Lompoc City Council Agenda Item

City Council Meeting Date: May 4, 2010

TO: Laurel M. Barcelona, City Administrator

FROM: Ronald V. Stassi, Utilities Director

SUBJECT: Authorization to Execute Lodi Energy Center Documents

Recommendation:

The City Council adopt the attached Resolution No. 5631(10):

(1) Adopting the California Energy Commission (CEC) environmental analysis, findings, and mitigation measures along with the City Council’s own findings regarding the same as responsible agency for the significant impacts of the Lodi Energy Center Project (LEC or Project) and direct the City Administrator to immediately record a Notice of Determination with the San Joaquin and Santa Barbara County Clerks; and

(2) Approving both the LEC Power Sales Agreement (PSA), and the LEC Project Management and Operation Agreement (PMOA) relating to the financing, construction and operation of the LEC Combined Cycle 280 MW power plant, and authorize the Mayor to execute those two agreements on behalf of the City of Lompoc (City); and

(3) Designating the City Administrator as the City official responsible for appointing, and from time-to-time, changing as necessary, the City’s representative and alternate representative on the LEC Project Participant Committee (PPC).

Background

The Northern California Power Agency (NCPA) is developing a gas-fired power plant called the LEC located in Lodi, California. The plant is nominally rated at 296 MW, but it is limited to 280 MW due to transmission rights.

In January 2007, the City Council authorized the Second Phase Agreement which provided $320,000 for funding the City’s share of LEC planning and development activities. Then in December 2007, the City Council authorized additional Second Phase planning work and additional expenditure of $180,000.
The City’s Generation Entitlement Share (GES) as specified in the Second Phase Agreement is 1.960% which is approximately 5.49 MW of capacity from the Project. (When the planning and development activities were being concluded the City’s participation level was rounded at 2.00% and 5.6 MW.)

There are currently fourteen Project Participants including the City as identified in the table below. Some minor adjustments in the participation amounts have occurred and may occur again, however, the City’s participation will become finalized if the City Council approves the staff recommendations contained in this report.

<table>
<thead>
<tr>
<th>Participant</th>
<th>Allocation (Percent)</th>
<th>Megawatts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Azusa</td>
<td>2.7857</td>
<td>7.80</td>
</tr>
<tr>
<td>BART</td>
<td>6.2500</td>
<td>17.50</td>
</tr>
<tr>
<td>Biggs</td>
<td>0.2679</td>
<td>0.75</td>
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<tr>
<td>CDWR</td>
<td>33.3332</td>
<td>93.33</td>
</tr>
<tr>
<td>Gridley</td>
<td>1.9643</td>
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</tr>
<tr>
<td>Healdsburg</td>
<td>1.5714</td>
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</tr>
<tr>
<td>Lodi</td>
<td>9.3561</td>
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<tr>
<td>Lompoc</td>
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<tr>
<td>Modesto</td>
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</tr>
<tr>
<td>Plumas-Sierra</td>
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<td>Port of Oakland</td>
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<td>PWRPA</td>
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<td>Silicon Valley Power</td>
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<tr>
<td>Ukiah</td>
<td>1.7857</td>
<td>5.00</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>100.0000</strong></td>
<td><strong>280.00</strong></td>
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Planning Efforts: As part of the initial development phase of the Project, NCPA filed an Application for Certification (AFC) with the California Energy Commission (CEC) in September 2008. All LEC related air emission reduction credits, water supply agreements, land use agreements, air permits have been attained and the power island equipment ordered. Detailed Project engineering is approximately 50% complete.

The AFC was approved by the CEC on April 21, 2010, and the initial development phase of the Project is nearing completion. In order to proceed with financing and construction of the Project, the approval of the LEC Power Sales Agreement (PSA) and final determination of Generation Entitlement Shares for the LEC Project Participants will be necessary. Upon approval of the PSA by all
Participants, financing activities will begin, with construction scheduled to start in June 2010 and Project commercial operation date targeted for June 2012. The Project construction budget, excluding the necessary financing expenses is estimated to be $375.3 million.

**Project Agreements:** The NCPA Commission has approved the Power Sales Agreement (PSA) that is attached to this report. The PSA must additionally be approved by each Participant including the City of Lompoc. The City Attorney has reviewed the PSA and has approved it as to form. A Project Participation Committee (PPC) was formed pursuant to the Second Phase Agreement and is to be “re-established” pursuant to the terms of the PSA. The PPC will be responsible for the governance of Project activities and will act and vote on Project related matters in an official capacity. The decisions by the PPC will be binding upon Project Participants and upon NCPA as the Project Manager. Each Project Participant would have one representative on the PPC whose vote would be cast in accordance with the respective Participant’s Generation Entitlement Share. One of the actions requested of the City Council as a part of this item is to authorize the City Administrator to formally designate to NCPA the name of the City’s representative and alternate representative to the PPC.

The PSA contains provisions for how the LEC Project will be financed, and establishes three separate indenture groups associated with Project financing. Indenture group A will consist of the ten NCPA member Project Participants plus two non-NCPA Participants (City of Azusa and the Power and Water Resource Pooling Authority). Indenture Group B consists of the California Department of Water Resources and Indenture Group C consists of the Modesto Irrigation District. NCPA will separately sell bonds for the share of Project costs represented by Indenture Group A and Indenture Group B. Modesto Irrigation District (Indenture Group C) will finance its share independently.

NCPA will proceed to finance the Project upon receipt of executed PSAs from all Project Participants and completion of other necessary documentation. Upon financing of the Project, the City will be bound and obligated to pay, solely out of its electric department’s revenues, its share of Project Cost based on billing amounts to be calculated by NCPA each month for a period of thirty (30) plus years or the life of the Project. The first monthly invoice from NCPA will be issued prior to the expected date of LEC commercial operation in June 2012. In return, the City will receive its share of Project capacity, energy and other attributes (ancillary services, environmental attributes, etc.).

**Key highlights of the PSA include:**

- **Take or Pay Agreement:** Each Participant will be obligated to pay its proportionate share of the Project Cost based on the billing amount to be
calculated by NCPA each month for a period of 30 years or the life of the project, whichever is longer. Payments are required whether or not power is produced from the Project. Such payments will be made solely from the electric department’s enterprise fund revenue

- **Proportionate Entitlement**: Each Participant will receive its proportionate share of Project output and other attributes (including capacity, ancillary services, environmental attributes, etc.) from LEC.

- **Option for Independent Fuel Purchases**: Participants may provide physical fuel for the plant up to their respective GES, or to rely on NCPA to obtain such fuel supply. Gas hedging activities are not a part of the LEC Project. NCPA intends to develop a gas hedging program separate from the LEC Project in which NCPA Members may elect to participate. (The City has indicated its interest in such a program.)

- **Rate Covenant**: Participants covenant to raise rates, fees or other charges as necessary in order to make requisite Project payments required under the PSA. However, the obligation to pay is an obligation limited to the Electric System, and is not an obligation of the general fund.

- **Step-up Obligations**: The “step-up” obligation among Participants in case of payment default is specific to each of the 3 indenture groups. However, operating and maintenance step-up costs flow across all Participants. The defaulting participant remains liable for all costs despite the step-up.

A second agreement entitled the Project Management and Operation Agreement (PMOA) is also attached for approval. The City Attorney has reviewed the PMOA and has approved it as to form. It is the desire of each Participant that NCPA manage and operate the LEC Project based on NCPA’s capabilities and experience in operating similar projects. NCPA has agreed to operate the Project pursuant to the directives and guidelines of the PMOA, as such the PMOA may be modified over time by the PPC. The roles, obligations and responsibilities of the PPC and NCPA are addressed in the attached PMOA.

**Key highlights of the PMOA include:**

- **Project Operation**: NCPA shall be responsible for planning, operating, and maintaining the Project, and to effectuate the delivery and sale to each Participant of its share of Capacity and Energy and other power products from the Project. NCPA will run the Project only when it is ‘economical’ to run. The Project will participate in the Balancing Authority’s energy, capacity and ancillary services markets to maximize the value of the Project.

- **Economic to Run**: NCPA will schedule and run the Project only when it is economic to run. The Project will participate in the Balancing Authority’s available energy, capacity, and ancillary services markets to maximize the value of the Project.
• **Governance:** Governance shall be by the PPC which shall determine operational guidelines for the Project, approve annual budgets, and oversee Project activities.

• **Allocation of Certain Costs:** Participants that are not members of NCPA will be subject to the JPA Cost Assessment costs, intended to recover NCPA overhead costs relating to the LEC that are paid by the Members directly through annual JPA assessments. Such costs shall be separately identified and billed to each non-NCPA member Project Participant.

• **NCPA to Follow Directives:** NCPA is obligated to follow the directions of the PPC in managing the Project where such direction would affect only the Project. The LEC Project and the PPC cannot override general NCPA procedures and policies which apply to other NCPA projects in addition to the LEC Project.

**Adjustments in Participation Levels:** In order to finance the Project, 100% Project subscription must be attained. Each Project Participant has the right to adjust its participation level downward prior to executing the PSA. If one or more Project Participants elect to reduce their level of Project Participation, one or more other Project Participants must increase theirs to assure Project financing and construction. Since it may becomes necessary for other participants to increase their participation, staff is also seeking City Council authority to increase its participation level based on a pro rata share determined by the City’s participation level identified in the current agreements. If some other formula is used for determining that increase, then staff would return to the City Council for further direction.

**Fiscal Impact**

The estimated cost of construction of this Project is $375.3 million. For Lompoc, at the 2.00% share level, the annual cost of debt service is estimated to be $607,658; provided, that if the City’s share level is increase as stated in the paragraph immediately preceding this paragraph, then that debt service amounte would be increased accordingly.

The estimated cost of project energy when the Project goes on-line is $69 per megawatt hour assuming a gas price of $7 per mmbtu. (For reference, gas is currently priced at about $4.50 per mmbtu and has fluctuated from approximately $4.50 to $14.00 over the five-year period ending in December 2009.) The LEC will be the most efficient gas powered power plant in Northern California. As a result, it will generate power at a cost lower than market based rates that may or may not be available under long-term contracts. (For reference, Lompoc’s average cost of electricity in 2009 was approximately $77/mWh on a comparable basis.) There is an expected benefit (net present value) when comparing the difference between the estimated market cost of power and the production cost of power from this plant over the life of 30 years.
Participation in the Lodi Energy Center is not expected to cause an increase in electric rates beyond those multi-year rate adjustments which were approved by the City Council on November 3, 2009, primarily because energy provided from the LEC has been accounted for in those rate adjustments and will be displacing energy that is currently budgeted and being purchased on a short term basis. Besides providing needed energy at rates that are lower than the current market rate of long-term power contracts, the Lodi Energy Center will serve to stabilize power costs by providing a secure generation source.

Environmental Analysis:

The AFC approval by the CEC includes various environmental analysis, findings and mitigation measures under the terms of the Warren-Alquist Act (Public Resources Code section 25500 et seq.) That analysis, the findings, and mitigation measures, constitute the equivalent of an environmental impact report for purposes of the California Environmental Quality Act (CEQA, Public Resources Code section 21000 et seq.) as a "certified regulatory program" pursuant to CEQA Guidelines section 15251(j). The CEC in effect has acted as the "lead agency" for the Project for purposes of environmental analysis. As a consequence, rather than conducting its own independent environmental analysis under CEQA, the City is acting as a "responsible agency" under CEQA and is responsible for considering the analysis, findings and mitigation measures of the CEC and reaching its own independent conclusions on whether and how to approve the LEC Project. (CEQA Guidelines section 15096.) Specifically, as a responsible agency, the City must consider the lead agency's findings for each significant effect of the Project and make its own appropriate findings. The attached resolution makes all necessary findings for the City of Lompoc acting as responsible agency. Accordingly, the attached resolution (No. 5631(10):), specifically accepts the CEC prepared environmental documents including the mitigation conditions contained in the Approval for Certification document.

A copy of the AFC is attached on a CD for your review. A paper copy of this report as well as another copy of the CD is also available for review in the Utilities Director's office.

Summary:

Staff recommends the City Council adopt the attached Resolution No. 5631(10):

(1) Adopting the CEC environmental analysis, findings, and mitigation measures along with the City Council’s own findings (Exhibit A attached to the Resolution No. 5631 (10) regarding the same as responsible agency for the significant impacts of the LEC Project and direct the City Administrator to immediately record a Notice of Determination with the Counties of San Joaquin and Santa Barbara;
(2) Approve the PSA and the PMOA, and authorize City Administrator to execute them on behalf of the City of Lompoc; and

(3) Designate the City Administrator as the City official responsible for appointing, and from time-to-time changing as necessary, the City’s representative and alternate representative on the LEC PPC.

(4) Authorize an adjustment in the City’s level of participation in the Project in accordance with the criteria set forth in the above staff report.

Respectfully submitted,

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Ronald V. Stassi, Utilities Director

APPROVED FOR SUBMITAL TO THE CITY COUNCIL:

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Laurel M. Barcelona, City Administrator

Attachments:
1. Resolution No. 5631(10)
2. Lodi Energy Center Power Sales Agreement
3. Lodi Energy Center Project Management and Operations Agreement
4. CEQA Documents (CD)