

## ***Lompoc City Council Agenda Item***

***City Council Meeting Date: May 3, 2011***

**TO:** Laurel M. Barcelona, City Administrator

**FROM:** Ronald V. Stassi, Utilities Director

**SUBJECT:** Natural Gas Program Agreement

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### **Recommendation:**

The City Council adopt Resolution No. 5714(11) and authorize the Mayor to execute the Northern California Power Agency (NCPA) Natural Gas Program Agreement allowing the Utility Director or his/her designee to procure gas through NCPA.

### **Background/Discussion:**

The City of Lompoc is a Project Participant in three NCPA Natural Gas fired generation projects, namely Combustion Turbine Project No. 1 (CT1), Combustion Turbine Project No. 2 (CT2), and the Lodi Energy Center. As a result, the City of Lompoc has a need to procure natural gas through the use of forward market purchases (buying for future generating needs rather than buying on a daily or other short term basis) to assure greater rate stability for its customers.

The CT1 project consists of two Combustion Turbines (CTs) located in the City of Alameda and one CT in the City of Lodi. The total capacity of the CT1 project is 117.1 MW, of which the City of Lompoc owns a 3.5% or a 4.1 MW share.

The CT2 project consists of one sole unit, a 49.9 MW Steam Injected Gas Turbine located in Lodi, California. This project has been operational since 1995. The City of Lompoc owns a 5.0% or a 2.5 MW share of this project from April to October, and a 15.5% or a 7.7 MW share of this project from November to March.

The Lodi Energy Center (LEC) is a 280 MW natural gas fired generation facility located in Lodi California currently under construction that is scheduled to become commercially operational by June 2012. The City of Lompoc owns a 2.036% or a 5.7 MW share of the LEC.

The City of Lompoc Utilities Division, NCPA, and other NCPA members have developed a Natural Gas Purchase Program that can be used to purchase natural gas as fuel for electric power generation for the benefit of our customers. The City's expected cost of natural gas for its generation needs is expected to be about \$1.5 million/year for gas based upon \$6-7/MMBTU price.

***SUBJECT: Natural Gas Program Agreement (continued)***

This Agreement will allow the City to direct NCPA to purchase natural gas, through the use of forward market purchases or physical call options, (a call option is a contract in which the buyer has the right but not the obligation to buy a specified quantity of gas at a specified strike price within a fixed period of time) to reduce the portion of its natural gas needs that would otherwise have to be obtained in a potentially volatile spot market; thereby assuring greater rate stability for our customers. The Natural Gas Program Agreement is included as an attachment to this staff report. Participation in the Natural Gas Purchase Program will also provide a means for the City to take advantage of reduced procurement costs through economies of scale, and will enable the City to diversify its counterparty risk by subscribing to a more diverse portfolio of natural gas contracts than if the City individually selected a single natural gas supplier.

*Natural Gas Purchase Program Procurement Process*

The City, as a Participant in the Natural Gas Purchase Program can direct NCPA to procure natural gas on its behalf from third parties using competitive bids submitted in response to a NCPA Request For Proposals, or through direct purchases from the State Department of General Services (“DGS”) Gas Program, or its successor program, so long as the DGS program is available. All procurement of natural gas under the Natural Gas Purchase Program must meet certain conditions, including 1) all market purchases of natural gas shall be consummated in accordance with all NCPA Energy Risk Management Policy requirements including those limiting the term and volume of Natural Gas transactions; 2) each market purchase of natural gas, including the purchase of physical call options for natural gas, shall be capable of physical delivery of gas; 3) the third party Gas Purchase Agreements used to purchase natural gas shall be in the form of industry-standard forms of agreement for natural gas purchases, however, in any given instance, such agreement may be modified in the discretion of the NCPA General Manager and NCPA’s General Counsel, after consultation with Member, to include additional terms and conditions approved by Member; and 4) any environmental attributes associated with a given natural gas purchase will be procured by NCPA for the proportionate benefit of the Participants, including the City, that have subscribed to a given transaction. The City, as a Participant in the Natural Gas Purchase Program, will identify Designated Representatives to authorize NCPA to purchase gas.

*Third Party Gas Purchase Agreements*

NCPA will procure natural gas on behalf of the City through use of industry-standard forms of agreement for natural gas purchases as provided in Exhibit B of the Natural Gas Program Agreement, including but not limited to the North American Energy Standards Board (NAESB) base contract. NCPA staff, working in conjunction with its Special Counsel, has developed a standard form NAESB base contract, and a set of special provisions that are attached to the standard form NAESB base contract, to be used to purchase natural gas under the Natural Gas Purchase Program. NCPA will use its standard form NAESB base contract with special provisions to negotiate master natural gas purchase agreements with credit worthy suppliers.

**SUBJECT: Natural Gas Program Agreement (continued)**

In addition to NCPA's standard form NAESB base contract, NCPA has developed a model credit support addendum, and associated special provisions to the model credit support addendum, to be used in conjunction with the NCPA standard form NAESB base contract as required.

**Natural Gas Purchase Program Costs and Security Account**

The costs for participating in the Natural Gas Purchase Program include 1) a monthly fixed charge of \$600, 2) a proportionate share of variable program costs (referred to as Variable Gas Purchase Program Costs) based on the City's activity in the program, 3) transaction specific costs associated with the City's natural gas transactions, and 4) commodity costs specific to the City's natural gas transactions. In addition to the costs listed above, the City will be charged its proportionate share of program start-up costs, which include staff costs, legal costs, and costs associated with establishing the third party Gas Purchase Agreements that will be used under the Natural Gas Purchase Program. The City's share of program start-up costs will be equal to its normalized Participation Percentage in the Lodi Energy Center, which is estimated to be \$5,000.

The City, as a Participant in the Natural Gas Purchase Program will also be required to deposit funds into a Security Account held by NCPA prior to entering into any natural gas transactions. The City will be required to deposit into the Security Account held by NCPA an amount equal to the highest three (3) months of estimated commodity costs for all natural gas transactions the City has or will subscribe to as estimated by NCPA; provided, however, that such deposit may be satisfied in whole or in part either in cash or through a clean, irrevocable, letter of credit. The City's Security Account deposit will be monitored by NCPA to ensure it is sufficient to support the City's procurement activities, and to the extent City's Security Account is over or under funded NCPA will make adjustments to the City's account by either refunding surplus funds, or demanding additional funds be deposited in the Security Account if the current level of funds is deficit. In addition to the regular process for funding the Security Account, NCPA has the right to request the City make emergency deposits into the Security Account in order to support the City's obligations.

NCPA Facilities Committee, Legal Committee, and Commissioners along with member Utility Directors have reviewed and approved the Natural Gas Program Agreement. The NCPA Legal Committee agreed in principle and form with the agreement. The NCPA Commission approved said agreements during its March 24, 2011 meeting.

**Fiscal Impact:**

The cost of developing the Natural Gas Purchase Program will be billed based on actual costs, and will be allocated to each member who elects to participate in the program, in proportion to its normalized project participation percentage in the Lodi Energy Center. All prospective costs associated with management and administration of the Natural Gas Purchase Program will be included in the NCPA Annual Budget, and will be allocated to those members who elect to participate in the program in accordance with the NCPA Natural Gas Program Agreement.

**City Council Meeting Date: May 3, 2011**

**SUBJECT: Natural Gas Program Agreement (continued)**

**Conclusion:**

Staff recommends approval of Resolution No. 5714(11) and that the Mayor be authorized to execute the NCPA Natural Gas Program Agreement.

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Ronald V. Stassi, Utilities Director

APPROVED FOR SUBMITTAL TO THE CITY COUNCIL:

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Laurel M. Barcelona, City Administrator

Attachments:

- [Resolution No. 5714\(11\)](#)
- [Natural Gas Procurement Agreement](#)