

COUNCIL ACTION FORM

SUBJECT: POWER PLANT COAL CONTRACT EXTENSION (COMMODITY ONLY)

BACKGROUND:

The Ames Municipal Electric System operates two coal-fired generating units, Unit 7 and Unit 8. Both units currently burn ultra-low sulfur sub-bituminous coal as the primary fuel, additionally co-firing refuse derived fuel (RDF) and #2 fuel oil (as a fuel for start-up and boiler flame stabilization).

For the past five years the City has had a contract with the Peabody COAL SALES, LLC (Peabody) for their North Antelope Rochelle Mine (NARM) coal (**commodity only**) from the Powder River Basin located in Campbell County, Wyoming. In fact, the power plant has used this coal as its primary fuel continuously for more than 22 years. The NARM coal is a premier ultra-low sulfur sub-bituminous coal that has proved to be a very compatible fuel for our pulverized coal-fired boilers. It has a nominal heating value of 8800 Btu/lb and a sulfur dioxide content of 0.48 lbs.SO₂/mmBtu. **It is important to note that the City has a separate agreement in place with Williams Bulk Transfer, an Alliant Energy Transportation Company, for the delivery of coal from the mine to the City's power plant.**

On February 12, 2013 the City Council authorized waiving the City's Purchasing Policy requirement to solicit bids for coal and approved an amendment to the original agreement with Peabody COALSALES, LLC to supply coal for the City of Ames Steam Electric Plant for the period January 1, 2013 through December 31, 2015. The pricing for the coal was not firm for the final year of the contract due to coal's volatile market. The amendment allowed the City to enter into negotiations with Peabody for the final year.

Current plans call for the natural gas conversion project to be completed by April 2016, with the use of coal to be discontinued in December 2015. Since those dates cannot be guaranteed, however, the proposed agreement provides for the purchase of coal throughout 2016.

During the negotiation process, the City's goal was to limit the exposure to our declining coal requirements and extend the agreement through our final demand for coal prior to turning the power plant over to burn natural gas.

Peabody commenced the negotiation by proposing pricing for the next two years (2015 through 2016). Additional terms along with pricing included reducing the minimum annual tonnages and maintaining a clause allowing the City to reduce or suspend

delivery of coal with 120 days notice, without penalty. Over a period of four months, the City and Peabody exchanged four counteroffers, ultimately reaching a tentative agreement based upon the City staff's December 30 counteroffer.

Key features of the tentative agreement reached between Peabody and the City staff are as follows:

- I) Firm unit pricing for 2015 and 2016. The market-driven price for coal will increase 8% in 2015 over the 2014 rate, and the 2016 rate will increase 3.7% over 2015.
- II) Annual tonnages as follows:

2010 - 2012 Original Agreement	Minimum	Target	Maximum	Actual (Coal Burn)
2010	200,000	250,000	400,000	233,501
2011	200,000	250,000	400,000	213,827
2012	200,000	250,000	400,000	212,860
Amendment 1				
2013	150,000	200,000	300,000	191,772
2014	125,000	200,000	300,000	183,943
2015	125,000	200,000	300,000	
Amendment 2				
2015	100,000	n/a	n/a	
2016	n/a	n/a	n/a	

- III) Allow the City to reduce or suspend deliveries of coal with 120 days notice, without penalty.

Compelling reasons to approve this agreement include the following:

- 1) The unit prices for coal for 2015 and 2016 represent a good value for the City.
- 2) The North Antelope Rochelle Mine coal produces a premium sub-bituminous coal. Its combination of high heating value and ultra-low sulfur content makes it a very desirable fuel, with a low emissions yield, especially for SO₂. The nominal SO₂ emissions value from this coal is 0.48 lbs SO₂/mmBtu, which allows our plant to comfortably meet its SO₂ compliance limit of 1.2 lbs SO₂/mmBtu. In contrast, many other low-sulfur sub-bituminous coals have a heating value of approximately 8400 Btu/lb, and a sulfur content of 0.40 or higher, which may comply with the SO₂ emissions limit of 1.2 lbsSO₂/mmBtu, but leaves a very small compliance margin.

- 3) The City's Steam Electric Plant has used Peabody's NARM coal as its primary source of fuel for more than 22 years. This coal burns very well in our boilers with a low tendency to form deposits that foul (plug) the boiler.
- 4) Peabody understands the issues that our Steam Electric Plant currently faces. These include power market economics (versus our power plant's production costs); additional and more restrictive environmental regulations; and local, regional, and national political pressures, etc. As a result:
 - a. Peabody agreed to a very simple exit clause that, given 120 days notice, the City can reduce or suspend the delivery of coal, without penalty.
 - b. Peabody also agreed to reduce the minimum (tonnage) take from 125,000 tons per year in the previous agreement (2013 through 2015) down to 100,000 tons per year for 2015, and eliminating the minimum tonnage requirement for year 2016.

ALTERNATIVES:

1. Waive the Purchasing Policy requirement to solicit bids for coal and approve the second amendment to the original agreement with Peabody COALSALES, LLC to supply coal for the City of Ames Steam Electric Plant for the period January 1, 2015 through December 31, 2016, with coal to be supplied from Peabody's North Antelope Rochelle Mine located in Campbell County, Wyoming.
2. Reject the amended agreement with Peabody COALSALES, LLC, and direct staff to request proposals from suppliers of coal that would be compatible with the City's power plant boilers and provide reliable compliance with the existing SO₂ air emissions limit.

MANAGER'S RECOMMENDED ACTION:

City staff and Peabody COALSALES, LLC were able to reach an amended agreement for supply of coal that is very favorable for the City because of (1) a reduction in the minimum tonnage obligation of the City for the final two years of the contract, and (2) the City's ability to reduce or suspend deliveries of coal, without penalty, by providing Peabody COALSALES, LLC with 120 days notice.

Therefore, it is the recommendation of the City Manager that the City Council adopt Alternative No. 1, thereby waiving the Purchasing Policy requirement to solicit bids for coal as well as approving the second amendment to the original agreement with Peabody COALSALES, LLC to supply coal for the City's Steam Electric Plant for the period January 1, 2015 through December 31, 2016, with coal from Peabody's North Antelope Rochelle Mine located in Campbell County, Wyoming.