

REPORT OF GENERAL MANAGER

NO. 04-350

DATE November 17, 2004

C.D. 4

BOARD OF RECREATION AND PARK COMMISSIONERS

SUBJECT: GRIFFITH PARK - TOYON CANYON LANDFILL - CONCEPTUAL APPROVAL OF PROPOSED AMENDMENT TO CONTRACT NO. 1937 FOR THE ASSIGNMENT OF LANDFILL GAS LEASE

* K. Chan	<u>kc</u>	J. Kolb	_____
J. Combs	_____	F. Mok	_____
H. Fujita	_____	G. Stigile	_____



 General Manager

Approved _____ Disapproved _____ Withdrawn _____

RECOMMENDATION:

That the Board:

1. Approve in concept the proposed amendment to the terms and conditions of the current landfill gas lease with Covanta Energy Group (Contract No. 1937) conditioned upon confirmation that the proposed contractor has satisfactorily resolved sales and transmission issues with the Los Angeles Department of Water and Power;
2. Approve in concept the proposed assignment of the landfill gas lease from Covanta Energy Group to Toyon Landfill Gas Conversion, LLC, a special purpose entity, which is to be acquired by GreenGen Management, LLC on or before December 1, 2004;
3. Authorize Department staff to work with staff from the Bureau of Sanitation and the City Attorney to negotiate the terms and conditions of the proposed amendment of the landfill gas lease to be presented to the Board for final approval; and,
4. Instruct Department staff to provide Covanta Energy Group and GreenGen Management, LLC with a letter indicating the Board's approval in concept of the proposed amendment and assignment of the landfill gas lease, subject to approval by the City Attorney as to form and legality.

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SUMMARY:

On February 6, 1984, the City entered into a Landfill Gas Lease (Lease) with Cambrian Energy Systems, A Limited Partnership, (Cambrian) for the Toyon Landfill (Landfill) located within Griffith Park. The purpose of the lease was for the recovery of landfill gas and its use to make electricity for sale to Southern California Edison. Cambrian's interest in the Lease was assigned shortly thereafter to Pacific Lighting Energy System (PLES) which built the landfill recovery project (Project) in 1985. Covanta Energy Group (Covanta) acquired PLES in 1997 and has operated the Project since its acquisition.

Initially, the Project consisted of five engines. Natural gas was piped into the site to insure consistent operation by supplementing the methane recovered. At present, however, it is only possible to operate two of the engines due to the reduced quantities of gas being recovered from the Landfill. The quantity of gas recoverable from the Landfill will continue to decline over time, but it is expected that one or two engines can be run profitably for an additional five to seven years.

Since 2003, Covanta has expected that it would have to shut down the Project by the end of 2004 because of Rule 1110.2 (Rule) adopted by the South Coast Air Quality Management District (AQMD). The Rule requires all reciprocating engines, including the ones at the Project, to reduce the level of NOx emissions to less than 36 parts per million. If an engine cannot meet the reduced emissions requirements, then it has to be "removed from service" by December 31, 2004. At the time the Rule was adopted, the AQMD was aware that no proven technology was available to enable these engines to comply with the reduced level of NOx emissions.

Covanta's interest in exploring possible technologies was tempered by very high fees paid to the Department of Water and Power to allow generated electricity to pass through their system to supply Edison and also the rent paid to the Department which was used as mitigation to the Park for the landfill.

In June 2004, a number of parties including GreenGen Management, LLC (GreenGen) contacted Covanta to see if it was interested in selling its landfill gas projects. Covanta was willing to explore a sale of several projects, including the Project, but believed there were no credible technology options available to retrofit the engines. Accordingly, Covanta did not want to expend time pursuing any of the offers.

In August 2004, Covanta told the Bureau of Sanitation (Sanitation) that it was planning to shut down the Project by the end of the year and that it would soon be issuing a notice to the City of its intention to shut down the Project. The notice was sent on September 17, 2004. Sanitation had several concerns. First, it would end the royalties being paid to Recreation and Parks which averaged about \$140,000.00 a year and were dedicated to the park. Second, it would require Sanitation to add staff to take over the additional burden and cost of managing the collection system

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at the Landfill and cleaning the gas. The annual cost of this additional burden could range from \$75,000 to \$150,000. Third, Sanitation would be required to flare all of the gas recovered at the Landfill instead of using the gas to produce needed electricity from a reliable source of renewable energy as Sanitation is not in a position to perform this function. Sanitation encouraged Covanta to try to figure out a way to continue the operation of the Project and Covanta committed to try.

Meanwhile, GreenGen had identified a retrofit solution that would enable the engines to meet the reduced NOx requirements at a cost that would allow the Project to remain financially viable (provided certain concessions would be made). GreenGen renewed its approach to Covanta to sell the Project. Given the merits of the proposed technical solution and the concerns raised by Sanitation, Covanta agreed to sell the Project to GreenGen at a sales price that is nominal and is expected to only cover Covanta's transaction costs relating to the sale to GreenGen.

The alternative, since Covanta is not willing to invest their own capital into the Project to retrofit the engines and has issued a notice to the City that it intends to shut down the Project by December 31, 2004, and remove the engines and restore the site as required by the Lease, would be a complete loss of royalties to Recreation and Parks and significant costs to Sanitation to operate the collection system, and clean and flare all of the landfill gas. GreenGen is willing to acquire the Project. However, based on the capital expenditures necessary to retrofit the engines, the permitting costs, the cost of securing the variance from the AQMD and certain other costs, GreenGen made its offer to purchase the Project subject to a number of conditions, including a reduction in the royalty that is payable to Recreation and Parks under the Lease. The reduction is necessary to allow GreenGen to recover its investment with a fair return over the limited remaining life of the gas supply from the Landfill, taking into account the revenue and cost constraints of a 20-year old Project that is approaching the end of its useful life.

Covanta wants to transfer the Lease, with the City's consent, to a newly formed entity, Toyon Landfill Gas Conversion, LLC ("TLGC"), with the understanding that TLGC will be acquired by GreenGen on or before December 1, 2004. In connection with granting that Consent, the Lease will be modified as follows: (i) the royalty payable on the gross electricity sales of the Project will be reduced to a level not below 3 percent; (ii) a minimum monthly royalty of not less than \$5,000.00 per month will be payable by the Project; (iii) the collection system will continue to be operated by Covanta or GreenGen while the engines are being retrofitted; and (iv) GreenGen will provide some form of financial security to ensure the removal of the Project at the end of the Lease. The security would be in the form of a performance bond or a sinking fund in an amount mutually acceptable to the City and GreenGen, taking into account the likely removal cost and the resale value of the engines.

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Covanta and GreenGen are requesting expedited processing of the consent and the Lease modifications by the City because the purchase must be completed by December 1, 2004, and GreenGen does not want to proceed with closing the acquisition unless the consent and Lease modifications are formally agreed to or adequate assurances can be given by the City that such consent and modifications will be completed in due course.

If the proposed sale and the requested Lease modifications are not acceptable to the City, then Covanta will proceed with closure of the Project as indicated in the notice previously sent to the City.

Staff recommends that the Board approve the requested actions in concept and authorize Department staff subject to City Attorney approval to form, to issue a letter to Covanta and GreenGen confirming its approval in concept of the assignment of the Lease to TLGC and to the proposed Lease modifications.

The Superintendent of Griffith/Metro concurs with staff recommendations.

This report was prepared by Cid Macareag, Senior Management Analyst I.