



# CITY OF RIVERSIDE

## CITY COUNCIL MEMORANDUM



HONORABLE MAYOR AND CITY COUNCIL

DATE: August 26, 2003

ITEM NO: 61

**SUBJECT: TRANSFER FUNDS FROM ELECTRIC FUND'S COMPETITIVE TRANSITION ACCOUNT ("CTA") TO OPERATING, ENERGY RISK MANAGEMENT, AND REGULATORY RESERVE ACCOUNTS AND DISSOLVE THE CTA**

### **BACKGROUND:**

On June 16, 1998, the City Council approved establishing a Competitive Transition Reserve Account for the Electric Fund to handle competitive financial issues during the deregulation of the electric utility industry in California. This newly created account was restricted for internal purposes, and use of the funds required approval of the Board of Public Utilities and the City Council. Potential uses included but were not limited to: early pay-off of long term debt, buy-down of above market contracts, rate stabilization, or other competitive purposes. These funds would also be available for emergencies such as a natural disaster, to provide monies for repair of the utility plant, or other emergency purposes. The Washington International Energy Group Strategic Options Study, presented in 1997, also recommended establishing this cash reserve.

This fund was originally established by combining the Rate Stabilization and the Operating Cash Reserve Accounts, and was for a period of five years, during the phase-in of retail competition in the electric utility industry. At the end of the five-year period, when retail competition was expected to be fully phased in, it was anticipated that the Operating Cash Reserve Account would be re-established, and the Competitive Transition Account would be dissolved. The May 31, 2003, balance in this account is approximately \$28 million.

In June 2001, the Board of Public Utilities and City Council approved Riverside Public Utilities' Fiscal Policy. One component of the fiscal policy relates to cash reserve levels in order to reduce rate impacts to customers for certain extraordinary (one-time) events or projects, as well as covering normal budget variances. The approved policy sets minimum reserves of at least three months operating expenses, with a maximum amount of one year of operating revenues, and requires that reserves be evaluated annually.

In addition, in June 2002, the City Council, in conjunction with approval by the Board of Public Utilities, approved a three-year rate increase for the electric utility customers, along with the five-year electric financial plan. A portion of the approved three-year rate increase was to be used to build cash reserves. The levels outlined in the approved plan contemplated a five to ten year phase-in period to build reserves to the recommended level of \$75.0 million.

Although retail competition in the electric industry appears to be stalled for the near term, remaining competitive is still an important goal for the utility. Staff believes that continuing to build cash reserves is vital to the financial health and rate stability of Riverside Public Utilities (Utility), and will help mitigate risks and ultimately help avoid potentially huge rate increases in the future.

Staff has reviewed the current risk levels and contingencies, and recommends that three new reserve accounts be created to mitigate the known risks that the Utility currently contemplates, which could have a

significant financial impact. The overall level of recommended reserves will decrease by \$6.0 million, from the \$75.0 million contained in the current plan, to \$69.0 million – although a five to ten year phase-in period is still being advocated. The recommended reserve accounts and the associated components are:

**Regulatory Risk Reserves**

- Potential refund monies, previously collected in regulated markets (e.g. potential Federal Energy Regulatory Commission (FERC) refunds from the recent energy crisis or Participating Transmission Owner (PTO) revenues from the California Independent System Operator (ISO) which are currently under review by FERC). This amount would be subject to periodic adjustments when additional monies are collected that could be subject to refund at some future date.

**Risk Management Reserves**

- Price – the risk that power prices could experience similar volatility shown during the 2000-2001 energy crisis, (e.g. Riverside normally pays \$50-65 per MWh, but prices were as high as \$4,500 per MWh during the energy crisis)
- Counterparty credit – the risk of default by a party that Riverside purchases/sells power to/from

**Operating Reserves** – current fiscal policy requires a minimum ninety days operating expenses with a maximum level of one-year operating revenues that would be used for:

- Physical plant – risk of losing a major component (transmission line, generation plant, Vista substation, etc.,) which could take several months to rebuild, and would require continued payment of fixed costs and purchases of replacement power
- Weather – the risk that mild weather patterns will result in lower revenues to pay ongoing expenses
- Operating liquidity reserve – in the event of a major catastrophe that limits the ability of the Utility to provide power to Riverside residents, operating cash is needed to fund the ongoing distribution operations until such time as the system is restored and revenues are flowing to the Utility

In addition to amounts included above, staff recommends that additional funds be set aside to mitigate *unknown* risks from regulatory agencies (e.g. FERC, the ISO, the California Public Utilities Commission, etc.)

- Regulatory – *unknown* risk that the utility would have to comply with *new* policies or regulations (potentially retroactively applied) or assessed new fees/charges that could have a significant dollar impact to the utility

In order to help ensure rate stability and protect the financial health of the Utility, staff recommends that the Utility continue to build Cash Reserves in accordance with the intent of current electric financial plan and fiscal policy. Transferring the cash in the Competitive Transition Account into the three separate, internally restricted cash reserve accounts, then dissolving the Competitive Transition Account, and continuing to build cash reserves will help protect the Utility's customers from enormous future rate increases by mitigating the potential risks currently foreseen by the Utility. The Operating Reserve Account will also allow flexibility to address any other potential issues that are not currently contemplated, as well as allow use of the funds for other strategic purposes (e.g. early pay down of debt, funding new transmission or generation projects, etc.,). As an internally restricted account, any use of funds in the Reserve Accounts would require prior approval of both the Board of Public Utilities and the City Council.

The Board of Public Utilities unanimously approved these items at its regular meeting on August 1, 2003.

**FISCAL IMPACT:**

Establishment of the Regulatory Risk and Energy Risk Management Cash Reserve Accounts, and re-establishment of the Operating Reserve Account by transferring funds from the Competitive Transition Account, dissolving the Competitive Transition Account, and continuing to build additional cash reserves,

will help mitigate risks, and would help avoid large, unplanned, future rate increases to the Utility's customers. No additional appropriation of funds is needed.

**ALTERNATIVE:**

Maintain the Competitive Transition Account as presently established.

**RECOMMENDATIONS:**

That the City Council approve:

1. Establishing internally restricted Cash Reserve Accounts for Regulatory Risk, Energy Risk Management, and Operating;
2. Transferring \$4,000,000 into the Regulatory Risk Reserve Account from the Competitive Transition Account;
3. Transferring \$11,000,000 into the Energy Risk Management Reserve Account from the Competitive Transition Account;
4. Transferring the remaining balance from the Competitive Transition Account after subtracting out the above two transfers (approximately \$13 million) to the Operating Reserve Account; and
5. Dissolving the internally restricted Electric Fund's Competitive Transition Reserve Account as of July 1, 2003.

Prepared by:

Approved by:

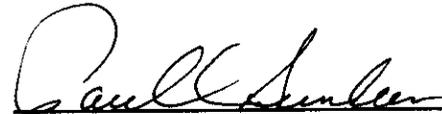
  
Thomas P. Evans  
Public Utilities Director

  
George A. Carvalho  
City Manager

Approved as to form:

Concurs with:

  
for Gregory P. Priamos  
City Attorney

  
Paul C. Sundeen  
Finance Director

TPE/DS/RK

Attachment: Board of Public Utilities minutes of August 1, 2003  
Proposed 2003/04 Reserve Levels - Draft

cc: City Attorney  
City Clerk

## DISCUSSION CALENDAR

➔ TRANSFER FUNDS FROM ELECTRIC FUND'S COMPETITIVE TRANSITION ACCOUNT ("CTA") TO OPERATING, ENERGY RISK MANAGEMENT, AND REGULATORY RESERVE ACCOUNTS AND DISSOLVE THE CTA

Finance/Rates Manager Reiko Kerr gave a background history of the Competitive Transition Account (CTA) and explained the reasons for transferring funds from the CTA account to the operating, energy risk management, and regulatory reserve accounts and dissolving the CTA account. Ms. Kerr answered questions from the Board members.

The Board of Public Utilities approved and recommended that the City Council approve:

- (1) Establishing internally restricted cash Reserve Accounts for Regulatory Risk, Energy Risk Management, and Operating;
- (2) Transferring \$4,000,000 into the Regulatory Risk Reserve Account from the Competitive Transition Account;
- (3) Transferring \$11,000,000 into the Energy Risk Management Reserve Account from the Competitive Transition Account;
- (4) Transferring the remaining balance from the Competitive Transition Account after subtracting out the above two transfers (approximately \$13 million) to the Operating Reserve Account; and
- (5) Dissolving the internally restricted Electric Fund's Competitive Transition Reserve Account as of July 1, 2003.

Motion – Gage. Second – Gipson.

Ayes: Acharya, Tavaglione, Gage, and Gipson.

Noes: None

Abstain: None

Absent: Peter Hubbard  
Jim Anderson  
Conrad Newberry, Jr., P.E. (Left meeting at 8:56 a.m.)

## CABLE TESTING AND REPLACEMENT UPDATE

Assistant Director Steve Badgett introduced Dave Bride, the project manager of the cable testing and replacement program. Mr. Bride made a PowerPoint presentation explaining the cable testing procedure, the results of the testing, and the projected schedule of which cables are to be replaced.

The Board of Public Utilities received and filed this staff report.

**DRAFT**

**RIVERSIDE PUBLIC UTILITIES  
PROPOSED 2003/04 RESERVE LEVELS  
(In millions)**

	<b>Current</b>	<b>Proposed</b>
	<b><u>Target</u></b>	<b><u>Target</u></b>
<b>Regulatory Risk Reserves</b>	\$ 4.0	\$ 4.0
<b>Energy Risk Management Reserves</b>	\$ 11.0	\$ 11.0
<b>Operating Reserves</b>	<u>\$ 60.0</u>	<u>\$ 54.0</u>
<b>Total Reserves</b>	<b>\$ 75.0</b>	<b>\$ 69.0</b>
<b>Transfer from CTA (estimated)</b>		<u><b>28.0</b></u>
<b>Balance left to fund</b>		<b>\$ 41.0</b>

**Proposed combined reserves rounded to \$69M—reduction of \$6M**

**Phase in over 5 – 10 years is still recommended**

**DRAFT**

RIVERSIDE PUBLIC UTILITIES  
PROPOSED 2003/04 RESERVE LEVELS  
(In millions)

	<u>Current level</u>	<u>Proposed level</u>
<b><u>Regulatory Risk Reserves:</u></b>		
–Potential Refund Monies in regulated markets *	\$ 4.0	\$ 4.0
<b><u>Energy Risk Management Reserves:</u></b>		
–Energy Price Volatility Risk Reserve (unhedged power)	10.0	10.0
–Counterparty Risk Reserve (minimum floor)	<u>1.0</u>	<u>1.0</u>
Subtotal	\$15.0	\$15.0
Transfer from CTA		<u>(15.0)</u>
<b>Balance remaining to fund</b>		<b>\$ 0.0</b>

\* Subject to monthly adjustment

**DRAFT**

RIVERSIDE PUBLIC UTILITIES  
PROPOSED 2003/04 RESERVE LEVELS  
(In millions)

	<b>Current</b>	<b>Proposed</b>
	<u>Target</u>	<u>Target</u>
<b><u>Operating Reserves</u></b> --90 days cash to fund:	\$ 57.5	\$50.0
--Loss of Physical plant		
--Revenue contingency for weather related reductions		
--Operating expenses (3 months, July – Sept)		
Regulatory Risk Reserve (CPUC, FERC, ISO etc.)	1.0	4.0
Transition funding for PERS increases	<u>1.5</u>	<u>0.0</u>
Subtotal operating reserve	\$ 60.0	\$ <u>54.0</u>
Transfer from CTA		<u>(\$13.0)</u>
<b>Balance to fund from future revenues</b>		<b>\$41.0</b>

61-7