TO: HONORABLE CITY COUNCIL
FROM: CITY MANAGER DEPARTMENT: PUBLIC WORKS
DATE: DECEMBER 13, 2004 CMR: 516:04

SUBJECT: APPROVAL OF AN AGREEMENT WITH WPI PACKAGING & MAINTENANCE, INC. TO END OPERATION OF THE LANDFILL GAS ELECTRICAL GENERATION FACILITY

RECOMMENDATION
Staff recommends that Council approve and authorize the City Manager to execute the attached Agreement with WPI Packing & Maintenance Company, Inc. (WPI) to end the operation of the landfill gas electrical generation facility.

BACKGROUND
WPI became the lessee and operator of the landfill electrical generating facility through a series of transactions. Originally, the City Council, on September 12, 1985, approved a Landfill Gas Lease and Operating Agreement with Cambrian Energy Systems for the development of the gas field and operation of an electrical generation facility at the City landfill (CMR: 426:5). Cambrian then assigned its rights to Pacific Lighting Energy systems. Subsequently, Palo Alto Landfill Gas Corporation (PALGC) took over the lease and operation of the facility through a Revised and Restated Gas Lease and Interconnection Agreement approved by the Council on November 16, 1989 (CMR 5125:89). PALGC subleased its interest in the site to Monterey Landfill Gas Corporation (MLGC) in December 1989. Electrical generation began at the City landfill on April 15, 1990 with output sold to PG&E through a power purchase agreement. In May 1994, PALGC sold its site improvements and other rights to WPI.

In August 1994, a consent and assignment agreement was signed between PALGC, WPI, Monterey Landfill Gas Corporation (MLGC) and the City of Palo Alto. Through this agreement the City consented to assignment of PALGC’s rights and obligations to WPI and MLGC.

On December 20, 2001, MLGC notified the City that this project was no longer economically feasible and pursuant to terms of the lease it was terminating the lease for the landfill electrical generating facility effective January 21, 2002. MLGC operated the system until January 21, 2002. The termination of the lease did not address WPI’s continued operations at the landfill. Due to the complexity and uncertainty of the legal relationship between WPI and the City with respect to the lease of the landfill site and operation of generation facility, on January 23, 2002, the City and WPI entered into a short term agreement, which has been periodically renewed, to allow WPI to operate the improvements on the site and to allow time to work out a long term solution for the facility.
Beginning in August 2002, WPI stated that it was operating at a loss, at an average of $35,000 to $50,000 a month. The landfill gas quantities have declined since it was first in operation. The 2-megawatt facility operates on two engines. With the age of the garbage, decline in waste flows and less organics being disposed in the waste stream, the gas field can only produce enough landfill gas to operate three-quarters of one engine (which produces one megawatt of power). Natural gas is currently being purchased and blended so electrical production can continue today.

In April 2002 the Utilities Department in cooperation with the Public Works Department evaluated several possible alternatives in order to (1) evaluate the financial interest of City of Palo Alto Utilities as potential owner, partner, or power purchaser; (2) develop and evaluate new ideas that could aid the City in achieving the best possible outcome. The recommendations that came from this analysis were: 1) do not purchase or lease the WPI generators; 2) do not enter into a power purchase agreement for CPAU to buy output from WPI; 3) offer WPI a custom gas rate consistent with CPAU rate policies; 4) and consider other alternatives including utilizing the landfill gas in the RWQCP incinerator, demonstration projects that employ innovative new technology or qualify for outstanding funding assistance or other uses for landfill gas such as methanol or CNG extraction.

DISCUSSION
Since July 2002, the City and WPI have been discussing various options for the future use of the landfill generation facility, including: entering into a lease with WPI through the remainder of the term of the power purchase agreement with PG&E; seeking other parties to participate in the operation of the facility; and winding down the operations of WPI at the landfill. During the discussions, the parties have disagreed about the current status of WPI’s interest with respect to the facility with the City arguing that the lease and sublease terminated on January 21, 2002 and that the short term agreement is the only instrument currently governing the relationship of the parties with respect to the facility and WPI arguing that it continued to have rights to occupy and operate the facility under the Sublease.

In February 2003 the Regional Water Quality Control Plant (RWQCP) reviewed the potential for utilizing the landfill gas in its incinerators in combination with natural gas currently being used. Its review found this to be technically feasible and environmentally responsible. The project would reduce the natural gas consumption at the RWQCP and pollutant emission through flaring at the landfill. The RWQCP plan is to keep all its natural gas burners and add a landfill gas burner only to the afterburner. This arrangement offers two benefits: it allows the RWQCP to maintain its process reliability, and it generates the “biggest bang for the dollar” since most of the natural gas consumption is in the afterburner. It is estimated that the gas generated at the City landfill could start to be utilized at the RWQCP as early as February 2005.

Based on the findings regarding use of the landfill gas at the RWQCP, City staff negotiated with WPI to terminate its occupation and operation of the landfill gas facility on terms and conditions set forth in the attached agreement. The agreement provides for WPI to vacate the site, remove certain large equipment; and terminate all agreements and permits related to their operations on the site no later than January 31, 2005. WPI is released from any obligations to restore or clean up the site. The City will accept the site “as is” and assumes responsibility for the operation, maintenance and clean up of the site. WPI and the City mutually release and waive claims they may have against each other. WPI indemnifies the City against claims arising from third party agreements related to the output of the facility and claims arising from its failure to perform
under the agreement. The City indemnifies WPI from claims arising from the condition of the site and any hazardous substances or defective soil conditions on the site.

Staff believes the risk associated with assuming responsibility to cleanup the site and indemnifying WPI for claims arising from the condition of the site are very low. In January 2003, Conor Pacific Environmental conducted an Environmental Site Assessment (ESA) in which the main purpose was to investigate the potential for hazardous substances on the site. The Conor Pacific Environmental ESA found that the primary sources of contamination at the site are from the use of motor oil and coolant to operate and maintain the electric power generation engines. Less than 20 square feet of total soil staining was observed. The estimate for demolition and clean up of this site was initially $50,600. Conor Pacific Environmental updated its report in November 2004 and found only one minor new oil spill, less than 1-square foot. Conor Pacific Environmental also updated its cost estimate for demolition and clean up to $57,000.

**RESOURCE IMPACT**

The RWQCP spends approximately $400,000 annually on natural gas. Approximately ¾ of the consumption is in the afterburner. It is estimated that the RWQCP would most likely still utilize half of its current natural gas amount. Hence, the annual fuel cost savings to the RWQCP is estimated to be approximately $200,000.

The Conor Pacific Environmental cost estimate for demolition and clean up of the generation facility site is $57,000. This would become the responsibility of the City if the agreement is executed.

**POLICY IMPLICATIONS**

This recommendation does not represent any change to existing City policies.

**ENVIRONMENTAL REVIEW**

Termination of the city’s relationship with WPI for operation of the landfill electrical generation facility is not a project subject to CEQA. Future projects to demolish the existing structures and to pipe gas to and use gas in the treatment plant will be subject to appropriate environmental review as the projects are developed and approved.

The use of landfill gas is in concert with the City’s Sustainability Policy. The RWQCP incinerators are equipped with pollution control devices and are more environmentally friendly than the landfill flare.

**ATTACHMENTS**

Attachment A: Contract

**PREPARED BY:**

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