CITY OF LOS ANGELES

CALIFORNIA

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Date: May 28, 2015

To: The Honorable City Council

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

Subject: Council File No. 15-0645 - Exit of Navajo Generating Station (NGS): NGS Asset Purchase and Sale Agreement, Term Energy Transaction Confirmation Agreement, Firm Entitlement Agreement, Energy Exchange Agreement

On May 19, 2015, the Board of Water and Power Commissioners ("DWP Board") adopted the above referenced inter-related agreements for Department of Water and Power's (DWP's) exit from NGS.

The attached report, dated May 14, 2015, represents the Office of Public Accountability's (OPA) transmittal to the DWP Board, and the General Manager, on the DWP's exit from NGS. The report contains OPA's advice on the NGS exit agreements.

Inasmuch as the exit from NGS and the associated inter-related agreements are before the City Council for its consideration, the OPA transmittal is submitted for your review. In the event you have any questions regarding this matter, please contact the OPA at 213-978-0220 or fred.pickel@LAcity.org.

Attachment: OPA Report on Exit from NGS dated May 14, 2015

cc: Honorable Mayor Eric Garcetti
Councilmember Felipe Fuentes, Chair, Energy and Environment Committee
Sharon M. Tso, Chief Legislative Analyst
Miguel A. Santana, City Administrative Officer
Marcie L. Edwards, General Manager, Department of Water and Power

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