

MEMORANDUM

TO: Burlington City Council

FROM: Ken Nolan, Manager of Power Resources

DATE: January 8, 2014

RE: **Purchase of Winooski One Hydro Facility**

cc. Barbara Grimes, BED General Manager

In September, 2012 the city council authorized the exercise of an option BED held to purchase the Winooski One hydroelectric facility, as well as the entering of arbitration if a purchase price could not be negotiated. The arbitration award was issued on December 11, 2013, and BED is now seeking approval to proceed with the purchase.

Background

The Winooski One hydroelectric generating facility is physically located in the Cities of Burlington and Winooski and is electrically located inside BED's service territory. The facility is rated at 7.4 MW and typically produces approximately 30,000 MWH annually (roughly 8% of BED's annual energy needs for all customer classes or the equivalent of the usage of 6,000-6,500 Burlington Residential Customers per year).

Prior to the facility's construction, Burlington had been looking to develop a similar project known as Chace Mill, and was in the process of obtaining a license from the Federal Energy Regulatory Commission ("FERC") when Winooski One filed a competing petition at FERC to develop its own project. Burlington and Winooski One engaged in litigation over the right to develop, and Burlington eventually agreed to transfer its development rights to Winooski One Partners in return for a lease payment, and the right to purchase the facility at "Fair Market Value" at the end of Winooski One's power contract with the State of Vermont (March 31, 2013). That right to purchase was embodied in the "option" that BED sought to exercise in September, 2012.

Activities to Date

From late 2011 to June 2012, BED staff attempted to negotiate a reasonable power purchase agreement with Winooski One partners that preserved Burlington's right to purchase the facility,

but delayed the option until the end of any new power purchase agreement. BED was unable to reach agreement with Winooski One and ended energy purchase discussions in June 2012. Around this time BED retained the services of LaCapra Associates to perform a preliminary evaluation of the cost of purchasing the facility to determine if proceeding with the purchase option looked viable. La Capra Associates analysis was used by BED staff to develop a preliminary business case for purchase of the facility. The conclusion reached in the business case was that exercising the purchase option was a viable (and the best option) for BED at that time.

The city council authorized exercising the option in September, 2012. BED then retained an expert to develop a formal Fair Market Value (FMV) for the facility and exchanged values with Winooski One in November, 2012. At that point BED and Winooski One agreed that they would be unable to agree on a value, so arbitration proceedings through the American Arbitration Association (AAA) were initiated.

Discovery through arbitration proceedings occurred throughout the summer of 2013 culminating in Hearings held from September 30th to October 4th in Burlington as well as November 7th and 8th in New York City. The arbitration award was issued by the panel of three arbitrators on December 11, 2013 and determined FMV for the facility to be \$16,000,000.

Opportunity

The current market conditions are favorable to potential purchasers of resources similar to Winooski One, including BED. Valuation of hydro facilities is typically based on the revenues the project can expect to receive for the resale of its energy and other related output. Wholesale market prices are near historic lows.

This purchase was evaluated in BED's Integrated Resource Plan, and was recommended in the least cost solution. It also compares favorably (based on the preliminary business case) with other renewable supply options. The final purchase price was evaluated again using the IRP methodology, and continues to show positive impacts for BED ratepayers.

Aside from the present market conditions being conducive to the acquisition, this is a unique (one-time) opportunity for BED to purchase the only hydroelectric facility within the city limits. The purchase will complete the efforts BED has undertaken over the past 10-years to move its supply portfolio to being sourced entirely from renewable generation, and will serve as a very effective hedge against future natural gas price increases.

Most importantly, the purchase will give BED a very long-lived generating resource with no fuel cost. Hydroelectric facilities are known to routinely operate for decades with many New England facilities approaching 100-years old.

The purchase would not only provide environmental and risk management benefits in the near term, but would help provide long term rate stability.

Remaining Risks

The arbitration was “binding”; however a court proceeding is required to confirm the award and put a judgment into effect. There remains a limited appeal process available to Winooski One in the form of seeking to “vacate” the arbitration award. The bar for getting such a Motion approved is extremely high, and would essentially require proving some form of fraud in the proceedings.

Under BED’s contractual arrangement with Winooski One interest begins accruing on the purchase price 18-months after the notice of exercise is issued, so interest on the purchase will begin accruing prior to April 1, 2014. Therefore, there is significant incentive for BED to close on the purchase as soon as practical.

The contract also states that BED is allowed one public vote on any required bond, and if that vote fails then the option is null and void. As result, BED is attempting to balance moving forward with the approval process as expeditiously as possible, with having sufficient clarity to facilitate the public vote.

Financial Considerations

BED has estimated the total cost of the purchase, purchase price plus bond issuance costs, to be \$18 million. However, this total cost will not need to be covered by the issuance of new bonds, due to other funds BED has (or will have) available.

In particular, BED issued bonds in 2009 that were in part earmarked for “renewable energy” purchases. \$4.9 million of those funds remain. They are presently anticipated to be used to purchase solar projects on city properties and to cover the arbitration costs associated with this purchase. However, \$1 million to \$2 million will likely remain available.

In addition, the debt service reserve fund related to the McNeil Generating Facility bonds issued in 1984 will become available for use in June, 2014. This is a \$10 million fund that could be partially used to fund the Winooski One purchase.

Balanced against using these funds for the purchase, BED needs to consider its other cash needs as well as statements in BED’s recent Moody’s rating review which stated that BED’s cash on hand was “weak,” and a key reason for maintaining a depressed credit rating.

Based on present projections of its likely cash position in June, 2014 BED is comfortable assuming that \$6 million from a combination of the 2009 bond and the McNeil bond debt service reserve could be used to reduce the amount of bonds needed to be issued for the Winooski One purchase, while still meeting cash levels desired by Moody’s.

In any event, BED would note that any new bonds associated with the purchase (even at the \$18 million total cost level) will result in new debt service substantially less than the debt service being removed from BED’s cost of service when the McNeil bonds are paid off in 2014, so these bonds associated with this purchase can be absorbed without any resulting rate pressures.

Next Steps

The Burlington Electric Commission unanimously approved proceeding with the purchase at their December 11, 2013 meeting, and moving the process to the city council. The Board of Finance, with Counselor Aubin absent, unanimously approved recommending the purchase to the city council at their January 6, 2014 meeting. If the city council also approves moving forward, a bond article will be placed on the Town Meeting Day ballot, and BED will begin moving toward setting a closing date for the purchase.

BED staff will be attending the January 13th meeting to answer any questions you may have.