

Date: November 10, 2023

To: Thomas B. Modica, City Manager



From: Robert Dowell, Director, Energy Resources

For: Mayor and Members of the City Council

Subject: **Covanta Operating Agreement – Notice of Termination**

On November 2, 2023, the City of Long Beach (City) was notified by Covanta Long Beach Renewable Energy Corporation (Covanta) that it was exercising its right to terminate Agreement No. 23336 (Agreement) effective January 31, 2024, by providing ninety (90) days advance written notice as required by the Agreement. The current Agreement with Covanta was due to terminate on June 30, 2024.

Background

The Southeast Resource Recovery Facility (SERRF) is a Waste-To-Energy operating facility co-owned by the City and the Los Angeles County Sanitation District (LACSD) under a Joint Powers Authority (JPA) with a 2/3 to 1/3 split between the City and the LACSD, respectively. SERRF is currently operated by Covanta under contract to the City.

SERRF was placed into service in July 1988 as a 30-year operating facility that has now been operating for over 35 years. In 2017, the City commissioned HDR Engineering, Inc. (HDR) to perform a physical condition assessment of SERRF to identify major capital expenditures that may be required to keep the facility operational beyond its original 30-year design life. HDR's assessment identified the following capital and refurbishment budgets to continue to operate SERRF beyond 2018:

- (1) To continue to operate through 2024, capital investments in the range of approximately \$8.185 million to \$12.885 million.
- (2) To continue to operate long term through 2039, capital investments in the range of \$40.905 million to \$66.310 million.

Based on HDR's findings, the City invested \$13.7 million in capital and refurbishments in SERRF in Fiscal Years (FY) 2019 and FY 2020 with the expectation that that facility would be capable of continuing to process waste and generate electricity through the Covanta contract term of June 30, 2024.

The passage of State Assembly Bill 1857 (AB 1857) in late August of 2022 removed the AB 939 waste diversion credit for jurisdictions that delivered municipal solid waste to existing Waste-To-Energy (WTE) facilities in California beginning January 1, 2023. Approximately 148 different jurisdictions brought their municipal solid waste to SERRF for the diversion credit,

which accounted for approximately 50 percent of the waste tonnage processed annually at SERRF and was a significant revenue source for the operations. The anticipated reduction of nearly 50 percent of the waste tonnage processed at SERRF, along with the corresponding loss of revenue, introduced significant financial risks to the City for SERRF's continued commercial operations, both in the immediate future as well as through the contract term of June 30, 2024.

Since the expiration of SCE's 30-year Power Purchase Agreement (PPA) in 2018, the SERRF Fund had been operating at an annual loss of approximately \$4 million, with this annual shortfall amount offset by available funds accumulated from prior years of operations. With the passage of AB 1857, staff estimated an additional revenue loss of \$2 million per month, which would further increase the revenue shortfall and quickly deplete funds available thus necessitating the closure of the facility at the end of February 2023.

As a result, the City met informally with Covanta and notified them of its impending notification to terminate the Agreement. Covanta proposed amending the commercial structure of the current Agreement to continue SERRF's operations and began negotiations with the City.

On January 17, 2023, City Council approved amending the commercial structure under the Agreement such that Covanta would take responsibility for all SERRF revenues and expenses for a contract period beginning on February 1, 2023, until the end of the contract term. Due to ongoing agreements for special waste and refuse pricing flexibility, Covanta was better positioned to profitably continue facility operations until the end of the contract term.

The amended commercial structure provided several benefits including:

- (1) Shifting the City's financial risks for the continued operation of SERRF to Covanta and secured the SERRF Fund balance through June 30, 2024, at which time such funds would become available for possible decommissioning operations.
- (2) Allowing for the continued operation of SERRF beyond the first quarter of 2023 while economically viable options were further evaluated under the Request for Proposal (RFP) issued on April 20, 2023, for the future of SERRF, including organic waste processing and procurement in compliance with SB 1383.
- (3) Ensuring compliance with the City's municipal solid waste management program as well as ensuring compliance with its Climate Action Plan (CAP).
- (4) Ensuring that there will be no change to the rate structure charged to the City for its own use of the SERRF facility for refuse operations.

Current Status

Over the past couple of months, Covanta has encountered several failures of equipment near or at the end of its design life and unanticipated outages that have resulted in significant facility downtime, compromising the economic viability of SERRF. Covanta agreed to the revised

commercial structure in the January 17, 2023, amendment as a “pilot” to evaluate if the facility was sustainable on its own accord which has recently proven not to be the case.

Covanta’s management is very concerned that the facility is not sustainable in its current state due to lack of clarity for SERRF’s future (difficult to retain their staff) and the age of the facility. Covanta has identified \$8 million to \$17 million of additional capital investment that would be required to extend the operating life of SERRF for an additional 5 years. An investment of this size by the City would deplete most, if not all, of the funds available in the SERRF Fund, leaving no funding available for the future decommissioning and demolition of the facility.

Covanta now finds itself in a similar situation as the City nearly a year ago with projected expenses exceeding revenues, resulting in the decision to exercise its right to terminate the Agreement for convenience.

Concurrently, staff is in the process of evaluating the responses to the April 20, 2023, RFP ER23-246 seeking to contract with a developer to design, permit, finance, own, and operate an organic waste receiving and processing facility at the SERRF site. A desired outcome of the RFP is to identify an operational and economically viable solution for the future of SERRF, including organic waste processing and procurement in compliance with SB 1383. Staff will continue to proceed with the evaluation of the RFP responses received on August 31, 2023, and anticipates issuing a Notice of Award to enter into an Exclusive Negotiating Agreement in the January 2024 timeframe.

Next Steps

Staff will continue to identify and evaluate any or all potential operating options for SERRF over the next 90 days while continuing its evaluation of the RFP responses. These operating options could include:

- (1) Utilizing Covanta to operate at a cost-plus term from February 1 thru June 30, 2024, while the parties negotiate a possible extension for operations past June 30, 2024.
- (2) Evaluating capital investment requirements for a possible extension of SERRF’s operations (i.e. - a 5-year term) with Covanta including some payback over the 5-year term, dependent upon facility profitability.
- (3) Examination of long-term capital needs and financial viability of larger investments to extend the life beyond 5 years.
- (4) Identification of any other potential operators with interest in running the facility
- (5) Staff will work with Covanta to develop a City-approved decommissioning plan for SERRF in the event that any negotiations undertaken fail to result in continuation of operations.

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- (6) Evaluation of the responses to add organic processing to the SERRF plant. In terms of the current RFP ER23-246 evaluation, the industry for organic processing is still developing in the United States and it is possible that the RFP Evaluation Committee may determine that the proposed organic technology is not proven or commercially viable. Additionally, exclusive negotiations with the selected RFP proposer may not yield a final contract with agreeable terms to move forward with the project.
- (7) Preparation of plans for landfilling the City's 800 daily tons should the SERRF plant no longer be available in the near future to dispose of the City's residential waste.
- (8) Estimation of the increased greenhouse gas emissions that would be generated from the closure of SERRF and the subsequent transportation and then landfilling of the City's 800 daily tons of refuse
- (9) Review of any federal or state grants to help pay for transition solutions or upgrades to the facility

If you have any questions, please contact Bob Dowell, Energy Resources Director, at (562) 570-2001.

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