



City of Palo Alto

City Council Staff Report

(ID # 6802)

Report Type: Consent Calendar

Meeting Date: 5/16/2016

Summary Title: Resolution Authorizing City Manager to Purchase Natural Gas

Title: Staff Recommendation That the Council Adopt a Resolution Authorizing the City Manager to Purchase a Portion of the City's Natural Gas Requirements From Certain Prequalified Natural Gas Suppliers Under Specified Terms and Conditions During Calendar Years 2016 Through 2022, Inclusive, With a \$100 Million Maximum Aggregate Transaction Limit; and Adopt an Ordinance Repealing Ordinance Number 4936, the Council's Prior Authorization for Natural Gas Purchases

From: City Manager

Lead Department: Utilities

Recommendation

Staff recommends that the City Council:

1. Approve the attached resolution (Attachment A) authorizing the City Manager or his designee to purchase a portion of the City's natural gas requirements from certain prequalified natural gas suppliers under specified terms and conditions ("Master Agreements") during calendar years 2016 through 2022, inclusive, subject to the following limitations:
 - a. The date for natural gas delivery for each transaction shall not exceed 36 months from the date the transaction is executed;
 - b. The delivery date for any transaction shall not extend beyond December 2022;
 - c. The maximum aggregate transaction limit under each Master Agreement shall be \$100 million;
 - d. All transactions are subject to the Palo Alto Municipal Code; and
 - e. All transactions are subject to the City's Energy Risk Management Policy, Guidelines and Procedures; and
2. Repeal Ordinance 4936 which authorized the City Manager to purchase a portion of the City's natural gas requirements from certain prequalified natural gas suppliers under specified terms and conditions during calendar years 2007-2022, inclusive. (Attachment B)

Executive Summary

An active set of creditworthy counterparties is essential to ensure that the City of Palo Alto Utilities (“City”) meets its obligation to meet customers’ natural gas demands. In 2007, via Ordinance 4936, Council authorized the City Manager to transact with a set of prequalified natural gas suppliers for the purchase and sale of natural gas via North American Energy Standards Board, Inc. Contracts (“NAESB Contracts”, or “Master Agreements”. Ordinance 4936 authorized the City Manager to transact with those counterparties under specified terms and conditions including a maximum expenditure of \$65 million per Master Agreement. An increase in the \$65 million maximum expenditure is needed to continue to purchase natural gas for the City’s retail load. Adopting the proposed resolution will realign the City Manager’s authority with the current set of counterparties and establish adequate expenditure limits. Repealing Ordinance 4936 and instead completing the proposed actions via resolution streamlines the City’s administrative process as well.

Staff will seek Council approval prior to execution of any transaction outside of the above limitations. Counterparties with valid gas Master Agreements include:

1. BP Energy Company;
2. ConocoPhillips Company
3. Mercuria Energy Gas Trading L.L.C.
4. Powerex Corp; and
5. Shell Energy North America (US), L.P.

Background

Approved Counterparties

In 2007, Council approved a set of gas Master Agreements (via adoption of Ordinance 4936) enabling the City to transact for natural gas and gas-related products. The approved Master Agreements were with the following counterparties:

1. BP Energy Company;
2. Coral Energy Resources, L.P.;
3. Sempra Energy Trading Corporation;
4. ConocoPhillips Company;
5. J.P. Morgan Ventures Energy Corporation; and
6. Powerex Corporation.

Between 2007 and 2015, Coral Energy Resources, L.P. merged into parent company Shell Energy North America U.S. L.P., and Sempra Energy Trading Corporation was sold to J.P. Morgan Ventures Energy Corporation, which was then sold to Mercuria Energy Gas Trading L.L.C. The current set of counterparties includes:

1. BP Energy Company;
2. ConocoPhillips Company
3. Mercuria Energy Gas Trading L.L.C.
4. Powerex Corp; and
5. Shell Energy North America (US), L.P.

Expenditure Limits

On April 19, 2012, Council adopted [Resolution 9244](#) amending the Gas Utility Long-Term Plan (GULP) Objectives, Strategies, and Implementation Plan to discontinue the laddering purchase strategy and implement gas supply rates that change monthly according to market prices as noted in [Staff Report 2552](#). With the exception of a few de minimis fixed-price transactions executed in the summer months to monetize excess pipeline capacity, all transactions are priced at the short-term monthly and daily market indices. Therefore, the City does not have any exposure to market price changes and does not have a need to diversify purchases across multiple counterparties to minimize credit risk.

Under Ordinance 4936, Council delegated authority to the City Manager to transact under Master agreements subject to certain conditions and restrictions including a \$65 million expenditure limit applied to each Master Agreement. Only two of the City's counterparties, Shell and Mercuria, are active bidders for the City's index-based purchases, and only \$7.5 million out of the \$65 million approved expenditure remains for Mercuria as of February 29, 2016.

Discussion

All transactions under the Master Agreements will be executed by staff in accordance with the Council-approved Energy Risk Management Policy, and internally-approved Energy Risk Management Guidelines and Procedures. Council is provided with an update of all executed transactions under the Master Agreements in the quarterly Energy Risk Management reports.

The cost of natural gas purchased under the Master Agreements is a function of market prices and the City's actual gas use. The City's expected gas commodity cost is \$8.3 million in fiscal year (FY) 2017 and is forecasted to increase to \$12.6 million by FY 2025, however gas prices are volatile and unpredictable and actual costs incurred and passed through to ratepayers could be different.

While the City has five enabled gas suppliers, it is likely that most transactions will be executed with the two suppliers that have been most active over the past several years. Staff recommends a maximum transaction limit of \$100 million for each Master Agreement. This increased limit will leave enough headroom, under the most heavily used contract, for an estimated five years of gas purchases.

Efforts are underway to expand the number of counterparties enabled under gas Master Agreements. Any new Master Agreements will be presented to Council for approval with recommended conditions and restrictions including a maximum expenditure limit for each Master Agreement.

Alternatives

Council could elect to approve different expenditure limits, however lower limits could reduce staff's ability achieve the lowest cost for gas supplies.

Resource Impact

Approval of the recommendation will not impact the FY 2016 budget nor the FY 2017 proposed budget request.

Policy Implications

Authorizing the City Manager to buy and sell natural gas to meet load obligations under the Master Agreements conforms to existing Council-approved Energy Risk Management Policy and the Palo Alto Municipal Code. Further, the recommendation is consistent with the Council-approved GULP Objectives and Utilities Strategic Plan objective to manage supply cost by negotiating supply contracts to minimize financial risk.

Environmental Review

Council's authorization for the City Manager to purchase natural gas from prequalified suppliers does not constitute a project for the purposes of the California Environmental Quality Act, under Public Resources Code Section 21065, thus environmental review is not required.

Attachments:

- Attachment A: Ordinance Repealing Gas NAESB Authority (PDF)
- Attachment B: Resolution Extending Authority for Master Agreements (PDF)

ATTACHMENT A

NOT YET APPROVED

Ordinance No. _____

Ordinance of the Council of the City of Palo Alto Repealing Ordinance No. 4936, Which Authorized the City Manager to Purchase a Portion of the City's Natural Gas Requirements from Certain Prequalified Natural Gas Suppliers Under Specified Terms and Conditions During Calendar Years 2007-2022, Inclusive

The City Council finds and declares as follows:

A. On March 12, 2007, the City Council adopted an ordinance authorizing the City Manager to purchase a portion of the City's natural gas requirements from certain prequalified natural gas suppliers under specified terms and conditions during calendar years 2007-2022, inclusive, with a maximum expenditure limit of \$65 million in for each Master Agreement.

B. Since Council's approval of Ordinance No. 4936, two counterparties, Shell Energy North America (U.S.) L.P., and Mercuria Energy Gas Trading L.L.C., have been active bidders for the City's index-based gas purchases, and only \$7.5 million of the approved \$65 million expenditure limit remains for Mercuria Energy Gas Trading L.L.C. as of February 29, 2016. An increase in the maximum expenditure limit is needed to continue to purchase natural gas for the City's retail load.

C. The Council intends to adopt a resolution authorizing the City Manager to purchase natural gas from one or more pre-qualified suppliers for delivery during calendar years 2016 through 2022, inclusive, so long as the supplier with whom the City negotiates a specific purchase transaction continues to be qualified and otherwise eligible to transact with the City. Increasing the expenditure limit will provide for an estimated five years of gas purchases.

D. Implementing this change via Council's approval of a resolution rather than an ordinance, as was done in prior years, will streamline the City's administrative processes. Therefore, staff recommends that Council repeal Ordinance 4936, and instead adopt a resolution to be recommended for Council approval on May 16, 2016, outlining the terms and conditions under which the City Manager can purchase a portion of the City's natural gas requirements.

NOW, THEREFORE, the Council of the City of Palo Alto does ORDAIN as follows:

SECTION 1. Ordinance 4936, Authorizing the City Manager to Purchase a Portion of the City's Natural Gas Requirements from Certain Prequalified Natural Gas Suppliers under Specified Terms and Conditions During Calendar Years 2007 Through 2022, Inclusive is repealed in its entirety.

NOT YET APPROVED

SECTION 2. The Council hereby finds and determines that the repeal of this Ordinance does not constitute a project under Public Resources Code Section 21065, thus no California Environmental Quality Act assessment is required.

SECTION 3. This ordinance shall be effective on the 31st day after its adoption.

INTRODUCED:

PASSED:

AYES:

NOES:

ABSENT:

ABSTENTIONS:

ATTEST:

City Clerk

Mayor

APPROVED AS TO FORM:

APPROVED:

City Attorney

City Manager

Director of Administrative Services

ATTACHMENT B
NOT YET APPROVED

Resolution No. _____

Resolution of the Council of the City of Palo Alto Authorizing the City Manager to Purchase a Portion of the City's Natural Gas Requirements from Certain Prequalified Natural Gas Suppliers Under Specified Terms and Conditions during Calendar Years 2016 through 2022, Inclusive

RECITALS

A. On April 19, 2012, the Council adopted Resolution #9244 amending the Gas Utility Long-Term Plan (GULP) Objectives, Strategies, and Implementation Plan to discontinue the laddering purchase strategy and implement gas supply rates that change monthly according to market prices, as described in Staff Report #2552.

B. In accordance with GULP, the City must purchase and, incidental to purchases, sell gas to meet the needs of its gas customers by contracting for terms varying from less than one month to one month. The City's Energy Risk Management Policies, described in Staff Report #5026, provide that the City will purchase only that quantity of gas meeting its load requirements at the time a transaction is executed.

C. By Ordinance No. 4936, adopted March 12, 2007, Council authorized the City Manager to negotiate and sign new, amended, or restated North American Energy Standards Board, Inc. contracts (each a "NAESB Contract" or "Master Agreement") with BP Energy Company, Coral Energy Resources, L.P., Sempra Energy Trading Corporation, ConocoPhillips Company, J.P. Morgan Ventures Energy Corporation, and Powerex Corporation, and further authorized the City Manager or his designee, the Director of Utilities, to negotiate one or more individual transactions, including, but not limited to, negotiating contracts, addenda, confirmations and transactions. The authorization extended to individual transactions executed under any number of NAESB Contracts with the referenced suppliers; provided, however, (a) the maximum expenditure under any NAESB Contract shall not exceed \$65 million in the aggregate; and (b) the maximum term of any transaction shall not exceed three years, commencing on the delivery date of the transaction.

D. Since Council's adoption of Ordinance No. 4936, three approved counterparties have undergone changes in corporate structure or ownership:

- a. On June 1, 2008 Coral Energy Resources, L.P. was merged into parent company Shell Energy North America (U.S.) L.P.
- b. On December 1, 2010 Sempra Energy Trading Corporation was sold to J.P. Morgan Ventures energy Corporation.
- c. In October, 2014 J.P. Morgan Ventures Energy Corporation sold to Mercuria Energy Gas Trading L.L.C. the portion of its gas trading business with which the City transacts. On September 21 Council adopted

NOT YET APPROVED

Resolution 9545 approving an Assignment, Assumption and Consent Agreement (Assignment Agreement) and authorizing the City Manager or his designee to execute the Assignment Agreement, effectively assigning the City's NAESB with J.P. Morgan Ventures Energy Corporation to Mercuria Energy Gas Trading L.L.C.

E. The current list of Council-approved counterparties includes: BP Energy Company, ConocoPhillips Company, Mercuria Energy Gas Trading L.L.C., Powerex Corporation, and Shell Energy North America (U.S.), L.P.

F. Since Council's approval of Ordinance No. 4936, two counterparties, Shell Energy North America U.S. L.P., and Mercuria Energy Gas Trading L.L.C., have been active bidders for the City's index-based gas purchases, and only \$7.5 million of the approved \$65 million expenditure limit remains for Mercuria Energy Trading L.L.C. as of February 29, 2016. An increase in the maximum expenditure limit is needed to continue to purchase natural gas for the City's retail load.

G. The City intends to purchase natural gas from one or more of these pre-qualified suppliers for delivery during calendar years 2016 through 2025, inclusive, so long as the supplier with whom the City negotiates a specific purchase transaction continues to be qualified and otherwise eligible to transact with the City.

H. Increasing the expenditure limit will provide for an estimated five years of gas purchases. Further, effecting this change via Council's approval of a resolution rather than an ordinance, as was done in prior years, will streamline the City's administrative processes.

NOW, THEREFORE, the Council of the City of Palo Alto RESOLVES as follows:

SECTION 1. The Council hereby authorizes the City Manager or his designee, the Director of Utilities, to purchase a portion of the City's natural gas requirements from the prequalified suppliers by negotiating one or more individual transactions, including, but not limited to, contracts, addenda, confirmations and transactions. The authorization shall extend to individual transactions executed under any number of NAESB Contracts or Master Agreements with the suppliers referenced in Recital F.

SECTION 2. The purchases negotiated under Section 2 shall conform to the following requirements:

- a. The maximum expenditure under any Master Agreement will be \$100 million;
- b. The maximum term of any transaction shall not exceed three years, commencing on the delivery date of the transaction. The sentence preceding notwithstanding, the City may enter into a transaction greater than three years, if the Council grants prior approval to such transaction.
- c. No transaction entered into with any of the referenced suppliers shall extend beyond December 31, 2022.

NOT YET APPROVED

SECTION 3. The Council hereby finds and determines that the adoption of this Resolution does not constitute a project under Public Resources Code Section 21065, thus no California Environmental Quality Act assessment is required.

INTRODUCED and PASSED:

AYES:

NOES:

ABSTENTIONS:

ABSENT:

ATTEST:

City Clerk

Mayor

APPROVED AS TO FORM:

APPROVED:

Senior Asst. City Attorney

City Manager

Director of Administrative
Services

Director of Utilities