




MEMORANDUM

TO: Mayor and City Council Members

CC: Marc A. Ott, City Manager

FROM: Larry Weis, General Manager 

DATE: December 1, 2014

SUBJECT: Fayette Power Project Resolution Response

On October 16, 2014, the City Council passed Resolution No. 20141016-023 directing the City Manager to conduct negotiations with the Lower Colorado River Authority (LCRA) to amend the participation agreement at the Fayette Power Project (FPP) so that greater operational control of the City's share of this resource is available to Austin Energy, including possible ownership of a single unit. The purpose of this memorandum is to respond to Council on the resolution's directives, as well as to outline policy, legal, financial and risk-related potential challenges to implementation.

Although Austin Energy staff has not fully evaluated the implications and potential outcomes of the proposed scenarios due to time constraints, Austin Energy recognizes that an accelerated ramp down or retirement has financial, legal and operational risks. The key challenge continues to be maintaining affordability, i.e., recovery of ongoing operating and maintenance costs, accelerated cash requirements for defeasance of debt and loss of revenue from the asset. Key legal issues are largely associated with renegotiation of the Participation Agreement and the increased risk profile associated with consolidation of ownership into a single unit.

The resolution requests an evaluation and renegotiation of the terms of the Participation Agreement. Austin Energy has initiated discussions with LCRA, per the direction of this resolution, and is working with leadership to determine where Participation Agreement elements can be mutually adjusted to the benefit of Austin Energy customers. In accordance with the agreement, Austin Energy owns, plans for, schedules and manages the output of 50 percent of Units 1 and 2 at FPP. The LCRA is the operator of the plant, but Austin Energy fully controls the output of its share of the units. Austin Energy staff determines the offer curves and other unit characteristics and offers the energy into the ERCOT centralized wholesale market, just as the other units the utility owns and operates. The LCRA does not drive the offer curve or output of

Austin Energy's share of the units. The only exception is that each participant agrees to schedule their contribution to low load operation.

Concentrating ownership into one unit would create Austin Energy's single largest generating unit (602 MW) which creates greater reliability risk exposure for Austin Energy's customers. Under the current operating arrangement, if one unit shuts down due to a planned or unplanned outage, Austin Energy still has the output of the other unit to dispatch. Ownership and control of only one unit increases the operational and financial risk when equipment failures and planned outages do occur. A diverse portfolio is good utility operational policy for Austin Energy and its customers. Furthermore, even if Austin Energy would own a single unit, Austin Energy and the City would remain legally responsible for 50% of costs directly attributable to Units 1 and 2, and 33% of those costs attributable to FPP as a whole. This results in customers being burdened by the on-going costs or ownership, with no offsetting revenue from power and energy sales to help reduce their bills.

Austin Energy briefed City Council in September 2012, December of 2013 and February of 2014 relative to the challenges created by early retirement of its ownership share in FPP. Austin Energy has developed plans to utilize existing rights of direct control of the output of FPP to achieve the 2020 Climate Protection Plan goals and will continue to evaluate the earliest possible retirement of its share in the project. The alternative pathway for accelerating the ramp down schedule is complex and dependent upon the disposition of the assets and the timing of the reduction in dispatch from Austin Energy, as well as the date of decommissioning. As we have previously discussed, the timing associated with the proposed retirement of Austin Energy's ownership of the plant is largely tied to the remaining debt of the plant, which is approximately \$307.7M (principal and interest). The majority of the debt was incurred to retrofit the plant with the latest environmental controls.

Defeating bond debt related to FPP prior to the date it becomes callable would involve certain financial and legal hurdles. The bond series include both municipal tax exempt and Build America Bonds. One series associated with non-scrubber debt of approximately \$10.2M is callable in November 2017 and a second series associated with scrubber debt of approximately \$280M is callable in November 2022. The Build America Bonds have a value of \$17.5M. Defeasance of the bonds prior to 2022, the callable date for the majority of the debt, would require a significant legal process since Austin Energy does not have the legal right to redeem or defease the bonds until that date. The likelihood of success in this legal proceeding is unknown since this type of action is without precedent and is dependent on many operational, financial and legal facts which are unknown at this time. Once the bonds become callable after 2022, Austin Energy has the legal right to defease the bonds. The debt would be considered defeased if Austin Energy placed cash or other assets, such as risk-free U.S. Government securities, with an escrow agent in a trust to be used solely for satisfying scheduled principal and interest payments of the defeased debt. The establishment of a trust-managed escrow fund is straightforward, and could be accomplished by negotiating, in coordination with Austin Energy's bond counsel and financial advisors, with a bank or trust that would serve as escrow agent. The trust would be restricted to owning only monetary assets such that the principal and interest earned are sufficient to retire the outstanding bonds as they come due.

It is important to recognize the overall portfolio and strategy for generation assets owned by Austin Energy, for the benefit of its customers. Making a decision to retire a baseload asset separate from a portfolio decision can be risky, resulting in unhedged financial risk for customers who are exposed to wholesale market prices within ERCOT. Austin Energy briefed the City Council in September and October of 2014 on the staff recommended Resource Plan. The recommendation strives to advance renewable energy supplies while maintaining customer affordability and financial stability of the utility. Austin Energy continues to recommend consideration of that balanced plan which increases utility scale solar supply, increases the renewable energy target, makes a new investment in high efficiency combined cycle natural gas capacity and targets the retirement of Decker and Fayette within the 2025 planning horizon.

In conclusion, Austin Energy's recommendation is to continue to optimize the FPP plant, which includes reducing carbon output as early as 2020, working with the LCRA in ongoing management and improvement of the facility and managing the wholesale energy sales opportunities in balance with the carbon reduction goals to support affordability for customers.