

DOCKETED

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Document Title:	334 City Council File 02-1135 - CAO Rpt re Amendments NG Risk Mgmt Policy LAAC 10.5.3 (01.06.06)(Bates Nos. LA001610-LA001613)
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TRANSMITTAL

0320-000145-0000

TO Ronald F. Deaton, General Manager Department of Water and Power	DATE JAN 06 2006	COUNCIL FILE NO. 02-1135
FROM The Mayor		COUNCIL DISTRICT

**Retail Natural Gas Policy
Amendment To Administrative Code Section 10.5.3**

Transmitted for further processing.
See the City Administrative Officer report attached.



MAYOR

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: *December 16, 2005*

CAO File No. 0320-00145-0000
Council File No. 02-1135
Council District:

To: The Mayor

From: William T Fujioka, City Administrative Officer



Reference: Letter from the General Manager, Department of Water and Power, dated November 8, 2005; referred for report November 10, 2005

Subject: **RETAIL NATURAL GAS RISK MANAGEMENT POLICY AMENDMENTS**

SUMMARY

The Department of Water and Power (DWP) requests approval of amendments to the Los Angeles Administrative Code to allow it to better operate within the current natural gas market. Natural gas is required by DWP to fuel power plants that generate power for daily use by the City ratepayers.

The current natural gas market is experiencing a rapid escalation of prices. Natural gas prices tend to trend with oil although they move separately. Natural gas is a commodity with an increasing demand due to a general increase in use for the generation of electricity. In addition, demand is somewhat seasonal as natural gas is used to heat a majority of households in the United States (the others are heated with electricity). The natural gas market is also currently limited in its ability to adjust to increases in demand. Hurricane Katrina damaged many natural gas facilities in the Gulf Coast, causing a supply shortage that drove prices upward. Foreign imports are limited as there are only five liquefied natural gas facilities in North America (although 19 more have been approved for construction and 21 more are proposed and awaiting approval – including a Long Beach facility). Inclement weather in Wyoming is limiting the amount of natural gas that can be drawn from the Pinedale field purchased by DWP in July of 2005. With all these factors combined, prices in the natural gas market have increased significantly from approximately \$5 per million British Thermal Units (mmBTU) in the summer of 2005 to approximately \$15 per mmBTU in early December 2005. It is not expected that prices will decrease significantly until at least March of 2006, if at all.

The rules and restrictions established in the Administrative Code recognized a different natural gas market than the current market. DWP is finding that the existing restrictions are significantly impeding the ability to obtain the lowest possible natural gas price and, therefore, minimize pressure on power rates. Thus, the DWP request would amend Section 10.5.3 of the Administrative Code to:

- Increase the maximum amount of time that DWP is authorized to contract for the purchase of natural gas from five years to ten years.

- DWP enters into long-term purchase contracts as a hedge against price increases. This will allow DWP to consider a broader range of contracts available in the natural gas market and attempt to secure the lowest unit prices.
- Increase the cap on the purchase price of natural gas set through purchase contracts from \$7.50 per mmBTU to \$10 per mmBTU.
- This will also allow DWP to consider a broader range of contracts for hedging the natural gas portfolio. In addition, it better recognizes current conditions in the natural gas market.

Other Potential Adjustments by DWP

On November 1, 2005, the DWP Chief Administrative Officer recommended that five actions be taken to address the increasing prices in the natural gas market. The recommendations are to:

- Increase the long-term *natural gas* hedging price cap from \$7.50 per mmBTU;
- Increase the short-term *natural gas* purchase price cap;
- Increase the short-term *power purchase* contract term;
- Seek authority to enter into long-term *power purchase* hedging contracts; and,
- Develop and launch aggressive energy conservation program options for DWP customers.

The conservation recommendation can be implemented by the DWP Board and management. DWP should be instructed to immediately begin implementation of the conservation recommendation. The remaining four recommendations require the approval of the Mayor and Council by ordinance. This request covers only the first of those four recommendations. The fourth recommendation, provision of authority for long-term power purchase hedging contracts, should be considered separately. However, DWP should be instructed to quickly prepare and present to the Council and Mayor a complete request that addresses as many of the remaining three recommendations as necessary.

RECOMMENDATIONS

That the Mayor:

1. Approve the request of the Department of Water and Power for amendment of Los Administrative Code Section 10.5.3 to:
 - Increase the amount of time that DWP is authorized to enter into contracts for the purchase of natural gas from five years to ten years; and,
 - Increase the cap on the purchase price of natural gas set through purchase contracts from \$7.50 per mmBTU to \$10 per mmBTU;
2. Instruct the Department of Water and Power to quickly prepare and present as many of the ordinance changes as necessary to allow the City to achieve the lowest possible natural gas prices; and,

3. Instruct the Department of Water and Power to implement an aggressive energy conservation program for DWP customers.

FISCAL IMPACT STATEMENT

There is no direct impact on the City General Fund or Power Revenue Fund. However, increasing the ability of DWP to purchase natural gas at the lowest possible price will lessen pressure on power rates and decrease the possibility of a reduction in the transfer to the City General Fund from the Power Revenue Fund.

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