TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: FEBRUARY 2, 2004 CMR: 134:04

SUBJECT: CITY OF PALO ALTO’S ENERGY TRANSACTION ACTIVITY REPORT FOR THE SECOND QUARTER, FISCAL YEAR 2002-03

This is an information report and no action is required.

BACKGROUND

The purpose of this report is to inform the City Council of the status of the City’s energy portfolio as of the end of the second quarter of Fiscal Year 2003-04. The City’s risk management policy requires that staff report to Council on the City’s energy portfolio composition compared to Council-adopted policy, portfolio performance, and other key market information.

DISCUSSION

Open Transactions as of December 31, 2003

Open transactions are commitments that the City has made to purchase either electricity or gas, but for which supplies have not been delivered.

Electricity. Apart from supplies from Western Area Power Administration and Calaveras, the City currently holds one long-term position in the energy market with non-governmental organizations. This is a Quarter 1 and Quarter 4 25 MW purchase for calendar years 2005 through 2009. The current market value of this transaction is $25.8 million, or a mark to market (MTM) value of $ 5.8 million.

Gas. The current gas portfolio consists of 143 monthly open transactions (transactions for which gas has yet to be delivered) over the next 36 months. The contract volume of these transactions is 3.92 million MMBtu with total commitments of $17.6 million. The current MTM value of these transactions is $3.2 million. The current MTM represents a $2.5 million increase, largely due to increased prices in the near term. The figure below
presents MTM values for each month for the next 3 years. The counterparties for the open transactions include BP North America and Sempra Inc.

The chart below shows the history of the MTM value for the entire gas portfolio since January 2002. This shows a continued trend of increases in MTM values for the portfolio over the recent years.
The laddered purchasing strategy continues to be implemented, with purchases in the near-term winter months exceeding 80% of anticipated load. Purchases for the final quarter of this fiscal year drop to 60%. The chart below presents the purchases made for each month over the next three years. The figure shows the fixed purchases already made, purchases for G3 customers (customers on a variable market based rate) already made, and the remaining volumetric exposure (i.e. not yet purchased).
Value at Risk
The “riskiness” of the energy portfolio is measured through the “value at risk” (or VaR). The VaR measures the risk that adverse market conditions will force CPAU to use reserves to cover costs over what is charged to ratepayers on purchases not yet made to meet load. In compliance with the Risk Management Guidelines, staff monitors the VaR to ensure that its value is limited to below 10% of the existing supply reserve levels for both electricity and gas.

Currently, the VaR for the electricity portfolio is 1.8% and that for the gas portfolio is 2.1%. The historic levels of both these values are presented in the following graphs, along with the values of the reserve levels.
Credit Risk

**Electricity.** Currently, the City purchases electricity from the Western Area Power Administration (WAPA) for most of its load. WAPA is a Federal Agency and operates under the full faith and credit of the United States Government, minimizing the City’s credit risk. The City does have one transaction with an A- rated counterparty. The current credit exposure is $5.8 million for a contract for delivery between 2005 and 2009.

**Gas.** The City has exposure to two counterparties totaling $3.1 million. The first counterparty is rated AA+, and currently the City has a credit exposure of approximately $880,000. The second counterparty is rated BBB+ and the City’s credit exposure is $2.3 million. This exposure has increased from the $557,000 noted in the First Quarter, largely due to increases in prices. In both cases the City’s credit exposure is well within the limits established by the Risk Management Policy and Guidelines.
ATTACHMENTS:

Attachment A: Consolidated Mark to Market Report of All Open Gas Transactions as of December 31, 2003

PREPARED BY: ________________________________

KARL G. VAN ORSDOL
Energy Risk Manager

DEPARTMENT HEAD APPROVAL: ________________________________

CARL YEATS
Director, Administrative Services

CITY MANAGER APPROVAL: ________________________________

EMILY HARRISON
Assistant City Manager