Contrary to industry best practices, the City of Victorville, and by extension the SCLAA, have initiated large high-risk capital projects without conducting proper due diligence or ensuring proper controls. Rather than conducting a competitive process for awarding major development contracts, City management has executed contracts to companies and individuals with previous experience or familiarity with the City. Rather than conducting transparent risk assessments and establishing clear project plans, City management has failed to fully assess potential risks and has not established project plans with clearly stated goals, budgets, milestones, or performance measures. Instead of establishing clear and effective controls, policies, and procedures, City management has allowed contractors to operate without close oversight and has not consistently enforced contract terms.

The absence of fully assessed risks, established project plans, and instituted controls has contributed to substantial failures of at least two power generation projects that required considerable financial investment. These two projects, which have ultimately resulted in substantial financial losses for the City and for SCLAA, are the Victorville Power Plant #2 Project and the Foxborough Power Plant Project.

Victorville 2 Project Poorly Planned and Managed

In September 2005, the City initiated a project to develop a 500 megawatt power plant, known as Victorville 2. The Victorville 2 project was never completed and ultimately cost the Southern California Logistics Airport over $50 million in losses with over $76 million invested to date. City management did not conduct proper due diligence before initiating the project or entering into an onerous and open-ended agreement with Inland Energy Inc., an outside contractor. Further, City management did not enforce all contract terms and did not formally manage the use of an open-ended provision in the agreement.

Project Initiated Based on Inland Energy Evaluation and Recommendations

On October 10, 2003 the cities of Victorville and San Marcos became the founding members of the California Clean Energy Resources Authority (Cal-CLERA), a Joint Powers Agency (JPA). The idea behind founding this JPA was the concept that cities in California needed to develop new, publicly owned and privately operated power generating facilities in order to protect their residents from pricing abuses and power shortages that had occurred during the State's energy crisis in 2000 and 2001.

Cal-CLERA had aggressively pursued other jurisdictions to become member cities in order to fund the development of up to four new power plants. After a 16 month campaign, Cal-CLERA was unsuccessful in recruiting any additional member cities due to their unwillingness to make financial commitments. However, based on acknowledgments from officials of cities contacted by Cal-CLERA that new generation was needed, Victorville officials decided to have Inland Energy conduct an evaluation of developing a 500 megawatt electric generating facility at the Southern California Logistics Airport.

In its March 2005 evaluation, Inland Energy concluded that the City should "commit to undertaking the development of a 500 megawatt hybrid plant at Southern California Logistics Airport without delay." This recommendation was based on (1) predictions by energy experts of a looming electric generating shortfall; (2) the City's "unique blend of positive political, economic, and infrastructure factors that favor the development of such a plant;" and, (3) the fact that the Cal-CLERA effort had "stalled." Inland Energy's evaluation downplayed the financial risk to the City stating that,

> The City's economic risk is mitigated by the fact that such a fully permitted plant at the SCLA site could likely be sold or transferred in 2007-2010 for far more than it cost, if the City elected not to proceed with the plant's construction.

The Inland Energy Evaluation also noted that the City could initiate the project without a definitive plan stating:

> This approach appears to be the best way for the City to control its own energy destiny- a number of options will be available to the City in 2007 when the permits are in place but all of them would allow the City to secure reliable electricity for the needs of its constituents at a competitive price, regardless of the state of crisis that the rest of Southern California's energy market may find itself in.

Lack of Due Diligence on Victorville 2 Project

City management did not conduct proper due diligence before initiating the Victorville 2 project. Specifically, management did not conduct a thorough independent analysis of risks prior to recommending that the Council approve the development agreement with Inland Energy and, notably, a subsequent agreement to purchase expensive turbine equipment from General Electric. Such analyses could have highlighted the significant financial, construction, and operational risks that the City and SCLAA were taking on with both contracts.

Neither City management nor Inland Energy established a formal business plan for the project and never established a project budget. Without such planning, the City and SCLAA proceeded without clearly defined goals, milestones, or performance measures. For instance, throughout the project and even after the City had committed over $182 million to General Electric for fuel generation equipment and related services, it was still unclear whether the City would own the plant or if it would be sold to a third party operator.

No Risk Assessment

City management did not prepare an independent risk assessment and there is no evidence that potential risks were formally discussed by the City Council. The staff report prepared for the City Council for the approval of the Inland Energy agreement contains a brief (three paragraph) narrative. The staff report contains no detailed discussion or analysis of the project or agreement, including the terms, compensation, potential fiscal impacts, or policy considerations.

No Formal Business Plan

Although no formal business or project plan was established, it is apparent from interviews with City officials and from a review of the Inland Energy agreement that the initial goal of the project was to make the necessary preparations so that the project could be "build ready." Essentially, the goal was to design the plant, obtain the requisite permits, and procure land so that another firm could construct and operate it. According to the Inland agreement, the process to fully permit the plant would take approximately 24 months to complete. A developer, such as an energy firm, could then theoretically purchase the development rights, build the plant, and either operate it or allow another firm or the City, through Victorville Municipal Utility Services, to operate it.

As the project evolved from the initial goal of preparing the plant for a "build ready" status, there was no formal reevaluation by City management or by Inland Energy regarding the potential changes to risks and costs.

No Formal Budget Established

City management and the City Council never formally established a budget for the Victorville 2 project. The closest approximation of a project budget can be found in the Inland Energy contract, which is discussed in detail below. However, this budget, which estimates $5.5 million in costs over a two year period, was simply for the "permitting" of the power plant and did not include the cost of land purchases; potential borrowing costs, such as bond issuances; and, staff time. Further, as the project evolved and grew from the initial goal of obtaining permits to constructing the power plant, there was no attempt to reevaluate or establish cost estimates.

Contract with Inland Energy Poorly Constructed and Implemented

Project and Contract Based on High Desert Power Plant Project

The City entered into the no-bid contract with Inland Energy based on a proposal from the company. City management and City Council members appear to have entered into the agreement with Inland Energy based on the company's experience in helping to develop the High Desert Power Plant,[1] which was widely seen as a lucrative success for the private interests involved. While the City did not commit public funds to construct the High Desert Power Plant, officials assumed that the City would see similar benefits by either: (1) selling the development rights (and retaining rights to a certain portion of the power generated) or (2) retaining ownership of the plant and, through private operation of the plant, selling electricity via power purchase agreements. There is no evidence that City management or City Council members formally evaluated or discussed the risks involved in using public funds to develop a large power plant.

[1] The High Desert Power Plant is an 840 megawatt plant that went online in 2003 at the Southern California Logistics Airport. The plant, which is privately owned and operated, generates power for the state grid by selling electricity through power purchase agreements. While the plant does not generate power for the airport or the City, it does provide tax increment revenue to SCLAA.

The development agreement with Inland Energy was based on a previous agreement between Inland Energy and Constellation Energy for development of the High Desert Power Plant. The agreement was written by attorneys representing Inland Energy using the High Desert Power Plant contract as a template. Although the City Attorney reviewed and provided comments on a draft contract, it does not appear that the City Attorney or other City managers actively negotiated the terms of the agreement to be substantively more beneficial to the City than the template contract it was based on. In fact, the agreement that the City entered into appears to be significantly *more* generous to the developer than the template agreement.

Inadequate Review of Contract Terms

City management did not conduct adequate research, in 2005, to determine if the agreement was consistent with other municipal power plant development agreements and in the best interests of SCLAA. When asked for briefing materials that went to City councilmembers prior to the adoption of the agreement, the City Attorney provided two memorandum that were issued in late August and early September 2005. As discussed later in this section, these two memoranda, which review Inland Energy's right to five percent (5%) of project operating profits in perpetuity, are vague and provide cursory analyses, given the financial risk that the City undertook. Further, one of these memoranda was provided as a response to a request from Inland Energy executives while the second memorandum is dated two days *after* the contract was executed.

Agreement Vaguely Defines and Poorly Controls Provision of Services

The agreement with Inland Energy allows for the company to be compensated for two types of services: (1) "development services" and (2) "supplemental services." While development services relates directly to the development of the power plant, supplemental services may include unrelated tasks.

Development Services

The agreement defines "development services" as including:

> negotiating any agreements necessary to implement the Project, and securing those permits and approvals required to entitle the Project for development, including any task having the purpose of improving or enhancing the value of such entitlements.

These services were the core of Inland Energy's role in the Victorville 2 project and included the permitting of the plant. These services were eventually expanded to include assistance with the construction of the plant. Inland Energy was paid approximately $12.2 million from 2005 to 2010 for development services related to the Victorville 2 project.

Supplemental Services

The agreement broadly defines "supplemental services" as including:

> any on-going technical or management task deemed necessary by the City Manager of Victorville including supervisory, administrative, consulting, advisement and other management services.

While these services, to an extent, may have been related to the Victorville 2 project, the supplemental services clause has been used to justify services completely unrelated to the project. Specifically, the City has paid over $607,000 to Inland Energy through May 2010 under this clause for other, consistently unsuccessful, projects. These expenditures have included:

- Over $166,000 for consulting services related to the City's unsuccessful efforts to obtain federal grant funding under the U.S. Department of Homeland Security's Immigrant Investor Program, also known as "EB-5;"

- Over $182,000 for consulting services related to the City's unsuccessful attempt to develop and construct a power plant at the Foxborough Industrial Park in the Bear Valley Redevelopment Project Area.

Additionally, Inland Energy was paid over $258,000 for consulting services related to the City's efforts to investigate the possibility of becoming a community choice aggregator.[2] While this service was related to the Victorville 2 project, it ultimately provided no tangible benefits to the project, the City, or SCLAA.

The supplemental services clause provides broad authority to the City Manager to procure additional services for "any on-going technical or management task" from Inland Energy without prior approval from the City Council. In fact, there is no evidence that the City Council formally approved the no-bid procurement of supplemental services from Inland Energy.

City Manager Curtailed Relationship with Inland Energy in 2009, but Firm Continues to Bill

In March 2009 the former City Manager formally notified Inland Energy that the City would no longer be procuring services outside of the Victorville 2 project beyond April 1, 2009. Subsequently, in July 2009, the successor City Manager informed Inland Energy that the City would no longer pay invoices for any work. However, under an informal and undocumented agreement with the City, Inland Energy may continue to provide services "at-risk," meaning that the company may continue to bill, but compensation is unlikely to occur until the City is able to sell development rights for the project to a third party. Inland Energy has continued to invoice the City for services provided on the Victorville 2 project under this informal agreement..

[2] Community Choice Aggregation, under State law, permits cities and counties to offer procurement service to electric customers within their boundaries. Community Choice Aggregation is the process cities and/or counties must go through to establish publicly owned electric utility services.

Inland Energy Invoices Poorly Documented

In May 2009, about four years after the commencement of the Victorville 2 project, the former City Manager formally notified Inland Energy that the firm's invoices to the City were not sufficiently documented. Specifically, the former City Manager noted that all of the invoices submitted by Inland Energy and 11 sub-consultants lacked "significant supporting documentation that report tangible details of services rendered." The former City Manager requested stronger documentation from Inland Energy and its subcontractors and gave a list specifying details that would have to be included in separate written reports on all future invoices.

In June 2009 the former City Manager sent another letter to Inland Energy reiterating the documentation required for payment of future invoices from Inland Energy. In the June 2009 letter, the City Manager indicated that Inland Energy failed to comply with these documentation requirements. The current City Manager has indicated that invoices submitted by Inland Energy under the informal "at risk" agreement since July 2009 have been just as poorly documented as the previous invoices.

Inland Energy Compensated for Victorville 2 Project Services Prior to Contract Execution

The City began compensating Inland Energy for work on the Victorville 2 project prior to the execution of the development agreement. Although the development agreement was executed on September 7, 2005, the City disbursed approximately $123,000 for "consultant services" related to the Victorville 2 project on June 29, 2005 and approximately $33,000 for services provided in July 2005 on the date that the contract was executed.

Compensation Structure is Generous, Broadly Defined, and Has Lasting Financial Implications

The compensation structure, as established in the development agreement is generous, broadly defined, and has lasting financial implications for the project and for SCLAA. The compensation structure of the development agreement with Inland Energy provides for two methods of compensation to the contractor: (1) a monthly management fee, and (2) a portion of "Project Operating Profit." While the monthly management fee reflects a common method for compensating purveyors of professional services, the fee appears to cover most of the costs that the company would incur and there is no cap to the amount that can be billed. The Project Operating Profit clause appears to be an unusual form of compensation and potentially troublesome for the effective sale and operation of the plant. A detailed description of these two types of compensation is provided below.

Monthly Management Fee

The monthly management fee, as defined in the development agreement, consists of:

1. The monthly costs of services based on hourly rates. The rates, as defined in the agreement were $150 per hour for "Consultant" staff and $250 per hour for "Senior Consultant" staff. The contract notes that the City would not be billed for the services of Mr. Buck Johns, the President of Inland Energy.

2. Reimbursement costs for "reasonable and necessary travel" (excluding travel to or from meetings in Victorville with City officials and staff).

3. Reimbursement for other "out-of-pocket" expenses incurred by Inland Energy in performing the services, including subcontracted services. Although the contract excludes legal services from reimbursement, a preliminary budget provided by Inland Energy estimates that $725,000 will be needed for legal services.

4. A 10% premium on all reimbursable costs. This fee is presumably to compensate Inland Energy for time spent on (1) administrative matters, including negotiating and administering contracts of subcontractors; (2) billing or reviewing the invoices of subcontractors; and, (3) administering accountancy requirements associated with subcontractor matters.[3]

Project Operating Profit

In addition to the conventional compensation structure established by the monthly management fee clause, the development agreement contains an "Additional Compensation" clause that provides Inland Energy with the "right to receive five percent (5%) of 'Project Operating Profit.'" The contract states that Inland Energy is entitled to this portion of the profit from the plant in "recognition of the unique value of the experience and expertise which Inland [Energy] commits to the performance of [development] services."

The additional compensation clause in the development agreement provides a much larger and more sustained form of compensation to Inland Energy than the monthly management fee and yet is only loosely tied to the consultant services provided by the company. In fact, the company's 2008 projections for the operational expenses of the 500 megawatt plant, includes this compensation, which was estimated to be $4.5 million per year by Grand Jury sources. Further, the development agreement contains no clauses to limit this compensation to a defined period of time (e.g. two years) or a capped amount (e.g. $10 million). Assuming that the plant was built and then operated for 30 years, Inland Energy would be entitled to compensation of approximately $135 million over the life of the plant (without adjusting for inflation). Under this scenario, Inland Energy would be compensated with an *additional* $135 million over 30 years for what was estimated in the agreement as 24 months of design, development, and permitting work.

Little Precedent to Support Project Operating Profit Clause

There is little precedent to support the five percent (5%) of Project Operating Profit included in the development agreement. No other City or SCLAA contract includes such a clause. Further, at the time the contract was considered, City officials knew of no other similar public contract that provided five percent of operating profit for development and permitting work.

[3] We have assumed that the 10 percent fee would cover these administrative costs, since the contract specifically states that the 10% fee may be charged provided that the labor covered by the hourly fees does not include administrative tasks.

Although City management has asserted that previous management based the profit clause on a 1999 agreement between Inland Energy and other private entities for the High Desert Power Plant Project, there is little evidence to support the relevance of this "template" agreement as a basis or justification for the fee. Under the "template" agreement, Inland Energy was providing similar services to two commercial entities[4] that it had previously been sharing membership interest with in the High Desert Power Project. Conversely, Inland Energy never had an ownership interest in Victorville 2; it was simply providing development services to the City. Further, under the "template" agreement Inland Energy's only form of compensation for such services was this percentage of operating profits and it was only 2.5 percent or *half* of what is provided for in the development agreement with the City. Conversely, the City agreed to pay Inland Energy a management fee based on hourly billings *and* five percent of operating profit for the life of the plant.

City Did Not Perform Sufficient Due Diligence of Project Operating Clause Prior to Adoption of Agreement with Inland Energy

As previously mentioned, the City did not conduct adequate research and due diligence in 2005 to determine if the agreement was consistent with other municipal power plant development agreements and in the best interests of SCLAA. Specifically, City management relied on two memoranda, both of which provide vague and cursory justification for the five percent project operating profit to be paid in perpetuity.

First Memorandum Written by a Firm at the Request of Inland Energy Executives

The first of these two memoranda was written by an attorney at the request of Inland Energy executives, *not* by City staff or by agents purported to represent the City's interests. This memorandum made a broad assumption that the hourly management fees would not cover the costs and expenses of Inland Energy. The memorandum does not provide further analysis or discussion of what costs may not be covered by management fees other than to state that the reimbursements would "not cover the lost opportunity costs associated with pursuing the project." Further, the memorandum infers that the project operating clause, which provides for five percent of project operating profits in perpetuity, as more in the City's interest than a large upfront cash payment. The memorandum provides no financial analysis to support this conclusion. Finally, there is no attempt to estimate or even provide a range of estimates for the potential payments that will be made to Inland Energy under various alternatives.

*Second Memorandum Dated Two Days **After** Contract Execution*

The second of these two memoranda reviewing contract terms was written by an attorney at the request of the former City Manager. Notably, the date of the memorandum is two days *after* the agreement with Inland Energy was executed, thereby negating any possible analysis or

[4] Inland Energy entered into the management services agreement (the template for the City's development agreement) with CP High Desert, LP, a Maryland limited partnership and CP High Desert I, Inc., a Maryland corporation pursuant with a Membership Interest Purchase Agreement on January 4, 1999. Under the Membership Interest Purchase Agreement, Inland Energy sold its 50% ownership to these two entities in the High Desert Power Plant project.

recommendations. Additionally, the author of the memorandum did not present his review as a service of a law firm. Rather, the memorandum, which lacks a letterhead, has the appearance of an informal or personal letter to the former City Manager.

This second memorandum opines that the five percent project operating profit is "not outside a range that *commercial* parties should find acceptable for a well-structured and profitable project." (emphasis added) Similar to the first memorandum, this review did not present any evidence that the clause would be in line with other municipally developed power plants. Further, the second memorandum does not provide any financial analysis of the impact of the clause or of potential alternatives.

The second memorandum also states that the Development Fee (project operating profit) "may be renegotiated downward" at the time that the City sells the project. However, this assumption ignores terms in the agreement, as discussed below, that shelter Inland Energy's "right" to five percent of net operating profits. Finally, the memorandum recommends that the development fee "should be subordinate to debt and available to be paid only if loan documents will not be violated by such payment." The executed contract did not contain such a clause.

Agreement Terms Strongly Protect Operating Profit Clause

At least three clauses in the development agreement protect Inland Energy's "right" to five percent of the net operating profits even if the agreement is terminated or the project is sold to a third party developer. Specifically, the clause on Inland Energy's right to five percent of net operating profits cannot be dissolved even if the contract is terminated or expires (unless it is terminated because Inland Energy breaches contract terms). Additionally, the agreement stipulates that Inland Energy will continue to have a right to five percent of net operating profits if the City were to sell development rights to a third party. Finally, Inland Energy could continue to be entitled to five percent of operating costs under the contract, even if the operating permits were denied by the State. That is, the company would retain its right to the additional compensation if the City were to terminate the agreement for failure to fully entitle the plant and subsequently resume and successfully obtain permits for the project within two years.

These clauses have substantial long-term implications for the potential development of the project as the City may not simply terminate the contract and any potential buyer of the development rights would be obligated to compensate Inland Energy for its right to five percent of lifetime net operating profits.

Contract Performance Terms Poorly Constructed and Implemented

The development agreement contains no effective performance measures for Inland Energy. The only clause that relates to the performance of the company states that Inland Energy "shall use its reasonable best efforts to perform the services and devote the time necessary to fulfill its obligations under this agreement." However, there are no specific mechanisms that would allow the City Council or City management to hold the contractor accountable for its performance.

Annual Budgets Not Provided

According to at least one City official, Inland Energy has not submitted proposed annual budgets as required under the agreement. This clause, if it had been enforced, could have provided an annual forum for the City Council and the public to revisit the project and obtain a status update on the progress of the project. The agreement had an initial two year budget of $5.5 million. In fact, the City has paid the company over $12 million over a five year period with Inland Energy continuing to invoice.

City Entered High Risk Agreement with General Electric without Proper Due Diligence or Transparency

In 2007, as Victorville 2 permitting was nearly completed, Inland Energy began advising the City to move forward with the purchase of equipment for the proposed plant. Inland Energy initiated negotiations with General Electric (GE) and advised the City, with some urgency, that it was important to make a commitment to GE due to the length of time required to procure the equipment and the desire for the plant to go online in accordance with the State's energy demand schedule.

Several City officials have stated that Inland Energy was driving the process to develop the Victorville 2 project with equipment purchases. Specifically, Inland Energy officials were briefing City officials, in closed session "workshops," with slide presentations that recommended the City move forward with a large financial commitment for the equipment purchase. Although we requested all briefing materials provided to City Councilmembers on the agreement with General Electric, none were provided.

Council Made Huge Financial Commitment to General Electric without Secure Funding Source

On December 4, 2007 the City Council ratified a resolution, which had been previously adopted in closed session, authorizing the City to execute an agreement with General Electric to purchase certain power plant generation equipment at a total contract price of $182,036,824. The contract called for the City to make an immediate initial down payment of $52 million[5] on the equipment. While the City used SCLAA bond funds for the initial down payment, financing for the remaining $130 million that was due in November 2008, had not been secured. According to City management, City officials were confident at the time that additional funding could be secured due to perceived demand from other jurisdictions in Southern California. Ultimately, City officials moved forward without any written or legal commitments from these jurisdictions, without bond financing in place, and without a committed third party prepared to purchase the development rights.

City Proceeded Despite Continuing to Lack an Independent Risk Assessment or Project Plan

The City proceeded with the adoption of this high cost, high risk contract with General Electric without an independent risk assessment or a formal project plan. As previously mentioned, City

[5] Based on a subsequent settlement agreement, we believe the actual amount of the down payment was likely $50,020,000.

management initiated the Victorville 2 project, specifically the development agreement with Inland Energy, without conducting an independent risk assessment. While the agreement with Inland Energy was initially estimated to cost the City $5.5 million over two years, the contract with GE was massively more costly, and therefore inherently carried more risk. Despite this elevated risk, the City continued to proceed with the project without the consideration of any independent evaluation of financial or operational risk to the City or SCLAA.

The City continued to proceed with the Victorville 2 project without a formal project plan. Essentially, the City did not have formal project goals, milestones, or a budget by which management, staff, contractors, and the public could understand the amount of progress and the ultimate aim of the project. This is illustrated, in part, by the fact that the City had not yet determined whether the development would be sold to a private firm or if the City would retain ownership and operate the plant through its Municipal Utility Services.

GE Contract Adopted without Transparency, Likely Violating the Brown Act

The consideration, deliberation, and adoption of the agreement with General Electric was conducted in an opaque manner and was likely in violation of State government code sections on open meetings known as the "Brown Act." The adoption of the contract in closed session does not appear to be permissible, since it was a public contract. Further, the consideration and adoption of the contract in closed session, even if deemed permissible, was not properly posted in the City Council's agenda. There is no mention of the resolution on the agenda or minutes for the November 20, 2007 City Council meeting, even though the agenda and a staff report for the Council Meetings on December 4 and December 18, 2007 stated that the resolution was "reported out of closed session" at the November 20, 2007 meeting. Further, an audio recording from the November 20, 2007 meeting posted by the City Clerk did not document any report out of closed session.

The first official public mention of the contract in a Council meeting about the contract was not made until December 4, 2007, the day before the contract became effective. Despite the enormous fiscal impact on the City and the SCLAA, the residents of Victorville and the other member jurisdictions of VVEDA[6] had no opportunity to obtain knowledge about the contract prior to Council adoption.

Weak Staff Disclosure of GE Contract Implications

The official Council meeting description of the GE contract and accompanying resolution did not clearly state the extent of the commitment. Specifically, the staff report accompanying the resolution to ratify the contract stated that there was no fiscal impact and provided no indication regarding what the resolution contained. The resolution itself, Resolution 07-340, was less than a page and contained only a broad description regarding equipment to be purchased for the Victorville 2 Project. The only portion of the contract that was made public was a copy of the one page table of contents.

[6] The City utilized SCLAA bond funds, which are secured by tax increment revenues supplied by all member jurisdictions of the VVEDA including Victorville, Hesperia, Adelanto, Apple Valley, and certain non-incorporated areas of the County.

City Defaulted on Payments to GE Resulting in Loss of up to $50 Million for SCLAA

City officials ultimately could not secure funding for the remainder of the purchase price of the power plant equipment. As a result, the City did not make its second scheduled payment in November 2008 and, on April 16, 2009, GE declared that the City had defaulted under the contract. Further, GE asserted that the City still owed additional amounts under the contract termination clause, although the City disputed the obligation.

On May 18, 2010, approximately one year after the City defaulted on its obligation, the City and SCLAA came to an agreement with GE to settle the dispute. According to the settlement agreement, GE shall retain all funds ($50,020,000) provided in the initial payment. However, as a future sales incentive, the City is entitled to credits of up to $10 million on future purchases from GE, subject to certain conditions. The credits expire on April 30, 2016.

City Management Continues Attempts to Sell Development Rights to the Project

City management asserts that the Victorville 2 Project is still "active" as the City has purchased land and accumulated entitlement permits for the power plant. City management has made attempts for over three years to sell the development rights to the project. Despite a request for proposals sent out in May 2009 to 13 firms, which had expressed interest, the City has not been able to successfully identify a project developer. City officials have noted that potential buyers must negotiate primarily with Inland Energy, due to the clause in the firm's development agreement with the City granting the right to five percent of project operating profits, estimated at $4.0 to $5.0 million annually, for the life of the project.

Victorville 2 Project Costs to Date Exceed $76 Million

The Victorville 2 project has cost the City over $76 million to date including approximately $50 million[7] lost to General Electric for the power plant equipment, $12.1 million disbursed to Inland Energy for development services, $3.8 million to other services providers, and $8.6 million for the purchase of parcels for the project. This estimate of project costs does not include funds dispensed for consulting services provided by Kinsell, Newcomb, & De Dios, the City's bond underwriter and to Goldman Sachs for financial services.[8]

The costs to date are a substantial departure from the preliminary budget prepared by Inland Energy and included in the development agreement. The preliminary budget, prepared in 2005 and shown in Table 3.1 below, estimated that it would cost $5.5 million over two years to fully entitle the project. While it's unclear if land costs were considered in 2005 when the Inland Energy contract was approved, the total costs incurred by the City, as shown in Table 3.2 below, are more than ten-fold what was estimated in September 2005.

[7] As previously noted, under a settlement agreement with GE, the City is entitled to credits of up to $10 million on future purchases from GE, subject to certain conditions. The credits expire on April 30, 2016.

[8] These services were primarily related to the efforts to secure private funding after the City entered into its commitment with General Electric for expensive power turbine equipment.

Although City management has asserted that there is substantial value in the permits that have been obtained, there has been no public independent accounting or estimation of this value. Further, while the permits are set to expire, there has been no analysis to determine the costs of keeping them active beyond the termination date. The City does not maintain a schedule of permit expiration, instead relying on Inland Energy to maintain such information.

Table 3.1
Victorville 2 Preliminary Budget Estimate for Permitting
As of September 2005

Cost Category	Pre-application months 1-6	Post-application months 7-24	Total
Environmental Consultant	$550,000	$800,000	$1,350,000
Engineer	275,000	400,000	675,000
Legal	125,000	600,000	725,000
Miscellaneous	100,000	200,000	300,000
Emission Offsets (ERC's)	550,000	0	550,000
Project Management	400,000	1,000,000	1,400,000
Contingency	200,000	300,000	500,000
Total	**$2,200,000**	**$3,300,000**	**$5,500,000**

Source: Services Agreement with Inland Energy dated September 7, 2005