

Agenda Report

To: CITY COUNCIL,
THROUGH THE DEREGULATION COMMITTEE

Date: July 13, 1998

From: ACTING CITY MANAGER

Subject: AMENDMENT TO THE LIGHT AND POWER RATE ORDINANCE, CHAPTER 13.04 OF THE PASADENA MUNICIPAL CODE, TO AUTHORIZE THE USE OF CONTRACTS TO SUPPLY ENERGY AND ENERGY SERVICES TO COMMERCIAL, INDUSTRIAL AND INSTITUTIONAL CUSTOMERS.

RECOMMENDATION:

It is recommended that the City Council direct the City Attorney to prepare an Ordinance to authorize the General Manager of the Water and Power Department (Department) to enter into contracts with its commercial, industrial and institutional customers for their long-term energy services requirements.

BACKGROUND:

It is important for the City to maintain a strong commercial, industrial and institutional base. It is also recognized that this customer sector must compete within their markets and their cost of operations is critical to remaining viable enterprises. Many commercial, industrial and institutional customers have expressed frustration with the Department's electricity rates. They have indicated an interest in entering into performance based energy services contracts that would result in lowering their bills in exchange for committing to an exclusive, long-term contractual arrangement with the Department. Under such an arrangement, Pasadena Water and Power would offer equity adjustment contracts employing a bill reduction factor (5%, 7%, 10%). The customer's bill will be unbundled as part of the contract.

Other contractual considerations may include but not be limited to: aggregation of customer meters or facilities, deferral of co-generation construction, supply and delivery of other energy related services.

The Department's commercial, industrial and institutional customers are being heavily solicited by other California and out of state energy companies and marketers. Although phase in of direct access for the Department's customers is planned to begin January 1, 2000, energy providers are currently offering incentives to customers to enter into long-term contract arrangements. Comparative commercial, industrial and institutional rates of neighboring utilities are below that of Water and Power's rates. It is recognized that Water and Power's commercial, industrial and institutional rates will ultimately need to be restructured to reflect market rates.

The Department desires to offer its commercial, industrial and institutional customers an interim alternative to rate restructuring by providing opportunities to receive price relief in exchange for entering into equity adjustment contracts. The term of the contract shall not expire before July 2002. It is anticipated that initially, bill(s) for the affected customer meters/accounts could be reduced by an amount of up to ten (10%) percent through a long-term contract with the Department. Depending on available funds to support the equity adjustment contract program, further bill reductions may be applied through the contracts with the customer. These contracts will be based on individual meters as many customers have multiple meters and all would not qualify for the equity adjustment.

The City has developed a sound financial plan to ensure the Department's competitiveness by the year 2002. The revenues and funds earmarked to support the financial plan shall not be used to fund the customer contracts. All funds to be used for entering into long-term contracts will be from new revenues not anticipated in the financial plan. Furthermore, the number of contracts entered into between the Department and the customers shall be limited to funds available from the aforementioned unanticipated revenues. Adoption of this ordinance will enable the Utility to continue its 91 year tradition of providing its customers with quality, competitive services at rates reflecting the economic benefits of a municipally owned power supply.

Current rates for large Commercial, Industrial and institutional customers do not equitably reflect Pasadena's energy supply and delivery cost. Commercial, industrial and institutional customers meeting certain contracting parameters will be eligible to participate in the equity adjustment program pursuant to the terms outlined in this Agenda Report. The affected customers are:

- Schedule P, Large Power Services customers.
- G-2, General Demand Service customers with demand levels equal to or greater than 100 kilowatts.

The first eligible customer meter/accounts will be the Schedule P meters served at 17 kilovolts or higher. The second eligible customer meter/accounts will be the Schedule P meters served at voltages below 17 kilovolts. The third eligible customer meter/accounts will be the G-2 meters served below 17 kilovolts but have demand levels equal to or greater than 100 kilowatts.

Customers will be notified of their opportunity to participate in the equity adjustment contact program. The program will be offered to Schedule P and G-2 commercial, industrial and institutional customers on a first come basis to the rate classes meeting the above criteria. Customer meters will be ranked according to the relative load factors beginning with the highest load factor meters.

Customers in the Large Power Service, Schedule P and General Demand Services, Schedule G-2 rate classes generate approximately sixty percent (60%) of the Department's revenues. These customers are prime targets of competitors who are making enticements to attract customers to sign option contracts with them. The Department could lose substantial revenues when the market opens to its customers. The Department believes its best contingency to help mitigate this risk is enter into long-term contracts with customers who would prefer to stay with the Pasadena Water and Power Department.

The targeted sources of the annual revenues to support the long-term contracts' objectives include:

- The wholesale sale of electricity and transmission resources that are above the requirements of the financial plan.
- The sale of natural gas and wheeling resources that are above the requirements of the financial plan through partnering arrangements.
- Sale of ancillary services to the Independent System Operator.
- The sale and/or lease of Department surplus properties or other assets.
- Savings derived through bond refinancing.
- Sales of behind-the-meter products and services.
- Cost containment measures.

Rates shall not be increased for residential and small business customers to fund the equity adjustment contracts.

It is estimated that approximately 240 commercial, industrial and institutional customers on the affected rate schedules could potentially receive between a five percent (5%) to ten percent (10%) equity reduction adjustment based on available funds generated from the above sources. Equity reduction adjustments would be based primarily on meeting certain load factor criteria.

The term of the equity adjustment contracts are expected to range from three and one half years up to ten years depending on the specific requirements of the customer and the Department.

The Department at a minimum shall collect from each customer under contract the revenues necessary to cover the cost of providing service to that customer including generation and debt service.

The Water and Power Department shall continue to collect the Stranded Investment Surcharge pursuant to previously adopted City ordinances.

Any customer financing of behind-the-meter projects shall be fully recovered by the expiration of the contract. Interest charged for any customer project financing shall not be less than the Department's cost of funds. Customer projects financed by the Department, as a part of a long-term contract shall be secured by sufficient collateral, credit ratings and/or approved bank letters of credit provided by the customer to fully protect the amount of the Department's investment. Early contract termination provisions shall be structured to ensure recovery of any and all investments including interest specified in the contract.

It is anticipated that absent the authority of the General Manager to negotiate and execute long-term contracts through a streamlined process, the Department will be at considerable risk of losing its large commercial, industrial and institutional customers to competitors. The estimated erosion of the commercial and industrial customer sector is difficult to measure at this juncture. Today there are over 300 registered energy providers vying for a share of California's energy market. Feedback from Water and Power customers indicate they are in fact targets of competitors' marketing strategies and tactics.

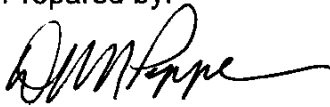
FISCAL IMPACT:

Maximum total dollars to fund the bill reduction contracts is \$6.2 million annually. However, the actual amount will be a function of the number of executed contracts and their respective terms. The total present value of the equity adjustment contracts portfolio shall not exceed the present value of the funds committed for the equity adjustment contracts. Furthermore, the revenues committed to fund the equity adjustment contracts shall be in excess of the fund required to support the Department's financial plan.

Respectfully submitted,


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