



Los Angeles
Department of
Water & Power

RESOLUTION NO. _____

BOARD LETTER APPROVAL

A handwritten signature in blue ink, reading 'David H. Wright', is written over a horizontal line.

DAVID H. WRIGHT
Senior Assistant General Manager
Power System

A handwritten signature in blue ink, reading 'Marcie L. Edwards', is written over a horizontal line.

MARCIE L. EDWARDS
General Manager

DATE: May 13, 2015

SUBJECT: Navajo Generating Station Asset Purchase and Sale Agreement
Term Energy Transaction Confirmation Agreement
Firm Entitlement Agreement
Energy Exchange Agreement

SUMMARY

LADWP currently owns 21.2 percent of the coal-fired Navajo Generating Station (NGS) outside of Page, Arizona. LADWP has been a participant in the project along with five other parties since 1969. The purpose of the proposed Asset Purchase and Sale Agreement (APSA) is to divest LADWP's interests in the NGS (NGS Assets). The purchaser of the NGS Assets is the Salt River Project Agricultural Improvement and Power District (SRP), the Operating Agent for NGS. This recommended action is a part of our coal reduction strategy as outlined in the LADWP Integrated Resource Plan and is in response to California legislative mandates, including Senate Bill 1368 – California Emission Performance Standards and Assembly Bill 32 – California Global Warming Solutions Act of 2006. Along with the APSA, LADWP will also enter into a Term Energy Transaction Confirmation Agreement (Energy Agreement) for LADWP to purchase approximately 55 Megawatts (MWs) of renewable geothermal energy from SRP's rights in the Hudson Ranch 1 Geothermal Project located in the Imperial Valley of Southern California through 2021, a Firm Entitlement Agreement providing transmission services to SRP through 2019 on transmission interests owned by LADWP which are part of the larger Navajo Project and an Energy Exchange Agreement which would serve the same end purpose of the Firm Entitlement Agreement in the event such latter agreement must be terminated early.

Because of the value of the existing transmission lines associated with NGS, LADWP will retain transmission rights associated with the project and will use these transmission paths to deliver renewable energy and other forms of energy to our customers.

Finally, as a condition for LADWP's early divestment from NGS, SRP and LADWP will use commercially reasonable efforts to cause one of the three coal-fired generating units at the plant to permanently cease operation by end of 2019.

The divestiture also keeps rates at a level lower than if we retain our share of this plant.

In accordance with Los Angeles City Charter Sections 385, 675(d)(1) and 675(e)(5) the Board has the authority to approve this transaction, subject to City Council approval by ordinance pursuant to Los Angeles City Charter Section 674 and Los Angeles Administrative Code Section 7.71(b).

RECOMMENDATION

It is requested that your Honorable Board adopt the attached Resolution, approved as to form and legality by the City Attorney, recommending the Los Angeles City Council's approval by ordinance of the APSA for the sale of LADWP's undivided ownership interests in the NGS Assets, the Energy Agreement, the Firm Entitlement Agreement and the Energy Exchange Agreement, in each case by and between LADWP and SRP per Los Angeles City Charter Section 674 and Los Angeles Administrative Code Section 7.71(b) and the Board's authority to act on and approve all future amendments to the respective agreements, without further approval by the City Council, provided that such amendments are ministerial and administrative in nature and do not increase the costs or extend the duration of the respective agreements.

ALTERNATIVES CONSIDERED

Senate Bill 1368 enacted in 2006 prohibits the renewal or extension of long-term contracts and agreements or new ownership investments designed and intended to extend the life of one or more generating units by five years or more for baseload generating stations that have carbon dioxide emissions greater than a natural gas-fired combined-cycle plant which would include the NGS Assets. LADWP's contractual and ownership obligations for NGS are currently set to expire by the end of 2019. Under California law, LADWP is essentially prohibited from taking actions to continue long-term ownership participation in coal-fired generation at NGS beyond 2019. Regardless of California law's impact on LADWP's long-term plans for NGS, some of the non-Californian NGS co-owners desire to extend the operation beyond 2019. In order to provide an orderly divestiture of NGS, LADWP has negotiated the APSA with SRP which upon taking effect would result in the end of coal-fired energy deliveries to LADWP from NGS approximately four years earlier than required by California law. This option also works best for LADWP as its Integrated Resource Plan has contemplated the replacement of coal-fired generation resources with increased energy efficiency measures, additional cleaner renewable energy, and backing up these two elements with a natural gas-fired plant. One major solar facility and one natural gas facility have been acquired and another major solar facility is under construction and will help replace the energy lost by the sale of the NGS Assets.

FINANCIAL INFORMATION

In exchange for the acquisition of LADWP interests in NGS, SRP will pay or transfer to LADWP the following:

1. A payment of \$10,000,000 at the sale closing subject to a limited market price adjustment at the end of 2019 in accordance with an agreed upon methodology incorporated in the APSA.
2. A payment of \$2,890,000 at the sale closing for Peabody Coal Mine Settlement.
3. SRP's 20 percent interest in the former Mohave Generating Station (Mohave Assets) which is primarily the underlying 2,500 acres of land.
4. SRP's various interests in the Eldorado Transmission System comprising the Eldorado Switchyard, the Eldorado Transmission Line, the Mohave Switchyard and other ancillary equipment. SRP will retain its pre-closing liabilities for the Mohave Generating Station and Eldorado Transmission System.

LADWP will continue to carry liabilities for the NGS Assets for the time in which it was a participant in NGS, including NGS decommissioning costs that may range up to \$17 million, and liabilities associated with the Kayenta Mine for the Final Mine Reclamation and Retiree Health Care Costs for miners up to a net total of \$15 million.

As a condition of the sale of LADWP's ownership interest in NGS, LADWP will enter into the Energy Agreement with SRP to purchase approximately 55 MWs of renewable geothermal energy from SRP's rights in the Hudson Ranch Geothermal Project located in the Imperial Valley of Southern California through 2021. The cost of this geothermal energy will range from \$80 to \$90 MW/hour consistent with current market pricing.

In addition, LADWP will enter into the Firm Entitlement Agreement with SRP to provide transmission services of 350 MWs of capacity on the Navajo–McCullough transmission line through December 23, 2019. The transmission services allow SRP to deliver to their customers or to the market the energy generated from the acquisition of LADWP's ownership share of NGS output. After 2019, LADWP will receive this transmission capacity back from SRP and will regain all of its original transmission entitlements.

Approximately \$59.3 million of the Power System's outstanding tax-exempt debt is allocated to the financing of Navajo's generation assets. LADWP will need to redeem or defease all of these outstanding bonds within 90 days after the closing of the asset sale using LADWP equity or proceeds of taxable debt. Such redemption or defeasance is needed to protect the tax exemption of these bonds in the event SRP decides, in the future, to use the generation assets that are part of this divestment transaction in a manner that creates "private business use" as defined in applicable Treasury Regulations. Private business use would occur, for example, through SRP's contracts with non-government entities (e.g., investor-owned utilities). Depending on the market conditions at the time of the divestiture, LADWP may have to redeem or defease the bonds at a slightly higher price than the par amount of \$59.3 million. LADWP Financial Services Organization is monitoring this obligation and will manage as a routine course of business.

In 2008, LADWP engaged Goldman, Sachs & Co. (GS) to provide financial services in support of the potential sale of the NGS Assets which initial three-year engagement was extended to July 29, 2016 pursuant to Amendment No. 1 to Agreement No. 47790. Over the past seven years, GS have assisted LADWP in performing due diligence, preparing potential sale offering materials, conducting valuation analyses and evaluating alternative divestiture options. Ultimately, GS concurred with the strategy to engage in bilateral negotiations with SRP, believing that given the changes to the power markets overall and specifically the impact on coal generation assets and the potential impacts on a sale process of the NGS Co-Tenancy Agreement's Right of First Refusal to purchase the NGS Assets, a bilateral negotiation would assist LADWP in maximizing the overall value of its undivided ownership interests in the NGS Assets. Furthermore, the Board approved a motion at its March 19, 2013 meeting directing LADWP to continue working with SRP to negotiate acceptable definitive agreements regarding the sale of LADWP's undivided ownership interests in the NGS Assets and bring back definitive agreements to the Board for its review and consideration.

This divestiture will provide savings to LADWP from contribution to any future expenses at NGS, such as Operation and Maintenance costs, Capital Projects, and Fuel costs. The total savings of these items for 2016 through 2019 is estimated at \$509 million. In addition, this divestiture will decrease LADWP's risk of future regulations and compliance requirements imposed by the Environmental Protection Agency (EPA) or State and Federal legislation. Some of the pending EPA regulations could require capital improvements at NGS, which could cost over a billion dollars.

Finally, this divestiture will have the lowest impact on retail rates. Maintaining NGS through 2019 will result in a retail rate increase of 2 percent, whereas this divestment reduces the rate increase to 0.5 percent. A one percent rate increase is estimated at \$30 million per year. Therefore, this divestiture transaction will provide a savings of \$157 million over the next three and a half years.

BACKGROUND

NGS is a coal-fired generating station located near Page, Arizona. It is comprised of three units of 750 MWs each, a coal train transportation system from Kayenta Mine to the power plant, an ash landfill area, a water pumping station near Lake Powell, and a water pipeline system. NGS began operation in 1974 and has operated continuously ever since. In 1999, NGS installed the Wet Scrubber system to control sulfur oxides emissions. NGS completed the installation of Low-NOx Burners in 2011. New environmental regulations are required by the U.S. Environmental Protection Agency for the control measures for Hazardous Air Pollutants, Regional Haze, Greenhouse Gases, Coal Combustion Residues, Cooling Water Intake Structures. These pending or proposed regulations threaten to require significant capital investments in NGS that could exceed a billion dollars for compliance.

LADWP's entitlement of the NGS generation capability is 21.2 percent which corresponds to 477 MWs of output. The other five co-owners of NGS are the United States Department of Interior Bureau of Reclamation (Bureau of Reclamation), the Arizona Public Service Company, NV Energy, the Tucson Electric Power Company

and SRP. In addition to the federal requirements, the State of California also imposed restrictions (Senate Bill 1368 and Assembly Bill 32) that effectively prohibit the continued participation of LADWP in NGS from and after December 23, 2019. It is imperative for LADWP to divest its interests in NGS and focus on cleaner sources of generation.

There are two transmission systems connecting to NGS. The Western Transmission System connects NGS to McCullough Substation in Nevada via Crystal Substation allowing power delivery to Southern California. The Southern Transmission System connects NGS to Westwing Substation in Arizona via Moenkopi Substation allowing power delivery to the City of Phoenix and its vicinity. Each transmission system has different sets of co-owners with LADWP as partial owner of the Western Transmission System and the NGS-Moenkopi portion of the Southern Transmission System.

Despite the sale of the NGS Assets, LADWP will keep its interests in the NGS transmission systems to retain its transmission diversification and accessibility in the Western region, and to provide a path for power transportation from new sources of renewable energy potentially developed in the Southwest.

In addition to the cash consideration, LADWP will also receive all of SRP interests in the Mohave Assets and the Eldorado Transmission System. The Mohave Assets include a former coal-fired generating station located in Laughlin, Nevada. That station is now completely decommissioned with all generating facilities and equipment removed from the plant site. The plant site has about 2,500 acres with access to cooling water from Colorado River and is a prime candidate for redevelopment as a renewable energy plant. The Eldorado Transmission System connects the Mohave Assets to Mead Substation which in turn connects to the LADWP transmission network. These two facilities are currently owned by LADWP, SRP, Southern California Edison and NV Energy.

The APSA is a complex transaction involving the exchange of multiple facilities between LADWP and SRP and requiring a number of conditions necessary to close. Certain of the conditions to close include the following:

1. Each of NV Energy, Arizona Public Service Company and Tucson Electric Power Company must waive their Right of First Refusal included in the NGS Co-Tenancy Agreement.
2. The Bureau of Reclamation must consent to the sale of the NGS Assets under the NGS Co-Tenancy Agreement.
3. Each of Southern California Edison and NV Energy must waive their Right of First Refusal included in the Eldorado Transmission System's Co-Tenancy Agreement.
4. The Bureau of Reclamation must complete an environmental assessment for this transaction in compliance with the National Environmental Policy Act (NEPA).
5. Environmental site assessments, unrelated to NEPA, associated with the properties being conveyed to SRP and LADWP must be satisfactorily completed.

The City Administrative Officer (CAO) Report dated May 4, 2015, is attached.

ENVIRONMENTAL DETERMINATION

In accordance with the California Environmental Quality Act (CEQA), it has been determined that the subject APSA and associated agreements are exempt pursuant to the General Exemption described in CEQA Guidelines Section 15061 (b) (3). General Exemptions apply in situations where it can be seen with reasonable certainty that there is no possibility that the activity in question may have a significant effect on the environment.

Furthermore, this transaction involves facilities outside of California and within the jurisdiction of federal laws. An environmental assessment that is in compliance with NEPA will be completed and approved by the Bureau of Reclamation prior to the conclusion of the sale.

CITY ATTORNEY

The Office of the City Attorney reviewed and approved the APSA, the Energy Agreement, the Firm Entitlement Agreement, the Energy Exchange Agreement and Resolution as to form and legality.

ATTACHMENTS

- Resolution
- Navajo Generating Station Asset Purchase and Sale Agreement
- Term Energy Transaction Confirmation Agreement
- Firm Entitlement Agreement
- Energy Exchange Agreement
- CAO Report