



PUBLIC UTILITY DISTRICT NO. 1 of CHELAN COUNTY

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May 4, 2011

Dear PUD customer:

Last November, we let you know that Chelan County PUD anticipated bringing fiber-optic access to your area with help from a federal grant from the Rural Utilities Service (RUS) as part of the national Broadband Initiatives Program to reach rural areas. Now we must report to you that the PUD has decided to withdraw from that grant program and cancel the project because cost estimates have risen too high and because the timetable for completion became impossible to meet as we acquired new information. I understand the frustration many of you feel, but there are good reasons for the decision.

Please allow me the opportunity to first provide a little background, then some of the facts and circumstances that went into our decision and, finally, some next steps.

As you may know, extensive customer outreach efforts during 2009 and 2010 led to a new strategic plan that was adopted by our Board of Commissioners last year. Through these outreach efforts, we found that a large majority of PUD customers wanted us to postpone or cancel the overall fiber build-out when the costs of the build-out would be high and the impact on electric rates would be too large.

With this in mind, back in August we had what appeared to be a golden opportunity – one that would allow us to extend the fiber network for a reasonable cost and manageable impact on electric rates. Faced with a decision regarding the \$25 million federal grant, the PUD again reached out to county residents to gauge support for the project. At the time, a majority of our customer-owners agreed to pay up to 3 percent more in their electric rates to help fund the PUD's \$8.3 million matching contribution and ongoing operations and maintenance expenses associated with the rural build-out. Armed with this information, PUD Commissioners agreed to accept the grant and later implemented a 2-percent electric rate increase, which was necessary to make the project pencil out financially.

Unfortunately, estimates at the time we filed the grant application failed to account fully for the cost of replacing numerous transmission structures (poles) in order to carry the extra fiber load and meet regulatory standards. In addition, we underestimated the time it would take to complete permitting and approval processes and the costs to reach many remote rural areas with underground lines in forested and hilly terrain. Finally, these and other factors negatively impacted the construction schedule making it impossible to meet the three-year RUS deadline.

At the March 21, 2011, PUD Commission meeting, with several service providers in attendance, open to the public and recorded on our website, we discussed some of the issues discovered during our ongoing review of the RUS fiber project and indicated that we would be back with a full report at a later date. A Page 1 Wenatchee World article the next day highlighted the issues discussed at that meeting and at a continuing public session that afternoon with numerous local elected officials. Then, at the April 11 meeting, also attended by service providers, PUD staff provided a full report including estimates that put potential costs as high as \$67 million instead of the original \$33 million estimate.

Knowing that the PUD would be responsible for 100 percent of any cost overruns, and facing a mandate to complete the project within three years, we asked RUS about the possibility of changing the scope of the project in order to complete at least some of the planned build-out using grant funds. We were told by RUS officials that they would not contemplate our proposed changes. Faced with significantly higher cost estimates and a construction schedule that was impossible to meet, PUD commissioners decided to withdraw from the project. No money had yet been received by the PUD from RUS.

In a related step, PUD commissioners on April 11 also voted to end the 2-percent rate increase that had been applied to all electric bills since last December in order to pay for the PUD's ongoing share of the build-out costs. Your next electric bill will reflect the decrease.

Here's where we stand now with the fiber network. Roughly 70 percent of Chelan County homes and businesses currently have access to fiber. A little over a third of those homes and businesses are taking service from one of our local service providers, and the PUD is currently contributing up to \$1,500 toward the cost of connecting new customers within the existing 70-percent footprint.

Installing a state-of-the-art fiber optic network in a rural county has required a big investment – over \$110 million so far. The fiber business has been losing roughly \$7 - \$8 million per year in recent years, and losses are expected to grow unless we adjust our business model.

Looking ahead, we are working to develop a solid, reliable long-term plan for the fiber program and hope to have that plan finished by the end of this year. We expect the plan will evaluate (among other things) the long-term costs to own, operate and maintain our existing fiber network, demand for broadband services in areas without access to PUD fiber, and various options for serving the remaining areas, where feasible. Once we have a full and complete understanding of the costs to operate, maintain and potentially expand the system, we can – with the help of our customer-owners – reach the best decision on how to move forward.

We will try to keep you informed throughout this process. I hope you will lend your voice to this effort.

We regret the sudden change in direction after sharing such optimistic news last fall. Our customer-owners continue to remind us that fiscal responsibility is a primary consideration, and, when faced with costs much higher than anticipated to complete the project and a required timeline that was impossible to meet, it was the only prudent decision – there was no other viable choice given the circumstances.

Sincerely,

A handwritten signature in black ink, appearing to read 'J. Janney', with a long, sweeping horizontal line extending to the right.

John Janney
General Manager