TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER

DEPARTMENT: UTILITIES

DATE: APRIL 25, 2005

CMR:186:05

SUBJECT: GAS UTILITY LONG-TERM PLAN (GULP) BIANNUAL PROGRESS UPDATE

This is an informational report and no Council action is required.

BACKGROUND

The Finance Committee voted unanimously on August 3, 2004 to accept staff’s recommendation to approve the six Gas Long-Term Plan (GULP) recommendations and requested that staff provide a biannual update on the status of the recommendations (CMR335.04). Council approved that recommendation on September 13, 2004 (CMR:368.04). This information-only report is an update on the six Council-approved Gas Long-Term Plan (GULP) recommendations.

Three main factors drove the need to develop GULP: (1) a need to review and update the current commodity purchasing strategy with public input; (2) the possible need to commit to PG&E assets as part of a PG&E bankruptcy negotiation (not applicable at this time); and (3) the need to be prepared for possible new regulations imposing minimum asset holdings for core customers. In addition, GULP addresses recommendation #20 in the Assessment of Utility Risk Management Procedures by the City Auditor, “CPAU should continue to regularly and actively (a) review the performance of the energy procurement strategy, (b) quantify the risk and cost consequences of alternatives, and (c) communicate the risks and costs of recommended revisions to the City Council.”

DISCUSSION

The GULP analysis evaluated potential City of Palo Alto acquisition and participation in five main areas: gas storage capacity, gas pipeline capacity, gas wellhead reserves, prepayment for gas, and gas efficiency programs. In parallel, the City gas commodity procurement strategy was revisited and revised (CMR:167:04). Currently the City holds no long-term gas-related assets.

Recommendation #1: Do not contract for natural gas storage capacity at this time.

Storage was analyzed for two potential purposes: (1) swing gas for load-supply balancing and (2) taking advantage of season price differences. The results of the analysis led to staff’s recommendation not to purchase storage assets at this time. The current arrangement the City
has with suppliers whereby gas is sold to or bought from the City at a pre-arranged daily market index prices in order to balance load and supplies is more cost-effective than storage. Storage cost is much greater than the expected benefit of seasonal price differences.

Staff is, however, investigating the benefits of jointly contracting with another municipality that has seasonal demands that are complementary to Palo Alto’s. The synergy created by such a partnership may result in an economically beneficial arrangement for both parties.

Recommendation #2: Do not acquire additional natural gas pipeline capacity at this time.
Pipeline capacity acquisition was not recommended given the City’s current gas commodity portfolio. Staff’s analysis showed that the tariff rates are much above the expected future value of all relevant pipeline routes and that the uncertainty of pipeline capacity value is such that the necessary long-term nature of such acquisitions does not result in an expected positive value. Staff’s analysis of this asset has not changed.

Recommendation #3: Approve staff undertaking initial steps related to gas reserve acquisition including: a) identifying and evaluating potential consortiums including joint action opportunities; b) entering into consortium agreement to scout properties; c) through the consortium, employing an investment bank and consultants to scout properties and spend up to $65,000 in FY 04-05 related to this effort; and d) through the consortium, identifying attractive, feasible opportunities.

Staff recommended pursuing joining a consortium to investigate potential natural gas reserve acquisition and, if successful, proceeding with the next step, namely hiring an investment bank and consultants to scout for gas reserve properties. This phase will utilize the proposed FY 04/05 budget for this project of $65,000.

Staff did identify a gas development project consortium of mostly Southern California electric utilities. The agreement among the parties laid out a multi-phase gas reserves purchasing plan whereby each participant committed, up front, to a percentage of all gas reserve purchases by the consortium. The City of Los Angeles was the project manager and the main financing organization was the Southern California Public Power Authority (SCPPA). Staff reviewed the agreement and the structure of the project and determined that the short timeline required for Palo Alto to make a large financial commitment was incompatible with the City’s process requirements. Additionally, staff was uncomfortable with the potential lack of control over the project decisions, and staff time was being spent on other high-priority projects.

Staff continues to seek out other consortiums including a possible project group involving Northern California Power Association (NCPA) members, a group with which the City already has a working relationship.

Recommendation #4: Do not participate in a gas prepay deal at this time.
The City could take advantage of its low cost of capital and prepay for natural gas in exchange for a discounted price under new regulations implemented by the IRS as of October 2003. While staff found that it may be possible to structure a prepay deal with little credit risk to the City, the estimated benefit of $50,000 per year was too small to justify the staff time and cost of formal, expert advice required to structure a deal. This recommendation has not changed. However,
staff will continue to monitor interest rates since, as interest rate rise, this type of project becomes more attractive.

Recommendation #5: Pursue any low-cost, high-value prospects to acquire supply-related resources that may arise from time to time.
This recommendation has not changed. No high-value supply-related resources have been identified. Staff is, however, in the process of analyzing the benefit of purchasing gas for delivery beyond three years from the present. Inflation-adjusted forward gas prices in the 2008-2010 timeframe appear relatively inexpensive in a preliminary analysis. Extending the time horizon for gas purchases would require amending the Gas Master Agreements and explicit Council approval prior to execution.

Recommendation #6: Develop comprehensive demand-side management goals and implementation plan by Fall 2004 in time for incorporation into FY05-06 and future ratemaking and budget decisions. In the interim, continue implementation of current and planned FY 04-05 demand-side management programs.

Development of comprehensive demand-side management goals is being managed under the Rocky Mountain Institute (RMI) project that was initiated in Fall 2004. Staff is working with RMI, a leading planning and analysis organization, to implement an integrated approach for a robust energy resource portfolio to meet balanced objectives and reliable service at low and stable cost/rates in an environmentally responsible manner. RMI has developed state-of-the art resource planning principles called the Energy Resource Investment Strategy (ERIS) which is directly applicable to CPAU. RMI received a grant from the William and Flora Hewlett Foundation to apply these unique ERIS principles to utilities resource planning. RMI will apply $30,000 of this grant to Palo Alto’s proposed project. Palo Alto’s cost is $75,600. The specific goal of the project is to refine the local resource elements of CPAU’s electric and gas portfolio implementation plans to meet the objectives and guidelines reflected in the long-term plans, with particular attention to local generation alternatives, and demand-side resources.

In the interim, staff recommended continuing implementation of current and planned FY 04-05 demand-side management programs (DSM). This includes evaluating opportunities to leverage portions of the annual Gas DSM budget of $225,000 to reduce Utilities costs. An example would be targeting supplemental furnace rebates to Rate Assistance Program (RAP) participants having older pilot light units in order to reduce the number of Field Service seasonal pilot turn-on and turn-off workload. This could result in savings to both the participating customer (operating costs) and the Utilities Department (labor and financial subsidies).

POLICY IMPLICATIONS
The GULP recommendations support the Utilities Strategic Implementation Plan (CMR:223:01), in particular, Strategy 2 – Preserve a supply cost advantage compared to the market price and Strategy 6 – maintain stable General Fund transfers, and maintain financial strength.
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