

Board of Directors
Phil Williams, President
Judy Guglielmana, Vice President
W. Ben Wicke, Treasurer
John Lloyd, Director
Harvey R. Ryan, Director



Elsinore Valley Municipal Water District

General Manager
Ronald E. Young
District Secretary
Terese Quintanar
Legal Counsel
Best Best & Krieger

Our Mission...

EVMWD will provide reliable, cost-effective, high quality water and wastewater services that are dedicated to the people we serve.

May 14, 2009

Riverside County Grand Jury
Attn: Nikki L. Harris, Foreperson
P.O. Box 829
Riverside, CA 92502

Re: 2008-09 Grand Jury Report "Elsinore Valley Municipal Water District Lake Elsinore Advanced Pumped Storage Project"

Dear Ms. Harris,

The Elsinore Valley Municipal Water District (the "District") is in receipt of the February 23, 2009 Grand Jury Report regarding the Lake Elsinore Advanced Pumped Storage ("LEAPS") Project (the "Report"). Pursuant to Penal Code section 933 et seq., the District is providing these written responses and reports as to the Grand Jury's Findings and Recommendations.

Response to Finding 1: The District disagrees partially with Finding 1.

The Report states that "[o]nly one bidder ... responded" to the RFP released by the District. The District, however, received four responses through the RFP process, one of which was from The Hydro Company, Inc. ("Nevada Hydro").

The Report states that The Nevada Hydro Company, Inc. ("Nevada Hydro") was "lacking history, experience, and financing" at the time that the 1997 Development Agreement was executed. This statement is true insofar as Nevada Hydro was a company formed specifically for the LEAPS Project and concurrently with the execution of the Development Agreement, such that it was not a longstanding entity at the time the Agreement was executed. However, the founding members of Nevada Hydro came from three companies and a law firm and were working on other water projects in the area, such that the group had the experience necessary to carry the Project forward. Finally, and regarding financing, it is generally accepted in the industry to raise capital as each phase of a project is brought forward, rather than to have full financing at the outset of the development period. (See also Response to Finding 2, below.)

The Report states that "[c]ontrary to standard business practice, the Development Agreement had no end date." It is true that the Development Agreement did not include a specific calendar date as the end-date. However, Paragraph 4.4 of the Development Agreement did provide specific factual occurrences that would result in the termination

of the Development Agreement, including default by a party, denial of the FERC license application, Nevada Hydro's transfer of its interest in LEAPS Project, or the end of the life of the Project. These termination events were appropriate given that the District was unable to predict by what specific calendar date the FERC process would conclude. Because the District was seeking permitting services rather than entering into a public works contract, the procedures followed by the District were appropriate and consistent with public agency contracting practices.

The Report states that “[n]o follow-up meetings were held with solicited bidders to determine the reasons for the no-bid response.” The District did not solicit responses from particular companies, accordingly there were no “no-bid responses.” Instead, the District invited responses by publishing the RFP in The Engineering News-Record where qualified firms were likely to see it. As noted above, there were four responses to those RFP publications.

Response to Finding 2: The District disagrees partially with Finding 2.

The Report states that Nevada Hydro “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 [District] for its expenditures.” Paragraph 3.1 of the Development Agreement, however, states that Nevada Hydro must reimburse the District upon “successful closing of all financing and/or equity contribution required to construct and operate the Project.” Accordingly, it is the financing of the Project, not the Project's completion, that would trigger any reimbursement obligation. Additionally, and as a practical matter, it is the District's understanding that Nevada Hydro has raised capital from time to time – for example, from Enron, Siemens, and Morgan Stanley – as was needed to carry the Project forward in the permitting process.

The Report states that “FERC approved only the TE/VS transmission portion of the application. [and] Nevada Hydro's explanation was that this was merely a postponement and not a rejection.” In fact, and although a Final Environmental Impact Statement has been prepared, FERC has not approved for construction any portion of the Project. In fact, FERC's jurisdiction over approval of the LEAPS Project is limited to the hydroelectric facility and ancillary structures, so it does not appear that FERC could separate the pumped storage and transmission aspects of the Project even if so desired. FERC has, however, considered whether it is appropriate for the Project to be included in the rate-base structure for California. On March 24, 2008, FERC issued its Order on Rate Incentives and Compliance Filings, which states that FERC is “approving incentives for Nevada Hydro's proposed TE/VS Interconnect.” The FERC Order also states that the “pumped hydro storage facility may not be ... functionalized as transmission for rate recovery purposes.”

The Report states that “Nevada Hydro requested California Public Utilities (CPUC) authorization to be the sole and lead agency on the transmission line.” The October 9, 2007 application to the CPUC actually states that the District has agreed to serve as

lead agency for the Project; “however, if the Commission determines that this approach is not feasible ...then the Commission may, sua sponte, determine to issue and certify an EIR (or Mitigated Negative Declaration) itself.” Additionally, the determination of which public agency is the “lead agency” for purposes of the California Environmental Quality Act (“CEQA”) is a determination made pursuant to the law, rather than any request made by a party.

The Report states that the “CPUC controls only transmission lines in California.” The CPUC has authority over many things, including public utility rate-setting and transmission line siting. The District’s understanding is that the CPUC is looking to FERC for ultimate approval of the LEAPS Project.

The Report states that the District “promptly responded to this action” by Nevada Hydro by sending out a November 21, 2006 letter. Although a letter of that date was sent by the District to Nevada Hydro, it was not sent specifically in response to the CPUC application by Nevada Hydro. Rather, it was intended to address a number of issues, including matters pending before FERC and the status of environmental review under CEQA.

The Report lists the dates, titles, and authors of three financial reports, but incorrectly states the title and date of the February 2006 report and the authors and date of the third report. For clarity, the three reports are as follows:

- “An Economic Evaluation of the LEAPS Project” (dated January 17, 2006) by Economic Insight, Inc.
- “An Economic Evaluation of the LEAPS Project and Associated Transmission” (dated February 6, 2006) by Economic Insight, Inc.
- “A Preliminary Economic Assessment and Strategic Review of the LEAPS Project” (dated April 12, 2007) by Shir Power Engineering Consultants, Inc. and Economic Insight, Inc.

The Report states that these three reports conclude that the LEAPS Project is not economically viable. This summary statement, however, draws conclusions from reports which draw their own conclusions. The primary conclusions of the January 17th report are:

- Nevada Hydro “overlooked the opportunities for selling into the California Independent System Operator’s (Cal ISO’s) balancing and ancillary (A/S) market.”
- “Since the base case annual revenue is less than that assumed Nevada Hydro it is important to explore other alternatives, even if they are not well defined at this time.”
- A “trend that could improve LEAPS economics is the growth of intermittent energy sources – solar, wind, and tidal power, to name three.”

- "When revenue and cost factors are considered we conclude that the LEAPS project is not viable at this time."

The primary conclusions of the February 6th report are:

- "Although the chances of obtaining a long-term contract with a large capacity payment are close to zero, there are important marketing opportunities in the Cal ISO's [ancillary services] market."
- "Nevada Hydro projects no revenue from [ancillary services] sales that we have concluded would be LEAPS' primary source of income."
- A "trend that could improve LEAPS economics is the growth of intermittent energy sources – solar, wind, and tidal power, to name three."
- "When revenue and cost factors are considered, we conclude that the LEAP project, as a merchant plant, is not viable at this time. The primary problem is the low differential between off-peak energy prices and on-peak energy prices."

The primary conclusions of the April 12th report are:

- The report "offer[s] a review of project benefits that have yet to be quantified or are qualitative. These include: Operational Benefits ... Environmental Benefits ... Lake Elsinore Water Quality Benefit ... [and] Forest Firefighting Benefit."
- "Our preliminary benefit assessment of the LEAPS project is based on existing economic studies covering the quantified benefits of the project."
- "Revenue sources from commercial operation simply do not reflect the full benefits of the LEAPS pumped storage project."
- "Although there is less demand for electricity storage between night and day, there is increased demand for grid balancing – a task perfectly suited for hydroelectric pumped storage plants."
- "A careful study of benefits based on less conservative assumptions and the assignment of some value to benefits not yet quantified should demonstrate a viable project."

The Report states that "some board members" were deliberately excluded from knowledge of the reports for more than two years. There was no deliberate act taken to deny Directors access to the financial reports. To the contrary, these reports were available upon request to any Director.

The Report states that the District was "forced" to publicly release the three financial reports. This is incorrect. After one of the reports was made public, the District's Board of Directors decided to formally waive the privilege over all three reports and release them to the public, so that the public would have a full and complete picture of all the financial analysis available.

The Report states that the District knew "that LEAPS was not financially viable using a market-based approach". This statement is true insofar as it is limited to the sale of

electricity on a market-based approach. However, and as quoted above, the April 12th financial report concluded that “[r]evenue sources from commercial operation simply do not reflect the full benefits of the LEAPS pumped storage project.” Ultimately, the April 12th report concluded that “[a] careful study of benefits based on less conservative assumptions and the assignment of some value to benefits not yet quantified should demonstrate a viable project.”

Regarding the Grand Jury's characterization of the District's June 20, 2007 meeting, a publicly noticed study session meeting was held by the District on June 20, 2007. Representatives of both Nevada Hydro and Morgan Stanley attended that meeting. During the public comment portion of the meeting, a representative of Morgan Stanley stated that Morgan Stanley was financially interested in the Project.

The Report states that “[t]he 1997 Development Agreement requires reimbursement to [the District] only when the entire project is fully completed.” As discussed above in Response to Finding 1, Paragraph 3.1 of the Development Agreement states that Nevada Hydro must reimburse the District upon “successful closing of all financing and/or equity contribution required to construct and operate the Project.”

The Report states that, “[r]ecognizing the financial vulnerability of the project, Nevada Hydro requested that the approval for licensing be cost-based rather than market-based.” In fact, Nevada Hydro filed an application for cost/rate-base treatment with FERC on December 1, 2005 – more than 18 months prior to the June 2007 meeting.

The Report states that stakeholders which objected to rate-base treatment of the LEAPS Project “own the operation of the transmission lines.” Those stakeholders (such as San Diego Gas & Electric and Southern California Edison) own the physical transmission lines, but the operation of those lines are fully managed by the California ISO and the use of the lines is dedicated to the benefit of the California energy grid.

The Report states that the District's Board of Directors voted to investigate the legal complexities of the Project on August 26, 2008. This meeting actually occurred on June 26, 2008.

Response to Finding 3: The District disagrees partially with Finding 3.

The Report states that the District is looking at a black start benefit as a “backup approach” to the sale of power from the LEAPS Project. In actuality, the potential of black start benefits, as well as other benefits, have always been a part of the analysis of the Project potential benefits.

The Report states that the consultant reports concluded that the LEAPS Project was “not economically viable.” The conclusions of the consultant reports, however, were actually that the LEAPS Project may provide several benefits that have not yet been quantified. (Please see Response to Finding 2, above.)

The Report states that the consultant reports concluded that building the LEAPS Project "solely for a 'black start' is economically prohibitive in comparison to gas turbine generation." Again, the reports concluded that there are many potential benefits from the LEAPS Project, but considering the "black start" benefit alone to the exclusion of other benefits would be more expensive than a gas turbine generation alternative. (Please see Response to finding 2, above.)

Report as to Recommendation 1: The Recommendation will not be fully implemented.

The District agrees with and will implement the Grand Jury's Recommendation insofar as the District has followed, and must continue to follow, public contracting laws and established contract policies and procedures. However, the remainder of the Recommendation would unreasonably expand the District's obligations beyond those required by the law. Under public contracting law, there is a difference between general services agreements and contracts for public works projects. Recommendation 1 does not acknowledge that difference and would require the District to follow the same procedures for "all future contracts." Additionally, the District cannot implement the Recommendation that "meeting with all solicited bidders should be mandatory." This Recommendation overlooks situations where, for example, bidders may not want to meet with the District such that the District would have to "force" a meeting; bidders may be located a great distance away such that significant travel costs would be incurred; or solicited bidders may not bid on the contract at all. Because the Recommendation would significantly expand the District's obligations in a manner that is not feasible and is inconsistent with what the law requires, the District will not implement all of Recommendation 1.

Report as to Recommendation 2: The Recommendation will not be implemented.

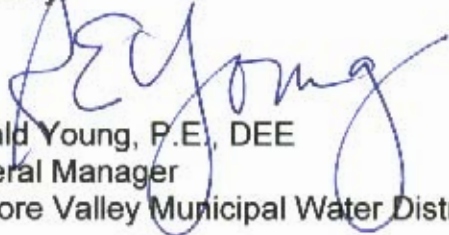
As discussed under "Response to Finding 2," above, the consultant reports do not flatly conclude "that the LEAPS project is not economically viable, especially the pumped storage portion." Instead, the consultant reports speak for themselves and reach a number of conclusions predicated on specific factual circumstances. As such, the District cannot implement Recommendation 2 because it does not acknowledge the limitations on the consultant reports and, thus, is unwarranted. However, the District's Board of Directors will continue – as it has done in the past – to evaluate all information and options available with respect to the LEAPS Project. The District's ongoing evaluation will include the consultant reports and all other information available.

Report as to Recommendation 3: The Recommendation has been implemented.

An accounting of LEAPS Project financials is currently available to the public. The District is a public agency and, as such, it maintains financial records that are open for public inspection and subject to disclosure under the Public Records Act. Receivables related to the LEAPS Project are part of those records and may be obtained and inspected upon request.

The District considers the above to provide thorough and full responses and reports to the Grand Jury's Findings and Recommendations in compliance with Penal Code section 933 et seq. Should you have any questions or require any further clarification, please do not hesitate to contact me at the District's offices.

Sincerely,

A handwritten signature in blue ink, appearing to read 'R. Young', is written over the typed name and title.

Ronald Young, P.E., DEE
General Manager
Elsinore Valley Municipal Water District

Cc: Board of Directors

**Elsinore Valley Municipal Water District
Lake Elsinore Advanced Pump Storage Project
Total & Net Cost Of Project Expended by EVMWD
As of March 31, 2009**

	<u>Public Outreach</u>	<u>Lobbyist</u>	<u>Printing</u>	<u>Travel</u>	<u>Other Costs</u>	<u>Total</u>
1993 - 1997	\$ -	\$ -	\$ -	\$ -	\$ 1,079,226	\$ 1,079,226
2001 - Current	145,131	242,166	17,437	2,340	2,713,392	3,120,467
Reimbursements	<u>(67,111)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(34,344)</u>	<u>(101,455)</u>
Net Cost	<u>\$ 78,020</u>	<u>\$ 242,166</u>	<u>\$ 17,437</u>	<u>\$ 2,340</u>	<u>\$ 2,679,048</u>	<u>\$ 3,019,011</u>
Total Cost	<u><u>\$ 78,020</u></u>	<u><u>\$ 242,166</u></u>	<u><u>\$ 17,437</u></u>	<u><u>\$ 2,340</u></u>	<u><u>\$ 3,758,274</u></u>	<u><u>\$ 4,098,237</u></u>

**Elsinore Valley Municipal Water District
Lake Elsinore Advanced Pump Storage Project Cost
Detail of Net Cost by Fiscal Year
As of March 31, 2009**

<u>Fiscal Year</u>	<u>Public Outreach</u>	<u>Lobbyist</u>	<u>Printing</u>	<u>Travel</u>	<u>Other Costs</u>	<u>Total</u>
2001	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
2002	64,382	-	-	-	3,336	67,718
2003	-	201,916	-	-	1,532	203,448
2004	6,210	40,250	12,458	2,340	60	61,318
2005	1,545	-	2,160	-	210,632	214,337
2006	5,883	-	2,819	-	956,474	965,176
2007	-	-	-	-	664,585	664,585
2008					675,355	675,355
2009					167,074	167,074
Total	\$ 78,020	\$ 242,166	\$ 17,437	\$ 2,340	\$ 2,679,047	\$ 3,019,012