MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

Rely on us.

TO: Commissioners Simpson, Brown, Helgeson, Manning and Mital

FROM: Dean Ahlsten, NERC Compliance Officer

DATE: September 6, 2013

SUBJECT: Potential McKenzie River Service Territory Transfer

OBJECTIVE: Information Only

Issue

Earlier this year, EWEB's Board and Management discussed the concept of transferring EWEB's McKenzie River Valley service territory. The Board conceptually supported opening discussions with other utilities. EWEB approached Lane Electric Cooperative (LEC) management proposing to enter in to discussions regarding the feasibility of transferring EWEB's McKenzie River Valley service territory to LEC. Teams were assembled and have been working on specifics of a possible transfer. This memo provides a brief update on the status of those discussions.

Background

EWEB serves approximately 3,100 customers in the McKenzie River Valley within an area bounded by Weaver Road in Springfield to the west and Thompson Lane just to the east of Vida. EWEB began serving this area in the 1940's or earlier after securing federal wholesale power from the new Bonneville Power Administration (BPA). Serving the McKenzie River valley also made sense because of the proximity of EWEB's Leaburg and Walterville hydroelectric projects.

These customers are currently served out of EWEB's Leaburg, Walterville, Hayden Bridge and Thurston Substations and they are surrounded on three sides by LEC's service territory which extends to Blue River, McKenzie Bridge and the surrounding areas. Retail loads for the area average around six-and-a-half MW's and gross revenue is approximately $5.1 million per year. This transfer would represent approximately a two-and-a-half percent decrease in EWEB load and a twenty-five percent increase for LEC.

The geographic area is 160 square-miles which constitutes approximately 70% of EWEB's overall service territory. Customer density in this rural area is just under 20 customers per distribution-line-mile as compared to just over 90 customers per distribution-line-mile in the metropolitan area.

Discussion

With the number of electric service providers in the Eugene-Springfield and surrounding area, boundary adjustments and customer exchanges are fairly common; however transactions involving this many customers and/or size of electrical load are infrequent. In the past 25 years EWEB has been party to four significant territory transfers: Willow Creek in 1989 (LEC); Gateway/Harlow Road in 1994 (SUB); Glenwood in 2001 (SUB); and Sierra Pine in 2005 (SUB).
EWEB/SUB boundary adjustments have been driven by changes in City jurisdiction / limits and the Eugene-Springfield Metropolitan General Plan goal of each municipality providing service within

the area of that municipality. Non-municipal providers such as Cooperatives and Public Utility Districts have PUC-approved service territories and transfers are often done to better align customers within these approved boundaries. The 1989 EWEB/LEC Willow Creek transfer also involved an 'ability to serve' component in the discussion. Underlying principles in all of these transactions include operational efficiency and avoidance of duplicate electric facilities.

EWEB management has discussed potential benefits associated with this transfer a number of times over the years, most recently in 2010 as a potential cost reduction strategy and again in 2012 when it was decided to pursue LEC's interest and the financial details. Some of the key considerations, as outlined in EWEB's/LEC's joint press release and customer letters sent out on July 23rd (attached), include the following:

- Rate parity – While EWEB and LEC rate designs differ based on kWh consumption, customer bills would be somewhat similar at average consumption. Due to rate design differences, individual customer bills could have fairly small differences at either below average or above average consumption.
- Comparable service models – EWEB and LEC service centers are within a few miles of one another indicating that response times would be comparable.
- Better alignment with operational models – EWEB's structure (people, process and tooling) is optimized for service to its 97% urban customers. Similarly LEC is optimized for service to its rural community customer base.
- Board representation – If served by LEC, customers in this area would be afforded the ability to elect their own representative on the Board.

When EWEB and LEC teams met for the first time on March 13th we established a set of mutual objectives including: 1) Neither EWEB, LEC, upriver customers or either party's other customer base would be disadvantaged by this transaction; 2) Achieve a decision by early summer in order to coordinate with 2014 budget processes; 3) Target January 1, 2014 for execution of the transfer; and 4) Minimize or eliminate inconvenience for customers.

Discussions have included the following components; a brief status report is provided for each area:

1) Cost Valuation – Establishes the sale price for associated assets (poles, transformers, switches, etc.). EWEB staff has completed a limited appraisal of these assets, based on plant inventory and age data, producing estimates for Original Cost Less Depreciation (OCLD) and Replacement Cost New Less Depreciation (RCNLD). RCNLD is defined as the cost of constructing a replica of the property at current prices, less accrued depreciation. OCLD is defined as the original cost of the property when it was put in service, less accrued depreciation. EWEB agreed to share costs with LEC for an independent review of this study which was completed in August by CVO Electrical Systems, LLC.

2) Transfer Costs – EWEB's direct costs associated with the transfer including unamortized conservation measures, outstanding loan balances, and costs for transferring and closing out customer and facility records, easements, etc. This also includes metering costs and any facilities reconfiguration that might be required to complete the transfer.

3) Power Supply – Under the terms and conditions established in BPA's Tiered Rate Methodology and EWEB's BPA Power Sales Agreement, EWEB will be required to allocate

and transfer to LEC a portion of its contract rights to purchase power at BPA Tier 1 Priority Firm power rates. In addition to transferring a portion of EWEB's Contract High Water Mark (CHWM), EWEB will also allocate a share of its Contract Demand Quantities (CDQs). CDQs are pre-determined monthly demand quantities based on historical data and used to determine the demand charge billing determinant for Load Following and Block-only customers. Transferring of CHWM and CDQs are subject to agreement by both Parties as well as BPA's approval. EWEB staff has been working with LEC and Pacific Northwest Generating Cooperative (PNGC) to reach an agreeable allocation level for CHWM and CDQ contract rights, assuming this to be a stand-alone load.

4) Long-Term / Temporary Lease of EWEB Transmission & Substation Capacity – If the transfer goes forward in 2014, for a period of time LEC will need to transfer energy purchases from BPA over existing EWEB transmission and substation infrastructure in order to deliver it to load. Terms of those transfers are defined in EWEB's Open Access Transmission Tariff (OATT) for Point-to-Pont (PTP) service. LEC has long-term plans to construct their own distribution substation near the Leaburg powerhouse, joint with EWEB, at which point they could take transmission service directly from BPA on its Blue River – Thurston 115 kV line.

The teams have exchanged initial conceptual proposals and have some gaps to close in terms of the purchase price, power supply issues and reimbursable expenses. The current target for execution of the transfer is April 1, 2014 (assuming a transaction is to occur). EWEB has agreed in concept to commit resources, on a temporary and reimbursable basis, to support transitional gaps in meter reading and storm response for the area.

There are some significant challenges to making a transaction of this nature work. As a general principle, 3 basic groups of customers generally need to be at least neutral or ideally all better off. The first group is the customer group potentially transferred from EWEB to LEC (McKenzie Valley). Based on the relative parity of rates, this appears to be possible. However, we also plan to listen to customer input at the September 17th meeting. The second group is remaining EWEB customers. Holding this group neutral to better off means that no "stranded" or fixed costs currently borne by the McKenzie customers are transferred to remaining EWEB customers. The third group is existing LEC customers. Because this transaction would be a very large increase in LEC customer base (about 25%), LEC is rightly concerned about impacts on its existing customer base, financial and operational impacts. While LEC and EWEB teams are still discussing the potential transaction no one underestimates the challenge of keeping important interest groups needs met.

LEC management will be discussing the transfer with its membership during its District meetings scheduled for September and October. Thus far, limited feedback has been received from upriver customers following the July 23 letter. Two customers were seeking clarification on whether or not they were included in the transfer, one had questions regarding the preservation of an existing photovoltaic net metering agreement with EWEB, and three have expressed concerns about maintaining existing levels of reliability, particularly during storm response. We have heard indirectly about some smart meter questions.

Recommendations/ Requested Action

No action is requested at this time. Please contact Dean Ahlsten at dean.ahlsten@eweb.org or 541-685-7136 with questions.

Attachments:

1) July 23, 2013 Press Release
2) July 23, 2013 Customer Letter

July 23, 2013

EWEB, Lane Electric discuss possible territory transfer

The Eugene Water & Electric Board and Lane Electric Cooperative are exploring a possible service territory transfer of EWEB's McKenzie River Valley territory to Lane Electric.

Representatives of the Eugene-based public utilities have been in preliminary discussions about a potential service territory transfer for several months. Based on a preliminary evaluation, it appears that a transfer could make technical, operational and general business sense. Over the past week, board members of EWEB and Lane Electric instructed staff to continue exploring a potential transfer.

"It's fairly common for utilities to discuss voluntary changes to service territory that make technical, operational, business and customer sense," said EWEB General Manager Roger Gray. "If either Lane Electric or EWEB believes such a transaction did not make sense, it would not occur. Part of evaluating what 'makes sense' includes customers' view on any transfer."

EWEB's McKenzie River Valley territory includes almost 3,100 customers stretching from Thurston Road just outside of the Springfield city limit east to Thomson Lane near Vida. Lane Electric's service territory generally surrounds this area on three sides, and includes the Blue River and McKenzie Bridge communities.

"While a territory transfer appears to make sense at this preliminary stage, we want to visit with EWEB's upriver customers as well as our members to hear their thoughts about a transfer," said Lane Electric General Manager Rick Crinklaw.

If the governing boards of each public utility authorize a transfer, it would represent a 25 percent increase to Lane Electric's customer base. "That's a big step, and we want to make sure our members have a chance to talk about it with us about it first," Crinklaw said.

EWEB and Lane Electric plan to discuss the possible transfer with their customer-owners in September and October during regularly scheduled meetings. The utilities also plan to hold a series of upriver community information meetings to answer questions and listen to customer viewpoints on a possible transfer.

A preliminary evaluation of the possible transfer indicates some solid reasons to continue exploring what could become a beneficial transaction:

- Lane Electric and EWEB rates are very similar. Although the rate structures have some differences, actual bill impacts depending on consumption levels would be marginal.

- EWEB and Lane Electric both dispatch troubleshooters and repair crews from their respective west Eugene operations facilities, so response times would be similar.

- Lane Electric's service model is optimized around a rural utility model. More than 95 percent of EWEB's customers live in the city of Eugene, which makes it primarily an urban service model. Both utilities have excellent service records that stress reliability, and that would not change.

- EWEB commissioners are elected based on geo-political boundaries (city of Eugene voting wards), which means EWEB's upriver customers are not able to vote for their utility representative. If those in the McKenzie River Valley area become Lane Electric customers, they would participate in Lane Electric elections.

The potential transfer does not include any of EWEB's McKenzie River generation facilities, which include the Leaburg/Walterville hydro project and the Carmen-Smith hydro project. EWEB would still retain certain transmission lines that deliver power from those generation projects.

For more information, contact:

Dave D'Avanzo, Lane Electric Cooperative
541-485-1151

Joe Harwood, Eugene Water & Electric Board
541-685-7471

July 23, 2013

Dear EWEB customer,

The Eugene Water & Electric Board and Lane Electric Cooperative are exploring a possible service territory transfer of EWEB's McKenzie River Valley territory to Lane Electric. No decision has been made, and won't be made, until Lane Electric and EWEB staffs have a chance to meet with potentially affected customers to hear their thoughts about a transfer.

Representatives of the Eugene-based public utilities have been in preliminary discussions about a potential service territory transfer for several months. Based on a preliminary evaluation, it appears that a transfer could make technical, operational and general business sense. Over the past week, board members of EWEB and Lane Electric instructed staff to continue exploring a potential transfer.

"It's fairly common for utilities to discuss voluntary changes to service territory that make technical, operational, business and customer sense," said EWEB General Manager Roger Gray. "If either Lane Electric or EWEB believes such a transaction did not make sense, it would not occur. Part of evaluating what 'makes sense' includes customers' view on any transfer."

EWEB's McKenzie River Valley territory includes almost 3,000 customers stretching from Thurston Road just outside of the Springfield city limit east to Thomson Lane near Vida. Lane Electric's service territory generally surrounds this area on three sides, and includes the Blue River and McKenzie Bridge communities.

"While a territory transfer appears to make sense at this preliminary stage, we want to visit with EWEB's upriver customers as well as our members to hear their thoughts about a transfer," said Lane Electric General Manager Rick Crinklaw.

If the governing boards of each public utility and the Oregon Public Utilities Commission authorize a transfer, it would represent a 25 percent increase to Lane Electric's customer base. "That's a big step, and we want to make sure our members have a chance to talk about it with us about it first," Crinklaw said.

EWEB and Lane Electric plan to discuss the possible transfer with their customer-owners in September and October during regularly scheduled meetings. Lane Electric representatives will be on hand at EWEB's Sept. 17 upriver Board meeting at the Leaburg Community Center to answer any questions affected customers might have on a transfer. EWEB representatives will also be on hand at the September or October during Lane Electric's McKenzie District meeting

to talk about a transfer. Both utilities will also hold additional upriver information meetings later in the year.

A preliminary evaluation of the possible transfer indicates some solid reasons to continue exploring what could become a beneficial transaction:

- Lane Electric and EWEB rates are very similar. Although the rate structures have some differences, actual bill impacts depending on consumption levels would be marginal.

- EWEB and Lane Electric both dispatch troubleshooters and repair crews from their respective west Eugene operations facilities, so response times would be similar.

- Lane Electric's service model is optimized around a rural utility model. More than 95 percent of EWEB's customers live in the city of Eugene, which makes it primarily an urban service model. Both utilities have excellent service records that stress reliability and that would not change.

- EWEB commissioners are elected based on geo-political boundaries (city of Eugene voting wards), which means EWEB's upriver customers are not able to vote for their utility representative. If those in the McKenzie River Valley area become Lane Electric customers, they would participate in Lane Electric elections.

The potential transfer does not include any of EWEB's McKenzie River generation facilities, which include the Leaburg/Walterville hydro project and the Carmen-Smith hydro project. EWEB would still retain certain transmission lines that deliver power from those generation projects.

Please don't hesitate to contact Joe Harwood or Dave D'Avanzo should you have any questions or concerns. Their contact information is below.

Sincerely,

Roger Gray, General Manager
Eugene Water & Electric Board

Rick Crinklaw, General Manager
Lane Electric Cooperative

Joe Harwood, EWEB
541-685-7471, joe.harwood@eweb.org

Dave D'Avanzo, Lane Electric
541-484-1151, dave.davanzo@laneelectric.com