

# Agenda Report

**To:** City Council

**Date:** April 30, 2007

**Through:** Municipal Services Committee

**From:** City Manager

**Subject:** Authorize the City Manager to enter into a contract with Southern California Public Power Authority ("SCPPA") for a 20 Year Prepaid Natural Gas Supply Agreement for an average of 2,000 MMBtu per day

## **RECOMMENDATION:**

It is recommended that the City Council:

1. Authorize the City Manager to enter into an agreement with Southern California Public Power Authority (SCPPA) for a 20 Year Prepaid Natural Gas Supply Agreement ("Agreement") to deliver an average of 2,000 MMBtu per day.
2. Adopt a Resolution authorizing approval of the Natural Gas Supply Agreement.
3. Grant the proposed Natural Gas Supply Agreement an exemption from competitive bidding pursuant to City Charter section 1002 (H), contracts with other governmental entities or their contractors for labor, materials, supplies or service.

## **BACKGROUND:**

The City of Pasadena Water and Power Department (the "Department") is continuously seeking to maintain a diverse resource mix that provides both reliable and low cost power to its customers. The Department is currently taking action to increase its renewable generation and cleaner-burning gas-fired generation that will remain a core component of the Department's total resources. Gas-fired generation is expected to be approximately 18% of Pasadena's resources within the next 10 years, including projected repowering projects to increase local generation. Inclusive of the expected increases in local resources, the Department is currently forecasting that its average annual natural gas volume requirement will be approximately 1.9 million MMBtu, reaching an average of about 5,000 MMBtu per day over the next 10 years. If approved, the proposed Agreement will supply Pasadena with an average of 2,000 MMBtu per day, or about 40% of the forecasted 10-year average requirement for the

next 20 years at a discounted price *below* a market standard index (i.e. SoCal Border Index). Pasadena's daily natural gas requirement for its share of the Magnolia Power Plant is approximately 2,500 MMBtu per day.

By executing this long-term supply Agreement, Pasadena will diversify its gas supply arrangements, as well as mitigate price and supply volatility. This will greatly improve the reliability of natural gas supplies over the next 20 years.

Pasadena also participates in SCPPA's Natural Gas Reserve project (approved by City Council on 11/20/2006) which is currently delivering about 475 MMBtu to Pasadena per day. The project is ultimately expected deliver up to 1,800 MMBtu per day for Pasadena. The Department has been procuring the balance of its natural gas volume requirement in the daily and monthly bilateral markets for a period up to one year in advance at index prices.

***Southern California Public Power Authority***

SCPPA, a California Joint Powers Agency, is able to offer discounted gas to Pasadena and five other participating municipal utilities (Los Angeles, Burbank, Anaheim, Colton, and Glendale; collectively, the gas users), due to its legislative authority, tax-exempt governmental status, and recent IRS regulations.

The vehicle that SCPPA will utilize in order to provide discounted gas to its participating municipal utilities is commonly referred to as a Natural Gas Prepayment Transaction. Commodity prepayment transactions are not new to municipal utilities. Several municipal utilities entered into commodity prepayment transactions as early as the 1990's. Pasadena participated in a similar program for prepaid natural gas with American Public Energy Agency (APEA) in 2000. However, the current form and structure of these transactions are based upon the final Internal Revenue Service (IRS) regulations adopted on October 3, 2003, followed by the adoption of the Energy Policy Act of 2005, which provided clarity on structures that are acceptable under the regulations. SCPPA, upon advisement of its tax counsel, has structured its prepayment transaction under the strictest compliance with the IRS regulations.

A natural gas prepayment transaction permits a joint action agency like SCPPA to borrow money at lower tax-exempt rates and to use the proceeds to pay a gas supplier an upfront (one-time) payment for delivery of fixed volumes of gas over a specified period of time. The gas must be used by a municipal utility in its own service area or by another "qualified user" through mutual agreement with the city. The discounted price that SCPPA offers to Pasadena and other participating municipal utilities is primarily the result of the difference between SCPPA's lower tax-exempt rates and the higher taxable cost of funds of the gas supplier. The price paid by Pasadena for natural gas through the terms of this Agreement will continually be lower by the guaranteed discount than spot market prices at the time gas is delivered.

Prepay transactions are highly structured in order to minimize the financial risks and exposures to SCPPA. Pasadena, as a gas user, is even further removed and protected as it simply has a "take-and-pay", non-recourse Gas Supply Agreement with SCPPA,

meaning that Pasadena is only obligated to pay for the gas actually delivered. Additionally, there are no step-up provisions in the Agreement that would require Pasadena to assume the risks or volume commitments of other SCPPA participants in the event of their default. As stated by the rating agencies in their research and credit publications relating to natural gas prepayments, the only risk to the gas users or municipal utilities is the unlikely event of early termination of the prepay transaction due to unforeseen events. In this case, the potential price exposure to Pasadena is limited to buying replacement gas in the spot market without the benefit of the discount, effectively returning the Department to its position in the natural gas market just as it is today.

### ***Pricing***

Under the terms of this Agreement with SCPPA, Pasadena will continue to purchase natural gas at the floating price set monthly at index, less a discount estimated between 35 cents and 60 cents per MMBtu to the SoCal Border Index price, for a 20-year contract. Shorter contracts result in fewer savings while longer contracts result in more savings. Long-term contracts also provide more reliability. A 20-year term was selected by Pasadena to allow for the best balance of savings, flexibility, and reliability. The contemplated volume and discount price will result in operational savings ranging from \$255,000 to \$430,000 annually, or \$5.1 million to \$8.5 million over the next 20 years, based on bond market conditions as of mid-January. The actual discount to index will depend on the market conditions at the time the Agreement is executed and will be locked in on the closing date, anticipated to be June or July 2007.

### ***Benefits and Risk***

The non-recourse structure of the Agreement allows Pasadena to continue treating natural gas purchases as an operating expense of the Department. The transaction has no impact on the Department's credit, debt capacity or financial coverage ratios, which has been confirmed with the various rating agencies. As indicated previously, the risk to Pasadena arises primarily if the transaction is terminated early due to non-performance. In the event of early termination, the Department would simply return to purchasing natural gas supplies as it does today, at the index price with no discount. In the case of non-performance by the gas supplier, this risk is at least partially mitigated through a "make-whole" provision in which Pasadena will be compensated at the present value of the unrealized savings that can't be replaced.

Under the terms of this Agreement, SCPPA and the participants, including Pasadena, are not exposed to counterparty credit risk. In the highly improbable event that the counterparty (Goldman, Sachs & Co.) experiences catastrophic financial failure or bankruptcy, the Agreement would terminate and the bonds associated with the transaction would be redeemed pursuant to terms of the Agreement.

### ***Gas Supplier***

SCPPA began soliciting interest to enter into a Gas Supply Agreement from its member agencies in late 2005. Upon receiving sufficient indications of interest from the member participants, SCPPA began an extensive RFP process to select a qualified gas

SCPPA Natural Gas Prepay Agreement

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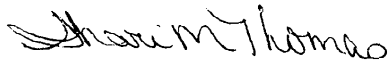
supplier/financial institution for a natural gas prepayment transaction. At the conclusion of the selection process, Goldman Sachs & Co. was unanimously selected based upon the approved selection criteria. Goldman Sachs & Co.' wholly-owned gas subsidiary, J. Aron, will be the gas supplier for SCPPA's Natural Gas Prepayment Transaction. The transaction is scheduled to close in June or July 2007 with gas flowing shortly after the closing date.

**FISCAL IMPACT:**

The Prepay Agreement will provide a secure and long-term supply of natural gas of approximately 2,000 MMBtu daily or 730,000 MMBtu annually, which represents about 40% of Pasadena's projected aggregate 10-year usage for the Magnolia Power Plant and local generation. The Agreement provides this supply at a discounted price below spot market price (the SoCal Index) over the next 20 years. The projected discount of 35 cents to 60 cents per MMBtu will result in savings of \$255,000 to \$430,000 annually or \$5.1 million to \$8.5 million over the next 20 years.

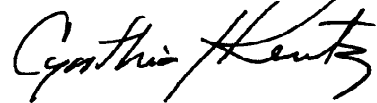
The cost associated with purchasing natural gas through the Agreement will be recovered through the energy charge component of the electric rates; just as costs for natural gas purchases are currently recovered. Estimated costs for natural gas purchases are included in the budget of the Power Supply division account 8229-401-841910-0501. Actual costs associated with the purchase of natural gas delivered through the Agreement will be based on index prices at the SoCal border (less the discount).

Prepared by:



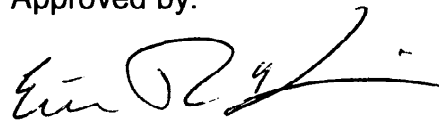
SHARI M. THOMAS  
Business Unit Director  
Water and Power Department

Respectfully Submitted:



CYNTHIA J. KURTZ  
City Manager

Approved by:



PHYLLIS E. CURRIE  
General Manager  
Water and Power Department

RESOLUTION NO.

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF PASADENA APPROVING THE GAS SUPPLY AGREEMENT BETWEEN THE CITY OF PASADENA AND THE SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY, AUTHORIZING THE CITY MANAGER TO EXECUTE AND DELIVER THE GAS SUPPLY AGREEMENT AND APPROVING THE PARTICIPATION OF THE CITY OF PASADENA IN THE ACTIVITIES AND PROGRAMS REFLECTED THEREIN PURSUANT TO THE TERMS AND CONDITIONS OF THE GAS SUPPLY AGREEMENT

WHEREAS, the City of Pasadena has participated with other members of the Southern California Public Power Authority (SCPPA) in investigating alternative means by which to secure critically necessary long-term reliable supplies of natural gas necessary to carry forth the city's electric generation responsibilities to its citizens of Pasadena; and

WHEREAS, the City of Pasadena and a number of other members of the Southern California Public Power Authority that are participants in the SCPPA natural gas prepayment program, to wit: the cities of Anaheim, Burbank, Colton, Glendale, LADWP and Pasadena, have carried out investigations and studies concerning the commercial advantages in utilizing a prepayment methodology for the acquisition of long-term reliable supplies of natural gas which are proposed to be carried forth and financed by SCPPA; and

WHEREAS, the City of Pasadena and other SCPPA member cities which are participating in this natural gas prepayment project have examined a variety of proposals from natural gas suppliers and interviewed individuals having

substantial background and experience in the issues associated with the acquisition of prepaid supplies of natural gas; and

WHEREAS, the member city participants in this SCPPA project have concluded the investigation associated with this program with the selection of a natural gas supplier (J. Aron) affiliated with a large financial institution (Goldman, Sachs & Co.) to carry forth the methodology contemplated by this specific gas supply and financing structure; and

WHEREAS, it is contemplated that SCPPA will sell bonds to finance a natural gas prepayment to J. Aron and, in turn, enter into a prepaid natural gas sales agreement with J. Aron, under which SCPPA will provide the gas generated pursuant to this prepaid natural gas sales agreement to the SCPPA participants which will take those amounts specified in the Gas Supply Agreements; and

WHEREAS, the proposed Gas Supply Agreement between the City and SCPPA will provide for certain terms under which the city will pay for and be entitled to certain predetermined amounts of natural gas to fuel its generation facilities; and

WHEREAS, the City of Pasadena desires to participate in this program to procure a long term reliable supply of natural gas by which to generate electricity to carry forth its responsibilities to provide reliable electric energy to its citizens

and desires to enter into the Gas Supply Agreement between Pasadena and SCPPA to carry forth these goals:

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Pasadena as follows:

1. In accordance with the City Charter and the laws of the City of Pasadena the City Council hereby approves the Gas Supply Agreement between the Southern California Public Power Authority and the City of Pasadena; and

2. The City Council authorizes the scheduling to the Pasadena Electric System of up to 4,000 MMBtu's per day of natural gas pursuant to the Gas Supply Agreement at a price entailing a discount from the applicable index equal to or greater than \$0.35 per MMBtu; and

3. The City Manager is hereby authorized to execute and deliver the Gas Supply Agreement, with such changes, insertions and omissions as shall be approved by the official executing the Gas Supply Agreement (such approval to be conclusively evidenced by such execution), and the City Clerk is hereby authorized to attest to such signature; and

4. The City Manager is hereby authorized to execute and deliver any and all other documents and instruments and to do and cause to be done any and all acts

and things necessary or advisable for carrying out the transactions contemplated by this Resolution.

5. This Resolution shall take effect on the date below.

This Resolution is passed and adopted at the regular meeting of the City Council of the City of Pasadena on this \_\_\_\_\_ day of \_\_\_\_\_, 2007.

AYES:


NOES:

ABSENT:

ABSTAIN:

\_\_\_\_\_  
CITY CLERK

APPROVED AS TO FORM:

  
Scott D. Rasmussen  
Assistant City Attorney