



EDMUND G. ARCHULETA, P.E.
July 24, 2009

*Via Email Transmission and
Original via US Mail*

Mr. Jimmy W. Janacek
4770 Vista Del Monte
El Paso, TX 79922

Dear Mr. Janacek

Thank you for attending and participating in this week's Public Service Board meeting. This letter is in response to the questions you asked at the Board meeting and the email you sent dated July 21, 2009. My answers are in summary or aggregate form to your questions.

Econometric modeling

We actively started evaluating desalination in 1990 and visited numerous plants in Florida. We also did pilot plant work in the early 90's. Before the desalination plant was built, the Utility had a series of evaluations prepared by various consultants in determining additional water supply alternatives for El Paso. We also contracted with U.S. Geological Surveys (USGS) to prepare a new groundwater model to determine the inventory of fresh and brackish waters and directions of flow. After several analyses by independent consultants, the Utility chose the local desal option over importation as the best alternative for the near future and to capitalize on the unique opportunity to partner with Fort Bliss in their own quest to build a desalination plant on Fort Bliss to serve their needs. Fort Bliss was in very early planning to build a 7.5 mgd plant while we were planning a 20 mgd plant. I believe Bill Hutchison, our Water Resource Manager, discussed this with you several months ago.

In essence, the Utility has implemented a multiple water resource supply strategy to ensure El Paso's long term water supply by building a "joint" plant. The plant is owned and operated by EPWU on land leased from the Army. A blend of well water, surface water, reclaimed water, desalination and conservation all play a role in El Paso's success to achieve water supply sustainability. The analysis used to go forward with the desal plant is contained in various documents over a series of years with technical, financial, environmental and legal decisions made along the way by the PSB. Thus, we prepared a lot of econometric analyses for this strategy.

Fort Bliss wholesale rate

The Utility charges a wholesale rate to Fort Bliss based on industry-accepted cost of service principles. The Utility uses a blended or average cost of service based on all wholesale operating and capital costs of the water system including well water, treated surface water and desalinated water. The reason for this is that Fort Bliss (like virtually all customers) receives water from all three sources throughout the year and from various meter connection points to Fort Bliss; 24 total. These blended sources of water to Fort Bliss justify a blended wholesale rate. Fort Bliss receives well water, water from the Jonathan Rogers Water Treatment Plant and desal water. In addition, Fort Bliss will use a combination of our supply and their own well water supplies, to meet their total demands.

In fact, all customers (retail and wholesale alike) in El Paso pay a blended rate as we combine the costs of all sources of water into the rates and do not segregate costs and rates based on geographic areas or a specific water source. The system is treated as a whole and this treatment and the use of blended or average cost rates is common practice for utilities across the country and is consistent with general ratemaking guidelines as promulgated by organizations such as the American Water Works Association (AWWA).

You state that the wholesale rate charged to Fort Bliss is smaller than the general El Paso retail rate and thus is a "loss" to the Utility. This statement fails to take into account the fact that a wholesale rate is the cost only for collecting and treating the water itself. Fort Bliss has a contract company, the Fort Bliss Water Supply Company, which receives the wholesale water and distributes it and stores for the post. This company also maintains and operates their water system; El Paso Water Utilities does not. Thus it is not unusual that the wholesale rate is less than a retail charge since the normal retail charge includes the cost of supply, treatment, maintenance and distribution of water, plus customer service to El Paso customers by the El Paso Water Utilities.

As I stated in the meeting, Fort Bliss hired a rate consultant to represent their interests and he reviewed the wholesale rate study prepared by our consultant to ensure they were charged in a fair and equitable manner. The Utility does not lose money on this contract, but instead charges Fort Bliss their equitable and proportionate cost for this water; for the service provided. The current rate to Fort Bliss is \$0.71 per ccf and will be updated annually once the contracts are signed. There is also no financial gain to Fort Bliss in the arrangement.

The real effect of these contracts with Fort Bliss is that the City now has substantially beefed up its drought contingency plan by having additional water supply capacity available when there is a serious river drought and our water treatment supply capacity is curtailed. The plant also provides emergency backup service in the event there is a disruption of service due to a major line break or power outage in other parts of the system. The desalination plant also provides a backup to Fort Bliss in case they have problems with their own wells. The security of the long-term desal supply coupled with this backup or redundancy as provided by the Utility, was an important factor in the decision to assign as many as 35,000 additional troops to Fort Bliss and as you know, this assignment has and will positively contribute to the economy of El Paso.

As stated previously, our rate consultant can review with you the detail wholesale rate analysis for Fort Bliss. He periodically is in El Paso working on various projects and can meet with you here in El Paso. Let me know your schedule and we can arrange a meeting.

Timing and sequence of approving of contracts with Fort Bliss

Fort Bliss asked that we sign the easement contract first and then send back to them which they will cross reference into their Water Sale Agreement and Water Purchase Agreement. Now that the PSB has approved the easement contract, we expect the other two agreements to be signed in the near-term. As stated, in the meeting, the Water Sale Agreement and the Water Purchase Agreement will encompass the tenets of the original MOU signed in March, 2005. The Utility can purchase all the water stated in the MOU from Fort Bliss to process through the desal plant and that water can be, and currently is being delivered to our customers today.

Plant capacity and service to Fort Bliss

As previously stated in numerous emails and documents provided to you, the plant can produce 27.5 million gallons per day (mgd) at its full capacity. It is common engineering practice to design plants for the future; not the present demand. It was designed for 80% of capacity, which is known as "firm" capacity, which accounts for one of five skids being out of service for maintenance. The plant is currently running at 3.5 to 4 mgd based on current demand. We project a gradual increase in plant production over the next 10 to 20 years as the City and Fort Bliss grow. We currently are maximizing the availability of surface water to meet summer demands to preserve the Hueco Bolson for times of drought and reduce overall cost. This is our planned strategy.

We are currently supplying Fort Bliss with 500,000 gallons to 1 million gallons per day. Fort Bliss's current total water usage is 3 to 4 mgd per day of which EPWU provides 10% to 15% of their demand. We project Fort Bliss's demand could increase to 8 to 9 mgd once the construction of the new Fort Bliss east facilities is complete and additional troops arrive over the next five years. This additional water demand will be provided by Fort Bliss and EPWU, but we have planned and anticipate that a majority of this additional demand will be provided by EPWU. The Water Purchase contract does commit El Paso to supply potable water to meet Fort Bliss demands. We believe we will easily meet this demand with plenty of capacity to spare for our El Paso customers.

Aquifer Exemption Status

The Environmental Protection Agency (EPA), Texas Commission on Environmental Quality (TCEQ) and New Mexico Environment Department (NMED) are handling our Aquifer Exemption Status application which is a very slow and deliberate process. This exemption allows for easier operational management of our three injection wells. This process is not yet complete.

Summary: Benefits to Water Customers and Bondholders

This plant is a tremendous asset for El Paso. We started planning a plant well before El Paso knew that there might be a Base Realignment and Closure (BRAC) decision to increase the size of Fort Bliss. The aquifer in the nineties was dropping 1 to 1.5 feet per year. Now, the aquifer is stable thanks to our overall management strategy to include this plant. The plant provides for long-term assurance of water for current and future growth of El Paso and Fort Bliss; whether we are faced with drought or other climate change impacts.

This is a tremendous partnership with the Army, and everybody across the State and Nation acknowledges that. At current annual water supply demands, Fort Bliss receives less than 1 percent of our total water supply. In the future, depending on how much they use their own wells, this could grow to as much as 5 percent.

I hope this response is helpful. Again let me know when you are available to meet with our rate consultant.

Sincerely,



Edmund G. Archuleta, P.E.
President & CEO

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