TO: HONORABLE CITY COUNCIL
FROM: CITY MANAGER                      DEPARTMENT: UTILITIES
DATE: MARCH 18, 2002                    CMR: 177:02
SUBJECT: APPROVAL OF AN AMENDMENT TO INCREASE THE CONTRACT AMOUNT WITH FLYNN AND ASSOCIATES FOR ELECTRIC REGULATORY AND TECHNICAL ASSISTANCE FOR $75,000 FOR FISCAL YEAR 2001-02 AND FOR $75,000 FOR FISCAL YEAR 2002-03

REPORT IN BRIEF

RECOMMENDATION

Staff recommends that Council authorize the Mayor to execute an amendment to the contract with the above consultant for related, additional but unforeseen work by $75,000 in FY 01-02 and by $75,000 in FY 02-03.

BACKGROUND

In 2001, following a competitive selection process in which a request for proposal (RFP) was sent to eighteen consulting firms known to offer relevant services, five firms submitted written proposals, and four firms were invited for oral interviews before a City selection committee, the City retained Flynn & Associates as the prime consultant to assist staff in the electric regulatory and technical area. The City signed a contract with Flynn & Associates for a total contract amount of $430,000; $150,000 in FY 01-02, $150,000 in FY 02-03, and $130,000 in FY 03-04 (CMR: 320:01). Flynn & Associates is providing assistance to the City in the areas of monitoring and analyzing regulatory proceedings (Task 1), developing strategies and positions to deal with critical issues (Task 2), improving reliability in the greater Bay Area (Task 3), and developing long-term solutions for City’s transmission needs (Task 4). The tasks are described in Exhibit A to the contract with the City.
DISCUSSION

Additional regulatory issues in the areas of transmission reliability into the Bay Area and cost increases related to future electric market structure designs expose the City to greater risk. In spite of lower market prices after the unprecedented high prices in 2000 and 2001, the fundamental structural problems that led to these high prices have not been fixed. Unfortunately, a lack of coherent state or national energy policy, combined with a plethora of new organizations with vague and/or overlapping regulatory responsibilities has resulted in staff having to monitor, analyze, coordinate and intervene in additional issues and areas. This will involve additional need of support from Flynn & Associates under Tasks 1 and 2.

The California Public Utility Commission (CPUC), authorized by the California State legislature in AB 970, is showing increased interest in ensuring adequate transmission in California. This has created an opportunity to substantially increase the City’s ability to influence the outcome of decisions at the CPUC, which affect the adequacy of transmission to Palo Alto. This includes the Path 15 Upgrade and other transmission projects to be built by PG&E to provide additional transmission capacity into the greater Bay Area and to the City. The City has been also meeting with PG&E over several months to study the benefits of additional transmission into the Bay Area to increase service reliability for Palo Alto’s customers. These activities have increased the need for support from Flynn & Associates under Tasks 3 and 4.

The City is facing an increased level of regulatory challenges related to providing low-cost and reliable electric transmission service. These include PG&E’s termination of the NCPA Interconnection Agreement (IA), with Palo Alto as a party, on March 31, 2002, and the California ISO’s Market design 2002 proposal for market power mitigation and congestion management. The latter is a proposal by the ISO to fix the fundamental structural problems in the ISO electricity markets that led to the high electricity prices in 2000 and 2001. If the ISO Market design 2002 proposal is implemented, it may expose the City to high local congestion costs.

In this dynamic regulatory environment, Palo Alto will protect its interests, particularly through increased coordination with other entities with similar interests, such as NCPA, Silicon Valley Power, City of Alameda, and the City and County of San Francisco. Flynn & Associates is developing a coalition of such parties to advocate the need for protection from high congestion management charges implied by the ISO Market design 2002. It will also support the staff in negotiation sessions between the NCPA and the ISO on a proposed Vertically Integrated Utility (VIU) tariff. The VIU tariff, if implemented, would reduce the costs of using ISO transmission service after the termination of the NCPA IA.
These regulatory consulting services constitute additional but unforeseen work. Additional resources ($75,000 in FY01-02 and $75,000 in FY 02-03) are needed to perform additional work in Tasks 1-4.

RESOURCE IMPACT

Additional funds of $150,000 needed for this recommended increase are included in the current year’s budget and will be included in the FY 02-03 budget proposal.

POLICY IMPLICATIONS

This recommendation is consistent with the Council approved Utilities Strategic Plan. Specifically, this recommendation supports Strategy 2 – Prepare a supply cost advantage compared to the market price. Key tactics to support Strategy 2 are to “Investigate partnerships, alternative sources and projects to secure low-cost, reliable transmission for commodity supplies” and “To manage exposure to energy commodity price risk.”

ENVIRONMENTAL REVIEW

These services do not constitute a project for the purposes of the California Environmental Quality Act.

ATTACHMENTS

A: Flynn & Associates Contract
B: Amendment No. One to Contract No. C2138656

PREPARED BY: Shishir Mukherjee
Resource Planner

DEPARTMENT HEAD: JOHN ULRICH
Director of Utilities
CITY MANAGER APPROVAL:

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EMILY HARRISON
Assistant City Manager