Agenda Report

September 24, 2007

To: City Council

From: City Manager

Subject: AUTHORIZATION TO ENTER INTO A CONTRACT WITH THE CITY OF AZUSA FOR THE SALE OF LOCAL RESOURCE ADEQUACY CAPACITY

RECOMMENDATION:

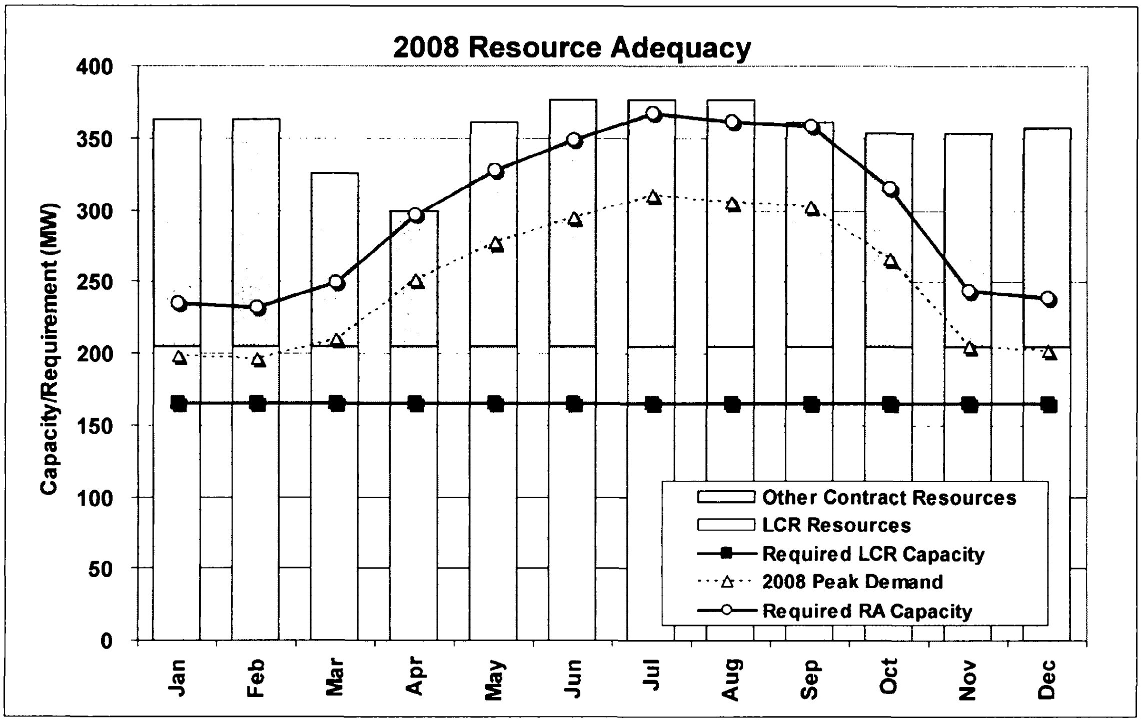
It is recommended that the City Council Authorize the City Manager to enter into an agreement with the City of Azusa for the sale of up to 10 MW of excess generation capacity for local capacity resource adequacy purposes during calendar year 2008 in the amount of $165,000.

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

BACKGROUND:

In the aftermath of the California energy crisis, the state regulatory agencies and the legislature have debated the means to prevent similar crises in the future. It is a generally accepted belief, and a long-standing policy and practice of Pasadena Water and Power ("PWP"), that electric load serving entities ("LSE's") such as PWP should plan ahead of time in the procurement of sufficient generation resources plus a reasonable planning reserve margin to ensure both the affordability and reliability of electric services. In November 2001, the City Council adopted PWP's 2001 Strategic Resource Plan ("SRP") which, in accordance with Western Electric Coordinating Council planning criteria and past practice, set PWP's planning reserve margins equal to 15% of forecast electric load plus transmission losses, which average 3% of load. For example, PWP must procure 367 MW of generation resources in order to meet the forecast 310 MW peak load in 2008. As this requirement applies on a monthly basis, PWP has excess capacity ranging from 3 MW to 130 MW for 2008, depending upon the month. The SRP also calls for PWP to maintain 150 MW to 200 MW of local generation capacity to ensure reliable electric service in Pasadena.

The following graph depicts PWP's total LCR and RA capacity (as vertical bars) as well as forecast monthly peak demand and required LCR and RA capacity.



Since 2005, the California Independent System Operator ("CAISO") has been developing continuously evolving rules for LSE's served by the CAISO such as PWP and Azusa. Generally, these rules include development of system-wide resource adequacy requirements ("RA") and local capacity resource adequacy requirements ("LCR") for LSE's, certification of generation resources for RA and LCR, developing associated obligations for such generators, and performing "backstop" capacity procurement by the CAISO to meet any RA or LCR deficiencies and allocation of associated costs. LSE's must report their capacity supply plans, showing their forecast load, planning reserve requirements, and generation resources under contract to meet the RA and LCR requirements to the CAISO by September 30 of each year.

While the CAISO tariff gives some latitude to local regulatory authorities, such as the Pasadena City Council, to adopt and enforce RA and LCR standards, most LSE's have opted to follow the CAISO's guidance to minimize their exposure to potential backstop procurement costs or penalties.

The CAISO has determined the amount of qualifying LCR capacity that each LSE must show that it has procured for Calendar Year 2008. PWP's 2008 LCR is

165 MW, or approximately 52% of PWP's projected 310 MW annual peak load. PWP's local power plant has been certified by the CAISO to provide 196.85 MW of qualifying LCR capacity, or about 32 MW in excess of PWP's LCR requirement. PWP is also working on certifying approximately 8 MW of additional LCR capacity from the Minnesota Methane landfill gas power supply contract.

As the CAISO has not established a market mechanism for buying and selling RA and LCR capacity, direct transactions through bilateral agreements are PWP's only vehicle for buying or selling these new capacity products

PWP has identified an opportunity to sell a portion of its excess local generation capacity to the City of Azusa to assist Azusa in meeting their 2008 LCR requirements. The sale includes only the right for Azusa to report the capacity to CAISO as meeting Azusa's LCR requirement so that Azusa is not subject to potential penalties or backstop procurement cost allocations. The sale does not include any entitlements to the capacity or energy output of PWP's local generation resources for ancillary services markets, operating reserves, or energy to meet load. PWP will continue to schedule these resources as needed for Pasadena's electric load or bid these resources into the CAISO markets and receive all associated revenues.

Historically, capacity and energy transactions entered into by PWP have been intended for actual use by, and delivery to, the buyer for the purpose of meeting electrical loads. The concept of buying and selling capacity solely for resource planning purposes such as RA and LCR is relatively new and has not been previously applied in Pasadena.

Economics of Expected Transactions

PWP sent out a request for bids to neighboring municipal LSEs that might have a need to procure PWP's excess RA and LCR capacity. Based on the responses thus far, PWP expects to sell an average of 7.9 MW per month of LCR for a total of $167,500.

PWP does not anticipate incurring any extra costs as a result of this sale. There will be no reduction in ancillary services or energy revenues from generator operation, nor will PWP lose the ability to use these resources according to its own needs.

By selling only excess LCR capacity that has been certified by the CAISO, PWP will incur no new risks or obligations.

Value of Local Generation

PWP relies on its local power generation plant to meet its 165 MW LCR. Based on data received from the request for bids, the 196.85 MW qualifying LCR capacity of PWP's local generation plants will save PWP customers approximately $3.8 million in 2008 by not having to procure such capacity from other sources. This is in addition to the revenues from LCR sales to Azusa described above. If PWP could sell its remaining excess LCR capacity, additional revenues of approximately $750,000 could be obtained in 2008. In addition, these units assist PWP in meeting system RA requirements, at an estimated annual value of $3.5-5.0 million annually. Thus, the implied planning capacity value (or regional "reliability" value) of Pasadena's local generation plants is nearly $10 million per year under current market conditions. This value does not include savings from using local generation to meet load when economic or revenues from ancillary service and energy sales to the CAISO.

FISCAL IMPACT:

PWP expects to receive additional wholesale revenues of $167,500, paid monthly in calendar year 2008, for sales of LCR capacity with no anticipated incremental costs. As with other wholesales sales, 75% of the net proceeds will be used to directly offset the retail Energy Charge and 25% will be retained in the Light and Power Fund.

Respectfully submitted,

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