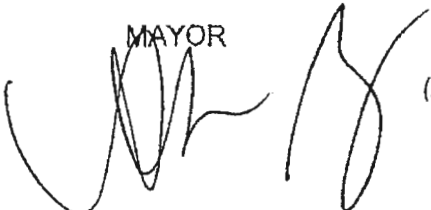


PPK -

POWER SYSTEM

MAY 06 2015

EXECUTIVE OFFICE

<b>TRANSMITTAL</b>		0150-10395-0000
TO Marcie L. Edwards, General Manager Department of Water and Power	DATE MAY 04 2015	COUNCIL FILE NO.
FROM The Mayor	COUNCIL DISTRICT	
<p><b>SALE OF NAVAJO GENERATING STATION INTERESTS.</b></p> <p>Approved and transmitted for further processing including Council consideration. See the City Administrative Officer report attached.</p> <p style="text-align: center;">MAYOR</p>  <p style="text-align: right;">(Ana Guerrero)</p>		

MAS:RR:06150088T

CAO 649-d

REPORT FROM

## OFFICE OF THE CITY ADMINISTRATIVE OFFICER

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Date: May 1, 2015

CAO File No.: 0150-10395-0000

Council File No.:

Council District: N/A

To: The Mayor

From: Miguel A. Santana, City Administrative Officer 

Reference: Communication from the Department of Water and Power dated April 10, 2015; referred by the Mayor for report on April 15, 2015

Subject: **SALE OF NAVAJO GENERATING STATION INTERESTS**

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### SUMMARY

The Los Angeles Department of Water and Power (LADWP; Department) requests approval of a proposed resolution authorizing the divestiture of DWP's 21.2 percent ownership interest in its coal fired Navajo Generating Station (NGS). NGS is a three unit, coal-fired generating plant located near Page, Arizona. The Department has had an ownership stake in NGS since 1974. Pursuant to Charter Section 674, and the Los Angeles Administrative Code (LAAC) Section 7.71(b), City Council approval by Ordinance is required. The proposed resolution and Agreements have been reviewed by the City Attorney and approved as to form and legality.

DWP states that this action supports the Department's coal reduction strategy as outlined in the Integrated Resource Plan (IRP). The divestiture of NGS also conforms to California legislative mandates including Senate Bill 1368 (SB1368) – California Emission Performance Standards as well as Assembly Bill 32 (AB32) – California Global Warming Solutions Act of 2006. These legislative mandates essentially block DWP from utilizing coal generated energy from NGS beyond its current license term ending in 2019.

The purchaser of the NGS assets is the Salt River Project Agricultural Improvement and Power District (SRP), the operating agent and a co-owner of the NGS holding a 21.7 percent ownership interest. The SRP offer will provide DWP with an early divestment opportunity that includes a monetary payment, an exchange of assets, and a geothermal energy purchase agreement.

Approval of the proposed resolution specifically authorizes several agreements listed below which are collectively identified as the Transaction Documents.

- Asset Purchase and Sale Agreement (PSA) provides DWP with (i) a \$10 million payment at closing and (ii) the transfer of SRP ownership interests in the Eldorado Transmission and Mohave Assets. Additionally, the PSA provides that SRP will lead efforts to cease operating one of the three coal-fired generating units at NGS by December 23, 2019.
- Term Energy Transaction Confirmation Agreement for DWP to purchase approximately 55 Megawatts (MW) of renewable energy capacity and 3,125,770 megawatt hours (MWh) of baseload energy from SRP's Hudson Ranch 1 Geothermal Project beginning

April 25, 2015 through October 30, 2021 with a cost between \$80 and \$90 per MWh. These energy purchase contracts have a total cost of approximately \$267 million and provide approximately one percent of the DWP renewable energy goals.

- Firm Entitlement Agreement and Energy Exchange Agreement provide transmission services to SRP through 2019 on transmission lines owned by DWP which are connected to the NGS. SRP will pay the cost of operation and maintenance (O&M) resulting in no net fiscal impact to the Department for the transmission services utilized.

The proposed resolution also provides a delegation of City Council authority to the LADWP Board of Commissioners (Board) to approve all future amendments to the Transaction Documents provided that such amendments are administrative in nature and do not increase the costs or extend the duration of the agreements. Furthermore, authorization is delegated to the DWP Board and DWP General Manager to execute the Transaction Documents, all certificates, and other associated instruments, without further approval by the City Council.

We have reviewed the proposed resolution and transaction documents and recommend that they be approved. Additional background information relating to this request is provided in the appendix.

## **RECOMMENDATIONS**

That the Mayor:

1. Approve an ordinance authorizing the sale of Navajo Generation Station and approving the proposed Board resolution, the Asset Purchase and Sale Agreement, the Term Energy Transaction Confirmation Agreement, the Firm Entitlement Agreement, and the Energy Exchange Agreement between the Los Angeles Department of Water and Power and the Salt River Project Agricultural Improvement and Power District; and,
2. Return the proposed resolution to the Department for further processing, including Council consideration.

## **FISCAL IMPACT STATEMENT**

Approval of the proposed resolution will provide revenue, an exchange of assets, and energy purchases. There is no impact to the City's General Fund. The proposed Agreement complies with the Department's adopted Financial Policies.

## **TIME LIMIT FOR COUNCIL ACTION**

The City Attorney advises that there is no time limitation for items approved by ordinance. However, DWP asserts that a condition of the SRP offer requires DWP Board of Commissioners approval prior to June 1, 2015.

**APPENDIX**

**NAVAJO GENERATING STATION**

Navajo Generating Station (NGS) is a coal fired generation facility located outside of Page, Arizona, which is comprised of three 750 MW units, a coal train transportation system, an ash landfill area, a water pumping station located near Lake Powell, and a water pipeline system. Operated continuously since 1974, NGS has served the Department as a significant source of low cost energy capable of providing DWP with an average of 12 percent of its average energy requirements. DWP states that mandated emission requirements have necessitated periodic capital investment. Specifically, in 1999, NGS installed a \$420 million Wet Scrubber system to control sulfur oxides emissions. In 2011, NGS installed a \$44 million Low-NOx Burner system to increase energy efficiency and to reduce emissions of nitrogen oxide. The DWP share (21.2 percent) of these capital investments was \$89 million and \$9.

New environmental regulations that are proposed or pending from the United States Environmental Protection Agency (EPA) will require additional capital investments for compliance at NGS that DWP estimates could exceed a billion dollars. In addition, the State of California has also imposed restrictions (e.g. Senate Bill 1368 and Assembly Bill 32) that effectively prohibit the continued participation of DWP in NGS after December 23, 2019. The restrictions specifically prohibit any extension of a power contract or plant ownership or other expenditures that would extend the life of a power plant by five years. Penalties would be addressed by California Energy Commission, the authorized regulatory body for municipal utilities in California.

NGS is co-owned by six entities consisting of the DWP, SRP, the United States Department of Interior Bureau of Reclamation (Bureau of Reclamation), the Arizona Public Service Company, NV Energy, and the Tucson Electric Power Company. According to the Department, NV Energy also intends to discontinue its ownership in the plant and plans to divest its interest by 2019. The following table shows the current and proposed level of ownership interests based upon the DWP divestment only.

<b>NGS Co-Owners</b>	<b>Current Ownership</b>	<b>Proposed Ownership</b>
DWP	21.2%	0%
SRP	21.7%	42.9%
Bureau of Reclamation	24.3%	24.3%
Arizona Public Service Company	14.0%	14.0%
NV Energy	11.3%	11.3% <sup>1</sup>
Tucson Electric Power Company	7.5%	7.5%

<sup>1</sup> NV Energy is anticipated to divest its ownership by 2019.

**EXCLUDED ASSETS**

The Department will retain its ownership interests in the associated NGS transmission systems to maintain its transmission opportunities in the western region for new sources of energy.

Two separate transmission systems connect 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 DWP as a partial owner of both the Western Transmission System (DWP owns 48.9 percent) and the Southern Transmission System (DWP owns 21.2 percent).

## FINANCIAL CONSIDERATIONS

In consideration for the acquisition of the DWP interests in NGS, the Department will receive from SRP both monetary compensation and ownership interests in various SRP-owned assets, listed as follows:

- Payment of \$10 million at the sale closing subject to a fair market price adjustment in 2020. If the 2020 value of NGS increases, the additional value is to be split evenly with SRP paying DWP a 50 percent share of the greater value. If the value decreases, DWP will refund up to \$9 million to SRP. There is no impact to the City's General Fund.
- SRP's 20 percent interest in the decommissioned Mohave Generating Station (MGS) which is primarily the underlying land. Upon closing, DWP will own a 30 percent interest in the MGS. The SRP interest in MGS is appraised at \$3 million.
- SRP's interests in the Eldorado Transmission System comprising the Eldorado Switchyard, the Eldorado Transmission Line, the Mohave Switchyard, and other ancillary equipment. The SRP interest in these assets is appraised at \$2 million.

Valuation – The proposed offer by SRP has been reviewed and analyzed by the DWP, two financial advisory firms hired by DWP, and by this Office. Various aspects were considered in the valuation including, but not limited to, the cost of operating NGS, the forecasted market cost of energy, and the DWP cost for replacement energy. The findings of these analyses indicate that continuing to own DWP's interest in NGS will negatively impact the Department. DWP will benefit from the SRP offer due to the increased cost of coal fuel compared to natural gas and various avoided costs from divesting NGS prior to 2019. Avoided costs consist of operations and maintenance, administration, fuel, labor, and overhead expenses.

Allocated Tax Exempt Debt – There is approximately \$72 million of outstanding tax exempt debt that DWP allocated to the NGS. Due to certain restrictions regarding the use of tax exempt debt for non-governmental agencies, DWP expects to redeem these bonds within 90 days of completing the sale to SRP. Funding options available for the outstanding bonds are listed below; however, further analysis is needed to determine the optimal solution.

- Refund debt allocated to the NGS using taxable bonds which could provide higher interest rates than the regular tax-exempt bonds.
- Utilize cash reserves from the Power Revenue Fund and/or Debt Reduction Trust Fund (DRTF). However, DWP states that a majority of the allocated debt is variable and advises to not use DRTF funds for the variable debt due to arbitrage issues.
- A combination of the options.

Continuing Liabilities: – DWP will continue to carry NGS liabilities for the time in which it was a co-owner including Decommissioning Costs, Final Reclamation Costs (FRC), and Retiree Health Care Costs (RHCC) for miners. The total current liability is estimated at \$43.7 million

The existing Co-Tenancy Agreement among all co-owners does not include any provision for a decommissioning fund. As a result, decommissioning costs will be provided from the Power Revenue Fund at the end of service life for NGS anticipated in 30 years or more.

Navajo maintains an ongoing Final Reclamation Cost (FRC), and Retiree Health Care Cost (RHCC) billing cycle for all its co-owners. The post retirement expense is calculated based on a pre-established and agreed upon discount rate and health care cost trend assumption Expected Postretirement Benefit Obligation (EPBO). Navajo has been operating since 1976, and the final 'True Up' is expected to take place in 2027. DWP has been contributing to these costs in addition to several community outreach programs (i.e. Peabody Annual Scholarship, free electricity for miners' homes, providing job opportunities at NGS). It is estimated that DWP contributes approximately \$950,000 per year to NGS for RHCC, FRC, Peabody Scholarship and various other related expenditures. DWP, along with other participants, pays these contributions on a monthly basis to SRP (the Operating Agent for Navajo). During the past 40 years, DWP states that it has contributed a total of approximately \$38 million.

SRP will retain its own pre-closing liabilities for the Mohave Generating Station and Eldorado Transmission System.

#### **ASSET PURCHASE AND SALE AGREEMENT (PSA)**

The Asset Purchase and Sale Agreement (PSA) is a complex transaction involving the exchange of multiple facilities between LADWP and SRP. The PSA also provides that SRP will lead efforts to cease operating one of the three coal-fired generating units at NGS by December 23, 2019.

Prior to the closing of this transaction, numerous conditions must be satisfied including the following:

- Right of First Refusal included in the NGS Co-Tenancy Agreement (CTA) must be waived by Co-Owners NV Energy, Arizona Public Service Company, and Tucson Electric Power Company.
- The Bureau of Reclamation must consent to the sale assets under the NGS CTA.
- Right of First Refusal included in the Eldorado Transmission System's Co-Tenancy Agreement must be waived by Southern California Edison and NV Energy.
- The Bureau of Reclamation must complete an environmental assessment for this transaction in compliance with the National Environmental Policy Act (NEPA). The Bureau of Reclamation has been briefed on the substance of the sale. However, it is anticipated that an official review will only begin after the City of Los Angeles and SRP have approved the sale. The duration of this review is expected to be approximately six to nine months.
- Environmental site assessments associated with the properties being conveyed to SRP and DWP must be satisfactorily completed.

- All NGS owners must agree on a method for allocation of the NGS lease and associated payments between the generating station and its transmission systems as DWP divests its interests in NGS facilities while retaining its ownership interests in the transmission systems. All of the owners have approved this proposed agreement.

**TERM ENERGY TRANSACTION CONFIRMATION AGREEMENT**

As a condition of the sale of NGS, DWP agrees to enter two energy contracts with SRP to purchase 55 MW of renewable energy capacity (up to 3,125,770 MWh), along with the associated environmental credits, from SRP's interest in the Hudson Ranch 1 Geothermal Project. The Hudson Ranch 1 Project is located in California within the Imperial Valley. DWP states that the cost of energy is consistent with current geothermal market pricing with a range between \$80 and \$90 per Megawatt hour (MWh) including renewable energy credits. The total cost of these energy purchase contracts is approximately \$267 million and will provide approximately one percent of the DWP renewable energy goals. The complete term of the two contracts is April 25, 2015 through October 26, 2021.

Pursuant to Ordinance Number 177678, adopted by the City Council on June 28, 2006, the DWP General Manager is authorized to execute transactions for the purchase and sale of wholesale energy, transmission services, and ancillary services that do not exceed 18 months in duration. The first energy contract does not require Council consideration. The second contract term exceeds 18 months and is subject to approval by ordinance, in accordance with Section 674 of the City Charter. The following table summarizes the two energy contracts:

Hudson Ranch Geothermal Plant (55 MW capacity) – located in the Imperial Valley, CA				
Agmt	Term	Cost / MWh	Contract Quantity MWh	Total Cost of Energy
1	April 25, 2015 – Oct. 24, 2016	\$80.00	716,770	\$57,341,600
2	Oct. 25, 2016 – Dec. 31, 2019	\$85.59	2,409,000	\$130,584,663
	Jan. 1, 2020 – Oct. 23, 2021	escalating to \$90.00		\$79,497,000
<b>Total</b>			<b>3,125,770</b>	<b>\$267,423,263</b>

## **FIRM ENTITLEMENT AGREEMENT AND ENERGY EXCHANGE AGREEMENT**

DWP will also enter a Firm Entitlement Agreement with SRP to provide transmission services on the Navajo-McCullough transmission line and the Navajo-Moenkopi transmission line during the four year period between January 1, 2016 and December 23, 2019. This transmission service allows SRP to continue to deliver energy to their customers or to the market. After 2019, DWP will gain control of the SRP share of transmission capacity along with the existing DWP transmission entitlements. Upon the shutdown of one generating unit in 2019, the transmission capacity requirements are anticipated by DWP to be reduced enough to allow SRP to no longer rely on DWP owned transmission line capacity for bringing power to SRP customers.

The Energy Exchange Agreement effectively replaces the Firm Entitlement Agreement and allows SRP to receive energy from DWP at the McCullough switchyard in the event the Firm Entitlement Agreement is terminated prior to 2019 or invalidated by the Federal Energy Regulatory Commission (FERC). The DWP considers this a low probability event as the DWP and SRP are not subject to FERC requirements.