

Agenda Report

April 9, 2007

To: CITY COUNCIL
Through: MUNICIPAL SERVICES COMMITTEE

From: CITY MANAGER

Subject: AUTHORIZATION TO ENTER INTO A CONTRACT WITH THE SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY AND THE ALLIANCE FOR COOPERATIVE ENERGY SERVICES POWER MARKETING, LLC FOR SERVICES TO MANAGE ENERGY TRANSACTIONS

RECOMMENDATION:

It is recommended that the City Council Authorize the City Manager to enter into a contract ("Contract") with the Southern California Public Power Authority ("SCPPA") and the Alliance for Cooperative Energy Services Power Marketing, LLC ("APM") for services to manage energy transactions and energy scheduling in an amount not to exceed \$1,000,000/year plus \$185,000 in one-time set up fees.

This contract is exempt from competitive bidding pursuant to City Charter Section 1002(h) contracts with other governmental agencies or their contractors, and City Charter Section 1002(f) contracts for unique or professional services.

BACKGROUND:

Due to the increasing complexity of energy markets and demands on existing Pasadena Water and Power ("PWP") staff and resources, staff recommends contracting with SCPPA and APM to provide support services related to energy portfolio position analysis, reporting, and optimization; counterparty credit evaluation and monitoring; and transaction execution, scheduling, confirmation and settlements. These services would be provided in accordance with Pasadena's approved Energy and Credit Risk Management Policy. The proposed Contract allows PWP the option to retain control and key decision making authority at various levels.

Each hour of every day, PWP must determine how much energy is needed and where it will come from. PWP forecasts its hourly electric loads and chooses the most reliable and economic generation, contractual, and spot-market energy resources options to meet these electric loads. Once the resource "schedules" are set, they must be communicated electronically, in various formats, to various resource operators, utilities, power system operators, and regulatory bodies. This process is followed on a "day-ahead" basis, called "pre-scheduling," and then repeated for every hour during the day the energy is actually used in what is called "hour-ahead" or "real-time" scheduling.

Real-time energy scheduling functions are currently performed by PWP's Senior Power Dispatchers. The Senior Power Dispatchers also provide oversight of, and assistance to, power distribution switching operations. As a result of increased power distribution workload associated with the Power Distribution System Master Plan, it was concluded that switching activities would increase by mid-2007 to the point where the Senior Power Dispatchers would no longer be able to support both functions. Since real-time energy transactions and scheduling requires a continuous 7x24 operation, an additional five staff positions would be required at a cost of approximately \$800,000-\$1,000,000 per year to manage real-time energy transactions and scheduling.

The single largest challenge facing Pasadena and many SCPPA members is the Market Redesign and Technology Upgrade ("MRTU") initiative being pursued by the California Independent System Operator ("CAISO"). Scheduled to go live January 31, 2008, MRTU will significantly change energy trading and scheduling practices in California and will have substantial financial and operational impacts on Pasadena. It will require substantial investment to train staff, participate in market simulations, and upgrade Pasadena's software systems, business practices and procedures. Furthermore, there will likely be many incremental changes in the market design and procedures throughout 2008 requiring additional systems changes. In order to adequately prepare for MRTU while continuing to perform current energy scheduling activities, Pasadena would need to nearly double its staff resources in this area for the next two to three years.

Several SCPPA members are struggling with similar issues, and collaborated in an effort to review options to manage them. While the concept of developing a joint scheduling operation was discussed, increasing staffing, developing necessary expertise in locational marginal pricing and financial congestion management, and upgrading software systems within the short time line dictated by the MRTU implementation schedule (and the Master Plan for PWP) were deemed infeasible. The interested SCPPA members agreed that outsourcing these services was the most viable solution in the near term.

The members interested in joint-action through SCPPA issued a Request for Proposal ("RFP") on September 22, 2006 to solicit proposals from possible solution providers and get pricing proposals. A total of seven vendors submitted proposals. A SCPPA evaluation team short-listed three vendors based on their experience, breadth of services, client references, and overall value. Following additional presentations to SCPPA and reviews of client references, APM was selected for contract negotiations, due largely to their extensive experience with public power clients and specific experience in the CAISO markets.

APM operates as a non-profit limited liability corporation that is owned by, and provides energy scheduling services to, cooperative electric companies and public power agencies. APM has a staff of approximately 150 individuals and proven information systems to support transactions for their current customer base of approximately 25 electric cooperatives, municipalities, and public corporations. APM's fees are based on a cost-of-service model, rather than for profit, and APM has successfully worked with customers, including four that operate in the CAISO, to develop cooperative relationships to the benefit of both parties.

The proposed Contract will provide Pasadena and other participating SCPPA members with services from substantial staff resources and sophisticated software systems that would otherwise be too costly for small to medium utilities to maintain. The Contract will include a "Service Schedule" for each participating SCPPA member that provides the option to select from a range of services priced according to their specific needs and demands. The Service Schedules may be amended over time by the Participating Member in a manner similar to change orders.

Under the Contract, Pasadena would designate APM to act as an agent on Pasadena's behalf for transacting in bilateral and CAISO energy markets and have the option to designate APM to perform similar services for natural gas. Initially, APM staff would be granted the same-day and day-ahead transaction authority and be responsible for associated scheduling functions. Over time this authority may be extended to include balance of month transactions. APM will also execute transactions in forward markets with prior approval from Pasadena for each transaction.

In addition to transaction services, APM will provide analytical support to PWP's energy portfolio optimization and risk management processes. APM will provide daily credit and position reports, recommend transaction and dispatch strategies, and invoice-ready transaction settlements data. APM will use proprietary software tools configured to model PWP's assets, loads, and current trade positions.

APM maintains rigorous controls to continuously monitor portfolio and credit positions, and to ensure that all trades are conducted with authorized counterpar-

ties and within authorized limits. PWP and APM will develop trading controls and an authority matrix to reflect and enforce Pasadena's Council-Approved Energy and Credit Risk Management Policy.

For Pasadena, this Contract provides an opportunity to reduce the procedural burden on existing staff so that they may focus more time on strategic initiatives related to energy transactions (e.g. performance evaluation, management reports, forward hedging strategies and asset optimization) and to study and prepare Pasadena for the substantial impacts of MRTU and other industry and regulatory changes. Furthermore, it will free up Senior Power Dispatchers to focus on safely planning, executing, and reviewing switching orders to support the increased activity related to the Power Delivery Master Plan. APM will provide the "duplicate staff" necessary to work through the challenges of MRTU implementation and provide PWP an opportunity to evaluate options for these services in the future.

While APM will be required to develop, implement, and maintain necessary technology and systems to perform services on behalf of PWP, at this time PWP intends to retain systems, skills and knowledge required to self perform energy transactions, scheduling, and settlements to the extent practical. As a result, PWP does not anticipate any immediate reductions in staff or software expenses. PWP will reevaluate the financial and staff impacts of maintaining MRTU-compliant software systems as major investments may be required.

The initial term for Pasadena is three years, however the contract provides for both indefinite extensions and early off ramps.

The total cost of these initial services, \$815,000 per year (plus a \$185,000 implementation charge), is approximately equivalent to the costs of staffing an additional desk to support real-time transactions and scheduling processes. However, the services provided for this price go beyond real-time transaction services to include analysis of PWP's forward portfolio to support risk management and portfolio optimization, credit risk management, day-ahead and forward market energy transactions, and energy transaction verification services.

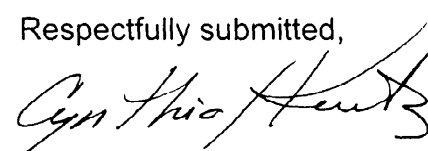
Staff is recommending contract authority of up to \$1,000,000 annually to accommodate growth in services, such as gas portfolio and transaction management, and cost escalation in costs over the first three contract years.

Under terms of the contract, liability is strictly limited and damages are limited to one-year's total compensation in the event of gross negligence or willful misconduct.

FISCAL IMPACT:

A one time implementation charge of \$185,000 and annual costs of approximately \$815,000 (not to exceed \$1,000,000/year) will be charged to the Power Fund budget (account 8114-401-841500-0561). Sufficient funds exist for FY2007 and will be requested for FY2008. The cost associated with this Contract will be recovered in the Energy Charge component of Pasadena's electric energy rates, and will have no impact on the General Fund. These costs may be offset by reduced energy procurement costs and/or enhanced revenues as a result of improved energy portfolio management.

Respectfully submitted,



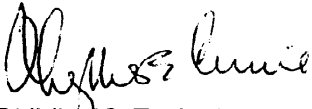
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