

JOURNAL OF SPECIAL COMMISSION WORK SESSION
May 20, 2010

City Commission Work Session

Mayor Winters presiding

CALL TO ORDER: 8:35 a.m.

ROLL CALL: City Commissioners present: Michael J. Winters, Robert Jones, Bill Bronson, Mary Jolley and Fred Burow. Also present were the City Manager, City Attorney, Director of Fiscal Services/Executive Director of ECP and the Administrative Secretary.

ELECTRICITY BRIEFING – PART 1

City Manager Greg Doyon explained the importance of providing background to bring the Commission up to speed to address the public, make a decision on the future of Electric City Power Inc. (ECPI) and frame the City's future relationship with Southern. He added the specific contracts will be discussed in Part 2 at a later date.

City Attorney Jim Santoro provided a PowerPoint presentation on ECP. He explained that from 2003-2004, the City joined Southern Montana Electric G&T in partnership with five rural electric cooperatives, established ECP (Ordinance 2861) and the Montana Public Service Commission (MT PSC) issued a license to the City of Great Falls, doing business as ECP, to serve large customers. In 2005, Ordinance 2925 restructured ECP as a non-profit corporation, authorizing ECP to become ECP, Inc. (ECPI). Mr. Santoro noted that some contracts will reference ECP and some ECPI.

Commissioner Jones asked if there was a private board created when ECP was formed in 2003. Mr. Santoro responded no. Commissioner Jones asked if there was a private board created when ECP restructured in 2005. Mr. Santoro responded yes. He explained that in June, 2006, MT PSC issued a license to ECPI to serve customers, with an exception of small customers. In September, 2006, MT PSC expanded the ECPI license to serve all customers in a pilot program.

Mr. Santoro reported that liabilities include an October, 2004 agreement between Southern and the City that approved Southern receiving process water in lieu of cash for energy costs. Mr. Doyon noted Rich Ecke, *Tribune*, asked if there was an agreement that Southern would pay the City in lieu of taxes since an annexation could not be done. Commissioner Jolley stated there is reference to payments in lieu of taxes when a law (ordinance) changed allowing City services to property owners with unique circumstances outside the City limits. Director of Fiscal Services/Executive Director of ECP Coleen Balzarini explained the City services ordinance is also used by other entities.

Mayor Winters asked if the October, 2004 agreement would allow the City to pay Southern with water. Mr. Santoro responded that future water credit would be issued. Mr. Doyon noted the City had a verbal understanding of a rate that was not approved by the Southern Board after contracts had been negotiated. Ms. Balzarini explained Southern had received indicative pricing

from PPL and a proposed rate from Southern. When customers agreed to come on board with fixed rates, those contracts were entered into. Southern finalized their contract with PPL, which was higher than the indicative pricing. The City finalized its agreement with Southern. The Southern Board said there was too much of a disparity between the price the co-ops receive and the new contracts at that time and were not willing to approve the rate. They were willing to remove the cash outlay stipulation. Mr. Doyon explained the deficit started with that scenario.

Commissioner Jolley noted that ECP has not sustained itself from day one, as stated in the Ordinance. Mayor Winters commented that the issue is the disparity between what other people are paying and what ECP customers are paying. Ms. Balzarini agreed that the issue involves the cost to acquire the energy, the cost customers paid for the energy and how that was paid back.

Mr. Doyon asked if the Ordinance should be rewritten to include a timeframe for steps to be taken. He pointed out that the steps being taken now will map out the decision-making process by the Commission over the next couple months. Mr. Doyon explained the next session will provide a clearer picture when the contracts are discussed.

Commissioner Jolley expressed concern regarding assets attached to ECP. Commissioner Jones questioned if there was an opportunity in 2004 for the City to back out of the agreements due to the fact the indicative pricing was higher. He noted the City could calculate there would be a loss from the first day. Ms. Balzarini commented there was the intent that prices would increase in the future and would reach the blended rate. She added there were price increases, but not enough to catch up because of the way the contracts are structured through June, 2011.

Commissioner Burow questioned when Dorsey & Whitney's legal services were retained. Ms. Balzarini stated that probably took place in 2004. Commissioner Burow asked if the City has ever had anyone on board who knew how to prepare electrical contracts. Ms. Balzarini explained the July 1, 2011 contracts were written by Chapman & Cutler and Dorsey & Whitney, co-bond counsel with expertise in energy industry. Those existing contracts have the cost plus pricing that goes into effect July 1, 2011.

Commissioner Burow questioned if counsel advised the City they may be going down shaky road. Ms. Balzarini responded that is hindsight; the intent and the projections indicated the City would be out of this deficit by now, other than the \$1.1 million. She stated the projections were valid, but they didn't work.

Mr. Santoro noted the relationship with the generating plant and the water agreement. Ms. Balzarini explained that currently there is a deficit of \$1.1 million; as the revenues come in the direction will reverse. This is a self-correcting liability and a self-correcting deficit, assuming Highwood Generating Station (HGS) begins operation and uses City raw water.

Mr. Santoro reported that an additional liability, Resolution 9534, authorized borrowing \$1.5 million from First Interstate Bank in December, 2005. The purpose was to pay for the City's portion of design, engineering, feasibility and environmental costs to construct HGS.

Commissioner Jolley noted that in 2004 the City Commission authorized the expenditure of \$2

million from existing City funds to facilitate HGS development. Ms. Balzarini explained the \$2 million included authorizing borrowing \$1.5 million; \$500,000 was authorized from existing City funds. Commissioner Jolley also noted that some documents state the \$1.5 million were to be used to pay back the existing City funds from which the \$1.5 million had been taken. Mr. Doyon stated that Commission motion will be reviewed.

Mayor Winters asked who received the benefit of the \$1.5 million. Ms. Balzarini responded that the City's balance sheet shows an asset/investment in HGS. The City investment was \$2.4 million, including interest during construction. Of that amount, \$1.2 million were written off. Therefore, the remaining investment is \$1.2 million, with an expenditure of \$1.2 million. Mayor Winters questioned if that was a paper transaction or actual cash. Ms. Balzarini responded that \$2.4 million were transferred to Southern; \$1.5 million of which was borrowed.

Mr. Santoro noted an additional liability of approximately \$3 million interfund advances. Commissioner Burow questioned if a note from ECP is the only collateral for that amount. Ms. Balzarini explained that amount is one of the liabilities that could not be recovered if ECP were to be shut down now. In contrast, Ms. Balzarini noted that the \$1.5 million debt has an asset value that could be mitigated.

Mr. Doyon reported hearing on the radio Tim Gregori, General Manager of Southern, state that the City doesn't have an obligation in the \$85 million currently being invested in HGS, but rather part ownership. Ms. Balzarini explained the City has an obligation. When Southern charges the City for energy, part of the payment will be used to retire the debt Southern borrowed. Commissioner Burow questioned if the City would have a continuing payment to Southern if ECP is shut down. Ms. Balzarini agreed, unless ECP is sold.

Mr. Santoro reported that the current ECPI Board is the City Commission. He explained Ordinance 2925, as codified, states ECPI shall not issue or incur indebtedness without the prior approval of the City Commission. Also, the Board shall consider and recommend rates and charges for electricity supply and other services. Mr. Santoro also reported current ECPI bylaws state the Board may authorize any officer or officers, agent or agents, employee or employees, to enter into any contract or execute any instrument in the name or on behalf of the Corporation.

Commissioner Burow questioned whether the Board can make decisions without Commission approval. Commissioner Jolley questioned what form that Board authorization can take, i.e., written, verbal, telephone call, past practice. Mr. Santoro responded he believes authority must be in writing to present to the Commission. Commissioner Jolley explained that in the past there was authorization for officers or agents to enter into contracts; that is how clients and terms were obtained. She added that only rates required Commission approval.

Ms. Balzarini reported that all of the contracts were in place before ECPI was created. Mayor Winters questioned who made the contracts. Ms. Balzarini responded the City Commission. Mayor Winters asked the difference between ECP and ECPI. Mr. Santoro explained the powers of ECPI are set out through statutory language as a nonprofit, such as the corporation can sue or be sued, can purchase, lease or otherwise acquire, sell, convey property, etc. ECP was not under a statutory guideline.

Commissioner Burow commented that under ECPI, the Board did have power to negotiate contracts. Commissioner Jolley reported contracts were explained. Ms. Balzarini reported the City Commission d/b/a ECP approved contracts with the City, Great Falls Airport Authority, Federal Express, Montana Air National Guard, Great Falls Housing Authority, Great Falls Public Schools, Benefis, General Mills and Montana Refining. ECPI approved contracts with the Pilot Program customers, two small groups of new corporate customers and Barretts Minerals. Commissioner Jolley noted that, under ECPI, only rates required Commission approval.

Mr. Santoro commented there is a difference between rates and other provisions that will be distinguished in Part 2. He added there is a gray zone concerning Commission authority and Board authority. Ms. Balzarini commented that the ECP Board was very conservative in their understanding of their authority. She believes the majority of that Board did not believe they had the authority to take some of the actions that this Commission has questioned weren't done.

Mr. Santoro reported on ECPI customers. Industrial customers comprise approximately 55%. Mr. Doyon commented the breakout of customers will aid in rate discussions and deficiencies in meeting costs. Ms. Balzarini clarified that is a comparison of the amount each customer should be paying to pay for the services Southern provides ECPI. However, the City has other costs such as debt service expenses, operating costs, legal fees and interest from funds borrowed from other funds. Commissioner Bronson questioned if the percentages are an average of the expenses and revenues collected for the industrial group. Ms. Balzarini agreed. He also questioned if the average is true for each customer. She stated that is true. Mayor Winters asked the definition of a principal taxpayer. Ms. Balzarini explained they are one of the top ten taxpayers in the County.

Mr. Santoro also reported on percentages and expenses paid to revenues for Government customers, Non-Profit customers, Mid-Size Commercial customers and Pilot Program customers. Commissioner Burow questioned if customers in a co-op pay the same rate. Ms. Balzarini responded that would have been a nice goal, but because the City is not a co-participant in HGS, rates are different. Commissioner Burow noted that each group should pay a standardized rate. Ms. Balzarini stated she would like to get to one rate, at least for the energy supply side. Commissioner Jolley asked if the 22 MW still peaks as high as 29 MW. Ms. Balzarini explained that the 22 MW is an average.

Mayor Winters noted that most of the twelve residential customers are either City employees or Board members. He questioned how those customers were chosen. Ms. Balzarini explained that the PSC and Montana Consumer Council were involved in authorizing and setting up the Pilot Program. There are no other programs like this in the State. It was envisioned in 1997, during deregulation, there would be different choices like telephone service. There was a concern that small users would not be knowledgeable or properly represented. Each customer in the Pilot Program has some knowledge of the energy industry. Ms. Balzarini added that these customers are currently paying more than they would have paid with NorthWestern Energy. Mayor Winters commented that ECP appears to have been conceived on intention and perception.

Ms. Balzarini reported that Southern has entered into long-term market purchase agreements

with PPL through 2019. Those agreements envision the consumption of the five co-op members, as well as ECP customers. Commissioner Jolley asked if there is a dedicated mix of purchased power for ECP because of anticipated needs, as with the other co-ops and their anticipated needs. Ms. Balzarini responded there is a projection of needs, however, currently the projection for ECP is flat. Mr. Doyon commented on the creation of a generation facility and the need to have that portfolio to obtain financing. Southern's expectation is that ECP will be purchasing power through 2019 or beyond. Ms. Balzarini noted ECP has a contract beyond that date. Southern has energy supply contracts to service through 2019. Mr. Doyon added there is a potential strategy that will emerge over time that will be helpful to the Commission as it makes decisions.

Ms. Balzarini also reported that in 2008, the Wastewater Treatment Plant Co-Gen facility was built. This facility is a renewable resource that generates less than one-half MW (generally .35 MWh) since inception. Mr. Doyon commented that the track record of Co-Gen is not good. The facility requires waste products and there are also issues with the Malt Plant and EPA with the discharge. He noted that one of the options for eliminating the discharge issues and the H₂S gas is a pre-treatment plant.

Ms. Balzarini explained that since 2008, there has been a legislative mandate to provide funding that will help promote renewable energy development. Mr. Doyon commented the State recently adopted a statewide residential building code for energy efficiencies. Commissioner Bronson added that front costs for construction will increase.

Ms. Balzarini noted the 4% investment in HGS is anticipated to come online in 2011. Currently there is a 45 MW base. The next two 45 MW phases will be evaluated depending on the outcome of current performance. Mr. Doyon noted the City's fire services agreement with HGS must be considered and will be discussed at a later time.

Mr. Santoro noted the rate structure, particularly the target charge. Ms. Balzarini explained the dollar per MWh for the renewable energy credit in 2015 will increase to \$1.50. That is a known number. She explained the rate structure is based on the goal of ECP becoming profitable by 2019. In 2020 there is a planned increase to 20%, depending on the legislature. She noted there is a ceiling with a penalty of \$10; if the market for renewable energy credits goes higher, everyone will take the penalty. Mr. Doyon noted that he has requested Ms. Balzarini begin charting out what would be needed under different timeframes to restore the debt as soon as reasonably possible.

Commissioner Burow questioned if ECP customers who choose to not renew their contract and go with NorthWestern Energy can return as ECP customers when their contract is up. Ms. Balzarini responded that customers smaller than 5 MW who don't go to NorthWestern Energy but receive their supply elsewhere can return to ECP when their contract is up. She added that ECP customers cannot be served by rural co-ops. Commissioner Burow noted that losing some of the larger customers could be a concern.

Mr. Santoro reviewed timelines for considering contract renewals with ECPI customers. Benefis and Montana Refining will be up for renewal soon. Staff is continuing negotiations regarding early implementation of "Supply Cost" rate contracts. Mr. Doyon explained he would like the

Commission to consider rate approvals. Ms. Balzarini explained that because of the required notice process, she recommends moving forward simultaneously with Commission action on the notices and rates. She will ask the Commission for parameters, i.e. not exceed a certain amount or a percentage. She added another option could be to negotiate with each customer, present the contracts to the Commission and then proceed with the notice process. Another option could be negotiating with each customer and go through the process individually.

Mr. Doyon questioned if Ms. Balzarini could phone each customer and suggest a percentage increase. He noted she is proposing a hook for the early implementation. She would recommend stepping them up to the increase and providing a stabilized rate for the next five years. ECP would then be committed to that timeframe. Mr. Doyon noted the players involved are the residents/taxpayers in the City that purchase power, the Commission, ECP, staff, NorthWestern Energy, PSC, the Legislature, with Southern in the middle. The goal is to find the balance to recoup lost costs to replenish what has been invested over a period of time. He explained that it is unclear how Southern will react if the City signals a specific exit timeframe. Mr. Doyon added that the long-term desire of the Commission must be considered; is there a benefit to continue ECP.

Mr. Santoro explained there are several issues to consider. The next session will focus on ECP/customer contracts. That information can be used when considering ECP/Southern's commitment.

Ms. Balzarini reported that 10% across the board is not a viable option because each customer has a different rate. Some customers are already paying an adequate amount to cover their share of the costs. Other customers need to be paying in excess of 20%. The goal is to achieve a more consistent rate. Ms. Balzarini explained she has rate projections from Southern. Fixed costs are included, along with the unknown market change which could be 3% or less, or as high as 8%. Customers want to know ECP is only trying to cover costs and build adequate reserves. If ECP's rates go down, customers want their rates to go down because the Commission authorized rate movement within a certain window.

Commissioner Burow noted that all contracts go to cost-plus in 2011. He expressed concern with limiting cost-plus to a certain percentage and charging a larger percentage at a later date. Ms. Balzarini requested the Commission authorize certain parameters to offer to ECP customers. Any variables more or less will require Commission action.

Mr. Doyon stated Part 2 will be scheduled within a couple weeks.

ADJOURN

There being no further discussion, Mayor Winters adjourned the work session of May 20, 2010, at 10:00 a.m.