THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED: July 13, 2010 REPORT NO: 10-105

ATTENTION: Natural Resources and Culture Committee
Agenda of July 21, 2010

SUBJECT: Amendments and Modifications to the Miramar Landfill Gas Power Projects Agreements

REFERENCES:
1. City Manager's Report No. 95-265, dated November 15, 1995
2. City Manager's Report No. 98-36, dated February 28, 1998

REQUESTED ACTIONS:

A. Authorize the Mayor or his designee to execute the following Amendments:
   1. Amended and Restated Landfill Gas Lease and Operating Agreement;
   2. Amendment to the Non-Operating Interest Acquisition Agreement with NEO San Diego, LLC;
   3. Amendment to the Privatized Cogeneration Facility and Energy Sales Agreement;
   4. Amendment to the Cogeneration Facility Site Lease Agreement;
   5. Amendment to the North City Privatized Cogeneration Facility and Energy Sales Agreement;
   6. Amendment to the North City Cogeneration Facility Site Lease Agreement;
   7. Amendment to the Digester Gas Agreement with MM San Diego, LLC; and
   8. Second Amended and Restated Well Installation Agreement with NEO San Diego, LLC, MM San Diego, LLC and Miramar Energy, LLC.

B. Authorize the Mayor or his designee to execute the following new Agreements:
   1. City-Developed North City Expansion Project Landfill Gas Purchase and Sale Agreement with NEO San Diego, LLC;
   2. Contingent Landfill Gas Purchase and Sale Agreement with MM San Diego, LLC;
   3. Contingent Landfill Gas Purchase and Sale Agreement with Miramar Energy, LLC;
   4. Phase III Cogeneration Facility Site Lease Agreement with Miramar Energy, LLC;
   5. Supplemental Guaranty Agreement from Fortistar Methane 3, LLC; and
   6. Site Lease Guaranty Agreement from Fortistar Methane 3, LLC.

STAFF RECOMMENDATION: Adopt the Ordinance.

SUMMARY:

Background

On December 4, 1995, the City Council approved a 20-year contract (Ordinance number 00-18235) with NEO San Diego LLC (NEO) to install landfill gas (LFG) collection systems in the City's Miramar North, West Phase I and West Phase II Landfills and to operate all the Miramar LFG collection systems at no cost to the City. The Council also approved a 20-year contract and land lease with MM San Diego LLC (MM San Diego) to privatize a 6.4 MW cogeneration system at the Metro Biosolids Center (MBC) to be fueled with LFG and digester gas to provide MBC electricity at a discount. These projects were federal tax code section 29 tax credit driven, thus requiring that all the Miramar Landfill gas rights be awarded to NEO.

On February 25, 1997, the City Council approved a 20-year contract (Ordinance number 00-18384) and a land lease for MM San Diego to privatize a landfill gas fueled 5.7 MW North City Cogeneration Facility (NCCF) at the North City Water Reclamation Plant (NCWRP). This Agreement provided the City an eight percent royalty on all MM San Diego revenues from the NCCF to be split 50/50 between the Environmental Services Department (ESD) and the Public Utilities Department (Public Utilities). This Agreement also allowed the royalty to be used to pay for future LFG well installations, not needed for power generation, but needed for landfill gas compliance issues. NCWRP was provided electricity at a discount and ESD was provided free electricity on most of the Miramar Landfill.

On March 17, 1998, the Council approved amendments to these Agreements (Ordinance number 00-18475) with NEO and MM San Diego to accommodate lender requests, to resize NCCF to 3.8MW to match the landfill gas available at the time and to provide MM San Diego rights to the MBC digester gas and NEO a Non-Operating Interest Acquisition Agreement for tax purposes. The term of all existing agreements is stated as 20 years from acceptance date of the final project, NCCF. The NCCF was accepted on December 31, 1998.

In August 2006 the City signed a Letter of Interest with MM San Diego and NEO to install approximately 20 wells in the West Phase II Landfill and to build an expansion to the NCCF. MM San Diego unsuccessfully bid the project's electricity to SDG&E. In September 2008 the Marine Corps Air Station Miramar (MCASM) issued a sole source Request for Proposals for electricity produced from the Miramar Landfill to Fortistar Methane Group LLC (Fortistar), the owner of NEO and MM San Diego.

New Projects

Per the existing Agreements, the City must approve any additional projects that use the landfill gas. The proposed Amendments to these Agreements will extend all of these 20-year agreements by eight years to December 31, 2026 to accommodate MCASM's requirement for a 15-year energy sales agreement. The Amendments also include an option for the City to take over operations of the LFG system at the end of the existing term, December 31, 2018, when the City would sell gas to MM San Diego, and Miramar Energy, LLC (Miramar Energy) for their power plant commitments. NEO San Diego will install approximately forty new LFG wells in West Phase II and will continue to work with the City to extend the height of the LFG wells in West Phase I and West Phase II, as the landfill elevation is raised. To serve MCASM, Fortistar will form the special purpose project company, Miramar Energy, LLC, who will design, construct, own and operate two 1.6MW LFG fueled engine generators and lease space for this equipment from the City that is available on the MM San Diego MBC property and in the MBC Cogen building. Miramar Energy will have 60 days from the time these agreements are executed by the City to complete their Power Purchase Agreement with MCASM or any other energy customer. The Mayor may provide Miramar Energy with up to a 6-month extention to execute a power purchase agreement.

MM San Diego will also invest up to $200,000 in the MBC and MBC Cogen switchgear, increasing MBC's electrical system's reliability.

NEO will sell excess LFG to Public Utilities at a favorable rate and cooperate with Public Utilities' plan to build a 1.6MW expansion to the MM San Diego owned NCCF. This planned City owned engine generator power plant is not part of this Council action and will be brought forward at a future date once this concept is fully developed.

The Miramar Energy power plant and the NEO gas sales to the City will provide the City with new royalties of approximately $220,000/year in addition to the existing NCCF royalties of approximately $110,000/year, for a total of approximately $330,000/year. The Second Amended and Restated Well Installation Agreement will again allow these royalties to be used to install additional landfill gas wells and keep these power plants' landfill gas system in compliance with regulations.

Landfill gas system compliance loans will be capped at $2,500,000. The available royalties are projected to cover the entire $2,500,000 loan amount within the 15 years remaining on these amended contracts. The City reserves the right to refinance or pay off this loan at any time.

EQUAL OPPORTUNITY CONTRACTING INFORMATION:

Equal Opportunity Contracting Program (EOCP)
Funding Agency: City of San Diego
Goals: 15% Voluntary (MBE/WBE/DBE/DVBE/OBE)
Subcontractor Participation: construction contractors have not yet been selected. Contractors will be selected once the final design and permitting of the installation and EOC outreach for contractors is complete. City staff will monitor achievement of goals prior to issuing a Construction Notice to Proceed, which is a defined term in the Agreements.

FISCAL CONSIDERATIONS:

The total increase in Public Utilities and Environment Services Departments' revenues associated with these Amendments is approximately $220,000 per year provided to the City by MM San Diego, Miramar Energy and NEO San Diego. The total revenues from royalties are expected to be $330,000 per year annually during the remaining term of these amended contracts. When not used to fund additional well installations, the royalties will be deposited 50% in the Sewer Revenue Fund #700001, General Ledger Account 423026 and 50% into Environmental Services Fund #700039, General Ledger Account 424071. If these royalties are used to pay off loans made under the Second Amended and Restated Well Installation Agreement, these two funds will be obligated for one half of any delinquent loan payments.

Public Utilities provides its 50% of these royalties to pay for additional required landfill gas wells to ensure the source of fuel for its inexpensive electricity stays in compliance with applicable laws. Loan amount may not exceed $2,500,000 without Council approval.

Approval of the Amendments will provide benefits to the City through the avoidance of $1,500,000 in capital cost for the installation of landfill gas wells for compliance, and $200,000 for upgrades to the MBC switchgear.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

The Landfill Gas Lease and Operating Agreement with NEO San Diego and the Privatized Cogeneration Facility and Energy Sales Agreement and the Cogeneration Facility Site Lease Agreement with MM San Diego were authorized by Council on December 4, 1995.

The North City Privatized Cogeneration Facility and Energy Sale Agreement and the associated site lease with MM San Diego and the Well Installation Agreement with NEO San Diego and MM San Diego were authorized by Council on February 25, 1997.

All the above mentioned Agreements with NEO San Diego and MM San Diego were Amended and Restated and authorized by Council on March 17, 1998 along with the Digester Gas Agreement with MM San Diego and the Non-Operating Interest Acquisition Agreement with NEO San Diego.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

This item has been reviewed and approved by the Metro Commission at their February 4, 2010 meeting and by the Independent Rate Oversight Committee (IROC) at their February 16, 2010 meeting.

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Stakeholders: Marine Corps Air Station Miramar, Wastewater ratepayers, Miramar Landfill users, SDG&E, Public Utilities Commission.

Impacts: Avoided capital expenditures, lowers costs through increased revenues, cleaner air, reduced landfill emissions, reduced need for additional electricity utility infrastructure.

Ann Sasaki
Assistant Public Utilities Director

Alex Ruiz
Interim Director of Public Utilities

Attachments:

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14. Site Lease Guaranty Agreement from Fortistar Methane 3, LLC