

Agenda Report

DATE: October 19, 1998

TO: ATTENTION DEREGULATION COMMITTEE
CITY COUNCIL

FROM: CITY MANAGER

SUBJECT: AUTHORIZATION TO ENTER INTO CONTRACTS WITH
CITIZENS POWER SALES FOR ENERGY TRADING AND RISK
MANAGEMENT SERVICES

RECOMMENDATION

It is recommended that the City Council approve the accompanying resolution authorizing the General Manager of the Water and Power Department to enter into a contract with Citizens Power Sales for energy trading and risk management services.

BACKGROUND

In February 1997 the Water and Power Department issued a request for proposals to identify agencies interested in forming "strategic alliances" with the City's Water and Power Department. The Phase 1 evaluation process was completed on May 20, 1998, and on July 13, 1998 the City Council directed staff, with the assistance of a professional negotiating team, to pursue the following high priority areas:

1. Energy trading and risk management
2. Gas supply and retail gas sales
3. New energy-related products and services

The staff and the negotiating team have reached tentative agreement with Citizens Power Sales ("Citizens") for energy trading and risk management services. The objective of this strategic alliance agreement is to combine Pasadena's generating and transmission resources with Citizen's skill and expertise in energy trading and risk management to substantially increase net

revenues to Pasadena. This agreement is expected to provide the following key benefits to Pasadena:

1. **New Revenue:** \$1.25 to \$2.6 million per year net trading profits through a profit sharing mechanism in the agreement. It is a performance-based contract with no minimum fees to Citizens and no down side trading risk to Pasadena.
2. **Preserve Current Benefits:** Pasadena would have first call on Pasadena's facilities to serve retail load and sell ancillary services into the Independent System Operator (ISO) market. This will preserve 100 percent of the current benefits provided by Pasadena's assets while allowing Citizens to extract the remaining value through trading at different delivery points.
3. **Risk Management Services:** Citizens will assist Pasadena in formalizing Pasadena's risk management policies and procedures with regard to market and credit risks. Pasadena will continue to schedule resources for its internal retail load. This ensures that Pasadena will retain its excellent system reliability and preserve the current benefits of its long-term energy contracts, i.e. low volatility and firmness of supply. Pasadena will not be engaging in speculative trades, therefore it will continue with its low risk procurement activities for the purpose of supplying Pasadena's retail needs.
4. **New Retail Energy Products:** Citizens will assist Pasadena in the development of hedging strategies to be used in conjunction with new retail energy products offered to Pasadena customers when they have a choice of energy suppliers, i.e. fixed prices, market index prices, price caps, etc.
5. **Training:** Citizens will train Pasadena personnel in risk management and trading techniques during the term of the contract. This training will create a synergy between the two organizations that is expected to increase the performance under the contract. It is not intended to replace the work that Citizens is doing.

This energy trading and risk management agreement has a five-year term with a unilateral termination provision after the second year. If Citizens does not produce either \$1.25 million per year for Pasadena in the second year, or \$2 million in total net gains for the first two years, then Pasadena can unilaterally terminate the agreement at that time.

It is recommended that the City Council approve the accompanying resolution authorizing the General Manager of the Water and Power Department to enter

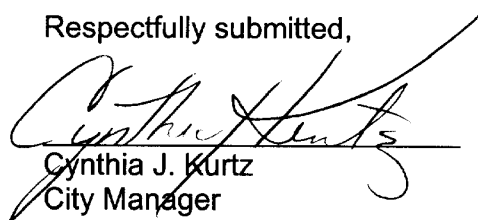
into a contract with Citizens Power Sales for energy trading and risk management services in accordance with the above terms and conditions.

FISCAL IMPACT

This energy trading and risk management agreement is expected to yield \$1.25 to \$2.6 million per year in net trading profits. There is no negative fiscal impact as it will generate net revenues through a profit sharing mechanism in the agreement with no minimum fees to Citizens and no down side trading risk to Pasadena.


The first \$500,000 per year in new revenues generated from this agreement will be contributed to the reserve for stranded investment, as required by the Water and Power deregulation financial plan. Any excess revenue will be used to support the equity adjustment provisions of the long-term customer contracts recently approved by the City Council.

Respectfully submitted,



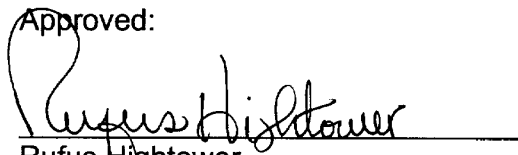
Cynthia J. Kurtz
City Manager

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