

November 4, 2009

Honorable Mayor Greg Nickels  
Honorable Bruce Harrell, Chair: Energy and Technology Committee  
Seattle City Hall  
600 4<sup>th</sup> Ave  
Seattle WA 98124

cc:

*Honorable Jean Godden, Richard Conlin, Richard McIver: Energy and Technology Committee*  
*Jorge Carrasco, Superintendent Seattle City Light*  
*Anthony Kilduff, Council Central Staff*  
*Members of the Rates Advisory Committee*

## **Report of the Seattle City Light Rates Advisory Committee** ***November 4, 2009***

### **Opening Statement:**

The Rates Advisory Committee began its work on September 15<sup>th</sup> and met on eight consecutive Tuesdays in addition to several phone calls and a few side-meetings in an effort to understand the issues related to our charge and to bring you the recommendations and observations in this report. We sought information and held discussions with the Seattle City Light Advisory Committee, former RAC members, representatives from Central Staff and City departments, Council support staff, City Light leadership and staff as well as the constituencies that we represent; the ratepayers of Seattle City Light.

Our mission was to evaluate the current revenue requirements of Seattle City Light (per City ordinance # 123032), evaluate the proposal the Mayor presented to City Council in October which included an increase in rates and changes to financial policies and to make other observations that might help inform the Council and the Mayor as you consider and take action on these issues.

The recommendations presented here are those for which a majority of RAC members present at the last two meetings agreed to bring forward. Minority or dissenting opinions and independent recommendations and observations by members of the RAC are included in the attached addendum and are either alternate or additional opinions of one or more members of the RAC apart from our consensus report.

### **Broad Context:**

First and foremost ratepayers want reliability and fair and predictable rates. Essential to being able to provide this to Seattle City Light's customers is a well-considered long range strategic plan that is supported and adopted by Council, supported by ratepayers and is part of a unified process that combines budgeting and rate-setting based upon the strategic plan. All three of these important planning elements are presently not in place and are not unified. It is the recommendation of the Rates Advisory Committee that achieving this becomes a paramount goal of Council as the governing body of the Utility going forward.

This concept is so important that it is worth stating twice. Only an adopted consensus strategic plan that is designed to achieve a sustainable and healthy Utility that provides reliability, dependability and fair and predictable rates through strong and enduring financial policies that drive a unified budgeting and rate-setting process is capable of weathering economic storm fronts already experienced twice in this decade. It is time for the City Council as the Board of Directors of the Utility to unify strategic planning, budgeting and rate-setting.

RAC members wish to note that when City Light budget development precedes the revenue requirement analysis process as opposed to both occurring simultaneously, it places the burden to balance the ledger almost solely on rate-setting. It also creates a situation where the evaluation of revenue requirements occurs on a one-sided per functionary basis. The processes should occur together allowing for informed adjustments of both income and expense until a package can be presented for debate and adoption.

The current financial situation of Seattle City Light is serious and significant. Based on current proposed spending levels, the Utility has reached a revenue shortfall of approximately \$140 million on total revenues and other funding from bonds of \$1.05 billion and is in deficit some 14% which will continue to grow without difficult and painful decisions that will impact all stakeholders.

Compounding the revenue shortfall is the reduction in debt service coverage ratio set by Council policy which has decreased from the 2.0 to 1.3 and which jeopardizes the Utility's ability to maintain its AA- bond rating at a time when the Utility will soon seek a new and bond sale to fund capital projects. A strong bond rating is also needed to capture a market opportunity to refinance existing debt at a lower interest rate, saving as much as \$35 million according to City Light financial planners.

The authorized and projected expense to revenue gap of \$140 million could not come at a worse time for the ratepayers of Seattle City Light. It is the experience of the members of the RAC that, in terms of economic recovery, many elected officials are still wishing for the best but need to recognize that any economic recovery is more likely to be slower and longer.

What is sometimes seen more clearly by residents and businesses is the cumulative burden of multiple economic impacts from multiple sources. An example would be two-year solid waste increases of 48% in the same time proximity of a budget proposal that includes SCL rate increases of 22% over 3 years if the electric wholesale market doesn't recover quickly or further budget cuts are not made. As representatives of citizens, labor and business in Seattle, it is our responsibility to ensure that you understand that many residents and businesses are struggling for their economic survival. We have received an overwhelming unfavorable response to the possibility that City Light rates might increase significantly over the next three years.

## **Observations & Comments:**

Recognizing the deepening economic situation for residents and our area employers, we also recognize there are few choices available to balance the Utility's financial situation and none that are not painful to all stakeholders. Before making our revenue requirement recommendations, we wish to further note the following:

1. We realize that the three elements of the Mayor's proposal are somewhat interrelated and dependant on each other: 1) The proposed rate increase, 2) relaxing the financial

policies of debt service ratio and debt service retirement schedule, and 3) the proposal to adopt a power rate adjustment mechanism or PRAM. Notably absent from the Mayor's proposal is a fourth and significant element; 4) that of deeper budget cuts at Seattle City Light. We believe that costs can be driven down from current spending levels.

2. Seattle City Light's O & M budget has increase 30% since 2007. Employment or positions at City Light in 2009 are some 130 positions or 7.4% higher than just one year ago at a time when most enterprises have introduced furloughs or reduced staffing by significant numbers. We were unable to analyze staffing appropriateness at City Light with the information that was provided.
3. We also recognize that Utilities have a unique business model. They not only sell an essential commodity, but they have an obligation to serve. SCL has not seen a loss of business as have many businesses – they have experienced a loss of revenue that is responsible for at least half the shortfall in net income. The utility cannot stop producing and delivering electricity in the same way a company that realizes a significant drop in sales can reduce production in an economic downturn. This is not to say some cutbacks should not be expected.
4. It should also be recognized that in recent years City Light has taken on additional spending, some in the form of unfunded mandates but some, in hindsight, were related to over-reaching initiatives that relied too heavily on the revenues from the sale of surplus power.
5. Acknowledging volatility in energy markets, the RAC has concerns with City Light's projection of \$120 million in revenue from surplus power sales on the wholesale market in 2010.
6. We believe that City Light has become too dependent on net revenues from surplus power sales. Having said this, we also believe that the Utility's power portfolio should remain long and that the budget dependence on revenue from these sales be adjusted lower.
7. The RAC found it difficult, if not impossible; to properly evaluate the appropriateness of City Light's budget and spending without more time and additional expertise.

### **Revenue Requirement Recommendations:**

Everything should be done to keep rates as low and stable as possible during this economic recession. Long-term rate predictability that is driven by an adopted long-range strategic plan that informs a unified budgeting and rate-setting process is in the best interest of the City, the Utility and ratepayers.

1. The RAC confirms that a rate adjustment of approximately 7-8% effective January 1, 2010 is needed to close the gap between revenues and expenses.
2. Immediate and further reductions in City Light's budget should be identified and implemented, but cuts to the conservation program should not be included in any

reductions as investments in this program yield the best return to the Utility and ratepayers.

3. The majority of RAC members cannot support and do not recommend adoption of a Power Rate Adjustment Mechanism or PRAM at this time.
4. Reducing the debt service coverage ratio to 1.6 seems an acceptable risk to the Utility's future bond rating knowing that City Council can make the case to the rating agencies should wholesale revenues fall too short the Council can and will act to increase rates when and if this occurs. In fact, the Council can more accurately target the magnitude of any additional rate adjustment needed and when they might be needed. This method of income stabilization is also preferred because it would yield more scrutiny by Council and both sides of net revenue (income and expense) can be considered as opposed to relying solely on increasing revenues to achieve net revenue needs.
5. Once short-term decisions on rates are made, we recommend that the Mayor and the Council transition immediately into strategic planning that envisions a future state of the Utility where no matter what crisis may arise, the impacts on the Utility and ratepayers are mitigated because an integrated strategic plan and long term revenue and spending plans have positioned the Utility to provide reliability and fair and predictable rates.

The Rates Advisory Committee believes that more time, information and expertise is needed to evaluate the risk to City Light's bond rating, the impact on rate stability and predictability, and the concerns associated with the PRAM or alternative revenue stabilization options. These should be considered in early 2010.

### **Addendum, minority reports and alternate opinions [Attached]**

**TO: Seattle City Council**  
**FROM: Dave Gering**  
**RE: RAC Minority Report**  
**11/02/09**

This is my first experience communicating with the City Council outside my role as an employee for a local industrial business association. I am submitting this report instead on my own behalf as an “at large” member of the Seattle City Light Rate Advisory Committee (RAC).

As an “At Large” representative to the RAC, I attempted to view the proposed “PRAM” and the proposed rate increases based on my personal experiences and perspectives as someone who has worked and lived with my family in Seattle since 1977, enjoying extremely dependable City Light electric service. I also tried to use what I learned through volunteer civic activities including serving as co-chair for the 2004 King County Governance Commission and as a member of a City of Seattle transportation citizen advisory committee that subsequently turned into the campaign committee for the “Bridge the Gap” initiative in 2006.

My experience on the county governance commission was highly valuable in learning how large organizations can fail to successfully adapt to external and internal changes and the value of effective, long-term strategic planning in the public sector. Bridge the Gap helped me learn about the challenge of providing basic infrastructure maintenance amid the evolving priorities of a large general purpose local government.

As a member of the RAC, I agreed with the majority findings and recommendations except for the differences listed below.

**1) More Leadership Engagement Instead of a PRAM.**

All city elected leaders who are ultimately responsible for City Light need to become more engaged with the major strategic issues that presently confront the utility and its ratepayers. In my view, a new Power Rate Adjustment Mechanism (PRAM) would make that engagement less likely to occur.

City Light is a billion dollar public enterprise. It was astonishing to learn that the utility operates without the guidance of a strategic plan agreed to by city leadership. During the RAC process, we learned a draft strategic plan was submitted to the City Council by City Light a couple of years ago. City Council staff suggested changes and sent the draft back to City Light. City Light made some changes, but instead of resubmitting the plan for council consideration, the utility simply published the plan on its own in 2008.

A strategic plan is no cure-all, but it seems likely that the public process of producing, discussing and debating a strategic plan might have identified the extent to which City Light had become dependent on surplus energy sales. The process might have even identified ways to avoid or better manage the present revenue shortfall.

**2) Not enough information for a rate recommendation.**

The proposed rate increases are being considered during the worst economic recession in 75 years. This makes it especially important for City Light to present the case for a rate increase in a clear manner that can be understood by ratepayers. Most of us on the RAC found it difficult to get adequate information about utility revenues and expenses. I agree with the majority report that it was “difficult, if not impossible, to properly evaluate the appropriateness of City Light’s budget and spending without more time and additional expertise.” Given this difficulty in evaluating the utility’s financial condition, I disagree with the RAC decision to recommend a rate increase. I don’t believe we had adequate information to judge if rate increases or reduced expenses are required at this time.

I appreciate the effort put into the RAC by City Light staff, but they seem to be subject to significant constraints when attempting to publicly discuss with a citizen group issues involving utility expenses, revenues and efficiencies. Directly engaging the City Council in these discussions might dramatically change the dynamics of the information flow.

**3) Guard our unique assets.**

According to the US Department of Commerce, the greater Seattle metropolitan area is the fourth biggest export production center in the nation with exports valued at \$57 billion in 2007. Thanks to our renewable regional hydro resources, that type of economic output is produced by one of the greenest electric generating systems in the world. This green industrial production capacity is a boon not only to our region, but the nation.

Our capacity to produce this environmental and economic “win-win” should be a cornerstone for any future strategic planning effort for the utility. City leaders should closely scrutinize initiatives that detract from this function and the utility’s ability to provide all ratepayers with access to such a remarkable renewable energy resource.

November 4, 2009

Individual observations and suggestions by: Rod Kauffman, Chair 2009 Rates Advisory Committee

This is the third RAC on which I have served since the mid-late 1990's. The size of the committee has varied from nearly 30 to the current format of nine. RAC's have been engaged as short as eight weeks to as long as several months. Eight weeks is probably too short, thirty is too large, nine is good if the talent and skills of the nine members cover a wide range of expertise. RAC members gave generously of their time and talent and were quite capable, but some were left feeling they still could not get to the depth of understanding they needed.

As mentioned in the consensus report, I urge the Mayor and Council to unite the budgeting and rate setting review process within an adopted strategic plan. I also urge you to consider that a citizen and business advisory committee that is charged only with revenue requirement review of the Utility after a proposed budget has already been presented is only half as effective in suggesting the appropriateness of rates as they could be. My point is that perhaps it is time that those who review and comment on revenue requirements and rates should interface at the time of budget development since revenue requirements are naturally impacted by the expense side of the equation. Commenting on income need after the fact diminishes the revenue requirement review effort to a pre-functionary exercise.

To develop this thought further and to be directly to the point, what is needed in my view is a change to one of two processes; either create a Utility Commission of industry experts supported with an independent auditor or financial analyst and staff who can dig much deeper into the Utilities business and financial needs and operations or combine the functions of the City Light Advisory Committee and Rates Advisory Committee and provide them the same independent financial expertise and support and charge them with a deeper review of both the income and expense side of the business and involvement in a strategic plan. Above all, please develop and adopt a short and long term strategic plan that informs the budgeting, rate-setting, and policy development process and envisions as its goal, a Utility capable of weathering or mitigating an economic crisis (ensuring rate predictability) and that considers an asset management program that fosters preventative maintenance as opposed to the practice of responding only to system or component failure. Progress has been made, new financial policies had been adopted, but here we are looking at suspending them or modifying them. I acknowledge that hindsight is 20/20 and that planning is a process and that policies evolve. I'm just suggesting that they evolve even better when informed by an adopted strategic vision.

The Council needs this help as the issues are complex and the history and institutional memory are too much to expect an elected City Council who is charged with so many other critical issues to remain strategically engaged over time. It's about the perspective and prospective vision function you provide as the Board of the Utility.

I respectfully suggest that a joint meeting of the City Light Advisory Committee and Rates Advisory Committee, Council and the Executive would foster dialogue on how we can combine budgeting, rate-setting and strategic planning into a new go forward process.

Thank you for asking me to serve on the RAC and for considering these observations.

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