

**San Francisco Public Utilities Commission
Audit Response**

Introduction

SFPUC Overall Comments: Regarding the Calpine energy services contract, the Budget Analyst fails to note that the losses posited in the Introduction are presented without showing the corresponding and offsetting third-party sales, which reduced actual losses to \$11,848,855, rather than the \$52,625,350 shown in Table 1. It is important to place the Calpine contract in the appropriate historical context. The Calpine contract is a legacy of California’s energy crisis, a point reflected in the Budget Analyst’s February 21, 2002 report to the Board of Supervisors that said of the Calpine contract:

“Based on the extraordinary wholesale electric market volatility and wholesale prices during the first four months of 2001...the decision to enter into the Calpine contract by the Public Utilities Commission and the Board of Supervisors in May of 2001 was reasonable and prudent at that time.”

The Introduction also refers to the SFPUC’s providing free or reduced rate electricity to several City departments. Please note that this action was taken at the direction of the Mayor’s Office and is temporary.

1. The Hetch Hetchy Enterprise’s Failure to Develop a Business Plan

SFPUC Overall Comments: The SFPUC remains committed to furthering utility best practices throughout the organization. Because the Hetch Hetchy Enterprise is a unique credit, we recognize the importance of providing strong assurances to the rating agencies as to the Enterprise’s financial viability. Board of Supervisors Resolution #431-04 adopting the policy to fund City departments at rates that reflect the cost of services is a vital directive that supports our planning efforts.

Recommendations

The Public Utilities Commission General Manager should:

- 1.1 Make the finalization of a Hetch Hetchy Enterprise business plan an early priority of her administration.

SFPUC response: Agree.

- 1.2 Develop an ongoing Hetch Hetchy Enterprise business planning process which incorporates cost-of-service rate review and performance measurement processes.

San Francisco Public Utilities Commission
Audit Response

SFPUC response: Agree; performance measurement is a routine part of the SFPUC's annual budget process.

The Board of Supervisors should:

- 1.3 Reserve all FY 2005-2006 capital project appropriations for the Hetch Hetchy Enterprise until the Department transmits a Hetch Hetchy Enterprise business plan to the Board of Supervisors.

SFPUC response: Disagree. While the 2005-06 capital budget is not yet finalized, it will include funding for the San Francisco Electric Reliability Project, for ongoing San Joaquin Pipeline repairs, Hetch Hetchy roads rebuilding, the Mayor's Energy Conservation Account and solar energy projects. Reserving all these funds could jeopardize progress on some of the projects, as well as the department's ability to meet its water and power delivery obligations.

2. Water Resource and Power Generating Risk

SFPUC Overall Comments: Because the Hetch Hetchy system provides both water and power, we constantly balance our allocation of resources within the context of the Water First policy and integrate this policy fully into our operations. The purpose of risk management is not revenue optimization; it seeks to eliminate significant downside risks. Risk management allows for careful and prudent operation of the water and power systems within all legal, regulatory and policy contexts.

It is important to note that the risk of purchases for MID and TID will diminish substantially in 2005 (when the obligation to purchase Class 3 energy for MID terminates), be further reduced in 2006 (when the obligation to provide firm Class 1 energy for TID terminates), and will disappear entirely in 2008 (when the obligation to provide firm Class 1 energy to MID terminates). At that point the risk of purchases will arise only from the SFPUC's firm obligations for municipal load and retail customers, primarily the Airport Tenants and Norris Industries. By 2008, Hetch Hetchy Water and Power will have effectively reduced its firm delivery requirements from 260 MW for the combined load of the City, MID, & TID, which can be financially challenging in low water years due to the volatile power market, down to the estimated 150 MW load for the City's customers—a level that is not difficult to achieve. The elimination of 110 MW of firm delivery obligation achieved by the contract renegotiations was a more effective and less expensive risk management strategy than hedging to ensure the availability of those 110 MW. (R W Beck concurs that eliminating a firm supply obligation that is below prevailing wholesale market prices generally produces better financial results than could be achieved through hedging under a formal risk management program.)

**San Francisco Public Utilities Commission
Audit Response**

Recommendations

The Public Utilities Commission General Manager should:

- 2.1 Establish an effective risk management process that includes leadership by executive-level staff.

SFPUC response: Agree.

- 2.2 Consider the R.W. Beck risk assessment in defining the scope and membership of the risk management committee.

SFPUC response: Agree.

- 2.3 Establish the responsibility of the Risk Management Committee to include evaluating the financial impact of power purchases and sales and power initiatives and presenting the evaluation to the Public Utilities Commission when the Commission is considering policy initiatives.

SFPUC response: Agree.

- 2.4 Re-evaluate the functions of the existing Manager, Streetlights and Special Projects position upon transfer of the Streetlight Management Program to the Department of Public Works, as recommended in Section 7, including evaluating, defining and expanding the risk management functions of this position and specifying how the risk management functions of this position will promote and support the Public Utilities Commission's risk management process. To ensure segregation of risk management functions from the operating decisions of the Public Utilities Commission, this position should be reassigned from the Hetch Hetchy Enterprise Department to the Business Services Division.

SFPUC response: While we are in strong agreement that our risk management functions should be strengthened and that some redeployment of staff time will help achieve this goal, we disagree that transferring the Streetlight Management Program is necessary to improve risk management. We address a possible transfer of the Streetlight Management Program in our responses to Section 7 below.

- 2.5 Designate one existing executive-level manager with authority and expertise in managing water supply and power generation to be responsible for making coordinated operating decisions regarding water supply and power generation.

SFPUC response: The General Manager is currently reorganizing the agency and is discussing and reviewing the responsibilities of each division with SFPUC leadership. All recommendations, from both internal and external sources, will be taken into account.

**San Francisco Public Utilities Commission
Audit Response**

3. Analytical Software Implementation

Recommendations

The Assistant General Manager, Operations, should:

- 3.1 Assign responsibility for overseeing implementation of the software packages to appropriate senior level managers, including setting firm timelines and deliverables, and reporting back to the Assistant General Manager, Operations on a regular basis.

SFPUC response: Agree.

The Director of Information Technology Services and the Hetch Hetchy Enterprise Director of Power Operations should:

- 3.2 Jointly prepare and enforce timelines for implementing the Hetch Hetchy Enterprise data mart, including regularly reviewing the data mart implementation to ensure that the timelines are met and reporting to the Assistant General Manager, Operations.

SFPUC response: Agree.

4. Maintenance and Materials Management

Recommendations

The General Manager should:

- 4.1 Submit a Project Operations Maintenance Section organizational chart and supporting materials to the Board of Supervisors Finance and Audits Committee following a review of that organization's structure and allocation of positions.

SFPUC response: Agree.

The Acting Director of Water Operations should:

- 4.2 In conjunction with the Superintendent of Operations and the Information Manager, establish a timeline for development of the Maintenance Management Policies and Procedures Manual, and report on the status of the manual development to the Acting General Manager, Operations, prior to June 30, 2005.

SFPUC response: Agree.

- 4.3 In conjunction with the Superintendent of Operations and the Information Manager, establish a timeline for development of the Materials Management

San Francisco Public Utilities Commission
Audit Response

Policies and Procedures Manual, and report on the status of the manual development to the Acting General Manager, Operations, prior to June 30, 2005.

SFPUC response: Agree.

- 4.4 Ensure that the Project Operations Maintenance Section incorporates automated planning and scheduling processes into its everyday maintenance activities, including forming a Planning and Scheduling Group with the talent and management support required to accomplish the job.

SFPUC response: Agree; we will work toward implementation.

- 4.5 Ensure that the Project Operations Maintenance Section initiates maintenance reporting on a continuing, periodic basis. The *Management by Objectives Report* produced by the Water Pollution Control Division is a useful model.

SFPUC response: Agree.

- 4.6 Use MAXIMO reports when deciding on resource allocations.

SFPUC response: Agree.

- 4.7 Ensure that all tools and equipment are inventoried annually.

SFPUC response: Agree.

- 4.8 Ensure that the items in the storage yard adjacent to the shops area are brought under inventory control or disposed of.

SFPUC response: Agree.

- 4.9 Review the Project Operations Maintenance Section's organizational structure in order to improve its economy and efficiency.

SFPUC response: Agree. We are reviewing staffing and compensation issues among Hetch Hetchy Enterprise personnel and will include the organizational structure in that process.

5. Hetch Hetchy Enterprise Personnel and Administration

Recommendations

The Acting Director of Water Operations should:

San Francisco Public Utilities Commission
Audit Response

- 5.1 Establish a timeline to develop an Administrative Policies and Procedures Manual for Moccasin to include all current Department and Division policies and procedures, as a priority and report to the Assistant General Manager, Operations, on the status of the Administrative Policies and Procedures Manual prior to June 30, 2005.

SFPUC response: Agree.

The Acting Director of Water Operations and the Acting Director of Power Operations should:

- 5.2 Require all Hetch Hetchy Enterprise managers and supervisors to complete performance evaluations for all staff annually.

SFPUC response: Agree; 100 percent compliance is a priority for the General Manager.

- 5.3 Include completion of staff performance evaluations annually as a goal and objective in the Hetch Hetchy Enterprise managers' and supervisors' performance evaluations.

SFPUC response: Agree.

- 5.4 Establish procedures for and monitor compliance with the Department's Entrance and Exit Policy, including ensuring the correct use of forms and forwarding the forms to the Human Resource Services Bureau when required, and ensure full compliance with the Employer Pull Notice Program.

SFPUC response: Agree.

6. Billing and Collection of Electricity Accounts

Recommendations

The Public Utilities Commission should:

- 6.1 Establish penalty fees for retail electricity customer accounts that are 30 days or more past due.

SFPUC response: Agree.

The Director of Customer Services should:

- 6.2 Develop written policies and procedures for collecting retail electricity customer accounts, including procedures for terminating electricity service to retail electricity accounts that are 90 days past due.

San Francisco Public Utilities Commission
Audit Response

SFPUC response: Agree.

- 6.3 Routinely provide aged account receivables reports to the Hetch Hetchy Enterprise Retail Services Manager.

SFPUC response: Agree.

The Hetch Hetchy Enterprise and the Port should:

- 6.4 Develop joint protocols to ensure timely collection of Port electricity customer accounts, including written procedures for terminating electricity service to retail electricity accounts that are 90 days past due.

SFPUC response: Agree; Hetch Hetchy Enterprise Retail Service Section is currently working with the Port on an MOU that will include policies and procedures on collecting delinquent accounts as well as disconnection of service.

7. Streetlight Management

SFPUC Overall Comments: We will consider the Budget Analyst's proposal to transfer the Streetlight Management Program to another department. This is not a decision to be made lightly; rather, it is a complex policy matter that will involve consideration of many contractual issues that were not discussed in the audit report. As multiple entities are involved with streetlights within the City, we will take into account the network of roles and responsibilities involved with streetlight maintenance, as well as the financial interests of the SFPUC and the City.

Recommendations

The General Manager should:

- 7.1 Authorize staff to negotiate with the Department of Public Works over the specific Streetlight Management Program resources to be transferred from the Public Utilities Commission to the Department of Public Works to ensure that the program is adequately resourced.

SFPUC response: See above.

- 7.2 Promote leveraging of alternative funds for streetlights while continuing Hetch Hetchy Enterprise funding of streetlights to ensure that there is no impact on the General Fund.

SFPUC response: If we do not transfer the Streetlight Management Program to another department, we will seek alternative funds for streetlights to supplement Hetch Hetchy Enterprise's funding of the Program.

San Francisco Public Utilities Commission
Audit Response

- 7.3 Negotiate a memorandum of understanding between the Public Utilities Commission and the Department of Public Works. This memorandum of understanding would set energy efficiency goals for the Streetlight Management Program in order to contain the cost of Hetch Hetchy Enterprise Fund revenue transfers.

SFPUC response: See above.

8. The Power Policy Division's Output

Recommendations

The Public Utilities Commission General Manager should:

- 8.1 Ensure that the Power Policy Division's work program sets goals for new energy efficiency and alternative energy initiatives in terms of public policy, return on capital investment, and recovery of development costs funded by the Hetch Hetchy Enterprise Fund.

SFPUC response: Agree.

- 8.2 Ensure that all cost benefit analyses for new energy efficiency and alternative energy initiatives fully take into account foregone revenues for the Hetch Hetchy Enterprise and realistic operational capacity projections.

SFPUC response: Agree.

- 8.3 Include in the Power Policy, Water Operations, and Power Operations Divisions' work programs a comprehensive energy efficiency project for the Hetch Hetchy water supply and power generation system.

SFPUC response: Agree.

- 8.4 Develop a process, in collaboration with the Department of Environment, to evaluate, update, and revise the goals of the *Electricity Resource Plan*.

SFPUC response: Agree.

- 8.5 Submit each year to the Board of Supervisors, in collaboration with the Department of Environment, a joint annual report on progress against the annually updated and revised *The Electricity Resource Plan*.

SFPUC response: Agree.

San Francisco Public Utilities Commission
Audit Response

The Board of Supervisors should:

- 8.6 If negotiations to obtain control of a site for a new power plant are not successfully concluded by January 31, 2005, require the General Managers of the Public Utilities Commission, the Port, and MUNI, with appropriate support from the Real Estate Division of the Department of Administrative Services, the City Planning Department, the Department of Environment, the Department of Public Health, and the City Attorney's Office, to (a) submit a bi-weekly report to the Board of Supervisors and the Mayor on the status of the site negotiations until a site is successfully secured, and (b) attend a public hearing before a Board of Supervisors committee to outline the interagency activities which are taking place to secure a site.

SFPUC response: Agree.

- 8.7 Require the Public Utilities Commission General Manager to (a) submit a monthly report to the Board of Supervisors on progress against all of the San Francisco Electric Reliability Project's other project milestones, and (b) attend periodic public hearings before a Board of Supervisors committee to report on progress.

SFPUC response: The General Manager discussed the status of the project at the December 15 meeting of the Board of Supervisors Finance Committee and expects to keep the Board and the Mayor informed of all progress on this project.

9. The Power Policy Division's Organizational Structure

Recommendations

The General Manager should:

- 9.1 Incorporate into the position descriptions and performance evaluations for the Assistant General Manager, External Relations and the Assistant General Manager, Operations a requirement to work closely with each other to manage the policy/operations split between the Power Policy Division and the Water Operations and Power Operations Divisions.

SFPUC response: Agree.

- 9.2 Eliminate the 1.00 FTE Classification 5643 Manager, Resource Planning and Administration position.

San Francisco Public Utilities Commission
Audit Response

SFPUC response: The General Manager is currently reorganizing the agency and is discussing and reviewing the responsibilities of each division with SFPUC leadership. All recommendations, from both internal and external sources, will be taken into account.