TO:       HONORABLE CITY COUNCIL

FROM:    CITY MANAGER       DEPARTMENT: UTILITIES

DATE:     MARCH 1, 2004                      CMR:159:04

SUBJECT: ADOPTION OF A RESOLUTION AUTHORIZING THE CITY MANAGER TO EXECUTE A LETTER OF AGREEMENT FOR THE OPTION TO PURCHASE EXCESS CAPACITY FROM THE WESTERN AREA POWER ADMINISTRATION

RECOMMENDATION

Staff recommends Council adopt the attached resolution authorizing the City Manager to execute the attached Letter of Agreement with the Western Area Power Administration for the option to purchase excess capacity electric power that becomes available during the period of April 1, 2004 through December 31, 2004.

BACKGROUND

City of Palo Alto Utilities’ existing Western Commercial Firm Power contract is an important asset that allows for significant flexibility to cover electricity loads at cost-based prices. Over the years, CPAU and Western have developed several ancillary agreements to harvest extra value created by long-term relationships. These include a Letter of Agreement (LOA) that makes excess capacity electric power (WEC) available to customers such as CPAU. The current WEC LOA expires on March 31, 2004. This CMR requests Council approval of a nearly identical replacement WEC LOA. Council approved last year’s WEC LOA in CMR 179:03 on March 17, 2003. Palo Alto participated in the 2003 WEC to spend about $1.4 million for energy that saved about $2.7 million thereby producing a net savings of about $1.3 million.
WEC is an energy product that Western markets if the Central Valley Project is producing more energy than Western is obligated to provide under existing contracts. WEC power is typically priced at about 2 cents per kilowatt-hour (kWh). By purchasing it, CPAU can substitute it for higher cost resources in its energy portfolio that can range from 3 to 10 cents per kWh. This produces a savings for CPAU and helps maintain low retail rates.

The volume of WEC available to CPAU is highly variable and depends on the water operations and the generator operating conditions of the Central Valley Project, and on the loads of CPAU and Northern California Power Agency (NCPA). Neither CPAU’s participation in, nor the existence of the WEC marketing program affect the physical operation of the Central Valley Project with respect to river releases.

**DISCUSSION**

Staff is requesting that Council adopt a resolution authorizing the City Manager to execute an LOA with the Western Area Power Administration for WEC purchases with a cost not to exceed $5,000,000. On February 24, 2004, Western provided signed WEC contracts for customers to execute for the April 1, 2004 - December 31, 2004 time period. WEC power will likely be available and economically attractive on about April 10, 2004. The attached WEC agreement is nearly identical to the four prior annual WEC contracts. Western offers signed standardized WEC contracts to participants and does not allow negotiation for customization.

There is very low risk in executing transactions under the agreement, because the City is not obligated to accept the energy when it is offered by Western.

- NCPA will continue to use alternative resources if its cost (market price) is lower than the cost of WEC (2 cents).
- The market price would have to unexpectedly fall below 2 cents per kWh within one day in order to realize a loss. This would have to happen more than 90% of the time for net savings not to be realized.

**RESOURCE IMPACT**

Net savings to CPAU from its participation in the WEC program are estimated at about $1,000,000 for the term of the agreement and could range between $0 and $5 million. Net savings depend on many variables including:

a) Hydrology
b) United States Bureau of Reclamation’s maintenance of generators

c) The difference between market prices and the WEC price

Entering into the agreement has no fixed cost. Exercising the agreement costs about 2 to 2.7 cents per kWh. NCPA, on Palo Alto’s behalf, will exercise the agreement as often as possible when the gross savings from that exercise exceed 2 cents/kWh.

POLICY IMPLICATIONS

The proposed agreement complies with, and is subject to, continuing adherence to the CPAU’s Energy Risk Management Policies, Guidelines, and Procedures. This recommendation also supports the second of the City’s Energy Risk Management Objectives listed in the Council-approved Energy Risk Management Policies [CMR 400:02], “Preserve a Supply Cost Advantage”, whereby “Wholesale transactions are effected to maximize the value of assets for the benefit of CPAU’s retail customers. CPAU will take actions to: …. (b) enhance revenue by taking advantage of flexibility inherent in CPAU contracts and resources…” Furthermore, all daily transactions undertaken by NCPA to manage this agreement are subject to NCPA’s own internal risk management policies and procedures and are overseen by the NCPA Commission and its own Risk Oversight Committee.

It is also consistent with the Council-approved Utilities Strategic Plan [CMR 418:00 and 432:02] Strategy 2: Preserve a supply cost advantage compared to the market price; and Strategy 3: Streamline and manage business process to allow the City of Palo Alto Utilities to work efficiently and cost-effectively.

ENVIRONMENTAL REVIEW

Execution of the WEC purchase agreement does not constitute a project for the purposes of the California Environmental Quality act.
ATTACHMENTS

A: Resolution authorizing the City Manager to execute the attached WEC Letter of Agreement
B: Western WEC Letter of Agreement 04-SNR-00647 April 1, 2004 - December 31, 2004
C: Form 410: Certification of Nondiscrimination

PREPARED BY: ______________________________
TOM KABAT
Senior Resource Originator

DEPARTMENT HEAD: ______________________________
JOHN ULRICH
Director of Utilities

CITY MANAGER APPROVAL: ______________________________
EMILY HARRISON
Assistant City Manager