



City of Palo Alto

City Council Staff Report

(ID # 11086)

Report Type: Consent Calendar

Meeting Date: 6/22/2020

Summary Title: Approval of MPP Agreement

Title: Adoption of a Resolution Approving the Amended and Restated Market Purchase Program Agreement With the Northern California Power Agency (NCPA) and Authorizing the City Manager or Designee to Authorize NCPA to Purchase and Sell Electricity and Related Products Under the Agreement, and Approving Revisions to the City's Energy Risk Management Policy

From: City Manager

Lead Department: Utilities

Recommendation

Staff recommends that the City Council approve a Resolution ([Attachment A](#)):

- 1) Approving the Amended and Restated Market Purchase Program Agreement (MPP) with the Northern California Power Agency and Authorizing the City Manager or their Designee to Authorize NCPA to Purchase and Sell Electricity and Related Products Under the Agreement ([Attachment B](#)); and
- 2) Approving revisions to the City's Energy Risk Management (ERM) Policy to enable transacting under the MPP Agreement ([Attachment C](#)).

Executive Summary

The City has long utilized services provided by the Northern California Power Agency (NCPA) to more effectively manage the electric utility and lower operating costs. Entering into the Amended and Restated Market Purchase Program (MPP) Agreement will enable the City to utilize NCPA staff and resources for the City's medium-term electric portfolio planning and resource management functions, functions that are currently carried out in-house. Authorizing NCPA to purchase and sell market power, resource adequacy capacity products, and renewable energy credits on behalf of the City will enable Palo Alto to achieve operational efficiencies and free up additional staff time to devote to other projects and programs. The purchases and sales made by NCPA on Palo Alto's behalf under the MPP Agreement will conform to NCPA's Energy Risk Management Policy and Regulations, and to the City's Energy Risk Management Policies, as amended. Proposed revisions to the City's Risk Management Policy reflect the changes to the transacting processes under NCPA's MPP. In the event of a conflict between the City's and NCPA's ERM governing documents, staff will direct NCPA to adhere to the City's Policy via staff's authorization of individual transactions under the MPP.

Background

The City is a founding member of NCPA (founded in 1968), a joint action agency providing members with opportunities for joint ownership of generation, transmission and other projects, as well as supporting programs such as electrical load and supply balancing services and legislative advocacy to publicly owned utilities throughout Northern California. The City currently participates in various services and programs offered by NCPA.

The City purchases most of its electric power through long-term contracts and has enough renewable and carbon-free power to meet its electric load on an annual basis. However, in certain months the utility has a surplus of energy, and in others, a deficit. The City sells energy when it has a surplus and purchases it when it has a deficit. In addition, during years when low rainfall results in lower output from its hydroelectric generators, the City may need to purchase additional energy (or, conversely, sell additional energy in years with heavy rainfall). Staff purchases and sells most of its energy three months to three years ahead to hedge against major unexpected spikes or drops in market prices in the more volatile short-term energy markets. To-date in-house staff has managed these transactions.

Discussion

Overview of the MPP Program and Advantages of Palo Alto Joining the Program

NCPA established the Market Purchase Program in 2007 to expand NCPA's services beyond the short-term services provided under its Pooling and Scheduling Coordination Program Agreements. Under these agreements, NCPA balances members' electric loads and supplies on a daily, hourly, and sub-hourly basis. Under the MPP, participating members authorize NCPA to undertake on their behalf transactions of durations of greater than a month – in some cases for durations of multiple years, depending on member governing body approvals.

Since Palo Alto had already established a robust process to transact electric supplies for terms greater than a month, Palo Alto did not join the MPP program at its inception. However, as NCPA's program has now matured with eight MPP members¹ and the volume of Palo Alto's own transactions of durations greater than a month has diminished in recent years², Palo Alto staff sees greater synergies in joining the MPP program and discontinuing Palo Alto staff's independent efforts in this regard. Transactions undertaken under the MPP will be for applicable electricity supply-related products from the Authorized Products list of Palo Alto's Energy Risk Management Policy (ERMP)³. City staff will continue to transact for natural gas products under City's existing ERM Program. The electricity-related products the City expects to have NCPA transact for consist of purchases and sale of energy, resource adequacy capacity and renewable energy certificates. The volume of these transactions may vary between \$7 million to \$20 million depending on the level of hydroelectric production in a given year.

¹ The current MPP members are: the cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Ukiah, and the Bay Area Rapid Transit district (BART).

² The City's transactions in the medium term (one month to 36 months in duration), have declined considerably in recent years because Palo Alto has entered into numerous 25-30 year long power purchase agreements for solar photovoltaic and other renewable energy supplies. For example, the average annual volume of transaction by staff during the CY 2010-11 timeframe was \$19 million and that in the CY 2018-19 timeframe was \$12 million.

³ The City Council last approved an update to the Energy Risk Management Policy in December 2018 ([Staff Report # 9813](#)). Authorized Products, listed in Section G of the City's ERM Policy, include electrical energy, capacity, ancillary services, electric heat rate products, Renewable Energy Certificates, and Low Carbon Fuel Standard credits, as well as gas, transmission, and storage.

Staff estimates that approximately 0.25 FTE to 0.35 FTE of Palo Alto staffing time could be saved by NCPA taking on this role, enabling these staff to perform other functions. In addition, it will decrease the extent of management oversight needed, shifting from day to day oversight to more programmatic oversight of NCPA's procurement practices. The cost of participating in the program is estimated at \$50,000 per year. Even though from a purely financial perspective, joining this program may only offer a break-even proposition, the operational efficiency benefits that it would enable makes joining the program an attractive option.

Authorization and Oversight of MPP Transactions

The City and NCPA closely coordinate the City's load, scheduling and resource needs, and this will continue with the City's participation in the MPP. Upon Council approval, transactions under the MPP Program will be authorized by a member's Utilities Director (UD) (through a delegation of authority from the City Manager) and approved as to form by the City Attorney. Upon authorization, the transactions will be undertaken by NCPA staff in accordance with NCPA's ERMP. When a member authorizes NCPA to undertake a transaction with a third party on its behalf, the member ensures NCPA's procurement process substantially conforms with the member's own procurement process, ERMP, and Guidelines⁴. If NCPA's requirements differ substantially from the City's, staff will require additional conditions as needed to ensure each transaction meets the City's requirements.

Specifically, Sec 2.30.340(c) of the City's municipal code requires standard terms for wholesale utilities commodities and services contracts, including the use of standard form contracts such as those of the Edison Electric Institute, and the Western States Power Pool, Inc. These agreements are the same master agreements approved for use by NCPA in Exhibit E to the MPP. In addition, unless waived by Council action, a contract for electricity wholesale utility commodities and services must include the following terms: (1) governing law of the state of California; (2) choice of venue in Santa Clara county; and (3) a counterparty credit rating of at least BBB- established by Standard & Poors and a Baa3 credit rating established by Moody's Investors Services.

In addition, the Sec. 2.30.340(d) of the City's municipal code permits NCPA to purchase and sell wholesale utility commodities and services on the City's behalf, provided that NCPA's procurement process is substantially similar to the City's, unless such compliance is waived by Council action.⁵ Section (d)(2) requires the City Attorney to determine whether NCPA's procurement process is substantially compliant with the City's, and deems NCPA's process compliant if NCPA conducts a formal proposal solicitation process, and executes a standard form contract requiring the governing law, venue and credit terms listed above. Council is permitted to waive these requirements, as appropriate.

Palo Alto Utilities staff, the City's Procurement Officer, and the City Attorney's Office have undertaken a review of NCPA's current processes and controls and have determined that NCPA's procurement process and risk guidelines for MPP transactions are substantially similar to the City's. Key elements of NCPA's procurement and ERMP controls in place are listed below. Please refer to the table in Appendix 1 at the bottom of the document for more detail.

⁵ Similarly, transactions may be exempted from competitive solicitation under Section 2.30.360(l) of the City's municipal code, so long as NCPA's solicitation method and contract form is substantially similar to that required by the City's municipal code.

1. Clearly defined roles, responsibilities, and authority
2. Segregation of duties and delegation of authority
3. Avoidance of speculation and conflict of interest
4. Competitive procurement process
5. Counterparty credit management
6. Transactions limited to authorized products
7. Risk management reporting and management oversight
8. Master agreement contracting terms with vendors

The City is represented on NCPA's governing board, the NCPA Commission, and several other oversight committees, including the energy Risk Oversight Committee which provides oversight over controls established for transactions under the MPP program, as the City's Utilities Risk Oversight and Control Committee does for transactions handled in-house.

Overall, NCPA has a proven track record of performing these functions for eight other members over the past thirteen years and is well positioned to do the same for Palo Alto for the foreseeable future. In the event the City later decides to bring this function back in-house, or outsources it to a third party, the transition will likely take a year to accomplish, to train staff and have the new process in place. The MPP agreement requires a two-year notice to withdraw from the agreement.

Recommended Approval of Resolution

The resolution ([Attachment A](#)) recommending Council approval includes the following stipulations for approving the MPP agreement and for transactions executed under the agreement:

1. Transaction terms may not exceed five-years.
2. Transactions must be pre-authorized by the City Manager or the Utilities Director.
3. While the term of the MPP Agreement with NCPA extends until NCPA terminates upon 2 years' written notice to all participations, staff recommends setting a City-imposed limit of Dec. 31, 2040 on the City's participation in the MPP. In 2038, staff will bring a recommendation to terminate or extend participation in this program to Council and work with NCPA to implement Council's action accordingly.
4. There will be no transaction dollar limit, since the annual transaction costs can vary widely from \$7 million to \$20 million depending on the year and the City's procurement needs; however, the City's transaction volume under the MPP Agreement in any given fiscal year may not exceed the Council-approved budget for that fiscal year, and transactions will be limited to those that meet Palo Alto's need for electricity-related Authorized Products, as defined in the City's Energy Risk Management Policy.
5. Transactions must comply with the City's Energy Risk Management Policy, Energy Risk Management Guidelines and Municipal Code, including but not limited to sections 2.30.340(c) and (d), which require certain standard contract terms and forms for wholesale utilities commodities and services contracts, and set forth the process by which NCPA may purchase and sell wholesale utility commodities and services on the City's behalf;
6. Transactions will be exempt from competitive solicitation under Section 2.30.360(l), so long as NCPA's solicitation method and contract form is substantially similar to that required by the City's municipal code.

As each transaction is considered, Utilities staff will compare NCPA and Palo Alto procurement policies and notify the City Attorney and Procurement Officer of any changes to ensure the appropriate level of review for determining whether NCPA's procurement methods are substantially similar to the City's.

In addition, staff proposes revisions to the City's ERMP to recognize the role of NCPA and the MPP agreement to manage electric supply to optimally serve the City's electrical loads, resource management and regulatory compliance needs. The City plans to retain the ability and systems to independently perform these functions through CY 2021, in the event there is a need to do so due to unforeseen circumstances.

Public Engagement

Contracting for energy supply through the MPP agreement is a process to streamline internal operations and hence there was no public engagement in this regard.

Resource Impact

Execution of the MPP Agreement will lower Palo Alto staffing by approximately 0.25 FTE to 0.35 FTE (including both utility and General Fund staffing costs). This benefit will be offset by an increase in annual NCPA management services cost of up to \$15,000. Also, in order to participate in the MPP, Palo Alto needs to maintain financial reserves at NCPA sufficient to cover the cost of transactions for the highest three months, which is estimated currently at \$4 to \$8 million. Staff anticipates providing a letter of credit (LOC) to cover this obligation, the cost of which is estimated to be \$35,000 per year. This amounts to a total cost of \$50,000 per year, for Palo Alto to participate in the MPP. In addition, Palo Alto would incur a one-time fee of \$25,000 for the initial bank LOC set up.

Overall, the net financial impact of transacting through NCPA will be close to neutral to the electric utility, but will help further streamline operations internally, lower the extent of management oversight needed and free up staff time to work on other projects and programs.

Policy Implications

Entering into the MPP agreement to contract for services from NCPA is consistent with the Utilities Department's Strategic Plan mission statement of "providing safe, reliable, environmentally sustainable, and cost-effective services."

Environmental Review

The Council's adoption of a resolution authorizing the City Manager to execute the attached MPP Agreement, and amending the City's ERMP, does not require California Environmental Quality Act review, because these actions are not projects under section 21065 of Public Resources Code and section 15378(b)(5) of CEQA Guidelines, as administrative governmental activities which will not cause a direct or indirect physical change in the environment.

Appendix 1

Table 1. Comparison of the elements of Palo Alto’s and NCPA’s procurement and ERMP

		City Energy Risk Management Policy (ERMP) and Guidelines (Guidelines)	NCPA Energy Risk Management Policy (NCPA ERMP) and Energy Risk Management Regulations (Regulations)
1.	Clearly defined roles, responsibilities, and authority	<p><u>Section C of the ERMP:</u></p> <p>Section C defines the overall roles and responsibilities for the City’s implementation of the ERM Policy. Additionally, the ERM Guidelines and Procedures contain more specific information describing these roles and responsibilities within the energy risk management program structure at the City. The ERMP describes the roles and responsibilities of the City Council, Utilities Advisory Council, City Manager, Utilities Risk Oversight and Coordinating committee, CPAU’s ASD, and the Front Office, Middle Office, and the Back Office.</p>	<p><u>Section 4 of the NCPA ERMP, Section 4 of the Regulations:</u></p> <p>Section 4 of the NCPA ERMP defines the overall roles and responsibilities for implementation of NCPA’s Energy Risk Management Policy. It outlines the basic roles and responsibilities of each function – the NCPA commission, General Manager, Risk Oversight Committee, Risk Management Committee, Front Office, Middle Office, Back Office. Specific details and the specific roles and responsibilities of the oversight and operational divisions within the ERMP structure at NCPA are outlined in the Energy Risk Management Regulations document, developed by the ROC and revised from time to time.</p>

2.	Segregation of duties and delegation of authority	<p><u>Section C of the ERMP:</u> Section C describes segregation of duties and delegation of authority, by describing the roles and responsibilities of the City Council, Utilities Advisory Council, City Manager, Utilities Risk Oversight and Coordinating committee, CPAU’s ASD, and the Front Office, Middle Office, and the Back Office.</p>	<p><u>Section 3.3 of the NCPA ERMP:</u> Section 3.3 of the NCPA ERMP states that responsibilities related to energy transacting shall be segregated in a manner consistent with the control principles listed in Section 3.1 of the NCPA ERMP, by means of clearly defined roles and responsibilities for the Front Office, Middle Office and Back Office operations. Specific roles, responsibilities and organizational structure of these functions are outlined in Section 4. Section 3.3 also states that controls shall be fully integrated into all business activities of NCPA and there shall be active participation by senior management in risk management processes.</p>
3.	Avoidance of speculation and conflict of interest	<p><u>Section D.1 of the ERMP:</u> The ERMP prohibits speculative buying and selling of energy products, defining speculative buying as buying energy not needed for meeting forecasted load or selling energy that is not owned. The ERMP prohibits entering into transactions for the purpose of speculating on market conditions.</p>	<p><u>Section 2.5 of the NCPA ERMP:</u> The NCPA ERMP’s “Purchase to Cover Load Serving Obligations: No Speculation” section highlights that NCPA’s overall objective for energy procurement activities is to cover the load serving obligations of members. It prohibits NCPA from engaging in activities that expose NCPA or its members to speculative transacting risks, and dictates that NCPA shall only utilize approved transaction parameters as determined by the ROC and outlined in the Energy Risk Management Regulations.</p>
4.	Competitive procurement process	<p><u>Section D.3 of the ERMP, Section J.3 of Guidelines:</u> ERMP and Guidelines state that, unless otherwise authorized, traders shall attempt to obtain quotes from at least three eligible counterparties. If fewer than three counterparties are eligible, traders should proceed with as many as possible.</p> <p>Section 2.30.340 of the City’s Municipal Code provides additional detailed procurement requirements for wholesale utility commodity transactions.</p>	<p><u>Section 10.3.2 of the NCPA ERM Regulations:</u> The NCPA ERM Regulations describe the following competitive procurement requirements: For Approved Product transactions scheduled for delivery further than one (1) week in advance, quotes for forward commitments, with the exception of exchange traded transactions, must be obtained competitively from available and approved counterparties, consistent with the size and type of transaction and counterparty. Alternatives are to be evaluated on an equivalent basis. Front Office staff must obtain quotes from at least two (2) qualified suppliers, with the exception of member-to-member transactions, if two (2) approved</p>

			counterparties are available. Alternatives are to be evaluated on an equivalent basis.
5.	Counterparty credit management	<p><u>Section E of the ERMP:</u> The Palo Alto ERMP discusses strategies to minimize credit exposure risks related to wholesale commodity transactions and potentially defaulting counterparties. PAMC Section 2.30.340 sets forth creditworthiness standards and contractual provisions applicable to wholesale utility commodity contracts. As such, transactions carried are limited to counterparties with a Standard and Poor’s issuer rating of BBB- or better, or a Moody’s Investor Services issuer rating of Baa3 or better. Council can approve exemptions to counterparty credit requirements under PAMC Section 2.30.340(c).</p> <p>In addition, Appendix 1, Section 1 of the Guidelines establishes the maximum counterparty transaction limits and credit exposure limits.</p>	<p><u>Section 2.1 of the NCPA ERMP:</u> The NCPA ERMP has requirements similar to that described in PAMC Section 2.30.340, that for all fixed price energy transactions, the counterparty must possess at least a BBB- (or equivalent investment grade rating) by a nationally recognized statistical rating organization (NRSRO). NCPA staff may consider counterparties with a rating below investment grade, or a counterparty without a NRSRO rating on a case-by-case basis with the approval of the ROC.</p> <p>In addition, Section 18.2 of the Regulations establishes maximum counterparty transaction limits and credit exposure limits.</p>
6.	Transactions limited to authorized products	<p><u>Section G of the ERMP:</u> Section G of the ERMP lists the types of products the City Manager can transact for under Council-approved Master Agreements.</p>	<p><u>Section 20.2 of the Regulations:</u> Section 20.2 describes the “Approved Products”, or the types of Energy related products that NCPA is authorized to transact, and Appendix 6 Regulations lists these Approved Products.</p>
7.	Risk management reporting and management oversight	<p><u>Section F of ERMP, and Section G of the Guidelines:</u> The ERMP highlights the importance of reporting critical information to relevant parties as a key component of energy risk management. The ERMP and the ERM guidelines describe the various types of reports required of the different units in the risk management organizational structure, the content of the reports, and the frequency of producing those reports.</p>	<p>Several sections of NCPA’s ERM Regulations describe various risk management reporting requirements such as NCPA members’ open positions reporting, compliance exceptions reporting, market data monitoring and reporting, counterparty exposure and transaction limits reporting, etc. Appendix 7 of the document lists the entire set of required management reports and reporting frequency.</p> <p>Section 3 of the ERMP outlines control</p>

		Appendix 5 of the ERM guidelines lists the entire set of required management reports and reporting frequency.	principles that include accurate and effective management reporting, and performance measurement and reporting.
8.	Master agreement contracting terms with vendors	<u>Section F of ERM guidelines:</u> Section F of ERM guidelines describes counterparty contractual guidelines such as required contract terms with vendors, preferred credit contract form and terms, and compliance with Section 2.30.340 of the City’s Municipal Code.	<u>Section 14 and Section 20 of the Regulations:</u> Section 14 discusses contract terms to address counterparty and credit risk, and Section 20 discusses wholesale credit/counterparty management strategies (including Master Enabling Agreements).

Attachments:

- Attachment A: Resolution Approving MPP and Modifications to ERMP

NOT YET APPROVED

Resolution No. ____

Resolution of the Council of the City of Palo Alto Approving the Amended and Restated Market Purchase Program Agreement with the Northern California Power Agency, Authorizing the City Manager or Their Designee to Authorize NCPA to Purchase and Sell Electricity and Related Products Under the Agreement, and Approving Revisions to the City's Energy Risk Management Policy

R E C I T A L S

A. The City of Palo Alto (City, Member, Participant) is a founding member of the Northern California Power Agency (NCPA), a joint action agency providing members with opportunities for joint generating, transmission and other projects, as well as supporting programs such electrical load and supply balancing services and legislative advocacy to publicly owned utilities throughout Northern California.

B. NCPA offers its members additional support services such as transacting in energy supplies and related products for durations of greater than one month. These energy products include the purchase and sale of energy, electrical resource adequacy capacity, renewable energy credits and other authorized electricity-related products as outlined in Section G of the Council-approved Energy Risk Management Policy.

C. Approval of the attached Market Purchase Program (MPP) Agreement between the Northern California Power Agency (NCPA) and the City will provide the opportunity for the City to receive the benefit of these new services.

D. Section 6.3 of the MPP Agreement provides that the City's Designated Representatives are responsible for committing to individual transactions on behalf of City and that the governing board of said member delegates authority to NCPA to bind the City/Participant to contractually receive and pay for service offerings in writing through a Participant Authorization process.

E. In addition, the City's participation in the MPP Agreement requires revisions to the City's Energy Risk Management Policy to recognize NCPA's role to transact in energy supply products for durations greater than a month, and to stipulate that such transactions will be undertaken under the framework of NCPA's Energy Risk Management Policy, with additional conditions, if any, imposed by staff upon each transaction as needed to conform to City's ERM Policy, Guidelines and Municipal Code.

The Council of the City of Palo Alto RESOLVES as follows:

SECTION 1. The Council approves and authorizes the City Manager or their designee to execute the Market Purchase Program Agreement (MPP Agreement) (Attachment B) between the Northern California Power Agency and the City of Palo Alto

NOT YET APPROVED

under which the City may authorize NCPA to purchase and sell electricity and related products on behalf of the City;

SECTION 2. The Council designates the Utilities Director as the City’s Designated Representative under the MPP Agreement to authorize NCPA to purchase and sell electricity and related products on behalf of the City, subject to the following conditions:

- a. Transaction terms may not exceed five years;
- b. Transactions must be pre-authorized by the City Manager or the Utilities Director.
- c. The City’s transaction volume under the MPP Agreement in any given fiscal year may not exceed the Council-approved budget for that fiscal year, and transactions will be limited to those that meet Palo Alto’s need for electricity-related Authorized Products, as defined in the City’s Energy Risk Management Policy.
- d. Transactions must comply with the City’s Energy Risk Management Policy, Energy Risk Management Guidelines and Municipal Code, including but not limited to sections 2.30.340 (c) and (d), which require certain standard contract terms and forms for wholesale utilities commodities and services contracts, and set forth the process by which NCPA may purchase and sell wholesale utility commodities and services on the City’s behalf;
- e. Transactions will be exempt from competitive solicitation under Section 2.30.360(l), so long as NCPA’s solicitation method and contract form is substantially similar to that required by the City’s municipal code.

SECTION 3. The Council authorizes the City’s participation in the MPP until the end of 2040. In 2038, staff will bring a recommendation to Council to terminate or extend participation in the MPP, and will work with NCPA to implement Council’s direction accordingly.

SECTION 4. The Council approves modifications to the City’s Energy Risk Management Policy (Attachment C) to recognize the role of NCPA in transacting electric energy-related products under the MPP agreement.

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NOT YET APPROVED

SECTION 5. The Council's adoption of this Resolution authorizing the City Manager to execute the attached MPP Agreement, and amending the City's ERMP, does not require review under the California Environmental Quality Act, because these actions are not projects under section 21065 of Public Resources Code and section 15378(b)(5) of CEQA Guidelines, as administrative governmental activities which will not cause a direct or indirect physical change in the environment.

INTRODUCED AND PASSED:

AYES:

NOES:

ABSENT:

ABSTENTIONS:

ATTEST:

City Clerk

Mayor

APPROVED AS TO FORM:

APPROVED:

Assistant City Attorney

City Manager

Director of Utilities

Director of Administrative Services