatt hours is generally 2% - 8% higher than what is actually paid, as reflected on the monthly budget reports. Responding, Mr. Trinnear stated that although it is known what would be paid for three (3) years, additional hedges are layered on every month, which results in different numbers for the amount budgeted and actual expense. He stated that the volume of hedges constantly increases. He confirmed that the hedges added after the budget was finalized were below the budget price, which is why it is reflected in this way on the budget reports.

In response to Mr. Blakeman, Mr. Koenig stated that the composite information is released but not the individual hedging transactions. He stated that the budget report provided is reflective of commitments made.

Mr. Koenig stated that the three (3) year hedge program had been expanded to five (5) years and has a declining block profile. At the beginning of this year, the City would have expected to be approximately 80% hedged for FY 2015, 60% for FY 2016, 40% for FY 2017, etc. He stated that it is attempted to stay within those targets; however, if there is a really good opportunity to go above this staggered approach, it would be considered at the RMC meeting. Elaborating, Mr. Trinnear stated that there are minimum and maximum bounds, which decline each year.

Referring to Calpine, Mr. Blakeman questioned if a reduction in congestion is expected when the Calpine Unit comes on. Responding, Mr. Trinnear anticipated that this would have a positive affect for Dover pricing.

The meeting adjourned at 4:03 p.m.

Lester Blakeman
Acting Chair

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