

Agenda Report

November 20, 2006

To: CITY COUNCIL
THROUGH MUNICIPAL SERVICES COMMITTEE

From: CITY MANAGER

Subject: AUTHORIZATION TO INCREASE THE AMOUNT OF NATURAL GAS PURCHASED UNDER THE "NATURAL GAS PROJECT GAS SALES AGREEMENT" NO. 18,842 WITH THE SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY TO A MAXIMUM OF 2,000 MILLION BRITISH THERMAL UNITS PER DAY

RECOMMENDATION:

It is recommended that the City Council Authorize the City Manager to increase the amount of natural gas purchased under the Natural Gas Project Gas Sales Agreement, Contract No. 18,842 ("Contract") with the Southern California Public Power Authority to a maximum of 2,000 Million British Thermal Units ("MMBtu") per day.

The Contract is exempt from competitive bidding pursuant to City Charter Section 1002(h) contracts with other governmental agencies or their contractors.

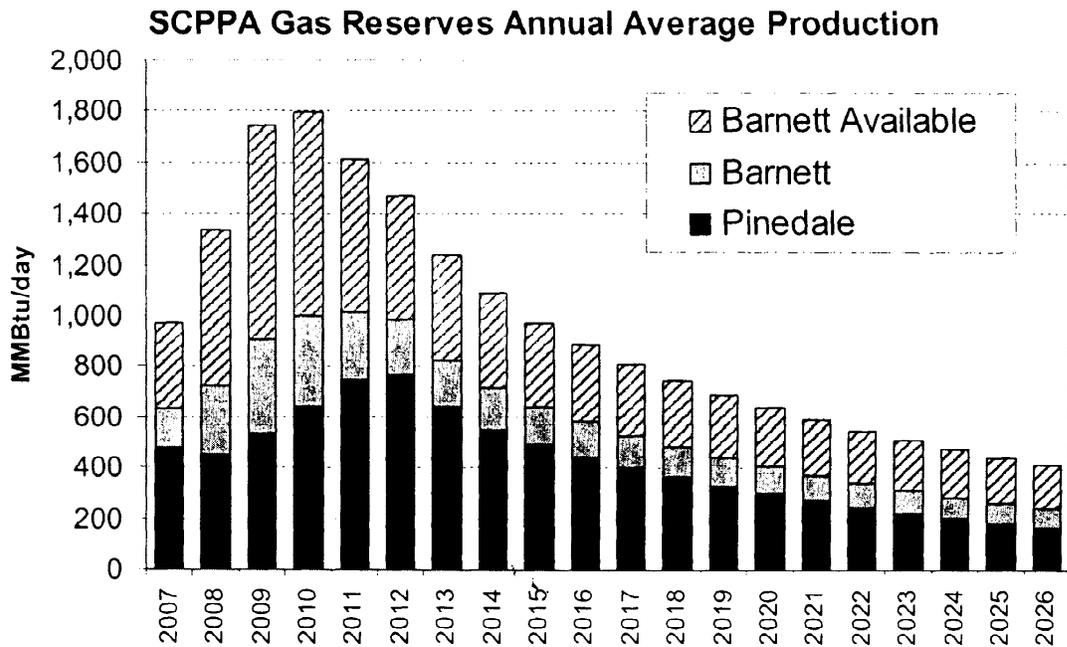
BACKGROUND

On May 23, 2005, the City Council authorized the City Manager to enter into a contract with the Southern California Public Power Authority ("SCPPA") for up to 1,000 Million British Thermal Units ("MMBtu") per day of natural gas derived from various natural gas reserve properties located in North America. At the authorized maximum deliveries of 1,000 MMBtu per day, the Contract could provide up to 13% of Pasadena Water and Power's ("PWP") forecast annual gas needs at a stable price that is not dependent upon the volatile natural gas market or contracts with private energy marketing firms and is predictable for budgeting purposes.

SCPPA has procured two gas producing properties, one in the Pinedale region of Wyoming and the other in the Barnett Shale Formation in Texas. PWP has been receiving gas from the Pinedale field for over a year at an attractive price. The Barnett property was secured on October 26, 2006, and PWP expects deliveries to commence by January 2007 at below market costs. SCPPA does not anticipate securing any additional properties under the Contract, but SCPPA has secured an option to increase its ownership of the Barnett property.

Based on proven reserves at this time, the average cost of gas over the next 30 years from the Barnett property is anticipated to be under \$6/MMBtu. The Barnett formation is in the early stages of development and has the potential to provide greater deliveries than currently projected with denser drilling. Assuming proven reserves increase as a result of additional drilling, the average cost of this gas may decline from current projections.

At the previously approved level of participation, the combined total proven reserves from these two properties are projected to provide PWP with approximately 620 MMBtu per day in 2007 and a maximum of 1,000 MMBtu per day in 2011 as shown in the figure below. Approximately 75% of the deliveries will be from the Pinedale property and 25% from the Barnett property.



The proposed increase would result in a more balanced supply from the two properties and result in average deliveries over the next 20 years that reflect Pasadena's original level of interest in securing natural gas from ownership in producing properties. Assuming Pasadena increases its share of the Barnett property to the maximum available, the expected combined maximum delivery rate will reach approximately 1,800 MMBtu per day in 2010 and the expected annual average production over the next 20 years will increase to approximately 950 MMBtu, with 45% from the Pinedale property and 55% from the Barnett property. Depending on the level and success of the drilling program at these properties, actual deliveries may be more or less than projected in any given year, and it is possible that PWP will receive in excess of 2,000 MMBtu per day in some years.

Changes in SCPPA Participation

When SCPPA identified the Barnett property and performed due diligence, it was anticipated to provide a relatively small amount of Pasadena's share of the reserves. Although Los Angeles Department of Water and Power ("LADWP") supported the Barnett property based on its merits and developed a staff recommendation, they did not receive authority to proceed with this project. The decision whether to participate was not based on the merits of the Barnett property but rather based on a desire to concentrate LADWP resources on other projects. The City of Glendale also chose to not participate and additional shares were available to the remaining participants.

These remaining SCPPA participants (Anaheim, Burbank, Colton, and Pasadena) and the Turlock Irrigation District opted to take their maximum shares up to their authorized levels, and SCPPA reduced its commitment to procure the property with the option of securing additional volumes within 45 days of closing. The City of Burbank has increased its participation and others are considering this during the 45 day window that ends December 10, 2006. The additional authorization being requested is to allow the City to procure the reserves available from the two participants that have opted out of the project. As described above, the average deliveries over the next 20 years are estimated to be 950 MMBtu/day. Since some years exceed the 1,000 MMBtu/day authorization, this additional authorization clarifies the quantities anticipated under the two projects.

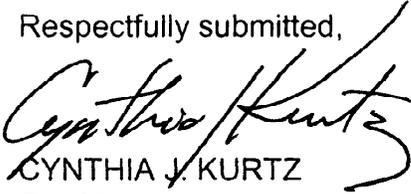
Capital Costs

At the current authorized level of participation PWP has paid \$9.2 million to secure the two properties, and expects to pay an average of \$0.9-1.2 million annually in on-going capital costs to support the drilling programs at these two properties over the next five years. If Pasadena increases its participation in the

Barnett project, PWP will incur additional one-time costs of approximately \$6 million to secure the property and an additional \$1 million per year on average over the next five years to support the drilling programs. These capital expenditures are reflected in the estimated total cost of gas from these properties.

FISCAL IMPACT:

The projected cost of natural gas procured under this contract will average between \$5.50 and \$6/MMBtu (at present value) which is below projected average market prices. Additional capital expenditures to support the drilling program and increases or decreases in proven reserves may result in lower or higher average gas production costs. All costs associated with this contract will be recovered in the Energy Charge component of Pasadena's electric energy rates. To the extent the cost of fuel procured under the Contract is below market rates, the Energy Charge rates will reflect these savings.

Respectfully submitted,

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