

OFFICIAL PROCEEDINGS OF THE
BOARD OF WATER, ELECTRIC,
AND COMMUNICATIONS TRUSTEES
OF THE CITY OF MUSCATINE, IOWA
FEBRUARY 24, 2009 – 5:30 P.M.

The Board of Trustees met in regular session at Muscatine Power and Water's Administration/Operations Building, 3205 Cedar Street, Muscatine, Iowa, on Tuesday, February 24, 2009 at 5:30 p.m., CST.

Chairperson Doyle Tubandt called the meeting to order. Members of the Board were present as follows: Trustees Doyle Tubandt, Warren Heidbreder, Scott Ingstad, Joan Axel and Gary Carlson.

Also present were Sal LoBianco, General Manager of Muscatine Power and Water; Donald W. Kerker, Board Secretary; Duane J. Goedken, Board Attorney; Charles Potter, KWPC/KWCC Radio Station; Ray Danz, Erika Cox, Brandy Dulceak, Terry Curry and Brenda Christensen of Muscatine Power and Water.

Chairperson Tubandt asked if there was anyone in attendance who wished to make any public comments.

There were no public comments.

The minutes of the January 27, 2009 public hearing and regular meeting were presented, as previously submitted to all Board members in written form. Trustee Ingstad moved, seconded by Trustee Carlson, that minutes be approved and placed on file as submitted. Motion carried. All Trustees present voted aye.

The January 27, 2009 Audit/Finance Committee meeting minutes were received and placed on file.

The list of expenditures and transactions for January was presented as previously submitted to all Board members in written form. After review and discussion, Trustee Heidbreder moved, seconded by Trustee Axel, to ratify payment of \$6,845,322.23 for the Electric Utility, \$341,727.23 in the Water Utility, and \$1,833,318.79 for the Communications Utility for a cumulative total of \$9,020,368.25. Motion carried. All Trustees present voted aye.

The next item on the agenda was a recommendation to approve the revised Unit 9 Turbine Overhaul Project. This project was approved as part of the 2009 operating budget, with the project cost of \$1,000,000. Several issues have arisen since the project was developed in the summer of 2008 that require the approved amount for the project be increased to \$1,400,000.

When the project was originally developed, the estimated time to complete the overhaul was planned for four weeks. Since that time, it has been determined that the boiler needs to be chemically cleaned during the last week of the scheduled outage. Therefore, in order to properly support the chemical clean, the turbine overhaul needs to be completed in three weeks instead of the scheduled four weeks.

The principal drivers for this increase in project costs is the need to supplement plant staff with outside labor to allow us to complete the overhaul within the modified three-week timeframe, along with the recently identified need to replace several stages of the turbine's inter-stage shaft sealing packing. The estimated cost for outside labor is

\$195,000. An additional Field Support Engineer from General Electric (GE) will also be needed to support the around the clock work schedule. That additional cost is estimated at \$136,000. GE will also be providing a technician to balance the turbine/generator at the end of the outage at an estimated cost of \$30,000. The estimated cost of replacing the shaft packing is \$100,000.

Consideration was given to extending the outage one week to avoid the additional outside support costs, but that option is not cost effective since each day of outage on Unit 9 costs the Utility approximately \$150,000 (now closer to \$66,000 to \$70,000 due to softening wholesale prices) in purchased power and lost power sales opportunity costs.

After review and discussion, Trustee Carlson moved, seconded by Trustee Axel, to approve the revised Unit 9 Turbine Overhaul Project for the new amount of \$1,400,000.00.

Mr. LoBianco next reviewed the General Manager Report. As previously discussed with the Board, Muscatine Power and Water was participating in the Iowa Municipal Base Load Generation Study. This study pertains to a proposed base load generating unit at Muscatine Power and Water's site. The study was sponsored by several municipal entities, including Muscatine Power and Water. The cost of the study was prorated to each entity by their nominated megawatts or share of the proposed generating unit. The study has progressed in phases, both Phase I and II have been completed.

Phase I of the study was a feasibility study of MP&W's generation site and included the review of six coal-fired technologies, their associated projected bus-bar costs, and related environmental considerations. Phase I found no major flaws with the concept of constructing a 400 megawatt generating unit at the MP&W plant site.

Phase II of the study, included a high level transmission study, permitting study, and MISO market, locational marginal pricing (LMP) study. The study sponsors met in April to review the results of Phase II and concluded that the next phase would be detailed design and permit application. The sponsors decided that the ensuing months should be used to determine each company's interest in continuing with the project. To help MP&W determine how its' interest in an 80 MW share of the unit would impact costs, and to help quantify other potential benefits and risks of such an investment, Black and Veatch was hired to complete a Generation Resource Planning Study.

Final results of the study by Black and Veatch indicated that it is more cost effective for MP&W to retain and continue to operate Units 7 and 8, especially in this time of regulatory uncertainty. A copy of the Executive Summary of the Study is available on request. MP&W has communicated with the lead entity of the Municipal Base Load Study that based upon the results of our planning study MP&W is not interested in participating further in this potential project, and therefore MP&W's site is not available at this time for further consideration as a potential site for a joint project.

Costs for participation in both Phases of the Base Load Study and Resource Planning Study were \$150,272; \$66,272 for Phase 1 and Phase 2 of the study and \$84,000 for the Generation Resource Planning Study done by Black and Veatch.

Mr. LoBianco informed the Board that a meeting was held with the Personnel and Public Relations Committee on February 13 to review the status of recruitment, retention and employee compensation activities, and to gather input for the compensation study. Market models recommended by the consultant were reviewed and discussed. The annual salary merit program was also discussed. Mr. LoBianco expressed his appreciation for the feedback from Trustee Axel and Trustee Carlson. Staff anticipates meeting with the

Committee again when the compensation study is completed for further review and to prepare for the annual salary merit recommendation.

Next Mr. LoBianco reviewed Muscatine Power and Water's application for the Governor's Iowa Environmental Excellence Award. Staff prepared and submitted applications for the Governor's Iowa Environmental Excellence Award and two Special Project Awards. The awards have been given annually since 2001 to recognize leadership and innovation in managing Iowa's natural resources. The program seeks to honor applicants that demonstrate result-oriented, sustainable strategies including reducing waste generation, developing energy efficiency or renewable energy technology, establishing educational and/or prevention programs that result in environmental improvements, and creating programs or processes that balance economics with the environment.

The MP&W Special Award applications focused on the specific topics of Waste Management and Energy Efficiency/Renewable Energy. The MP&W Excellence Award application included information from the Special Award applications, in addition to other information. The applications highlighted air pollutant emissions reductions from the generating units, utilization of coal combustion products such as slag, fly ash and synthetic gypsum, community-wide energy efficiency education for students, residents, businesses and contractors, along with the Utilities energy audit program, rebate program and participation in "Trees Forever."

Monsanto is a past local winner. They received the award for their Sand Prairie Restoration Project as part of the Big Sand Mound Nature Preserve and their associated educational activities. Cedar Falls Utilities also has won an award; their accomplishments included developing the Iowa Distributed Wind Generation Project, supporting Cedar Falls "TREES," reducing carbon dioxide emissions and having the highest number of customers in Iowa participating in a renewable energy program.

The awards are coordinated by the Governor's Office, the Iowa Department of Natural Resources, the Iowa Department of Agriculture and Land Stewardship, the Iowa Department of Economic Development, the Iowa Department of Education, the Iowa Department of Public Health, and the Iowa Waste Reduction Center.

The applications are currently being judged by the above mentioned groups and the recognition ceremony will be sometime in June. Applicants can expect to be notified of results sometime in the next few months. The results will be communicated at a future Board meeting. Trustee Heidbreder questioned if the number of man hours put into something like this was an excessive amount that could be spent doing something else. Mr. Danz replied that hours were minimal as the people filling out the application were very familiar with the projects.

Mr. LoBianco communicated that outage energy has been secured for the Unit 9 maintenance outage, scheduled for the month of March. This purchase was approved in the 2009 Operating Budget in the amount of \$70/MWh for a total estimated cost of \$2,895,480. The actual purchase totaled \$1,930,286.00 (\$50.06/MWh) for an anticipated savings of over \$950,000. The softness of the wholesale energy market worked in our favor in this instance.

The next item on the GM report was that EPA promulgated the Clean Air Interstate Rule (CAIR), which became effective on July 11, 2005. This rule is designed to further reduce sulfur dioxide (SO₂) and nitrogen oxide (NO_x) emissions from power plants in the eastern United States using a "cap and trade" program. A cap and trade program sets a maximum limit on tons of emissions in the area covered by the program. EPA allocates

authorizations to emit SO₂ and NOx in the form of emissions allowances (an allowance equals one ton of a pollutant) to each source in the program, with the total amount of allowances limited by the cap. A source is required to have an adequate number of allowances for the tons of a pollutant that it emits. Each source can design its own compliance strategy to meet the overall reduction requirement, including sale or purchase of allowances, installation of pollution controls, implementation of efficiency measures, etc.

The NOx reduction program was set to begin January 1, 2009 and the SO₂ program in 2010. However, on July 11, 2008 the US Court of Appeals for the District of Columbia, in response to several petitioners, vacated the rule, but did not remand it back to EPA for a remedy. Subsequently, EPA and others asked for a rehearing of the rule by the court. In response, the US Court of Appeals remanded CAIR back to EPA without vacatur on December 23, 2008. This action makes the rule effective again until EPA remedies the flaws in the rule or promulgates a new rule.

All this legal maneuvering occurred during the projection/budgeting process. The cost of NOx allowances was not included in financial projections, or the operating budget, because the rule was not reinstated until December 23, 2008. The number of NOx allowances the EPA allocated to MP&W is not adequate for the number of tons of NOx emitted. This shortfall is not a surprise. The decision to install Overfire Air NOx reduction equipment on Units 8 and 9 and purchase additional allowances was based on MP&W's least cost compliance plan that was adopted from the Black and Veatch Environmental Compliance and Power Supply Study completed in February 2006.

Staff has estimated the number of NOx allowances needed for compliance in addition to those allocated to MP&W by EPA. Two types of NOx allowances are needed. They are annual and seasonal (period May – September) allowances. Allowance prices are market based and differ for annual and seasonal allowances. The Board was provided a table showing the number of each of the two types of allowances needed and their estimated annual cost. The issues and the related financial impacts had also been reviewed with the Audit/Finance Committee during its January 2009 meeting.

As long as CAIR is in effect in its current form, and additional NOx emissions controls are not installed on Units 8 and/or 9, MP&W will need to purchase allowances annually. Staff is developing an allowance purchase strategy for 2009 needs and future years. At this point, it is Staff's recommendation that approximately one-half of the needed allowances for 2009 be purchased in the near term to help hedge against future potential price spikes and/or volatility that may be result of the final disposition of the rule by EPA. It is widely believed that under the current Administration that the final outcome will not be a vacatur of the rule by EPA. Mr. LoBianco requested an indication of support from the Board to proceed with the expenditure to purchase approximately one-half of the NOx allowance deficit. The Board asked for further explanation on banking the options if we don't use them and how long they are good for, Mr. Danz explained that the options are good until whenever you need them. Trustee Tubandt explained that other businesses have also been caught off guard since the rule was put back into affect after vacatur. He went on to explain that the rule says you must buy allowances. Although the price of allowances continues to drop, you can't tell when they will start to increase again, so it is smart from a risk management standpoint to lock-in and layer in your purchases at this time. After more discussion the Board agreed to this strategy and authorized the General Manager to begin the process of proceeding with the expenditure to purchase approximately one-half of the NOx allowance deficit.

The last item on Mr. LoBianco's General Manager Report involved an update on the critical issue to "Monitor the effect of the developing economic situation and identify potential responsive actions by each of the utilities." Under Mr. Kerker's leadership, a team is working on this critical issue and efforts are underway to prioritize projects and personnel decisions. To date, the General Manager and staff have met several times to review current open and budgeted positions resulting in the deferral of filling a number of these positions. Mr. Kerker's team has also been working on a system for prioritizing projects and thus far a number of capital projects and expense projects have been deferred as well. The team will also be monitoring the Utilities' financial performance and establishing thresholds where some of the deferred personnel and projects may be released. There will be a report of the economic impact of these efforts at a future meeting. Trustee Heidbreder asked that staff make sure they are considering all "what if" alternatives and strategies for each of these alternatives. There was some discussion on wholesale sales and the inability to predict where this may go and the effect it will have on the Utility. Mr. Kerker reminded the Board that we have money in the extraordinary O&M account for situations such as this, and that we will be debt free January of 2012, which is very positive if wholesale sales continue to drop. There was also some discussion on wind power. Mr. LoBianco reviewed information that he had received at a recent IAMU meeting regarding some wind options available for investment. The Board needs to decide if it wants to have a proactive or reactive stance on a renewable energy program. There will be more discussion on this at future meetings.

Mr. LoBianco asked Mr. Kerker to review a recent letter Mr. Kerker had received from Virchow Krause & Company (VK), which is MP&W's auditing firm. He gave each Board member a copy of the letter along with an additional letter from VK to the Board of Trustees. Mr. Kerker explained that the letters communicated the responsibilities VK has to the Utility to identify internal controls and compliance with laws and regulations under Generally Accepted Auditing Standards (GAAS) and Government Auditing Standards (GAS). He also encouraged the Board to call either him or Russ Hissom of VK if they had any questions or concerns.

The January Financial Operating Statements and Balance Sheets for the Electric, Water, and Communications Utilities were previously submitted to all Board members in written format. Mr. Kerker drew the Boards attention to the January Electric Utility's statements. One of the drivers for variance from the budget for the Electric Utility included a softening of wholesale sales energy market, resulting in reduced revenue of \$755,959 compared to Budget. Steam Sales exceeded budget by \$394,928, due mostly to a pass through of NOx costs charged to GPC. The key driver of the increase in operating expense compared to budget was additional costs of \$513,135 for NOx emissions allowances that were not budgeted. Operations and Maintenance both showed positive results compared to budget. The Change in Net Assets was \$618,041 less than budget for the Electric Utility.

The Water Utility's financials showed that the efforts to reduce maintenance and operating costs were able to come very close to off-setting the lower gallons of water sold to customers, showing a Change in Net Assets that was only \$1,573 less than budget for the Water Utility.

Mr. Kerker stated the Communications Utility financials indicated that the Data/Internet revenue was higher than budget, along with reduced operations expenses and maintenance costs, resulting in a \$46,168 improvement over budget.

Mr. Kerker also provided the Board with a document that explained the projected impacts to the Change in Net Assets (Net Income) for 2009 due to adjustments in projected

wholesale energy prices, NOx allowance charges that were not originally budgeted, increase in project costs to #9 overhaul and pension cost changes. These adjustments were offset some by the purchased energy savings that were realized on the Unit 9 Spring Outage. The new revised net income for 2009 is \$803,573, down from \$7,526,000 that was forecasted for 2009 in the 10 year projections. Mr. Kerker explained to the Board that although the quantity of wholes sales is down only 3%, the price is considerably lower than what was projected, taking our January 2009 gross margin percent for wholesale sales down to 33.2%, vs. the 2009 budgeted estimate of 57.8% and the 2008 gross margin percent of 61.7%. To offset some of these losses, the Utility has been monitoring spending very closely to help control expenses. Mr. Kerker reviewed a spreadsheet that he provided to the Board quantifying deferred project costs for 2009 to offset the loss of income from lower wholesale energy prices. Some projects that were deemed less critical have been deferred to the second half of 2009 or beyond. The Utility has been careful not to jeopardize safety, reliability or customer service when reevaluating project needs. Mr. Kerker stated that Ms. Cox is also working on quantifying the savings of deferred positions and this information will be provided to the Board in a future update.

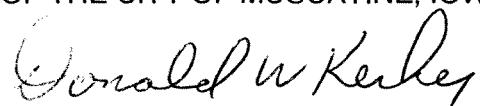
Trustee Ingstad moved, seconded by Trustee Axel, to receive and place on file the January Operating Statements and Balance Sheets for Electric, Water, and Communications Utilities. Motion carried. All Trustees present voted aye.

The Competitive Quotes for Public Improvements Report was presented as previously submitted to all Board members in written format. There were no items for approval. The report was received and placed on file.

The departmental reports were presented as previously submitted to all Board members in written form. The Customer Input Report was reviewed. The Communications Utility had an above average number of calls due to digital transition, including the channel lineup changes and the new box charge. The Board also reviewed some additional feedback that they had received recently from customers. Additional general discussion was conducted on the departmental reports. Trustee Axel moved, seconded by Trustee Heidbreder, to receive and place on file the January departmental reports. Motion carried. All Trustees present voted aye.

Chairperson Tubandt asked if there were any other items of business. With no other items of business, Trustee Ingstad moved, seconded by Trustee Heidbreder, that the meeting be adjourned at 6:40 p.m.

BOARD OF WATER, ELECTRIC,
AND COMMUNICATIONS TRUSTEES
OF THE CITY OF MUSCATINE, IOWA



Donald W. Kerker
Board Secretary