UTILITY COMMITTEE

The Utility Committee Meeting was held on June 27, 2011 at 5:00 p.m. with Chairman Bonar presiding. Members present were Mr. Lynn, Mr. Blakeman, and Mr. Snaman. Mrs. Williams was absent.

AGENDA ADDITIONS/DELETIONS

By unanimous consent, the agenda was approved, as presented.

Informational Presentation by Delaware Electric Cooperative on the Pros and Cons of Their Purchase of the City of Dover Electric System

Mr. Bonar advised members that they would be considering the possibility of an outside entity taking over the operation of the City of Dover Electric Department. He indicated that the Delaware Electric Cooperative (DEC) had expressed interest in pursuing this option. Mr. Bonar introduced Mr. J. William Andrew, President and CEO of DEC.

Mr. Andrew stated that he was contacted by Mr. Bonar approximately two (2) weeks ago requesting that the Co-op present information regarding the possibility of DEC purchasing the City of Dover Electric System. He stated that DEC evaluated public information and toured the City of Dover Electric System and determined that it was an excellent system.

Mr. Andrew and Mr. Gary D. Cripps, Chief Financial Officer (CFO) of DEC, provided a presentation on the Pros and Cons of DEC Purchasing the City of Dover Electric System ***(Attachment #1).*** Mr. Cripps stated that both the City of Dover and DEC have positive attributes and felt that the two (2) organizations would function better together. He indicated that a consolidation of these business enterprises would be fruitful for many years to come.

Referring to the Key Benefits, listed on Page 2 of the presentation, Mr. Cripps stated that members of DEC are controlled by a Board of Directors who are elected annually in August and serve three (3) year terms. He noted that Mr. William Wells, Chairman of the Board of Directors, was also present. Mr. Cripps stated that if Council opts to proceed with the proposal, City of Dover utility customers would realize lower utility rates and that the impact would be approximately $25M per year. He advised members that consolidation with the City of Dover would provide rate stability over the long term, particularly as it relates to the market and the effects of economic development in the State of Delaware. Mr. Cripps stated that DEC has a Power Supply Contract, which will expire in 2054, with Old Dominion Electric Cooperative, headquartered in Richmond, Virginia. He explained that Old Dominion Electric Cooperative is asset based and serves 600,000 customers in the aggregate.

Mr. Cripps noted the importance of economic development and indicated that DEC's first priority is to protect current businesses in the City of Dover and Kent and Sussex Counties. He advised members that DEC has 32,000 customers in Kent County and the City of Dover has 23,000 customers. Mr. Cripps stated that if DEC purchases the City of Dover's Electric system, their customer base would increase to 55,000 in Kent County, which would necessitate the establishment of a DEC facility in Dover. In addition, he stated that there would be a need for two (2) additional districts, as well as two (2) additional members to serve on the DEC Board of Directors.

Mr. Cripps stated that one of the key benefits of consolidation would be that City of Dover residents would retain ownership of the utility system. He advised members that DEC is an electric cooperative, a not-for-profit organization, and not an investor-owned utility. Mr. Cripps noted that this proposal is very different in that respect from a previous offer from Delmarva Power and Light, which was entertained by the City in 1993. He emphasized the benefit of retaining membership and ownership of the utility.

Mr. Cripps stated that the load diversity for DEC is 82% residential and that, long term, this is problematic. He explained that DEC needs additional commercial customers in order to obtain a better balance and more diversity. Mr. Cripps noted that without diversity, rates would increase and future generations would have a difficult time paying their utility bills. He explained that over the past one (1) to (2) decades, commercial expansion has occurred near the metro areas and, as a result, DEC has lost service territory to municipalities, which is the greatest single threat to DEC. He stated that by consolidating the City of Dover and DEC, this threat would be mitigated.

Mr. Cripps advised members that DEC is run from a government standpoint, as is the City of Dover's utility, noting that DEC is administered by an elected Board of Directors and Chairman. If the Co-op acquired the City's Electric Department, DEC would escalate from 83,000 members to 106,000 members, which would assist with power supply contracts, allow human resource needs to be absorbed, and provide opportunities to take advantage of material discounts that may become available. He noted that in the past, DEC and the City have purchased items jointly, which resulted in significant savings for the City.

Mr. Cripps acknowledged that municipalities considering similar options often express concerns about the future, noting that initial rates following acquisition may be favorable but future rates are uncertain. He advised members that DEC is open to competition and does not have a monopoly on their customers. He explained that their customers may choose to obtain electric supply from anyone that sells it in Delaware. Mr. Cripps stated that deregulation has benefitted DEC by forcing the organization to remain "agile" and maintain its competitive position. He advised members that operating a utility involves environmental, legislative, regulatory, and financial risk, and that the City's risk would be mitigated by consolidation. He indicated that the influence of a commercial mix and density would lower DEC's average cost and would yield great long-term benefits.

Mr. Cripps stated that acquiring the City's utility would result in a significant financial windfall. He explained that, for DEC customers, one of the big advantages would be economies on infrastructure leverage, i.e., infrastructure capital needs in some areas that can be supported by infrastructure that is already in place.

Referring to the Stakeholder Matrix on Page 3, Mr. Cripps explained that when a cooperative makes a margin, the margin is distributed to customers and is not turned into a profit. He noted that for the past two (2) years, DEC's Board of Directors authorized over $5M to be paid back to customers in the form of checks or as credits on their utility bills.

In response to Mr. Bonar, Mr. Cripps stated that if the capital credit exceeds $30 a check is issued to customers, and if it is under $30 a credit is applied to customer utility bills.

In regard to the City Leadership/Elected Officials listed on Page 3, Mr. Cripps stated that financing the City government would be accomplished through economic development and not by raising taxes or rates. He explained that an examination of the City's financial data indicates that approximately $27M is in reserves and stated that a consolidation of the two (2) organizations would not include a transfer of those reserves. Mr. Cripps noted that a potential disadvantage for the City would be the inability to balance its budget through the Electric Fund; however, he noted that DEC has a proposed solution to this concern that would be outlined further during the presentation. He explained that loss of operational control would be another potential disadvantage.

Mr. Cripps advised members that one (1) potential disadvantage to DEC members is that the acquired area (the City of Dover) may be excluded from access to the U. S. Department of Agriculture (USDA) Rural Utilities Service (RUS) Program, which provides below market funding for electric utilities.

Referring to Page 4, Mr. Cripps stated that the commercial loads involved support generation decisions and that, in regard to generation, the City should examine its commercial load and power forecast for the next 5, 10, 15 and 20 years ahead. He noted that consideration of the other 600,000 members that are part of the power supply group can significantly impact those decisions.

In reference to the commercial and industrial customers, Mr. Cripps noted that lower rates would impact large accounts such as the Bayhealth Medical Center and Dover Downs Race Track. Regarding energy management services and technical support, Mr. Cripps stated that DEC has a highly qualified staff, including a number of individuals with Masters of Business Administration degrees and approximately five (5) Professional Engineers in the Engineering Department.

Referring to the map on Page 5, Mr. Andrew stated that DEC serves 83,000 customers over 1,100 square miles, including the majority of the service territory in Kent and Sussex County. He explained that DEC surrounds the City of Dover and is contiguous in many areas. As a result, he stated that the City and DEC have a shared infrastructure. Mr. Andrew stated that the DEC can provide additional support to the City of Dover infrastructure and indicated that the City of Dover has an excellent electric system which is comparable to Delaware Electric Cooperative's system. He noted that DEC provides only electric service and the City of Dover, like other municipalities, provides multiple services. Mr. Andrew stated that electric rates are currently high, and commercial and industrial sectors are consistently under pressure for competitive advantages. He noted that the City of Dover has lost more that 295 commercial and industrial customers in the past two (2) years. Mr. Andrew advised members that State and regulatory burdens are increasing and extremely costly to the power industry. Recognizing that cities need additional funds to run their governments, he stated that electric systems require cash and capital to operate. He felt that consolidating the City's electric system with DEC would "free up" resources the City could devote to other utilities without raising rates or increasing taxes.

Referring to Page 6 of the presentation, Mr. Andrew stated that DEC rates are approximately 36% lower than the average rates in Delaware and that they have been able to maintain that for several years. He also noted that their rates were reduced during the last few years. Mr. Andrew indicated that the State of Delaware has passed possibly the most stringent renewable portfolio standards in the country; however, the fact that prices are already high raises concerns that the State will have challenges attracting and retaining businesses that rely on competitive electric prices. Mr. Andrew noted that DEC has perhaps the largest percentage of renewable portfolio in the State of Delaware, including 253 MW of wind that is producing energy daily. In addition he stated that DEC has a significant amount of landfill gas biomass and some hydro power. Mr. Andrew advised members that DEC is currently working on major solar facilities and hopes to operate these within the next two (2) years.

Referring to Page 7 of the presentation, Mr. Cripps stated that according to the City of Dover balance sheet, the net asset value of the City of Dover plant is $80M - $90M; however, he noted that typically municipal accounting capitalizes property at a low rate, and this is something that DEC recognizes. Mr. Cripps stated that the City of Dover and DEC would need to structure how the transfer would occur and how payments could be made that would equal the revenue stream that the City has been accustomed to over the years. He explained that rates for City customers would convert immediately to Cooperative rates. Mr. Cripps advised members that DEC would open a Kent County Operations Center in Dover and would possibly lease facilities in use by the City of Dover. He indicated that qualified City electric department employees would be needed by DEC, and it is hoped that the consolidation would have no impact on human resources. In addition, he stated that the City would gain the Cooperative as a substantial taxpayer.

Referring to Page 8, Mr. Andrew stated that the rate differential per year is $25M as of 2010 and is based on the latest information from the City of Dover that is publicly available. He indicated that the future value, based on the net present value over a 15-year period is more than $200M to rate payers and more than $300M over a 30-year period. In regard to economic development, Mr. Andrew advised members that energy is the second largest cost to businesses and stated that DEC can preclude that by making the City of Dover one of the lowest priced incorporated areas in the region. Regarding long-term competitive power supply, Mr. Andrew stated that Old Dominion Electric Cooperative is consistently seeking new energy-producing and capacity-producing businesses.

In conclusion, Mr. Andrew advised members that a consolidated enterprise would be a benefit to everyone and that rates would not rise due to consolidation. He noted that rate increases will occur; however, mitigating and retaining competitiveness will assist in maintaining and bringing employment to the City of Dover. Mr. Andrew felt the net value of $93M is understated and that DEC can structure several financial instruments and provide a net payment or a combination of payment and an annuity. He stated that if there is a need to meet the outlay of capital that is currently obtained each year from the power plant, this can be accomplished. It was his recommendation that members authorize an in-depth analysis and business case with an independent third-party market specialist. Mr. Andrew noted that DEC reviewed public information over a two (2) week period

and that more detailed information will need to be reviewed. He indicated that DEC is a transparent organization and that they are willing to review the information together with the City. Mr. Andrew advised members that it is costing the rate payers of the City of Dover $68,000 per day for each day that the City does not move forward.

In response to Mr. Snaman's question regarding DEC taking over current City of Dover purchase contracts, Mr. Andrew stated that this is an issue that would take further research. He noted that if DEC purchase contracts run for several years and are out of market, this would be an obstacle that must be evaluated.

Responding to Mr. Snaman, Mr. Andrew stated that Delaware Electric Cooperative is a member of PJM.

In response to Mr. Blakeman's question regarding the transfer of longevity and benefits for current City of Dover employees, Mr. Andrew stated that there are several legal matters involved and that this is an issue that the City of Dover and DEC would need to resolve. He noted that these details would be included in a contract. Mr. Cripps noted that DEC employees are also organized under the IBEW union. He reiterated that DEC would be interested in having all qualified electric department employees join their team.

Responding to Mr. Hutchison's question as to whether the City could charge an excise tax if DEC were to make the purchase, Mr. Cripps stated that this matter would have to be determined by the solicitor. Mr. Cripps noted that the idea has been discussed and that he had not heard anyone dispute the possibility.

Mr. Leary stated that he came to the meeting with a good deal of scepticism which has increased since the presentation. He explained that DEC has listed the short-term benefits of purchasing the City of Dover's electric system but not the long-term benefits. Noting the importance of the City's current ability to utilize revenue generated by the electric utility, he indicated that a great deal of additional study would be required before he would agree with such a proposal. Responding, Mr. Andrew noted that the City would have access to an asset-owned facility that has a record of being very reliable and is a low-cost provider in the State of Delaware. He explained that he would welcome an opportunity to discuss additional questions that members may have regarding the long-term benefits.

In response to Mr. Anderson's question regarding how DEC will work with residents who require additional time to pay their utility bills, Mr. Cripps stated that DEC has policies and procedures in place for residents who are not able to pay their utility bills at the time they are due. He explained that the Board donated $250,000 last year to assist customers with their bills and works closely with the Salvation Army and Catholic Social Services. He noted that DEC has a lot of flexibility in setting up payments and provides opportunities for customers to meet their utility obligations.

Responding to Mr. Anderson, Mr. Andrew stated that the outage rates, at worst, should stay the same. He explained that DEC would have an operations center located in Dover and would utilize current City of Dover employees. Mr. Andrew noted that the increased infrastructure and technological efforts and capabilities should assist in this area and that supplying power to the City will not involve some of the challenges of rural areas, although tree trimming would be an important priority.

Responding to Mr. Bonar, Mr. Andrew felt that if the City decides to study the transfer of their electric system further and hire a third party consultant, DEC would be willing to support the cost, especially if a transfer of ownership would take place; however, he wanted to ensure that the City is focused on moving forward. Mr. Andrew stated that DEC is willing to provide a price on a Request For Proposal (RFP) basis that is equal and fair or to discuss such a proposal on an exclusive basis.

Mr. Bonar relayed his appreciation to DEC and to employees in attendance from the City of Dover. He advised members that if the City decides to move forward with the transfer of the electric system, he would insist that employees retain their benefits and longevity. Mr. Bonar noted that employees were promised these benefits when they were hired and felt that it was important to retain them. He explained that this a challenging and difficult decision that will require a great deal of study before Council makes a determination.

The Committee took no action.

By unanimous consent, the meeting adjourned at 5:46 p.m.

Respectfully submitted,

David L. Bonar
Chairman

DLB/DD/ac/js/tm
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Attachment
Attachment #1 - Presentation - Pros and Cons of Delaware Electric Cooperative Purchasing the City of Dover Electric System

DELAWARE ELECTRIC CO-OP
"We Keep the Lights On"

City of Dover
Utility Committee Meeting
June 27, 2011

Delaware Electric Cooperative, Inc.

Together We're Better…

ATTACHMENT #1
Utility Committee Meeting of 06/27/2011

DELAWARE ELECTRIC CO-OP

"We Keep the Lights On"

We believe the combined strengths of the Cooperative and the City of Dover will produce a **superior organization** to the benefit of our customer-owners.

DELAWARE ELECTRIC CO-OP
"We Keep the Lights On"

Key Benefits – *"Together we're Better"*

Dover Utility Customers

Rates - Lower

Power Supply

Economic Development

Retain Ownership

Direct Governance

Third Party Supply/Competition

Mitigate Risk

Financial Windfall

Cooperative Customers

Rates – Stability

Load Diversity

Kent County Presence

Protect Service Territory

Economies of Scale

Improved Load Factor

Lower Total Average Cost

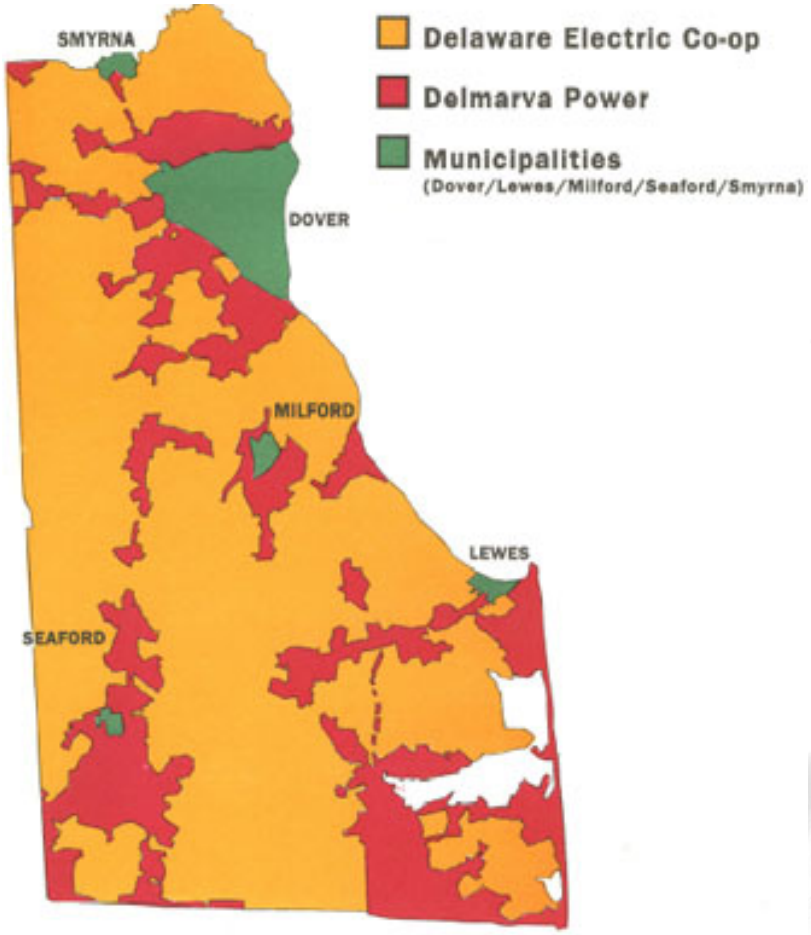
Infrastructure Leverage

Stakeholder Matrix	Advantages	Disadvantages
City of Dover Residents	Lower Rates Member-Owner Voting Rights/ Voice in Policy Supply Portfolio / Renewable Long Term Power Supply Economic Development Capital Credits Supply Choice Ops Center remains in Dover	HQ Office in Greenwood, DE
City Leadership/Elected Officials	Economic Development Eliminate Financial Risk Increase in Tax Revenues Citizens still own the utility Cash to Fund City needs Debt Elimination Reduced Liability Conversion of Reserves	Loss of subsidy thru Elec. Revenue Loss of Operational Control of System
Cooperative Members	Increased Rate Stability Increased customer base keeps future costs lower. Improved load factor lowers overall costs. Shared Infrastructure	Acquired area may be excluded from RUS Funding access. More Members Voting

Stakeholder Matrix	Advantages	Disadvantages
Cooperative Board of Directors	Increased Rate Stability Member Load diversity. Annexation threat Lessens. Improved economies of scale Commercial loads support generation decisions	
Commercial & Industrial Customers	Lower Rates Stability in Rates Ability to shop energy supply Energy Management Services and Technical support Capital Credits to bottom line	Off-tariff negotiating
Non-Resident Ratepayers	Lower Electric Rates Equal Representation Voting Membership	

DELAWARE ELECTRIC CO-OP

"We Keep the Lights On"





"Together We're Better"

DELAWARE ELECTRIC CO-OP
"We Keep the Lights On"

Challenges for all Delaware Municipalities…

Electric Rates are high

C & I sectors are constantly under competitive pressure

State & Federal Regulatory and Environmental burdens

Cities need $$$ to run their government

Competing for resources with other City utility services

Raise rates? Raise taxes? Spur economic development?

DELAWARE ELECTRIC CO-OP
"We Keep the Lights On"

"…rates are high in Delaware, particularly in industrial electricity, which is nearly 50 percent higher than the national average."

"Delaware has recently passed what are likely the most stringent renewable portfolio standard (RPS) in the country. However, the fact that prices are already high raises concerns that the state will have challenges attracting and retaining businesses that rely upon competitive electricity prices."

Analysis of Delaware's Economy, Sept. 2010
DEDO Study

DELAWARE ELECTRIC CO-OP
"We Keep the Lights On"

… the *"together we're better"* proposal

- Transfer Electric Business to the Cooperative.
- Co-op Provides equity pay-out based on fair market value.
- City/Co-op structures payments equal to transfers (multi-year)
- Rates for City customers would convert to current Co-op rates.
- Cooperative would open a Kent County Operations Center in Dover.
- Qualified City Electric Department employees would become DEC Associates.
- Gain in Membership necessitates two additional Board of Director positions from "Dover Districts".
- City gains substantial taxpayer/DEC.

DELAWARE ELECTRIC CO-OP

"We Keep the Lights On"

Is joining the Cooperative a prudent & viable option for the City of Dover in addressing….

Rate Affordability & Stability?

Economic Development?

Risk Mitigation?

Long Term Competitive Power Supply?

Continued Ownership and Governance?

Yes, Together we're Better!

DELAWARE ELECTRIC CO-OP
"We Keep the Lights On"

Conclusion

- Consolidated enterprise benefits all stakeholders
- Current DEC Rates will not rise due to consolidation
- Current City of Dover ratepayers will see immediate decrease due to the acquisition.
- Long Term Power Supply Costs and Risks will be mitigated.
- Positive Economic Impact to the Dover Community.
- Significant Financial Windfall to City of Dover.
- Time to authorize in-depth analysis and business case with independent 3rd party merger specialist.

Preliminary information based on the publicly available documents including COD Statement of Net Assets, 6/30/2010, COD Electric Revenue Fund, 6/30/2010, COD Annual Engineering Consultant's Report, 12/2010, COD 2010 Comprehensive Annual Financial Report, City of Dover Rates & Tariffs, IBEW 1238 Labor Contract, 6/2010, Brief Field Visit *

DELAWARE ELECTRIC CO-OP

"We Keep the Lights On"

Questions?



"Together We're Better"