# 2008-2009 GRAND JURY REPORT
## Elsinore Valley Municipal Water District
## Lake Elsinore Advanced Pumped Storage Project

### Background

Elsinore Valley Municipal Water District (EVMWD), governed by and elected five-person board, was created with a mission statement, which stipulates: "The District will provide reliable, cost-effective, high quality water and wastewater services that are dedicated to the people we serve." In addition, the EVMWD is responsible for the quality and water level of Elsinore Lake. Currently, reclaimed water is purchased to maintain the prescribed water level. The current annual EVMWD revenue is seventy-five million dollars, two-thirds of which comes from ratepayers and the remainder of which comes from various grants.

EVMWD provides water and sewer services to a ninety-seven square mile area located between the cities of Corona and Temecula in the western portion of Riverside County. Elsinore Lake is five miles long and two miles wide. Its primary source of water is the San Jacinto River. In the mid 1980's, the water level was extremely low due to drought and the amount of algae had increased. Reclaimed water was purchased to stabilize the level of Elsinore Lake.

In an attempt to recoup the cost of reclaimed water, a pump/storage power plant was proposed to pump water from Elsinore Lake to a yet-to-be-built reservoir in the Cleveland National Forest. The difference in height between Elsinore Lake and the proposed reservoir is 1,200 feet, which is conducive to the method of pump/storage. The pumping to the reservoir would be scheduled during the night when the market cost of electricity is lower. Then, during the day, the process would be reversed allowing the water from the reservoir to flow back down through large pipes, thus creating electricity in a manner similar to a hydroelectric dam. Electricity would be generated in the daytime when the market cost electricity is more expensive.

This newly-generated electricity would then be connected to a yet-to-be approved and constructed transmission line through the Cleveland National Forest to connect San Diego Gas and Electric (SDG&E) with Southern California Edison (SCE) farther north. This transmission line is known as the Telega-Escondido/Valley-Serano (TE/VS) line. It was stated, by a board member, that the difference between the cost of hydro-pumping and electricity generation would be favorable. The revenue realized would pay for Elsinore Lake's cleanup and water addition. The project is known as Lake Elsinore Advanced Pumped Storage (LEAPS).

## Findings

1. In 1997, the EVMWD issued a Request For Proposal (RFP) seeking a company to lead the project in development and financing. Only one bidder, a newly formed company incorporated in Nevada, responded. This company, called Nevada-Hydro, then became licensed to operate in California as The Nevada Hydro Corporation (Nevada-Hydro). On May 15, 1997, the EVMWD entered into a Development Agreement with Nevada-Hydro a company lacking history, experience, and financing. Contrary to standard business practice, the Development Agreement had no end date. The President of Nevada-Hydro, the President of the EVMWD Board, and legal counsel for EVMWD, signed this Development Agreement. No follow-up meetings were held with solicited bidders to determine the reasons for the no-bid response.

2. The Development Agreement, signed May 15, 1997, stated on page 2, paragraph 1.4: (In the following quote, FERC refers to Federal Energy Regulatory Commission.) "The Company will provide all necessary funding and will pay all expenses and costs to complete and submit the FERC license application to obtain the FERC license and to obtain related entitlements." Anticipating repayment from Nevada-Hydro, the EVMWD has spent approximately four million dollars in support of LEAPS.

   The Development Agreement outlines payment to EVMWD on page 3, paragraph 3.0. It details full repayment plus interest; however, there are disclaimers to the repayment found in the Development Agreement on page 3, paragraph 3.1 which states: "**. . .** the successful closing of all financing and/or equity contribution required to construct and operate the project and solely contingent upon such successful closing, the company will pay, within (30) days thereafter, District as follows, which amounts, unless otherwise agreed herein, shall comprise the sole consideration to which District is entitled herein." In essence, this three-man company must acquire financing for an estimated 1.3 billion dollars from outside sources and complete the entire LEAPS project before it is obligated to repay the EVMWD for its expenditures.

   FERC approved only the TE/VS transmission line portion of the application, potentially leaving EVMWD and its pump/storage plan out of the picture. Nevada-Hydro's explanation was that this was merely a postponement and not a rejection. The credibility of this position was challenged when Nevada-Hydro requested California Public Utilities Commission (CPUC) authorization to be the sole and lead agency on the transmission line. The CPUC controls only transmission lines in California.

On November 21, 2006, EVMWD Management promptly responded to this action by issuing a letter to Nevada-Hydro outlining EVMWD's future course of action. In part it reads: "As a public agency, the District is sensitive to situations which suggest that a private party is representing the District's interests**. . .**"

There have been three separate reports, which were compiled by outside consultants and paid for by EVMWD. Two by Economic Insight Inc. entitled "An Economic Evaluation of the LEAPS Project" dated January 17, 2006, and February 7, 2006. The executive summary begins by noting that Nevada-Hydro made mistakes in analyzing potential revenue by over valuing the differential between off-peak and on-peak energy. Nevada-Hydro provided a spreadsheet dated July 20, 2005, utilizing peak pricing of sixty-five dollars per megawatt hour (MWh) and twenty-five dollars per non-peak MWh. These values were valid ten years ago when there was escalation in pricing caused by deregulation. They are no longer valid as there is an insignificant difference between peak and non-peak pricing. Essentially, the report concludes that LEAPS is not economically viable. It also states: "**. . .**of the thousands of pages submitted only ten are devoted to economics." The third report entitled "A Preliminary Economic Assessment and Strategic Review of the LEAPS Project" by SHIR Consultants Inc. dated April 2008, also indicated that the project is "not economically viable."

Investigation revealed that some board members and members of the public were deliberately excluded from knowledge of the reports for more than two years. In April 2008, an EVWMD Board Member released one of the reports to the media, forcing EVWMD to release the remaining reports. The board and/or management knew years earlier that LEAPS was not financially viable using a market-based approach; however, they proceeded in spite of this knowledge.

At a public meeting on June 20, 2007, Nevada-Hydro announced that Morgan-Stanley Commodities, a division of the investment firm of Morgan-Stanley, would serve as the principal investor for the LEAPS project. The announcement did not immediately clarify that funding would cover only the TE/VS transmission line. This excluded the hydro pump/storage portion of LEAPS, thereby leaving EVMWD unsure of repayment. The 1997 Development Agreement requires reimbursement to EVMWD only when the entire project is fully completed.

Recognizing the financial vulnerability of the project, Nevada-Hydro requested that the approval for licensing be cost-based rather than market-based. California Independent System Operators (CAISO) stakeholders unanimously rejected this proposal. These stakeholders own the operation of the transmission lines.

After more than two years of negotiations, EVMWD's effort to enter into a new formal contract with Nevada-Hydro to ensure repayment reached an impasse. Worst-case scenario would be that repayment will never be made, nor will the pump/storage portion of the project ever be built. EVMWD's legal counsel has verified this. In a letter dated July 7, 2006, a board member had inquired: "What happens if the project doesn't go? How is EVMWD going to get their money back from Nevada-Hydro?" The response from legal counsel was: "If the project does not come to fruition, the amount that has been recorded as a receivable will be written off the District's financials." A present board member estimated the current expenditures at four million dollars.

At the August 26, 2008, board meeting, EVMWD voted (four to one) to investigate the legal complexities involved in removing itself from the LEAPS project. The investigation will be performed by EVMWD's legal counsel and reported upon in closed session.

3. As a backup approach, EVMWD is justifying the virtues of using the pump/storage for a so-called "black start". During a wide-area power outage, the fossil fuel or nuclear power generators turn off and need electrical power to restart. In the absence of this grid power, a "black start" needs to be performed to reactivate the power grid because time is of the essence in re-establishing electrical power. One of the stated advantages of hydroelectric power, unlike gas turbines, is the ability to start quickly with very little power (just enough to open the intake gates). This process would provide power online to start up the fossil fueled and/or nuclear operated stations. According to the consulting reports, the LEAPS project, while not economically viable for continuous operation, would provide such a quick start. According to outside experts, building the pumped storage portion solely for a "black start" is economically prohibitive in comparison to gas turbine generation.

## Recommendations

**Elsinore Valley Municipal Water District Board**
**Elsinore Valley Municipal Water District General Manager**

1. EVMWD must follow established contract policies and procedures, which require due diligence, in the selection of bidders in all future contracts. In addition, meeting with all solicited bidders should be mandatory.

2. The EVMWD Board of Directors should accept the results of the consultant reports, which conclude that the LEAPS project is not economically viable, especially the pumped storage portion.

3. The EVMWD Board of Directors should make available to ratepayers an itemized accounting of the approximately four million dollars spent thus far on the LEAPS project, including direct and indirect expenses and pass-through expenses paid to legal counsel.

**Report Issued:** **02/23/09**
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