Item 17

In REPORT FROM

OFFICE OF PUBLIC ACCOUNTABILITY

Date: May 14, 2014

To: The Board of Water & Power Commissioners
Marcie L. Edwards, General Manager, Department of Water & Power

From: Frederick H. Pickel, Ph.D., Executive Director/Ratepayer Advocate
Camden Collins, Deputy Director/Ratepayer Advocate

Subject: Exit of Navajo Generating Station (NGS): NGS Asset Purchase and Sale Agreement, Term Energy Transaction Confirmation Agreement, Firm Entitlement Agreement, Energy Exchange Agreement

HISTORY

The above referenced agreements, referring to "NGS" for "Navaho Generating Station," represent the culmination of many years of effort to cease further significant coal-fired generation investment by the Department of Power & Water (DWP). This is required by Senate Bill 1368, which prohibits new transactions or investment in coal-fired generation under certain circumstances. Subsequently, the City of Los Angeles adopted a policy accelerating exit from NGS to December 31, 2015.

Five utilities, including DWP, co-own this generation facility. DWP is the only California owner of NGS. The other owners are the U.S. Bureau of Reclamation, the Salt River Project, Arizona Public Service Company, Tucson Electric Power, and NV Energy. DWP's net book value in the investment is $28.3 million at fiscal year ending June 2014.

OPINION

The NGS exit agreements are reasonable in their terms and conditions, and constitute a fair deal for ratepayers given the unfavorable negotiation context unique to this facility. Over a range of assumptions, the implied cost of carbon emissions reduction falls between $9 and $12 per metric ton above the market price of carbon emissions, and is clearly reasonable. These implied carbon costs are less than those estimated at the time the City committed to an early exit strategy in 2013.

The risks associated with execution of these agreements are moderate, and mitigation of those risks has been sufficiently provided for in the proposed agreements. The sensitivity of rate impacts to carbon valuation assumptions is relatively low, posing little potential for forecast error in rates. The sensitivity of rate impacts to natural gas price estimate error is also low.

DWP has, in addition, taken reasonable steps to maximize other asset values and made fair concessions to facilitate an overarching agreement. As such, OPA reaches this conclusion on both a bundled and unbundled basis. In other words, OPA analyzed the coal-related terms on a stand-alone basis, and with other components like transmission agreements and geothermal facilities.

The residual environmental liability DWP bears under these terms and conditions is reasonable, and consistent with industry practice.

Many other negotiated outcomes, while theoretically possible, have evaporated with the passage of time. For example, at an earlier time DWP may have been able to exit ownership, and repurchase the plant output for a price close to 2.21 cents/kwh until 2020. OPA concurs with DWP's experience and opinion that this economic outcome, while more favorable to ratepayers, is not viable at this time and places insufficient value on avoidance of environmental externalities.

SCOPE OF REVIEW

The Office of Public Accountability (OPA) has reviewed the April 17, 2015 version of the Asset Purchase and Sale Agreement between DWP and the Salt River Project Agricultural Improvement and Power District, a subdivision of the state of Arizona. DWP answered all inquiries of OPA concerning these agreements.

cc: The Honorable Eric Garcetti, Mayor
Miguel Santana, Chief Administrative Officer
Sharon Tso, Chief Legislative Analyst