M-S-R PUBLIC POWER AGENCY STRATEGIC PLAN

Effective January 1, 2016

ADOPTED BY COMMISSION
September 23, 2015

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In 1997 the M-S-R PPA Commission directed the annual development of a strategic plan to address the issues faced by the Agency in the ensuing five-year period. The plan is updated and reviewed by the M-S-R PPA Commission in September of each year prior to the development of the annual M-S-R PPA Budget. The issues of Organizational Structure and Philosophy; Managing and Maintaining Assets; Financial Matters; and Joint Action Opportunities presented below characterize M-S-R PPA's strategic vision through 2021.

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I. Introduction

The M-S-R Public Power Agency (M-S-R PPA or Agency) was created on April 29, 1980, through a Joint Exercise of Powers Agreement among Modesto Irrigation District (Modesto), the City of Santa Clara (Santa Clara), and the City of Redding (Redding) – individually "Member" or collectively "Members," for the purposes of acquiring, constructing, operating and maintaining any Project for the purpose of providing electrical energy or other Project benefits for public or private uses. M-S-R PPA's assets include interests in Unit No. 4 of the San Juan Generating Station; the Southwest Transmission Project; and the Pacific Northwest Project, including the Big Horn Wind Energy Projects. Unless otherwise noted the participation in M-S-R PPA Projects is Modesto 50%, Santa Clara 35%, and Redding 15%.

M-S-R PPA's purpose is to maximize the value of its existing assets for the benefit of the Members and to respond to Member needs where joint action rather than individual action is deemed to be in the Member's best interests. M-S-R PPA is also intended to provide more responsive services to its Members than may be possible from larger or state-wide agencies or associations.

II. Organizational Structure and Philosophy

Since its formation, M-S-R PPA has been a member-directed, member-supported organization. M-S-R PPA is governed by a three-member Commission appointed by and representing the governing bodies of Modesto, Santa Clara, and Redding. The General Manager and Commission are advised by the Technical Committee and the Financial Management Committee, each comprised of representatives of the technical and management staff of the Members. The Technical Committee's purview includes engineering, technical, and economic aspects of the Agency's San Juan Project, Southwest Transmission Project, and Big Horn Wind Energy Projects, and potential future power, fuel supply and transmission projects. The Financial Management Committee's purview includes the Agency's bonded debt and investments. Additionally, the Risk Management Committee was established by and administers the Agency's Risk Management Policy and reports to both the General Manager and the Financial Management Committee. A copy of the Agency's current organization chart is attached as Exhibit "A."

Until 1997, management, legal, administrative and operational support were provided by employees of the Member systems. In 1997 M-S-R PPA first retained a contract general manager and a contract general counsel, separating these functions from any individual member system. The term of the agreement for general counsel services is open-ended. Agreements for general manager services run annually through December 31 with provisions for annual extensions. Commission action in 1998 provided for reimbursement of Members for the direct and overhead costs of employees providing services to M-S-R PPA. As required, contracts are made with third parties for legal, financial advisory and technical support.

This philosophy of being member-directed and member-supported was further reinforced in 1999 with the award of a contract to Modesto to provide Coordinator services. This agreement was for a three-year term with three optional one-year extensions and expired April 1, 2005. The M-S-R PPA Commission awarded similarly structured successor contracts to Modesto in 2004 and 2011. In March 2015, the most recent agreement was amended to extend the term of the services through March 2018.

The organization of the Agency and descriptions of its authorities and delegations is documented in a comprehensive Policies and Procedures Manual. Key enabling documents and controls are appended to the manual to provide a one-stop operations and governance resource. The manual was completed in December 2013 and is reviewed on an annual basis in conjunction with the annual review of this strategic plan.

The M-S-R PPA Members have identified a need for centralized access to Agency records and contracts to facilitate Member review and references to key documents. The Agency has established a web presence for public information and posting of notices, including Commission Agendas. The M-S-R PPA website was updated in 2014 and is divided into public and private sections where scanned and indexed electronic copies of key documents can be held in a password-secured section of the website for use by the Members. An archive of commission packages is in the public section of the website to partially satisfy Brown Act requirements.

Recommendations:

1. M-S-R PPA should continue to be member-directed and member-supported.

2. M-S-R PPA should continue to maintain a formal committee structure including the Technical and Financial Management Committees to discuss financial and technical matters in noticed Public and Closed Sessions.

3. M-S-R PPA should continue to contract for the direct provision of general manager and general counsel services and, when needed, provide timely succession plans for the replacement of incumbent candidates.

4. M-S-R PPA should periodically review its reimbursement policy for Member support to ensure its fairness and suitability for each Member.

5. M-S-R PPA should periodically review its needs for consulting and contract support services for adequacy of coverage and reasonableness of costs.

6. M-S-R PPA should periodically appraise its management and administrative processes and policies.

7. With the anticipated divestiture of the San Juan Generating Station by 2018 and Southwest Transmission Project assets in 2016, M-S-R PPA should prepare transition plans for the ongoing support of project committees through divestiture and their post-divestiture successors as needed.

III. Manage and Maintain Assets

San Juan Project:

M-S-R PPA has a 28.8% ownership interest in the 507 MW_{net} San Juan Generating Station (San Juan) Unit 4 operated by the Public Service Company of New Mexico (PNM). M-S-R PPA's rights and obligations for this project are primarily governed by the San Juan Project Participation Agreement (SJPPA) and M-S-R PPA's Bond Indentures.

On July 22, 2015, through Resolution 2015-02, the Agency approved the San Juan Restructuring Agreements whereby the Agency's operating interests in the San Juan Generating Station will be divested and provisions are made for the retention and bounding of certain legacy liabilities pertaining to mine reclamation, plant decommissioning, and environmental remediation. The resolution also contained findings that divestiture of the San Juan Project supports compliance with requirements of California Law including SB 1368 and AB 32, determined that the restructuring agreements were exempt from CEQA review, and accepted an Independent Consultant's Report finding that the sale or disposition of the Agency's 28.8 percent undivided interest in Unit 4 of the San Juan Generating Station effective December 31, 2017 represents the most efficient and economic use of such assets and does not impair the ability of the Agency to comply with the Indenture. These agreements will become effective upon the receipt of final regulatory approvals from the Federal Energy Regulatory Commission (FERC) and the New Mexico Public Regulation Commission (NM-PRC) which are anticipated to occur prior to January 1, 2016.

In conjunction with the proposed restructuring of the San Juan Project, the Agency has entered into a Capacity Option and Funding Agreement with PNM and its parent whereby M-S-R PPA (and the City of Anaheim) are relieved from the responsibility of paying the costs of Capital Improvements at the San Juan Project retroactive to July 1, 2014.

San Juan Project Operations (Regulatory Requirements):

The San Juan Project is subject to the requirements of the Clean Air Act and other environmental rules and regulations. The San Juan Generating Station Owners are parties to a Consent Decree entered May 10, 2005, which settled litigation and required installation of new pollution control equipment on all four (4) units to significantly reduce the total emissions of nitrous oxide (NO_X), particulate, sulfur dioxide (SO_2) and Mercury (Hg) from the plant. The capital cost to install the new pollution control equipment was $334 million. M-S-R PPA's percentage share of the capital cost for the emission systems upgrade equated to about $24.1 million. The portion of the project applicable to Unit 4 was completed in 2007 and is in operation.

In 2001 the United States (US) Environmental Protection Agency (EPA) issued guidelines to implement Best Available Retrofit Technology (BART) under the Regional Have Rule. Through a lengthy process, the EPA has approved a BART determination applicable to San Juan that requires, among other things, the installation of Selective Non-Catalytic Reduction equipment (SNCR) on San Juan Unit 4 or to cease generation of energy by January 31, 2016.

To date, the San Juan Unit 4 Participants have not affirmatively voted to approve any capital projects to implement the installation of SNCR. Most recently, in May 2015, PNM proposed a capital project for installation of SNCR on San Juan Unit 4 at an estimated cost of $70.5 million. As this project has not been approved, PNM exercised its authorities under the SJPPA and determined it was prudent utility practice to proceed with this project. This project is anticipated to be completed during the 50-day maintenance outage scheduled to being on October 3, 2015. As noted above, pursuant to the terms of the Capacity Option and Funding Agreement and the proposed Restructuring Agreements, the Agency has no responsibility for the funding of the SNCR project.

Pursuant to the Clean Air Act, M-S-R PPA has been granted certain (SO_2) emission allowances for the operation of its interest in San Juan. The allowances issued to M-S-R PPA are greater than those currently required for Unit 4 operations. These allowances are transferable and can be sold. In September 2005 the M-S-R PPA Commission adopted a policy for the management and disposal of surplus allowances. Although these allowances have had significant monetary value in the past, the vacature and remand of the Clean Air Interstate Rule (CAIR) in 2008 and a successor “Transport Rule” in 2012 led to a significant devaluation of the market value of allowances. Although the market value of such allowances remains less than $1 per ton, the Agency has retained a significant number of allowances for future sale.

Regulations promulgated by the California Energy Commission (CEC) pursuant to SB1368 prohibit any investments in baseload generation that does not meet an Emissions Performance Standard (EPS) of 1,100 pounds of CO_2 per MWh of electricity, with limited exceptions including but not limited to routine maintenance, requirements of pre-existing contractual commitments, system reliability, or threat of significant financial harm. M-S-R PPA is bound to own, operate, and maintain its share of the San Juan Generating Station in accordance with Prudent Utility Practice, the strictures of the various San Juan Project Agreements, its Bond Covenants, and fiduciary duties to prevent financial harm to its bondholders, M-S-R PPA Member ratepayers, and other San Juan Project Participants. Although the San Juan Generating Station emits about 2,000 pounds of CO_2 per MWh of electricity produced and thus does not meet the EPS, the impact on M-S-R PPA of these regulations has been reasonably mitigated to date by complying with the protocols allowing for routine and regular maintenance. On March 19, 2014 the CEC in Rulemaking (12-OIR-1) concluded that the threshold for reporting capital projects under SB1368 should be set at $2.5 million (or about 0.28% (0.0028) of annual capital expenditures for the San Juan Generating Station). The CEC further required that Publicly Owned Utilities (POUs) provide an annual compliance plan starting January 1, 2016 for each non-EPS compliant facility, including for investments, capital expenditures, contractual changes, sales of interest or other activity. However, these reporting requirements have an exemption for any facilities for which a POU has entered into a binding agreement to divest itself within five years; the exemption to remain for as long as the binding agreement is in place or the divestment has been completed. Given the current status of the Restructuring Agreements, it appears M-S-R PPA has met the requirements for this exemption.

Regulations promulgated by the California Air Resources Board pursuant to AB32 have the effect of proscribing or taxing the imports of electricity to California based on CO_2 emission levels. The M-S-R PPA Members, rather than the Agency itself, have been deemed to be the first jurisdictional deliverers of the San Juan Project and will bear the associated compliance burden. The first scheduled auction of surplus allowances occurred in November 2012 for the effective period beginning January 2013. The price settled at slightly above $10 per ton of CO_2. Subsequent auctions and results have been as shown below:

Date of Auction	2013/4 Clearing Price	2016/7 Clearing Price
February 16, 2013	$13.62	$10.71
May 16, 2013	$14.00	$10.71
August 16, 2013	$12.22	$11.11
November 19, 2013	$11.48	$11.10
February 19, 2014	$11.48	$11.38
May 16, 2014	$11.50	$11.34
August 18, 2014	$11.50	$11.34
November 24, 2014	$12.10	$11.34
February 18, 2015	$12.21	$12.10

The US EPA proposed a Clean Power Plan to cut carbon pollution from power plants. US EPA's proposal differs from state to state in its requirements and a Final Rule was issued August 3, 2015. The Chairman of the California Air Resources Board has previously stated that "California's own experience making significantly deeper carbon cuts than EPA is likely to require demonstrates that new, clean, generation and modernized infrastructure will not only maintain but improve system reliability." Federal legislation has been proposed, but not enacted, which could also regulate the emissions of "Greenhouse Gases" and may or may not preempt state or regional regulation is not considered likely in the near future.

Recommendations

1. M-S-R PPA should continue to operate in compliance with applicable regulations promulgated under the CEC Dockets 06-OIR-1 and 12-OIR-1 (related to SB1368) and take all other reasonable actions necessary to allow M-S-R PPA to continue to own, operate, and maintain its share of San Juan pursuant to Prudent Utility Practice and to protect Members and bondholders from financial risk through the completion of the San Juan Generating Station restructuring and final retirement of all related bonds.

2. M-S-R PPA should finalize all restructuring agreements affecting M-S-R PPA necessary to implement the San Juan Generating Station restructuring and to provide

for orderly termination of all third party agreements related to the ownership and/or operation of the San Juan Generating Station.

3. M-S-R PPA should continue to participate in the discussions of the San Juan Owners regarding the operation and future modifications of pollution control equipment associated with the 2005 Consent Decree and with subsequent legal and regulatory requirements to help ensure timely and cost-effective compliance thereto.

4. M-S-R PPA should continue suspension of its program to liquidate a portion of its Clean Air Act Emission Allowances until market conditions become suitable. The marketing plan for the sale of allowances should be reviewed periodically.

5. M-S-R PPA should ensure the continued reliability and ongoing cost competitiveness of the Project through active participation in all San Juan committees through the completion of the San Juan Generating Station restructuring and subsequently as necessary for the management and minimization of legacy liabilities.

San Juan Project Fuel Supply:

In October 2002, the San Juan Coal Company (SJCC) commenced long-wall mining at the San Juan Underground Mine. This new coal source replaced the increasingly costly operations at the two surface mines that formerly supplied the San Juan Generating Station. The reclamation of the surface mine sites and final reclamation of the underground mine at the cessation of mining are governed by the existing fuel supply agreements. Quantification of these obligations and mitigation of cost impacts remain under discussion with the SJCC including negotiations regarding post-term mine reclamation funding methods, mining cost reductions and risk/reward sharing, and future (post-2017) fuel sourcing. Pursuant to the Restructuring Agreements, M-S-R PPA remains obligated to purchase fuel through December 31, 2017 at a price of $50 per ton with no minimum-take requirements, subject to an agreement to dispatch its share of San Juan Unit 4 at an anuual level no less than 85% of the San Juan Unit 4 Equivelant Availability Factor, retains mine reclamation obliations as provided in the Mine Reclamation and Trust Fund Agreement as it may be amended, but has no ongoing obligation for the cost of procuring future (post-2017) fuel supplies.

The SJPPA provides M-S-R PPA with the right, along with the other San Juan Participants, to approve fuel supply policies and agreements. M-S-R PPA has actively participated in the development of new fuel agreements through its representative on the fuel negotiating team. M-S-R PPA's representative actively participates in the annual fuels budget process, negotiation of updates and addenda to the fuel supply agreements, and the oversight of PNM's administration of those agreements. Although M-S-R PPA will have a fixed fuel price under the Restructuring Agreements, it will remain directly affected by the allocation and the absolute value of reclamation cost both prior to and subsequent to December 31, 2017. PNM filed an agreement with Westmoreland Coal Company on May 1, 2015 with the

NMPRC. This agreement has Westmoreland taking over the San Juan Coal Mine from BHP Billiton in January 2016 and extending a contract to 2022. The new contract is expected to reduce fuel costs for the owners who remain in the San Juan Generating Station Project.

Recommendations

1. M-S-R PPA should continue to actively participate in the San Juan Fuels Committee and fuels management processes to encourage further economies and efficiencies in fuel supply to the San Juan Generating Station and the continued fair and equitable allocation of costs under future agreements including but not limited to fuel supply, miner retention, and/or mine reclamation agreements.

2. M-S-R PPA should support the finalization of the new fuel contract with Westmoreland Coal Company and the Operating Agent to ensure that fuel supplies and related mine services including mine reclamation and ash disposal continue on an orderly and cost-effective manner throughout the remainder of M-S-R PPA's ownership interest in Unit 4.

Pacific Northwest Project:

The Pacific Northwest Project initially consisted of contracts with the Bonneville Power Administration (BPA) for the delivery of power to the California-Oregon Border (COB) and thence to the M-S-R PPA Members through the California-Oregon Transmission Project (COTP.) The final agreement with BPA terminated on September 30, 2005. Subsequently, M-S-R PPA examined new renewable resources in the Pacific Northwest to satisfy three objectives: the development of substitute Pacific Northwest resources to replace deliveries from BPA contracts; the acquisition of eligible green power resources with associated environmental attributes to meet Renewable Portfolio Standard requirements of the Members; and the acquisition of power at prices reasonably competitive with the power market.

Big Horn Wind Energy Project:

On June 1, 2005, M-S-R PPA entered into a series of agreements (as amended in October 2005 and restated effective February 1, 2006) with PPM Energy, Inc. – now known as Iberdrola Renewables, LLC (Iberdrola) – to purchase wind power energy at a negotiated price, with a nominal installed capacity of approximately 199.5 MW and an expected annual capacity factor of about 35%, as firmed, shaped, and delivered to COB for a 20-year period. Power deliveries commenced on October 1, 2006 and will continue through September 30, 2026. Through an amendment of the original agreements effective December 1, 2008, M-S-R PPA has the right to continue to take the same output through September 30, 2031, or if the Big Horn Wind Energy Project is repowered, M-S-R PPA will have a right of first offer to negotiate a long-term power purchase for such repowered project. In consideration of these amendments, M-S-R PPA has assumed certain cost shares regarding the implementation of Wind Energy Integration Fees by BPA. On December 2, 2009, M-S-R PPA entered into a further series of agreements with Iberdrola to purchase wind power energy from the 50 MW

Big Horn II Wind Energy Project for a 25-year term from November 1, 2010 through October 31, 2035.

An Executive Order issued by Governor Arnold Schwarzenegger September 15, 2009, required M-S-R PPA and its Members to achieve specific Renewable Portfolio Standard (RPS) requirements culminating in a 33% obligation in 2020. These requirements were subsequently codified in legislation through the passage of SB1X 2 in April 2011. The requirements of SB 350 proposed in the current legislative session would modify the RPS to a 50% obligation in 2030. Current RPS law requires renewable energy projects to be "certified" as eligible renewable by the CEC. In addition, the CEC requires renewable projects to be tracked through the Western Renewable Energy Generation Information System (WREGIS). Both the Big Horn Wind Project and Big Horn II Wind Energy Project have been certified as eligible by the CEC. Iberdrola/Big Horn LLC has also registered the Projects with WREGIS as generators and BPA has registered as the qualified reporting entity for the Projects. In 2009, M-S-R PPA adopted procedures for the verification, accounting, and distribution of WREGIS RECs for these and future projects.

The Big Horn Projects were significant elements in each Member's 2014 renewable energy portfolio as tabulated below:

Member	Big Horn I Participation	Big Horn II Participation	Wind Energy (GWh)	Fraction of 33% RPS[2]
Modesto	12.5%	65%	**147**	**18%**
Santa Clara	52.5%	35%	**316**	**31%**
Redding	35.0%	-	**162**	**60%**

2 Based on Member calendar year 2014 estimates of recorded system load.

As discussed below, operating criteria and rules promulgated by FERC, Balancing Authorities, and regional planning and reliability entities may significantly affect the operation and dispatch of wind energy projects. Collectively these proposals reflect BPA's escalating difficulties in integrating 5,000 MW of variable wind energy production within its Balancing Area.

BPA Proceedings

To manage the integration of wind energy resources BPA has maintained systems including Dispatcher Standing Order-216 (DSO-216) and a subsequent Record of Decision (ROD) in 2011 regarding Environmental Redispatch. The Environmental Redispatch ROD was applied to impose significant curtailments in summer 2011. Pacific Northwest parties were displeased with this methodology and filed complaints with the Federal Energy Regulatory Commission (FERC). BPA then filed an Oversupply Management Protocol (OMP) with FERC and unilaterally applied it during the 2012 runoff season resulting in similar curtailments. Subsequently, the FERC accepted the oversupply protocol as an interim remedy conditioned upon Bonneville's filing of a proposed methodology for allocating displacement costs "in a manner that results in comparability in the provision of transmission service for all resources."

BPA issued its Final ROD in rate case BP-16 on July 23, 2015, in which it continues to allocate of oversupply costs to generators within the BPA Balancing Area Authority (BAA) in proportion to their transmission schedules compared to total schedules during the oversupply period. BPA is expected to begin efforts on BP-18 during the following fiscal year. M-S-R PPA will continue to participate in the workshops and filings related to this rate case to ensure costs are not allocated in a discriminatory manner for transmission. A Priorities Matrix and Action Plan has been prepared by Counsel and is used to manage the efforts of Staff, Counsel and Consultants in BPA Rate Cases.

FERC Proceedings

At the Western Electricity Coordinating Council (WECC) there are a number of initiatives underway related to energy markets, renewable generation, and rules for the use of the supporting transmission system. Of particular interest are ongoing activities regarding the market-based energy imbalance market (EIM). This EIM may affect curtailments, deliveries and transmission and ancillary services costs.

On June 19, 2014, FERC issued two orders its EIM proceedings, paving the way for the expansion of an organized market structure in the West. FERC conditionally accepted the CAISO's proposal to establish an EIM by extending its existing real-time market into other BAAs. This EIM began on October 1, 2014 with the expectation that it would coordinate transmission usage with EIM participants' Transmission Service Providers (i.e., BPA) while providing measureable reliability and economic benefits. NV Energy is expected to join the EIM on November 1, 2015, with Arizona Public Service and Puget Sound Energy following. The CAISO will provide energy imbalance services to Puget Sound, including transmission customers taking transmission service under Puget Sound's Open Access Transmission Tariff (OATT), thus expanding the EIM even further into the Northwest.

Members are continuing to follow these developing requirements and any impact that they might have on the Big Horn Energy Project.

Recommendations

1. M-S-R PPA should continue to administer the Big Horn I and II Wind Energy Project agreements to reduce costs and fees and maintain use of the Projects' environmental attributes in satisfying the Members' RPS or other requirements

2. M-S-R PPA should continue to track and allocate renewable energy production and associated WREGIS Renewable Energy Credits (RECs) from the Big Horn I and II Wind Energy Projects for the benefit of the Members and take all necessary steps to ensure that such generation and credits remain eligible to meet all applicable California renewable energy production requirements.

3. M-S-R PPA should continue to follow and to actively participate (when directed by the M-S-R Commission) in BPA's Wind Integration Charge or Variable Energy Resource Balancing Service (VERBS) processes, BPA rate proceedings, and FERC and judicial hearings. Reports to Members and solicitation of direction regarding filings, positions, and meeting representation shall be timely and proactive. Periodic conference calls among Member staff will continue to solicit Member input and discuss the implications and appropriate responses to these emerging threats. Priorities have been identified as follows and will be periodically ranked in a Priorities Matrix and Action Plan:

   a. M-S-R PPA will continue to work to minimize inappropriate cost shifts between BPA business units,

   b. M-S-R PPA will advocate for cost causation principles with emphasis on VERBS customers paying only for services they actually receive,

   c. M-S-R PPA will work with BPA on the development of operating protocols that support VERBS customers,

   d. M-S-R PPA will support BPA initiatives to maintain the reliability of the transmission and hydro generation system, and

   e. M-S-R PPA will support proposed BPA investments required to comply with reliability requirements and improve the Federal Columbia River Power System's Information Technology and communication capabilities.

4. M-S-R PPA should actively monitor Iberdrola Renewables' obligations and performance under the current agreements with respect to changing rules and regulations. Additionally, M-S-R PPA should monitor Iberdrola's financial structure and capitalization.

5. M-S-R PPA should track and actively comment upon proposed legislation and regulations as they may affect uses and benefits of M-S-R PPA wind contracts to meet California RPS requirements.

<u>Southwest Transmission Project</u>

M-S-R PPA owns participation shares of the Mead-Phoenix and Mead-Adelanto 500-kV transmission projects. In addition, it has other transmission rights with parties including Tucson Electric Power Company (TEP), Los Angeles Department of Water and Power (LADWP), and, until recently, Southern California Edison (SCE) which complete a transmission path from the San Juan Switchyard to Northern California. Collectively, all these elements are referred to as the Southwest Transmission Project (SWTP). As defined in Bond Indentures, the primary purpose of the SWTP was to provide the means for San Juan Project power to be efficiently and economically delivered to the Members, and M-S-R PPA is required to maintain sufficient transmission capability to effect such deliveries. The first and primary duty of M-S-R is to its Bond Holders.

The planned exit of M-S-R PPA from the San Juan Generating Station effective December 31, 2017 and structural changes in transmission markets called into question the need for the Agency to retain the SWTP in whole or in part. The Agency and its Members reviewed the efficacy of maintining the SCE Transmission Service Agreement in lieu of using alternate delivery means and commissioned a review of the highest and best use of the balance of the SWTP (also referred to as the Mead Interests.) Supported by independent reviews, the Agency and its Members concluded that terminations of the SCE ETC and sales of the Mead Interests would provide the greatest value to M-S-R PPA and its Members.

Following a competitive request for proposals conducted in 2014, M-S-R PPA entered into negotiations with LADWP, who proposed to acquire the Mead Interests through the Southern California Public Power Authority (SCPPA). A proposed Purchase and Sale Agreement with SCPPA has been completed. This tranaction is expected to close late in the first quarter of 2016.

Section 8.03 (a)(3) of the Indenture Of Trust Between M-S-R PPA And First Trust Of California, National Association, as Trustee Relating to M-S-R Public Power Agency San Juan Project Subordinate Lien Revenue Bonds Dated as of June 1, 1994 provides that prior to the sale or other disposition of the San Juan Project or any part thereof, the Agency shall file with the Trustee a Consultant's Report stating that the sale or other disposition of such portion of the Improvements will not impair the ability of the Agency to comply with the Indenture. The Indenture and related documents are also referred to as Bond Covenants. Such a report was prepared by Independent Consultant KBT, LLC which concluded it would be in accordance with sound utility practice to pursue a divestiture of the Mead Interests and that such divestiture would not impair the ability of the Agency to comply with Bond Covenants nor would it hinder M-S-R PPA’s ability to make debt service payments as prescribed in its financing documents.

As described above, in addition to pursuing sale or long-term layoff of the SWTP, M-S-R PPA was also advised to consider terminating the SCE ETC because it was no longer needed to deliver the San Juan Project energy to the Members since firm transmission service is available from the CAISO to economically and efficiently deliver such energy if and when necessary. The Agency was also advised it would be cost-effective to substitute delivery of San Juan Generating Station capacity and energy through the CAISO during an interim period between sale of the SWTP and the divestiture of the Agency’s interests in the San Juan Generating Station.

Consequently, the SCE ETC for service between Victorville-Lugo Midpoint and Midway was terminated by the Agency in accordance with three progressive requests from the Members. The capacity associated with Santa Clara (52 MW) was terminated effective January 1, 2014. The capacity associated with Redding (23 MW) was terminated effective January 1, 2015. The remaining capacity associated with Modesto (75 MW) was terminated effective June 1, 2015. Each of these terminations was supported by an Independent

Consultants' report prepared by Flynn RCI, Navigant Consulting, Inc. and Flynn RCI, respectively, who all concluded it was more efficient and economical to use alternate means to transmit San Juan Project energy than to retain the Members' respective rights to the SCE.

Other Transmission Issues

As a result of the Energy Policy Act of 2005, FERC has certified NERC as the Electric Reliability Organization to enforce compliance with reliability standards. M-S-R PPA registered as a "Purchasing-Selling Entity" (PSE) on February 20, 2007, and subsequently provided the M-S-R PPA Coordinator with instructions pertaining to applicable Reliability Standards including requirements, necessary actions, responsibility, and documentation. On June 2, 2014, NERC issued its Risk-Based Registration (RBR) Draft Design Framework and Implementation Plan, which proposed several significant revisions to NERC's compliance registration program. The draft included, among other things, a proposal to remove the PSE function as "commercial in nature." FERC accepted this proposal on March 19, 2015 and M-S-R PPA has been removed from the NERC Compliance Registry and is no longer required to demonstrate compliance with the Reliability Standards currently applicable to PSEs. M-S-R PPA previously determined that it was not required to register as either a "Generation Owner" or "Transmission Owner" based on the contractual obligations of the Project Managers for the San Juan and Southwest Transmission Projects.

The following table enumerates M-S-R PPA's existing transmission:

Southwest Transmission Project Elements	Existing M-S-R PPA Capability	San Juan Reservation	Available for Other Purposes
San Juan/FC Bus	146	146	0
Mead-Perkins	222	150	72
Mead-Marketplace	210	150	60
Mead-Adelanto	228	150	78
LADWP Service (Adelanto to V-L Mid-Point)	228	150	78

Recommendations

1. M-S-R PPA should complete its sale of the Mead Interests in a manner which is in accordance with sound utility practice and will neither impair the ability of M-S-R PPA to comply with Bond Covenants nor hinder M-S-R PPA's ability to make debt service payments as prescribed in its financing documents.

2. M-S-R PPA should continue to evaluate CAISO and RTO issues relevant to M-S-R PPA as they arise. Where possible, M-S-R PPA should rely on TANC and the individual Members for analytic and regulatory support. M-S-R PPA should

continue to make supportive filings with FERC only when there is a commonality of interest among the Members. Particular caution should be taken to avoid duplication of effort by TANC and M-S-R PPA and to assure an equitable allocation of costs to the Members by both agencies.

3. M-S-R PPA should continue to review and act upon FERC transmission rate filings affecting costs of delivery of M-S-R PPA resources to the Members only to the extent necessary to minimize financial and operational risks. Such efforts will be coordinated with the Members, BANC, and TANC to minimize costs and avoid duplication of efforts.

4. M-S-R PPA will review and take any further necessary actions to comply with NERC and WECC reliability and reporting requirements for Electric Reliability Organizations.

4. Financial Matters

M-S-R PPA will have approximately $207 million of outstanding debt on the various bond issues sold to finance the San Juan Unit 4 facilities and $9 million for the SWTP as of July 1, 2016. M-S-R PPA also holds about $83 million in operating funds and restricted and un-restricted reserves as reported in the June 30, 2015, Treasurer's Report. M-S-R PPA maintains a minimum of 60-days operating cash, including reserved funds, and accrues other reserves as required by Bond Indentures, to fund contingent liabilities, and to manage Member cash call requirements.

The Financial Management Committee monitors the financial markets and advises the General Manager regarding the issuance and management of the Agency's debt. The activities of the Financial Management Committee are supported by an independent Financial Advisor, currently the firm of Montague, DeRose and Associates, LLC.

Recommendations

1. M-S-R PPA should continue its efforts to use new financial products and market opportunities to lower the effective annual debt service on the San Juan Project and the SWTP.

2. M-S-R PPA's debt structure should be periodically reviewed to maximize the benefits to M-S-R PPA and its members.

3. M-S-R PPA should periodically evaluate and recommend debt-limit guidelines for use in the strategic evaluation and prioritization of future projects, including consideration of the use of prepay transactions.

5. Joint Action Opportunities

Background

Although each of the Members has developed its own power supply strategy through a combination of owned and purchased resources and has developed the infrastructure and a level of sophistication to perform their needed functions, the agency may remain a viable vehicle should future joint opportunities arise. Activities examined by M-S-R PPA Members have included joint natural gas operations and wind-energy storage and shaping projects. Opportunities for greater utilization or improvement of existing resources may occur from time to time. M-S-R PPA has been instructed in the past by its Members to prefer individual pursuit of new projects rather than joint M-S-R PPA efforts. As San Juan Generating Station and the SWTP are restructured and divested, M-S-R PPA should develop a plan for its ongoing and future overall structure. For example, should M-S-R PPA become focused solely on the Big Horn projects or are there other potential projects that would be best served by joint action? Are there synergies of needed generation between the Members that will continue to provide an impetus for further joint action? At similar junctures in the past neither the Big Horn Projects nor the Natural Gas Project implemented through M-S-R EA were envisioned prior to their development. However, if no future projects are contemplated and the need for the Agency is limited, it may be appropriate to consider assigning its functions to the Members and dissolving the Agency. Such a dissolution may not be permissible under the Tucson/San Juan Project Power Sales Agreement until all legacy liabilities pertaining to the San Juan Project, including but not limited to mine reclamation, plant decommissioning and environmental remediation, are satisfied and the term of related agreements concluded.

Recommendations

1. Upon the specific request of the Members, M-S-R PPA should continue to collect information on resource opportunities as they present themselves to M-S-R PPA. M-S-R PPA will retain this information and make it available to the Members upon request:
   a. Specific power supply alternatives (renewable or non-renewable resources);
   b. Distribution or assignment of assets to Members,
   c. Other risk reduction/mitigation measures; or
   d. Other supply/reliability enhancements.

2. M-S-R PPA should begin discussions and planning for the long-term path and level of involvement in the agency, once the restructuring and divestitures of the San Juan Generating Station and the SWTP are complete.

Renewable Portfolio Standard Risk/Opportunity

California has established RPS (Renewable Portfolio Standard) requirements for utilities pursuant to legislative and executive branch requirements. Proposed Federal and regional requirements are also expected to require substantial use of additional renewable energy resources. Other Western states have adopted rigorous RPS requirements. Pursuant to current California law, the M-S-R PPA Members adopted their own Renewable Portfolio Standards and have adopted additional policies and procedures to meet the 33% by 2020 state-mandated RPS. The CEC has implemented its reporting process for publicly owned utilities to verify that they are meeting interim targets toward the 33% state-mandated goal. A 50% mandated goal may be passed by the legislature this year. The CEC most recently released 15-Day Language including revisions to the RPS Regulation. M-S-R PPA and its Member entities are actively involved in monitoring and commenting on related CEC processes.

Recommendations

1. M-S-R PPA shall actively participate in State and Federal legislative forums to ensure that existing M-S-R PPA resources, both in-state and out-of-state, remain eligible for all RPS credits and purposes.

2. M-S-R PPA should continue to protect and enhance the viability and value of its existing renewable energy projects.

Non-Renewable Resource Projects

From time to time M-S-R PPA is presented with the opportunity to participate in additional non-renewable resource projects. Although such projects are not a priority for the Members, the Members may from time to time request that M-S-R PPA examine such projects.

Recommendations

1. M-S-R PPA should only respond to unanimous Members requests, if any.

6. Strategic Risks And Exposures

M-S-R PPA has developed a strong portfolio of generation and transmission assets. In the aggregate these assets have provided many years of cost effective energy supply to M-S-R PPA and its Members. However, there are inherent risks which could have potential adverse impacts to M-S-R PPA and its Members.

There are three broad categories of risk: Operational, Contractual, and Institutional. Individually and collectively they can affect the useful life and cost-effectiveness of M-S-R PPA's three primary assets: the San Juan Project, the Southwest Transmission Project, and the Big Horn Wind Energy Project.

Recommendations

1. M-S-R PPA shall regularly review risks to M-S-R PPA and its Members with respect to their participation in M-S-R PPA and develop mitigation plans as appropriate.

Legislative and Regulatory Management

M-S-R PPA has actively participated in the past six legislative sessions in the monitoring and amendment of renewable resources legislation and other bills affecting the operation of M-S-R PPA and Member resources. Legislative advocates were retained and an informal structure for obtaining Member positions has evolved. M-S-R PPA has also participated as a non-voting member of the CMUA Legislative and Regulatory Committee and CMUA Energy Policy Committee.

Recommendations

1. M-S-R PPA will take positions on only those bills and regulatory matters directly affecting M-S-R PPA Resources or M-S-R PPA's duties to its Members. M-S-R PPA may also, by request of the Members, take positions on bills of common interest to the entire M-S-R PPA membership.

2. The M-S-R PPA General Manager will regularly consult with the Members to coordinate Agency and Member positions on bills and regulatory matters.

3. M-S-R PPA will retain legislative and regulatory advocates as needed to support its positions on proposed bills and regulations and will coordinate with Members and like-positioned entities and trade associations to promote M-S-R PPA's interests.

Exhibit “A”
M-S-R Public Power Agency Organization Chart