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Via Federal Express
Docket Unit
California Energy Commission
Docket No. 06-OIR-1
1516 9th Street, MS-4
Sacramento, CA 95814

To Whom It May Concern:

Please find enclosed the Comments of the Salt River Project Agricultural Improvement and Power District, as Operating Agent of the Navajo Generating Station (the "Comments") regarding R.06-OIR-1, Proposed Adoption of Regulations Establishing and Implementing a Greenhouse Gases Emission Performance Standard for Local Publicly Owned Electric Utilities. A copy of the Comments was filed today with the Docket Unit via electronic mail.

Very truly yours,

Salmon, Lewis & Weldon, P.L.C.

By Rebecca C. Goldberg
Rebecca C. Goldberg

Encl.
cc: John B. Weldon, Jr.

ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of:	)	
	)	
Proposed Adoption of Regulations Establishing a	)	
Greenhouse Gases Emission Performance Standard	)	R.06-OIR-1
For Baseload Generation of Local Publicly Owned	)	(October 30, 2006)
Electric Utilities.	)	

COMMENTS OF THE SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT, AS OPERATING AGENT OF THE NAVAJO GENERATING STATION

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April 5, 2007

ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of:	)	
	)	
Proposed Adoption of Regulations Establishing a	)	
Greenhouse Gases Emission Performance Standard	)	R.06-OIR-1
For Baseload Generation of Local Publicly Owned	)	(October 30, 2006)
Electric Utilities.	)	

COMMENTS OF THE SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT, AS OPERATING AGENT OF THE NAVAJO GENERATING STATION

The Salt River Project Agricultural Improvement and Power District ("SRP"), as the Operating Agent of the Navajo Generating Station ("NGS"), herein submits comments on the Proposed Adoption of Regulations Establishing and Implementing a Greenhouse Gases Emission Performance Standard for Local Publicly Owned Electric Utilities (the "Proposed Regulations"). SRP submits these comments on behalf of the NGS co-owners with the exception of the Los Angeles Department of Water and Power of the City of Los Angeles ("LADWP"), hereafter referred to as the "Non-Jurisdictional NGS Owners." LADWP is submitting comments through the California Municipal Utilities Association and on its own behalf. In the Proposed Regulations, the California Energy Commission (the "Commission") seeks to adopt new regulations establishing a greenhouse gases emission performance standard for baseload generation power plants and a process for calculating the emission of greenhouse gases from baseload power plants.

NGS is a supercritical pulverized coal power plant that complies with all existing environmental regulations, including the Clean Air Act. However, NGS will not be in

compliance, nor is there commercially available technology to bring the plant into compliance, with the proposed greenhouse gases emission performance standard. The Non-Jurisdictional NGS Owners are concerned that, unless modifications are made to the definitions of "new ownership investment" and "covered procurement," the Proposed Regulations would impair existing contractual requirements of the NGS co-owners. The proposed definition of New Ownership Investment includes expenditures in preexisting power plants and would prevent LADWP from paying its share of costs at NGS. Such a restriction on LADWP would affect the functioning of NGS in two respects. To the extent that any of the following expenditures extend the life of the plant by five years or more, the Proposed Regulations would have (1) short-term effects of preventing annual routine operations and maintenance activities and (2) longer-term effects of precluding expenditures for capital improvements, such as renovations, and plant rebuilding in the event of destruction.

SRP is alarmed that, without any modification to the definition of "new ownership investment," the Proposed Regulations will unconstitutionally impair existing contractual obligations. Furthermore, SRP asserts that the Proposed Regulations will violate the Commerce Clause of the United States Constitution to the extent that the regulations control commerce outside of California's borders.

I. Background of Navajo Generating Station

NGS is a coal-fired electric generating plant located on the Navajo reservation near Page, Arizona. SRP is the Operating Agent of NGS and holds a 21.7% interest in the facility in its own right and a 24.3% interest for the use and benefit of the United States of America. SRP is an Agricultural Improvement and Power District, a political subdivision of the State of Arizona, which owns and operates electric generation, transmission and distribution systems and irrigation

and water supply systems. SRP provides wholesale transmission and retail electric services to more than 920,000 residential, commercial, agricultural and mining customers in Arizona.

In addition to SRP, the other co-owners of NGS are: LADWP (21.2% interest); Arizona Public Service Company (14% interest); Nevada Power Company (11.3% interest); Tucson Electric Power Company (7.5% interest); and the Bureau of Reclamation (24.3% interest), whose interest is held for its use and benefit by SRP. LADWP is a department organized and existing under the charter of the City of Los Angeles, a municipal corporation of the State of California. The Arizona Public Service Company and Tucson Electric Power Company are public service corporations organized under Arizona law. Nevada Power Company is a public service corporation organized under Nevada law. The Bureau of Reclamation, in 1968, was authorized by Congress to acquire an interest in NGS pursuant to the Colorado River Basin Project Act. 43 U.S.C. § 1523(b) ("the Secretary may enter into agreements with non-Federal interests proposing to construct thermal generating powerplants whereby the United States shall acquire the right to such portions of their capacity, including delivery of power and energy over appurtenant transmission facilities to mutually agreed upon delivery points, as he determines is required in connection with the operation of the Central Arizona Project.").[1] Together, all of the NGS co-owners are hereinafter referred to as the "NGS Owners."

NGS has a capacity rating of 2,250 megawatts (MW) from three 750MW units. Coal utilized at the plant comes from a mine that is located approximately seventy-eight miles to the

[1] The Central Arizona Project ("CAP") is the federal reclamation project constructed pursuant to the Act that allows for the annual transportation of approximately 1.5 million acre feet of Arizona's Colorado River allocation into the state for delivery to cities, industry, Indian communities, and agricultural districts in central and southern Arizona. The CAP canal is approximately 336 miles long. The Central Arizona Water Conservation District ("CAWCD") operates and maintains the CAP pursuant to a contract with the United States. CAWCD is obligated to repay the United States approximately $1.65 billion over the next 30 years for the costs associated with the CAP. Electricity from the United States' interest in NGS is used to power pumps and other facilities related to the operation of the CAP. Because the Bureau's entire share of power from NGS is currently not required to operate the CAP, the Bureau, through its agents, is authorized to sell the excess electricity in order to help the repayment of CAP's construction costs. See 43 U.S.C. § 1523(b).

east of the plant at the Peabody Western Coal Company's ("Peabody") Kayenta Mine, on the Navajo and Hopi Indian reservations. The NGS Owners purchase coal pursuant to the Amended Navajo Generating Station Coal Supply Agreement, dated February 18, 1977, entered into between Peabody and the NGS Owners, with the exception of the Bureau of Reclamation whose interests are administered by SRP. Coal is transported from the Kayenta Mine to NGS via an electric coal haul railroad. Under the Peabody Coal Leases, the Navajo Nation and the Hopi Tribe receive coal royalties and bonus payments, resulting in an enormous revenue source for the Nation and the Tribe. NGS and the Kayenta Mine collectively employ more than 700 tribal members.

In recent years, the NGS Owners have made significant improvements to the plant facilities. For example, in 1999, the plant's emission control equipment was upgraded to make it one of the cleanest coal plants in the nation. As a part of that upgrade, and at an overall cost of $417 million, the NGS Owners added scrubbers to each of the units that remove more than 90% of the plant's sulfur dioxide (SO_2) emissions. Other improvements at NGS include rebuilding the precipitator, which cost approximately $42 million, to improve air emission controls at the facility and replacing and upgrading the crystallizer, at a cost of approximately $5 million, to increase the efficiency of water usage and lessen the demand for additional water at NGS. Each of these improvements was the result of unanimous approval and funding by the NGS Owners.

II. The NGS Governance Agreements Require Unanimous Consent of the NGS Owners for Financial Expenditures

The NGS Owners are each parties to the Navajo Project Participation Agreement dated September 30, 1969 (the "Participation Agreement"), the Navajo Project Co-Tenancy Agreement dated March 23, 1976 (the "Co-Tenancy Agreement"), and the Navajo Project Navajo Generating Station Operating Agreement dated July 23, 1979 (the "Operating Agreement")

(together, the "Governance Agreements"). The initial term of the Governance Agreements expires in 2019, but the parties have the option to extend the contracts for up to 25 years.

Pursuant to the Governance Agreements, the Station Engineering and Operating Committee, which is comprised of two representatives of each NGS Owner, reviews and approves annual budgets for capital improvements, manpower and operations and maintenance expenditures. Participation Agreement, § 8.1.2 [Exhibit 1]; Operating Agreement, § 16.2 [Exhibit 2]; Co-Tenancy Agreement, § 9.3 [Exhibit 3]. Capital improvements include the betterment or replacement of any units of property at NGS. Operating Agreement, § 5.5 [Exhibit 2]. Some of these expenditures may have the effect of extending the life of NGS by five years or more. The NGS Governance Agreements require that any action or determination by the Committee regarding budget approval is by unanimous consent. Participation Agreement, § 8.8; Operating Agreement, § 16.2 [Exhibit 2]; Co-Tenancy Agreement, § 9.6 [Exhibit 3]. Once the Committee approves the budget, each NGS Owner is obligated for the costs incurred on the basis of its ownership shares in the project. Operating Agreement, § 17.1 [Exhibit 2]; Co-Tenancy Agreement, § 18.1 [Exhibit 3].

The Co-Tenancy Agreement also provides that, if the plant is destroyed and the cost of repair is less than 60% of the original cost, each NGS Owner is required to pay its share to reconstruct NGS. Co-Tenancy Agreement, § 13.1 [Exhibit 3]. Alternatively, if the plant is destroyed and the cost of repair is greater than 60% of the original cost, the participants shall repair the facility upon agreement. However, if a participant chooses to not participate, that party must sell its interest at the salvage value of its interest. Id. § 13.2. Moreover, if any transmission facilities, the railroad or pumping plant are destroyed, each participant is required to pay its share to reconstruct the destroyed facility. Id. § 13.3.

Failure to make the required payments, either those unanimously approved by the Engineering and Operating Committee or those required to replace the destroyed plant under the Co-Tenancy Agreement, would render that party in default of the NGS Governance Agreements. Id. § 18.1. In the event of such a default, the non-defaulting NGS Owners are obligated to remedy the default by advancing the necessary funds. Id. § 18.2. If the default lasts for a period of six months or more and the defaulting participant fails to cure or to act in good faith to cure such default, or if the default is the subject of arbitration and six months following the final determination the defaulting participant fails to cure or to act in good faith to cure such default, then the non-defaulting NGS Owners may suspend the right of the defaulting participant to its proportionate share of power generated at NGS. Id. § 18.5. During a period of suspension, the non-defaulting NGS Owners are obligated to bear all of the operations and maintenance costs, insurance and other expenses otherwise payable by the defaulting participant. Id. § 18.5.1.

III. The Commission's Definition of "New Ownership Investment" Unreasonably Broadens the Scope of SB 1368

California State Senate Bill No. 1368 (SB 1368) directs the Commission to enact rules to establish a greenhouse gases emission performance standard. It establishes sections 8340 and 8341 of the Public Utilities Code. The legislation states that "[n]o load-serving entity or local publicly owned electric utility may enter into a long-term financial commitment unless any baseload generation supplied under the long-term financial commitment complies with the greenhouse gases emission performance standard." Cal. Publ. Util. Code § 8341(a). Under SB 1368, Section 8340(j) provides that:

> "Long-term financial commitment" means **either** a new ownership investment in baseload generation **or** a new or renewed contract with a term of five or more years, which includes procurement of baseload generation."

Id. § 8340(j) (emphasis added). "Baseload generation" is defined as "electricity generation from a powerplant that is designed and intended to provide electricity at an annualized plant capacity factor of at least 60 percent." Id. § 8340(a). However, SB 1368 does not define "new ownership investment."

Although the California Legislature did not define the term "new ownership investment," the Commission does set forth a definition of that term in the Proposed Regulations. As currently drafted, the Proposed Regulations prohibit a local publicly owned electric utility from participating in a covered procurement if the greenhouse gases emission from the power plant exceeds the emission performance standard. Proposed Regulations, § 2902(b). A "covered procurement" includes "[a] new ownership investment in a baseload generation powerplant" or a "new or renewed contract commitment, including a lease, for the procurement of electricity with a term of five years or longer." Id. § 2901(d). Most importantly, the Proposed Regulations then define "new ownership investment" to mean:

> (1) Any investments in construction of a new powerplant;
> (2) The acquisition of a new or additional ownership interest in an existing powerplant previously owned by others;
> (3) Any investment in generating units added to a deemed-compliant powerplant, if such generating units result in an increase of 50 MW or more to the powerplant's rated capacity; or
> (4) **Any investment** in an existing, non-deemed compliant powerplant owned in whole or part by a local publicly owned electric utility that:
> (A) **is designed and intended to extend the life of one or more generating units by five years or more**;
> (B) results in an increase of greater than 10% in the rated capacity of the powerplant; or
> (C) is designed and intended to convert a non-baseload generation powerplant to a baseload generation powerplant.

Id. § 2901(j) (emphasis added). Therefore, under the Commission's definition of "new ownership investment" the emission performance standard would apply to expenditures made to existing plants owned in whole or in part by local publicly owned electric utilities prior to the

effective date of SB 1368, including, for example, renovations at already built facilities that would extend the life of the plant by five years or more.

The Proposed Regulations unnecessarily broaden the scope of SB 1368 by defining "*new* ownership investment" to apply to an *existing* ownership investment. The plain language of SB 1368 provides that only a "long-term financial commitment" triggers the application of the emission performance standard. Cal. Publ. Util. Code § 8341(a), (b)(1), (b)(2). Because SB 1368 defines a "long-term financial commitment," in part, as a "new ownership investment in baseload generation," by its own terms, SB 1368 does not apply to existing ownership investments. Black's Law Dictionary defines the term "investment" to mean "[a]n expenditure to acquire property or other assets in order to produce revenue." Black's Law Dictionary 835 (6th ed. 1990). It is clear that the Legislature was referring to expenditures "to acquire property or other assets" when it used the term "new ownership investment" as comprising a "long-term financial commitment." There is no evidence in the statute that the Legislature meant that a "long-term financial commitment" meant *any* outlay of funds for repairs, renovations or operations and maintenance at existing power plants. Yet, the Commission takes the plain language of SB 1368 and twists it so that the Proposed Regulations applies to expenditures at an existing power plant, such as a renovation or capital improvements for necessary equipment. The outlay of money at an existing power plant is not to acquire property or other assets, but to continue efficient and safe operation of the plant in accordance with the original purpose of the plant. Repairs, renovations, and operations and maintenance activities are neither a "new ownership investment" nor a "new or renewed contract" and, thus, do not fall within SB 1368's definition of "long-term financial commitment."

Moreover, the Legislature did not condition a "new ownership investment" on whether the investment extends the life of a plant by five years. See Cal. Publ. Util. Code § 8340(j). In SB 1368, the "five year" limitation applies only to new or renewed contracts for the procurement of baseload generation, which is the second clause of the definition of "long-term financial commitment." Id. That clause is separated by the conjunction "or" to indicate a choice between two alternatives. The language relating to a five year term applies only to a new or renewed contract. There is no similar time frame for a "new ownership investment," the first clause of the definition. However, the Proposed Regulations impose an additional constraint on the definition of "new ownership investment," by providing that any investment in an existing plant that extends the life of the plant by five years or more is a covered procurement. Proposed Regulations, § 2901(j). It is the Commission that has imposed this additional limitation, which the Legislature did not intend.

Regardless of the definition of "new ownership investment" contained in the Proposed Regulations, the Non-Jurisdictional NGS Owners contend that ongoing operations and maintenance activities should be specifically excluded from the Proposed Regulations. Because safety and environmental regulations require that a power plant be maintained to a certain baseline level, the NGS Owners will need to maintain the power plant as if it would function in perpetuity. For example, in the ten year plan for operations and maintenance expenditures for NGS, major plant systems will need to be refurbished, including the plant piping systems, fire water systems piping, main steam lines, superheaters, bottom ash, crossover ducts, breakers, underground cable, scrubber piping, control systems, ponds, and railroad ties and ballast. Some operations and maintenance expenditures may have the effect of extending the life by five years

or more. Such operations and maintenance expenditures are not a "new ownership investment" in NGS, but rather critical for the continual safe and efficient operation of the plant.

The Non-Jurisdictional NGS Owners are concerned that Proposed Regulations would have the negative effect of essentially paralyzing operations at NGS because the definition of "new ownership investment" would prevent LADWP from authorizing annual budgets that included funds for necessary maintenance, renovations and funding reconstruction in the event the plant is damaged. Under the broad definition of "new ownership investment" LADWP could not authorize expenditures for NGS to the extent that such an outlay of money would extend the life of the plant by five years or more. The Non-Jurisdictional NGS Owners contend that the Commission's interpretation of the term "new ownership investment" is outside the scope of the Legislature's intent and would impair existing contractual obligations of the NGS Owners.

According to the Governance Agreements, any decisions regarding budgets must be made by unanimous consent of a committee comprised of two representatives from each NGS Owner. Participation Agreement, § 8.1.2 [Exhibit 1]; Co-Tenancy Agreement, § 9.6 [Exhibit 2]; Operating Agreement, § 16.2 [Exhibit 3]. LADWP would be unable to approve any budget with expenditures for items that would have the effect of extending the life of NGS by five years or more because such a decision would cause LADWP to be in violation of the emission performance standard. Moreover, the Proposed Regulations would put a stop to any reconstruction of the plant in the event of destruction because LADWP would be unable to fund such efforts and in some instances LADWP could be in breach of the Governance Agreements. Without LADWP's approval, that would effectively halt the passage of all budgets containing expenditures for operations and maintenance, capital improvements or rebuilding efforts.

IV. The Commission Should Modify the Definition of "New Ownership Investment" to Prevent Any Unconstitutional Impairment of Contracts

LADWP has existing contractual obligations pursuant to the NGS Participation, Operating and Co-Tenancy Agreements. The United States Constitution and California Constitution prevent the state from impairing the obligations of contract. U.S. Const. art. I, Sec. 10, cl. 1; California Const., art. 1, Sec. 9. The Proposed Regulations, with the current definitions of "covered procurement" and "new ownership investment," would prevent LADWP from fulfilling preexisting contractual obligations. Consequently, the Proposed Regulations would thwart third parties (the other NGS Owners) from moving forward with annual budget approvals for routine operations and maintenance, capital improvements and funding restoration activities in the event of plant destruction, each of which are existing contractual obligations binding the NGS Owners.

A. The Proposed Regulations Would Impair Existing Contractual Obligations

The Contract Clause of United States Constitution provides that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts." U.S. Const. art. I, § 10, cl.1. Similarly, the California Constitution states, "[a] bill of attainder, ex post facto law, or law impairing the obligation of contracts may not be passed." Cal. Const. art. 1, § 9. The Federal and State Contract Clauses protect contractual obligations from impairment by the subsequent enactment of state law. Allied Structural Steel v. Spannaus, 438 U.S. 234, 244 (1978). The initial inquiry in the analysis of an alleged Contract Clause violation is whether the change in state law has operated as a substantial impairment of a contractual relationship. Allied Structural Steel, 438 U.S. at 244. The courts consider three components to determine whether an unconstitutional contractual impairment has occurred, including whether: (1) there is a contractual relationship; (2) a change in law impairs that contractual relationship; and (3) the impairment is substantial.

General Motors Corp. v. Romein, 503 U.S. 181, 186 (1992); Univ. of Hawaii Prof'l Assembly v. Cayetano, 183 F.3d 1096, 1101-02 (9th Cir. 1999).

1. A Contractual Relationship Exists Between the NGS Owners

As a preliminary matter, a court must determine whether there is a contractual relationship regarding the terms at issue. United States Trust Co. v. New Jersey, 431 U.S. 1, 17 (1977); Southern California Gas Co. v. City of Santa Ana, 202 F. Supp. 2d 1129, 1132 (C.D. Cal. 2002), aff'd, 336 F.3d 885 (9th Cir. 2003) ("Here, the parties agree that the 1938 Franchise is a 'contract' for purposes of Contract Clause analysis. We concur because it embodies a bargain between Santa Ana and the Gas Company."). In this case, the NGS Owners entered into a number of agreements relating to the terms and conditions of their interest and ownership of NGS and to establish their rights and obligations with respect to NGS. Specifically, the Participation Agreement, Co-Tenancy Agreement and Operating Agreement are bargained-for agreements that represent the contractual arrangement between the NGS Owners with respect to operation and ownership of the plant. Accordingly, there is a contractual relationship among the NGS Owners. These agreements and others have governed the relationship among the NGS Owners for more than 31 years.

2. The Proposed Regulations Render the Terms of the NGS Governance Agreements Fruitless

The Commission's Proposed Regulations will have the effect of impairing an existing contractual obligation if the definition of "new ownership investment" is not revised to exclude the investments made by publicly owned electric utilities in existing power plants. Because the

Commission is promulgating the Proposed Regulations pursuant to SB 1368, the regulations are a law for purposes of the Contract Clause.[2]

Together, the NGS Governance Agreements require unanimous approval by the NGS Owners for expenditures related to capital improvements and operations and maintenance of the plant and provide that any failure to pay required costs would cause a party to be in default. Upon passage of the Proposed Regulations, LADWP would be precluded from approving annual budgets that contained any spending for improvements to NGS or operations and maintenance activities that result in extending the life of the plant beyond five years. LADWP's prospective incapacity to approve such budgets would present a stalemate to the rest of the NGS Owners. Although each NGS Owner may individually decide whether capital improvement or operations and maintenance expenditures are reasonable, necessary, or economically feasible, the Proposed Regulations would present a regulatory block to LADWP. Similarly, the Proposed Regulations would also serve as a bar to fulfilling its contractual obligation to fund the reconstruction of NGS in the event of a destructive event. Thus, the Proposed Regulations would be a state-imposed impediment that would prevent LADWP from performing its rights and obligations under the Governance Agreements.

3. The Proposed Regulations are a Substantial Impairment on LADWP's Existing Contracts

In analyzing whether there is a substantial impairment of contract, the Supreme Court articulated that the severity of the measure must be examined. Allied Structural Steel v. Spannaus, 438 U.S. 234, 245 (1978). The state action does not need to totally destroy the private party's rights to be considered a substantial impairment. United States Trust, 431 U.S. at 26-27

[2] See City and County of San Francisco v. United Railroads of San Francisco, 190 F. 507, 510 (9th Cir. 1911), cert. denied, 225 U.S. 710 (1912) (a state may act through a municipal corporation to which it has delegated powers of legislation to the extent that the regulation is shown to have been enacted pursuant to the legislative authority of the state).

("But we cannot sustain the repeal of [the earlier contract] because the bondholders' rights were not totally destroyed."). An impairment that is severe, permanent and is an immediate change in existing contractual relationships violates the Contract Clause. Allied Structural Steel, 438 U.S. at 250. An impairment of a contract may be substantial if it deprives a private party of an important right. See United States Trust Co., 431 U.S. at 27-28. Similarly, a substantial impairment has been found where state action thwarts the performance of an essential term and defeats the expectations of the parties under a preexisting contract. Cont'l Ill. Nat'l Bank & Trust Co. v. Washington, 696 F.2d 692, 700 (9th Cir. 1983). Additionally, the Ninth Circuit Court of Appeals found an unconstitutional substantial impairment where a state act altered a financial term of an existing contract. Cayetano, 183 F.3d at 1104 (a pay lag statute was a substantial impairment of the parties collective bargaining agreements because a delay in receiving paychecks could cause financial hardship).

In Washington, the Ninth Circuit found that a state act that impaired preexisting obligations of bond issuers for bonds issued for nuclear power plant projects was unconstitutional. 696 F.2d at 702. Washington was a consolidated action that challenged an initiative passed in 1981 (the "1981 Initiative") that required a procedure of voter approval of subsequent bond offerings to finance and complete three nuclear power plants under construction. Id. at 694. The United States filed suit on behalf of the Bonneville Power Administration ("BPA"), which is the federal agency charged with marketing the power produced from federal hydroelectric projects in the Columbia River Basin. Id. The Washington Public Power Supply System ("WPPSS") was the builder of three nuclear power plants that were to be operated as part of the BPA program. Id. The WPPSS was comprised of twenty-three political subdivisions of the state, including public utility districts and municipalities. Id.

During the 1970s, the WPPSS entered into various agreements to build and operate power plants. Id.

The 1981 Initiative provided that no public agency could issue or sell bonds to finance construction or acquisition of any major public energy project unless it first obtained authority for the sale of such bonds through an election. Id. at 696. The Ninth Circuit found that the 1981 Initiative impaired the parties' existing contractual rights. Id. at 698. As the court noted, "WPPSS's ability to issue additional bonds was accordingly the centerpiece of the entire arrangement" for the construction of the power plants. Id. The court held that, although the 1981 Initiative may apply to future bond issues, it could not apply to the additional bond issues of WPPSS that were promised under the existing contracts for the plant construction "and that remain central to the accomplishment of their purpose." Id. at 699. Based on that conclusion, the court held that the contractual impairment was substantial and, thus, unconstitutional. Id. at 700. The court found that the issuance of additional bonds by WPPSS was essential to the performance of the contracts. Id. It noted that, prior to the passage of the 1981 Initiative, the issuance of additional bonds was within the discretion of the board of directors of WPPSS. Id. Because the 1981 Initiative added a requirement for approval by the electorate, the Ninth Circuit stated that "[t]he addition of the referendum requirement is, we conclude, a severe impairment that defeats the expectations of the parties under their contracts." Id.

Similarly, the Proposed Regulations would significantly restrict the NGS Owners' preexisting contractual rights set forth in the Governance Agreements. The provisions of the Governance Agreements intend that the NGS Owners will fund capital improvements, plant operations and maintenance, and rebuilding in the event of destruction. The Commission's

Proposed Regulations would unilaterally change the terms of the preexisting contracts by tying LADWP's hands and obstructing the other NGS Owners from proceeding.

If the NGS Owners cannot approve any measures to fund operations and maintenance activities, equipment or plant upgrades or rebuild, due to LADWP's regulatory inability to authorize such measures, NGS will be essentially at an impasse because upgrades or operations or maintenance measures that would have the effect of extending the life of the plant by five years or more could not go forward. Such a barrier would have serious consequences for the NGS Owners. The inability to maintain NGS may also result in the impairment of contractual obligations that NGS Owners may have under various debt financings and their associated bond resolutions. These resolutions contain covenants and representations that are made as part of any debt issuance, and their potential violation will have major and dire consequences to not only the NGS Owners, but to the many people and institutions that hold such debt securities in their investments. Moreover, a slowdown or early shutdown at NGS, resulting from LADWP's inability to approve cost measures, would have significant implications for the economies of the Navajo Nation, the Hopi Tribe, the states of Arizona and Nevada, and frustrate the interests of the United States with respect to the operation of the CAP.[3] Additionally, NGS is an asset held by its owners for the benefit of their customers and shareholders. The NGS Owners have an obligation to maintain this asset. The Proposed Regulations would interfere with the maintenance of the plant, breaching the understanding between the shareholders, customers and the utilities.

[3] Specifically, with respect the United States, the Proposed Regulations would have the effect of frustrating the United States' interests by interfering with its authority under the Property Clause. See U.S. Const., art. IV, § 3, cl. 2. The Property Clause grants to Congress the power to dispose of and make all needful rules and regulations respecting its property, including the power to lease lands, reserve interests in lands and impose conditions associated with the ownership of land. Id. Electric power has been held to be the property of the United States to which the authority granted under the Property Clause applies. See U.S. v. City and County of San Francisco, 310 U.S. 16, 29-30 (1940); Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 333-35 (1935).

Through the Proposed Regulations, the Commission would be imposing new limitations on the exercise of LADWP's rights under the Governance Agreements that have been in effect for three decades. The ability to finance capital improvements and operations and maintenance activities remains central to the continued successful and safe management of NGS.

4. The Contractual Impairment is Neither Reasonable nor Necessary to Fulfill the Stated Purposes of SB 1368.

Although the Commission has the authority to enact regulatory measures under the police power, that authority does not permit the Commission to alter the material terms of the existing NGS Governance Agreements. As the United States Supreme Court has noted, the state possesses the power to enact regulatory measures, but "private contracts are not subject to unlimited modification under the police power." United States Trust Co., 431 U.S. at 22. Legislation that adjusts or limits the rights and responsibilities of parties to a contract "must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption." Id.; see Allied Structural Steel, 438 U.S. at 247-48. Therefore, the Proposed Regulation's permanent nullification of vital provisions of the NGS Governance Agreements must be measured against the public purposes supporting the adoption of the law.

In United States Trust Co., the Supreme Court held that New Jersey could not retroactively alter a 1962 statutory bond covenant relied upon by the bond purchasers. 431 U.S. at 32. The covenant related to an agreement between New Jersey and New York limiting the ability of the Port Authority of New Jersey and New York to subsidize rail passenger transportation from revenues and reserves pledged as security for consolidated bonds. Id. at 3. A later act repealed the covenant in its entirety. Id. at 14. The Supreme Court held that the repeal was a serious impairment, in violation of the Contract Clause. Id. at 28. The Court noted that an impairment may not violate the Contract Clause if it is reasonable and necessary to serve

an important public purpose; however, it rejected the claim that the stated public concerns of mass transportation, energy conservation and environmental protection were goals that inherently justified loss by the bondholders. Id. at 25-26, 29. The Court held that the legislative act of repealing certain covenants relating to the bonds was unnecessary because the state could have enacted a less drastic modification that would not have entirely removed the covenant's limitations on the use of state revenues and reserves to subsidize commuter rail or the state could have adopted alternative means without modifying the covenant at all. Id. at 29-30.

In SB 1368, the California Legislature asserted that the public purposes in enacting the statute requiring the creation of an emission performance standard for greenhouse gases were to protect the state from the serious adverse consequences of global warming on the economy, health and environment. SB 1368, § 1(a). The legislation reasonably restricts the application of the emission performance standard to a "long-term financial commitment" that is defined as a new ownership investment. Cal. Publ. Util. Code § 8340(j). However, the legislation does not suggest that emission performance standard would apply to any additional expenditures of money by publicly owned electric utilities at an existing and currently owned power plant that will extend the life of the facility by five years. Any reference in the legislation to a limitation of "five years" applies only to a new or renewed contract for the procurement of baseload generation. Id. It is the Commission, not the Legislature, that has imposed this additional restriction on publicly owned electric utilities by preventing expenditures that have the effect of extending the life of an existing power plant by five years. Proposed Regulations, § 2901(j).

Indeed if the Proposed Regulations are approved without modification, they would likely have the opposite effect of the intended public purposes of SB 1368. Instead of having the ability to improve the performance, efficiency and emission of the facility, the NGS Owners

would be prevented from making any significant equipment advances because LADWP would be unable to approve such investments. Enhanced equipment could have the effect of reducing emission or have other beneficial environmental improvements. For example, under the Proposed Regulations, LADWP would have been precluded from approving the NGS capital budget for the installation of the SO_2 scrubbers, which reduced SO_2 emissions at NGS by more than 90%, rebuilding the precipitator, which improved air emission controls, and upgrading the crystallizers, which improved water efficiency at the plant.

Furthermore, if NGS is unable to operate due to LADWP's inability to approve capital budgets, that obstacle could have far-reaching ramifications for the interests held by the United States. The continued operation of NGS is imperative to the United States with respect to the management of the CAP. Power from NGS is used for the operation of the project, and the Bureau sells excess power to repay the cost of the CAP. As a result, to the extent that NGS is prevented from continuing operations, the Proposed Regulations may have the effect of frustrating the interests of the United States under the Colorado River Basin Project Act, 43 U.S.C. § 1523, and impairing the ability of CAWCD to satisfy its repayment obligation to the United States. The Non-Jurisdictional NGS Owners contend that there is a resolution to clarifying the Proposed Regulations so that it does not unconstitutionally impair existing contractual obligations and is in keeping with the legislative intent in enacting SB 1368. See Section III (C), infra.

B. Recommended Revisions to the Proposed Regulations

The Non-Jurisdictional NGS Owners request that the Commission modify the definition of "new ownership investment" so that the Proposed Regulations would not pertain to financial expenditures for certain activities, such as operations and maintenance, capital improvements for

equipment or plant upgrades and renovations, or necessary reconstruction, at existing power plants owned by a local publicly owned electric utility. The referenced expenditures are necessary at existing power plants for reliability, safety, preservation of plant value, and to enable the plant to comply with regulatory requirements and make necessary environmental improvements. Additionally, these expenditures allow plant owners to comply with contractual obligations entered into before the effective date of the Proposed Regulations. The Non-Jurisdictional NGS Owners contend that the referenced types of expenditures, which are necessary and beneficial for an existing power plant, should be excluded from the operation of the Proposed Regulations. The adoption of a modified definition of "new ownership investment" that would exclude operations and maintenance, capital improvements for upgrades and renovations, and reconstruction would eliminate the constitutional concerns that the Proposed Regulations would impair the NGS Owners' existing contractual relationships in violation of the Contract Clause.

V. The Proposed Regulations Violate the Commerce Clause by Regulating Out-of-State Conduct

The Commerce Clause provides that "Congress shall have Power . . . to regulate Commerce with foreign nations, and among the several States, and with Indian tribes." U.S. Const., art. I, § 8, cl. 3. The "dormant" Commerce Clause refers to the negative implications of the Commerce Clause that prohibits economic protectionism, a restriction prohibiting a state from passing legislation that is designed to benefit in-state economic interests by burdening out-of-state competitors. Wyoming v. Oklahoma, 502 U.S. 437, 454 (1992); New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 273-74 (1988).

The U.S. Supreme Court has adopted "what amounts to a two-tiered approach" to determine the validity of a statute that invokes the Dormant Commerce Clause. Brown-Forman

Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573, 578 (1986). The first tier is referred to as the "virtual *per se*" rule, which is applied when a statute directly regulates or discriminates against interstate commerce, or when the effect of a statute is to favor in-state economic interests over out-of-state interests. Id.; Alliant Energy Corp. v. Bie, 330 F.3d 904, 911 (7th Cir. 2003); Philadelphia v. New Jersey, 437 U.S. 617, 623-24 (1978). A facially discriminatory statute is subject to "the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory measures." Wyoming v. Oklahoma, 502 U.S. 437, 456 (1992).

The second tier is reserved for statutes that regulate evenhandedly, but have an indirect effect on interstate commerce. Brown-Forman Distillers Corp., 476 U.S. at 579; Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970). In those instances, the statute will be upheld "unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." Pike, 397 U.S. at 142. Thus, the court examines "whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits." Brown-Forman Distillers Corp., 476 U.S. at 579.

The United States Supreme Court has recognized that statutes that have the effect of controlling conduct beyond state boundaries are unconstitutional. Edgar v. MITE Corp., 457 U.S. 624, 642-43 (1982) (plurality). Thus, the Supreme Court has stated that "a statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of the enacting State's authority and is invalid regardless of whether the statute's extraterritorial reach was intended by the legislature." Healy v. Beer Institute, Inc., 491 U.S. 324, 336 (1989); see Edgar, 457 U.S. at 642-43. The "critical inquiry is whether the practical effect of the regulation is to control conduct beyond the State." Healy, 491 U.S. at 336. Finally,

the "practical effect of the statute must be evaluated not only by considering the consequences of the statute itself, but also by considering how the challenged statute may interact with the legitimate regulatory regimes of other States." Id. Applying this theory, courts have struck down laws that burden interstate commerce by imposing environmental conditions on citizens of the state when those same regulations have extraterritorial effects. See Nat'l Solid Wastes Management Ass'n v. Meyer, 63 F.3d 652, 657-58 (7th Cir. 1995); Hardage v. Atkins, 619 F.2d 871, 872 (10th Cir. 1980).

Similarly, the effect of the Proposed Regulations is that it will control the conduct of those engaged in commerce occurring wholly outside the state and, thus, directly regulate interstate commerce in violation of the Commerce Clause. The Proposed Regulations will force NGS, and conceivably other out-of-state power plants, to bring their facilities into compliance with California's regulatory standards. Although there is no commercial technology available today to bring an existing coal-fired plant into compliance with the emission performance standard set forth in the Proposed Regulations, such technology may be available at some point in the future. However, the Proposed Regulations will have the effect of precluding operations at NGS, located in Arizona, in the future by limiting LADWP from approving expenditures at the plant to the extent that improvements extending the plant's life by five years or more are required. The Proposed Regulations would prohibit LADWP, a California entity, from taking action at NGS in Arizona. Moreover, the Proposed Regulations will also have the effect of preventing a California publicly owned electric utility from having an ownership interest in any out-of-state coal-fired power plants. Therefore, the Proposed Regulations have the "practical effect" of regulating out-of-state commerce because it will preclude the operation of an out-of-state power plant that is not in compliance with the Commission's regulations on greenhouse

gases. The Supreme Court and other federal cases make clear that the Proposed Regulations violate the Commerce Clause's prohibition against directly regulating out-of-state commerce.

VI. Conclusion

For the foregoing reasons, the Non-Jurisdictional NGS Owners respectfully request that the Commission (1) adopt a modified definition of "new ownership investment" to specifically exclude operations and maintenance, capital improvements for upgrades and renovations, and reconstruction at existing power plants so that the Proposed Regulations do not unconstitutionally impair existing contractual obligations and (2) considers the potential unconstitutional Commerce Clause violations that will result upon passage of the Proposed Regulations.

Dated: April 5, 2007

Respectfully submitted,

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EXHIBIT 1

to dedicate any Capacity in the Transmission System for use by third parties.

7.11 The Transmission System will be interconnected with the Four Corners-Eldorado 500 KV transmission line at the Moenkopi Switchyard in accordance with the memorandum of intent attached as Exhibit H hereto.

7.12 For the purposes of Section 7, any use of any section of line by the United States which is in excess of the greater of (i) the United States' percentage cost responsibility in such line times the capability of such, or (ii) the capability required to supply the power requirements of the Central Arizona Project, shall be deemed to be non-firm use unless the right to such use shall have been acquired pursuant to Section 7.3 hereof.

8. ADMINISTRATION:

8.1 The Participants shall establish the following committees, whose functions and responsibilities shall be as described herein or in the subsequent Project Agreements:

8.1.1 One coordinating committee for the Navajo Project, consisting of one representative from each Participant, who shall be an officer or general manager of a Participant or the designee of the Secretary, or his authorized alternates.

8.1.2 One engineering and operating committee for the Navajo Generating Station, consisting of two representatives from each Participant.

8.1.3 One engineering and operating committee for the Transmission System, consisting of two representatives from each Participant.

8.1.4 One auditing committee for the Navajo Project, consisting of two representatives from each Participant.

8.2 The coordinating committee shall have the following functions, among others:

8.2.1 To provide liaison among the Participants at the management level.

8.2.2 To exercise general supervision over the engineering and operating committees and the auditing committee.

",

accounting and financial liaison among the Participants in connection with the engineering, construction, operation, replacement and reconstruction of the Navajo Project.

8.6.2 To review accounting and financial aspects thereof.

8.6.3 To advise and make recommendations to the coordinating committee, the Project Managers and the Operating Agents on matters involving auditing and financial transactions.

8.6.4 To perform such other functions and duties as may be assigned to it in the Project Agreements or by the coordinating committee.

8.7 Within thirty (30) days after the execution of this agreement, each Participant shall designate its representatives on the committees hereby established. Such designation shall be in writing, with copies mailed to each of the Participants.

8.8 Any action or determination of a committee must be unanimous.

8.9 All actions, agreements or determinations made by the committees shall be reduced to writing. In addition, the engineering and operating committees and

EXHIBIT 2

DUPLICATE ORIGINAL

COPY

NAVAJO PROJECT

NAVAJO GENERATING STATION

OPERATING AGREEMENT

BETWEEN

THE UNITED STATES OF AMERICA

ARIZONA PUBLIC SERVICE COMPANY

DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES

NEVADA POWER COMPANY

SALT RIVER PROJECT AGRICULTURAL
IMPROVEMENT AND POWER DISTRICT

TUCSON GAS & ELECTRIC COMPANY

FXECUTION COPY

(DWP NO. 10123)

relating to the operation and maintenance of the Navajo Generating Station.

3. AGREEMENT: The Participants agree as follows:

4. EFFECTIVE DATE: This Operating Agreement shall become effective when it has been duly executed and delivered on behalf of all the Participants.

5. DEFINITIONS: The following terms, when used herein, shall have the meanings specified:

5.1 ACCOUNTING PRACTICE: Generally accepted accounting principles, in accordance with FPC Accounts.

5.2 BENEFITS RATIO: The ratio to be determined as set forth in Exhibit C hereto.

5.3 CAPACITY: Electrical rating expressed in kilowatts (KW) or megawatts (MW) or kilovolt-amperes (KVA) or megavolt-amperes (MVA).

5.4 CAPACITY ENTITLEMENT: The entitlement of each Participant to Power from each unit of the Navajo Generating Station which shall be the product of its Generation Entitlement Share and the Net Effective Generating Capability of such unit.

5.5 CAPITAL IMPROVEMENTS: Any Units of Property, land or land rights which are added to the Navajo Generating Station, the betterment of land or land rights or the enlargement or betterment of any Units of Property constituting a part of the Navajo Generating Station, and the replacement of any Units of Property for other Units

of Property or the replacement of land or land rights constituting a part of the Navajo Generating Station, irrespective of whether such replacement constitutes an enlargement or betterment of that which it replaces, which additions, betterments, enlargements and replacements in accordance with Accounting Practice would be capitalized.

5.6 CAPITAL IMPROVEMENTS A&G RATIO: The ratio to be determined as set forth in Exhibit F hereto.

5.7 COAL SUPPLY AGREEMENT: The Navajo Station Coal Supply Agreement, entered into as of June 1, 1970, by and between Peabody Coal Company, hereinafter referred to as "Peabody," and the Co-Tenants, relating to a supply of coal for the Navajo Generating Station.

5.8 CONSTRUCTION AGREEMENT: The Navajo Generating Station Construction Agreement executed by and among the Participants, providing for the design and construction of the Navajo Generating Station.

5.9 CONSTRUCTION COSTS: The costs of constructing the Navajo Generating Station.

5.10 CONTRACT FOR INTERMITTENT TRANSMISSION: The contract between the United States Bureau of Reclamation-Upper Colorado Region and the Salt River Project, acting as Operating Agent, dated as of the 17th day of August, 1972, providing for transmission of start-up and emergency auxiliary Power and Energy to the Navajo Generating Station.

16. ANNUAL BUDGETS:

16.1 At least ninety (90) days before the commencement of the initial training period for the personnel that will perform Operating Work, the Operating Agent shall prepare and submit to the Station Engineering and Operating Committee for its review and approval, a budget (manning and dollars) for training such personnel. The Station Engineering and Operating Committee shall approve a training budget not less than sixty (60) days prior to the commencement of said initial training period.

16.2 Not less than one hundred twenty (120) days prior to the Date of Firm Operation of the first unit to be completed, and not less than one hundred twenty (120) days prior to the beginning of each calendar year thereafter, the Operating Agent shall prepare and submit to the Station Engineering and Operating Committee for its review and approval the proposed annual Capital Improvements budget, annual manpower budget, and annual operating and maintenance budget for Operating Work for the initial year of operation and for each such calendar year, respectively.

16.3 Not less than sixty (60) days prior to the Date of Firm Operation of the first unit to be completed and not less than ninety (90) days prior to the beginning of each calendar year thereafter, the Station Engineering and Operating Committee shall approve or fail to approve

an annual Capital Improvements budget, annual manpower budget, and annual operating and maintenance budget for Operating Work. In the event that the annual manpower budget or the annual operating and maintenance budget are not approved by the Station Engineering and Operating Committee in final form prior to the beginning of the next calendar year, the Operating Agent shall nevertheless continue to perform Operating Work in accordance with Section 6 hereof until such time as a budget has been approved or otherwise determined in accordance with the Project Agreements.

16.4 Any information required from any Participant by the Operating Agent in preparing the proposed budgets shall be supplied by such Participant.

16.5 The Station Engineering and Operating Committee may at any time during the year approve revisions to the annual Capital Improvements budget (subject to the provisions of Section 17.2 hereof), annual manpower budget, and the annual operating and maintenance budget for Operating Work.

17. CAPITAL IMPROVEMENTS:

17.1 All proposed expenditures for Capital Improvements, including a contingency allowance for capital expenditures if necessitated by an Operating Emergency, shall be included in the annual Capital Improvements budget. After such budget has been approved by the

Station Engineering and Operating Committee, each Participant shall be obligated for the costs incurred for such Capital Improvements on the basis of Generation Entitlement Shares, and each Participant's rights, titles, and interests therein shall be on the basis of Generation Entitlement Shares.

17.2 At any time the Station Engineering and Operating Committee may authorize Capital Improvements not included in the annual Capital Improvements budget; provided that any single Capital Improvement exceeding the sum of One Hundred Thousand Dollars ($100,000.00), shall be subject to authorization by the Coordinating Committee.

17.3 The Operating Agent shall submit to the Participants a forecast of cash requirements by months for any Capital Improvements. Said forecast shall be submitted on a yearly basis after final budget approvals have been made. A revised forecast shall be submitted when the Capital Improvements budget is revised and approved, or when significant changes in monthly expenditures from those previously forecast are anticipated.

17.4 The Operating Agent shall be responsible for the design and construction of Capital Improvements.

17.5 The costs of Capital Improvements shall include:

17.5.1 All costs incurred by the Operating

EXHIBIT 3

COPY

NAVAJO PROJECT

CO-TENANCY AGREEMENT

AMONG

ARIZONA PUBLIC SERVICE COMPANY

DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES

NEVADA POWER COMPANY

SALT RIVER PROJECT AGRICULTURAL
IMPROVEMENT AND POWER DISTRICT

TUCSON ELECTRIC POWER COMPANY

THE UNITED STATES OF AMERICA

CONFORMED COPY (through Amendment No 6)

DWP No. 10498

shall be deemed to be non-firm use unless the right to such use shall have been acquired pursuant to Section 8 2 hereof

8.11 Notwithstanding the provisions of this Section 8, Los Angeles shall have the right to use the McCullough Facilities or to interconnect its transmission system therewith for purposes other than those of the Navajo Project established pursuant to the Project Agreements; provided, that such use or interconnection shall not unreasonably interfere with the rights, titles or interests of the other Participants in the Transmission System as established pursuant to Project Agreements

9. **ADMINISTRATION:**

9.1 As a means of securing effective cooperation and interchange of information and of providing consultation on a prompt and orderly basis among the Participants in connection with various administrative and technical problems which may arise from time to time in connection with the terms and conditions of the Project Agreements, the Coordinating Committee, Auditing Committee, Transmission Engineering and Operating Committee and Station Engineering and Operating Committee, established under the provisions of Section 8 of the Participation Agreement, shall continue in existence and shall have the responsibilities set forth in Sections 9 2 through 9 5 hereof.

9.2 The Coordinating Committee shall be composed of one (1) representative of each Participant, who shall be the Contracting Officer or an officer or general manager of a Participant or the designee of any of the foregoing and shall:

9.2.1 Provide liaison among the Participants at the management level.

9.2.2 Exercise general supervision over the Station Engineering and Operating Committee, the Transmission Engineering and Operating Committee, the Auditing Committee and other

permanent or ad hoc committees established pursuant to Section 9.11 hereof

9.2.3 Consider matters referred to it by another committee.

9.2.4 Perform such other functions and duties as may be assigned to it in the Project Agreements

9.2.5 Review, discuss and act upon disputes among the Participants arising under the Project Agreements

9.3 The Station Engineering and Operating Committee shall consist of two (2) representatives designated by each Participant, and each such representative shall be authorized by the Participant by which he is designated to act on its behalf with respect to those matters herein provided to be the responsibilities of the Station Engineering and Operating Committee. The Station Engineering and Operating Committee shall

9.3.1 Provide liaison among the Participants and between them and the Project Manager and the Operating Agent for the Navajo Generating Station with respect to the engineering, construction, operation, maintenance, replacement and reconstruction of the Navajo Generating Station

9.3.2 Perform such other functions and duties as may be assigned to it in the Project Agreements or by the Coordinating Committee.

9.4 The Transmission Engineering and Operating Committee shall consist of two (2) representatives designated by each Participant, and each such representative shall be authorized by the Participant by which he is designated to act on its behalf with respect to those matters herein provided to be the responsibilities of the Transmission Engineering and Operating Committee. The Transmission Engineering and Operating Committee shall

9.4.1 Provide liaison among the Participants and between them and the Project Managers and the Operating Agents for the

Components of the Transmission System with respect to the engineering, construction, operation, maintenance, replacement and reconstruction of the Transmission System

9.4.2 Perform such other functions and duties as may be assigned to it in the Project Agreements or by the Coordinating Committee.

9.5 The Auditing Committee shall consist of two (2) representatives designated by each Participant, and each such representative shall be authorized by the Participant by which he is designated to act on its behalf with respect to those matters herein provided to be the responsibilities of the Auditing Committee. The Auditing Committee shall:

9.5.1 Develop procedures for proper accounting and financial liaison among the Participants in connection with the engineering, construction, operation, replacement, reconstruction and maintenance of the Navajo Project

9.5.2 Review accounting and financial aspects of the engineering, construction, operation, maintenance, replacement and reconstruction of the Navajo Project.

9.5.3 Advise and make recommendations to the Coordinating Committee, the Project Managers and the Operating Agents on matters involving auditing and financial transactions.

9.5.4 Perform such other functions and duties as may be assigned to it in the Project Agreements or by the Coordinating Committee.

9.6 Any action or determination of a committee must be unanimous.

9.7 All actions, agreements or determinations made by the committees shall be reduced to writing and any such action, agreement or determination shall become effective when signed by a representative of each Participant on the committee or an

obligations as are applied by the Project Agreements to the interest being transferred in the hands of the transferring Co-Tenant

12.11 Any Co-Tenant transferring an ownership interest pursuant to the provisions of this Section 12 shall remain liable and obligated for the performance of all of the terms and conditions of the Project Agreements, unless otherwise agreed to by all of the remaining Participants.

12.12 Any party who may succeed to an ownership interest pursuant to this Section 12 shall specifically agree in writing with the remaining Participants at the time of such transfer that it will not transfer or assign all or any portion of such ownership interest without complying with the terms and conditions of this Section 12

12.13 The provisions of this Section 12 shall not apply to any interest held by the Salt River Project for the use and benefit of the United States.

13. **DESTRUCTION:**

13.1 If a generating unit of the Navajo Generating Station should be destroyed to the extent that the cost of repairs or reconstruction is less than 60% of the original cost thereof, the Participants shall, unless otherwise agreed, repair or reconstruct such generating unit to substantially the same general character or use as the original. The Participants shall share the costs of such repair or reconstruction in proportion to their Generation Entitlement Shares in the generating unit so destroyed.

13.2 If a generating unit of the Navajo Generating Station should be destroyed to the extent that the cost of repairs or reconstruction is 60% or more of the original costs thereof, the Participants shall, upon agreement, restore or reconstruct such unit to substantially the same general character or use as the original;

provided, however, that should all of the Participants not agree to restore or reconstruct such unit, but some of the Participants nevertheless desire so to do, then the Participants who do not agree to restore or reconstruct shall sell their interests in such unit to the remaining Participants at a price equal to the salvage value of such interests. The Participants agreeing to restore or reconstruct such unit shall share the costs of restoration or reconstruction in the proportion that the Generation Entitlement Share of each bears to the total of Generation Entitlement Shares of such Participants.

13.3 If any facilities of the Transmission System, the Railroad or the pumping plant should be destroyed, the Participants shall, unless otherwise agreed, repair or reconstruct such facilities. The Participants shall share the costs of such repair or reconstruction in proportion to their cost responsibility for the facilities so destroyed.

14 **SEVERANCE OF IMPROVEMENTS:** Except as provided in Section 12 of the Indenture of Lease, the Co-Tenants agree that all facilities, structures, improvements, equipment and property of whatever kind and nature constructed, placed or affixed on the rights-of-way, easements, patented and leased lands as part of or as a Capital Improvement to the Navajo Project, as against all parties and persons whomsoever (including without limitation any party acquiring any interest in the rights-of-way, easements, patented or leased lands or any interest in or lien, claim or encumbrance against any of such facilities, structures, improvements, equipment and property of whatever kind and nature), shall be deemed to be and remain personal property of the Co-Tenant(s), not affixed to the realty

15. **CAPITAL IMPROVEMENTS:**

15.1 The Participants recognize that from time to time it may be necessary or desirable to make Capital Improvements or that

investments shall inure to the benefit of the United States and all losses on such investments shall be at the risk of the United States. If the proceeds exceed the amount of the obligation for which they are designated or held, then, upon written request of the Contracting Officer, Salt River Project shall pay such excess to the United States or its designee

17 **REIMBURSEMENT FOR COSTS AND EXPENSES.** The United States shall reimburse Salt River Project for all costs and expenses not otherwise specifically provided for which are imposed upon, measured by or associated with the interests held by Salt River Project for the use and benefit of the United States in accordance with the Project Agreements.

18. **DEFAULTS AND COVENANTS REGARDING OTHER AGREEMENTS:**

18.1 Each Participant hereby agrees that it shall pay all monies and carry out all other duties and obligations agreed to be paid and/or performed by it pursuant to all of the terms and conditions set forth and contained in the Project Agreements, and a default by any Participant in the covenants and obligations to be kept and performed pursuant to the terms and conditions set forth and contained in any of the Project Agreements shall be an act of default under this Co-Tenancy Agreement

18.2 In the event of a default by any Participant in any of the terms and conditions of the Project Agreements, then, within ten (10) days after written notice has been given by any non-defaulting Participant to all other Participants of the existence and nature of the default, the non-defaulting Participants shall remedy such default either by advancing the necessary funds and/or commencing to render the necessary performance, with each non-defaulting Participant contributing to such remedy in the ratio of its Generation Entitlement Share to the total of the Generation Entitlement Shares of all non-defaulting Participants

18.3 In the event of a default by any Participant in any of the terms and conditions of the Project Agreements and the giving of notice as provided in Section 18.2 hereof, the defaulting Participant shall take all steps necessary to cure such default as promptly and completely as possible and shall pay promptly upon demand to each non-defaulting Participant the total amount of money and/or the reasonable equivalent in money of non-monetary performance, if any, paid and/or made by such non-defaulting Participant in order to cure any default by the defaulting Participant, together with interest on such money and/or the costs of non-monetary performance at the rate of ten per cent (10%) per annum, or the maximum rate of interest legally chargeable, whichever is the lesser, from the date of the expenditure of such money and/or the date of completion of such non-monetary performance by each such non-defaulting Participant to the date of such reimbursement by the defaulting Participant, or such greater amount as may be otherwise provided in the Project Agreements.

18.4 In the event that any Participant shall dispute an asserted default by it, then such Participant shall pay the disputed payment or perform the disputed obligation, but may do so under protest. The protest shall be in writing, shall accompany the disputed payment or precede the performance of the disputed obligation, and shall specify the reasons upon which the protest is based. Copies of such protest shall be mailed by such Participant to all other Participants. Payments not made under protest shall be deemed to be correct, except to the extent that periodic or annual audits may reveal over or under payments by Participants, necessitating adjustments. In the event it is determined by arbitration, pursuant to the provisions of this Co-Tenancy Agreement or otherwise, that a protesting Participant is entitled to a refund of all or any portion of a disputed payment