TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: APRIL 19, 2004 CMR: 230:04

SUBJECT: CITY OF PALO ALTO’S ENERGY TRANSACTION ACTIVITY REPORT FOR THE THIRD QUARTER, FISCAL YEAR 2003-04

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 third 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 March 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. Since the last quarterly report, the City of Palo Alto Utilities has begun diversified purchases of blocks of forward supplies under the Council-approved Electricity Master Agreements (CMR 510:03). While approximately 45% of electricity supplies will continue to be supplied by the Western Area Power Authority (WAPA) and the Calaveras hydroelectric project, the City will increasingly purchase supplies from private sector entities. The figure below presents the current purchases (i.e. open positions) by the City by monthly delivery by supplier.
The City currently holds open positions in the energy market with three private sector power providers. The total Mark to Market (MTM) value of these transactions is $5.2 million. This value is little changed from the MTM value reported last quarter. Forward prices for electricity are presented below.
As noted in previous reports, the Mark to Market value represents the difference in price between the current value of the contracted supply and the original contracted price. The chart below presents the Mark to Market values for the City’s portfolio by month by counterparty.

![Electric Mark to Market Chart](chart.png)

While the Council is familiar with the Mark to Market concept, it should be repeated that a positive MTM value indicates an increase in the value of the purchase. While this increase does represent an increase in value for the City, it must be remembered that the MTM value also represents the City’s credit exposure. In other words, should a counterparty default in delivery of supply, the City would need to purchase commodities on the open market when prices would be higher.

Gas. The Council approved Gas Master Agreements (CMR:482:03) has allowed staff to expand the number of approved suppliers and diversify counterparty risks. The current gas portfolio consists of 120 monthly open transactions (transactions for which commitments have been made but gas has yet to be delivered) over the next 36 months. The contract volume of these transactions is 4.04 million MMBtu with total commitments of $18.5 million and an average price of $4.58 per MMBtu. The open commitments in gas by month and by supplier are presented below.
The current Mark to Market value of these commodity transactions is $1.5 million. If additional capacity contracts are included the Mark to Market increases to $2.2 million. The current MTM represents a minimal decline over last quarter as a result of forward (i.e. future) delivery price changes. The forward prices for gas delivery in the next 3 years are presented below.

The figure below presents MTM values for each month for the next 3 years. The counterparties for the open transactions are BP North America, Sempra Inc., Coral Energy and Conoco Phillips. As noted above, the increased number of counterparties and their financial strength are the underpinning of the staff’s efforts to diversify counterparty risks.
The figure below shows the history of the Mark to Market value for the entire gas portfolio on a rolling 36 month basis since January 2002. This shows a trend of increased MTM values for the portfolio since July of 2003.
The figure below presents the purchases made for each month over the next three years compared to estimated load.
Gas Supply Procurement Program for Pool Customers
Monthly Fixed-price Purchase Volumes Compared to Target
as of March 31, 2004

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, the Utilities’ Front Office and the Energy Risk Manager monitor the VaR and ensure that its value is limited to below 10% of the projected end-of-year supply rate stabilization reserve levels for both electricity and gas. Currently, the VaR for the electricity portfolio is 1.1%, a decline of 0.8% from last quarter. This decline is due to the City purchasing a greater portion of its load in fixed price, long-term contracts. The VaR for the gas portfolio is 5.0% or roughly a doubling of the VaR figure from last quarter. This is due primarily to a planned decrease in the gas stabilization reserve from $11 million to $7 million in order to reduce potential price increases to consumers. The historic levels of the VaR values for electricity and gas are presented in the following graphs.
Credit Risk

Electricity. Currently, the City purchases electricity from 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’s current exposure is little changed from last quarter, with one transaction with an A- rated counterparty having an exposure of $5.1 million. Other counterparty exposures are less than $200,000 total.

Gas. The City has exposure to four counterparties totaling $2.1 million over the next 36 months. The highest exposure is $1.8 million with a BBB+ company, with the remainder of the exposure split among three other counterparties. The total portfolio exposure remains unchanged from the previous quarter. In all cases the City’s credit exposure is well within the limits established by the Risk Management Policy and Guidelines.

ATTACHMENTS

A) Consolidated Mark to Market Report of All Open Gas Transactions as of March 31, 2004

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