

## DOCKETED

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<b>Project Title:</b>	Appeal by Los Angeles Department of Water & Power re Renewables Portfolio Standard Certification Eligibility
<b>TN #:</b>	213443
<b>Document Title:</b>	384 LADWP Board Resolution No. 003-166 - Retail Natural Gas Risk Management Policy (01.21.03) (Bates Nos. LA002826-LA002839)
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WHEREAS, Section 10.5.3 of the LAAC provides authority, within specified parameters, for the Board to enter into contracts for the purchase and delivery of natural gas and/or financial transactions for natural gas to be consumed in the production of electricity to serve the Department's retail customers for terms of up to five years; and

WHEREAS, prior to entering into any contracts and/or financial transactions for natural gas, Section 10.5.3 of the LAAC requires the establishment of a natural gas risk management policy, internal controls to safeguard Department assets, and a program to reduce the volatility of the net amount payable for natural gas to be consumed in the production of electricity to serve the Department's retail customers; and

WHEREAS, Section 10.5.3 of the LAAC also requires the establishment of an Energy Services Executive Risk Policy Committee that will provide oversight over the energy risk management activities of the Department, including natural gas; and

WHEREAS, the Energy Services Executive Risk Policy Committee is composed of at least five key management personnel, including the functional business equivalents of the Chief Operating Officer (Chief Administrative Officer), Chief Financial Officer ("CFO"), Assistant General Manager - Power Generation, Director of Planning and Projects, and Director of Power Supply Operations, with the CFO as chair of such committee; and

WHEREAS, Section 10.5.3 of the LAAC also requires the establishment of a 5-year budget that sets forth the volume of and expenditure for natural gas for each fiscal year to be consumed in the production of electricity to serve the Department's retail customers, which includes \$15,000,000 that represents the purchase price of financial transactions for natural gas, including brokers fees, if any; and

WHEREAS, the Board would like to amend Resolution No. 002-282 to authorize the Department to retain an outside auditor or comparable third party, and not the Department's current external auditor, to annually audit and prepare a report relating to activities authorized under Section 10.5.3 of the LAAC,

BE IT FURTHER RESOLVED, that the Board hereby approves the attached Retail Natural Gas Risk Management Policy for the Department, establishes the Energy Services Executive Risk Policy Committee, and amends Resolution No. 002-282 to authorize an outside auditor or comparable third party to annually audit and prepare a report relating to activities authorized under Section 10.5.3 of the LAAC, except the Board does not delegate the authority to enter into contracts and financial transactions for natural gas, as described in Section 10.5.3 of the LAAC until such time as the Board approves contracts with appropriate security, default and other terms pursuant to Section 10.5.3(1)(h) of the LAAC; and


BE IT FURTHER RESOLVED, that the Board hereby approves the attached budget ("Budget") that sets forth the expenditure for and volume of natural gas to be consumed in the production of electricity to serve the Department's retail customers for fiscal years 2002/03 through 2006/07, that includes a maximum expenditure of \$15,000,000 during the 2002/03 fiscal year for the purchase price of financial transactions for natural gas entered into by the Department, including broker's fees, if any.

I HEREBY CERTIFY that the foregoing is a full, true and correct copy of a resolution adopted by the Board of Water and Power Commissioners of the City of Los Angeles at its meeting held **JAN 21 2003**

  
Secretary

APPROVED AS TO FORM AND LEGALITY  
ROCKARD J. DELGADILLO, CITY ATTORNEY

OCT 23 2002

BY   
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Assistant City Attorney

LA002827

DEPARTMENT OF WATER & POWER  
CITY OF LOS ANGELES

RETAIL NATURAL GAS  
RISK MANAGEMENT  
POLICY

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NOVEMBER 5, 2002



LA002828

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## I. INTRODUCTION

Section 10.1.1(b) of the Los Angeles Administrative Code (the "LAAC") became effective on January 26, 2002. This section provides authority, within specified parameters, for the Board of Water and Power Commissioners (the "Board") to enter into physical contracts for natural gas used in the production of electricity to serve all of the Department of Water and Power's (the "Department's") customers (i.e., wholesale and retail customers) for terms of up to one year. This Section also provides for the Board to delegate its authority to enter into such physical contracts for natural gas to the General Manager of the Department.

Section 10.5.3 of the LAAC became effective on September 22, 2002. This Section provides authority, within specified parameters, for the Board to enter into physical and financial contracts for natural gas used in the production of electricity to serve the Department's retail customers (i.e., not wholesale customers) for terms of up to five years. This Section also provides for the Board to delegate its authority to enter into physical and financial contracts for natural gas to the General Manager of the Department.

Except for natural gas, which represents a substantial expense for the Power System, the costs of all other fuels used in the production of electricity at each of the Department's jointly-owned and contracted generation resources have been stable. Frozen retail electric rates and increasing reliance on natural gas-fueled Los Angeles Basin generation resources, coupled with the inherent volatility in the price of natural gas exposes the net income of the Power System to potentially significant fluctuations. Unexpected spikes in the price of natural gas, such as that experienced in 2000/01, could constrain the City transfer and destabilize retail electric rates.

The Department's Retail Natural Gas Risk Management Policy ("Policy") provides a framework for managing the risks associated with the volatility in the cost of natural gas used in the production of electricity to serve retail (i.e., not wholesale) electric customers. This Policy will be incorporated into a comprehensive energy risk management policy covering all significant Power System revenue generating activities that is currently being developed and is scheduled for completion in the current fiscal year.



## II. SCOPE OF POLICY

This Policy applies to all Contracts and Financial Transactions for natural gas entered into by the Department pursuant to Sections 10.1.1(b) and 10.5.3 of the LAAC, for the purpose of reducing the volatility in the price of natural gas used in the production of electricity to serve retail customers. Contracts involve the physical delivery of natural gas, whereas Financial Transactions involve exchanges of payments between the Department and counterparties based on specified natural gas price indices.

## III. STATEMENT OF POLICY

This Policy establishes Management's authority to enter into Contracts and Financial Transactions for natural gas pursuant to Sections 10.1.1 (b) and 10.5.3 of the LAAC, identifies the nature of Contracts and Financial Transactions that can be entered into by the Department, and establishes internal controls surrounding natural gas risk management activity.

## IV. PURPOSE OF POLICY

The purpose of this Policy is to establish a risk management program that is designed to mitigate the Department's exposure to unexpected spikes in the price of natural gas used in the production of electricity to serve retail customers.

## V. AUTHORITY AND MANAGEMENT RESPONSIBILITY

### General Manager

In accordance with Board Resolution No. XXXX, the Board has delegated authority to the General Manager of the Department to enter into Contracts and Financial Transactions for natural gas in accordance with Sections 10.1.1 (b) and 10.5.3 of the LAAC. The General Manager shall be responsible for:

- Ensuring compliance with Sections 10.1.1(b) and 10.5.3 of the LAAC and this Policy.



- Approving natural gas risk management strategies, plans, and parameters.
- Ensuring adequate internal controls exist to safeguard Department assets with respect to natural gas risk management activities.

**Energy Services Executive Risk Policy Committee**

In accordance with Board Resolution No. XXXX, the Board has established the Energy Services Executive Risk Policy Committee (the "Committee"). The Committee shall be comprised of the Chief Operating Officer (Chief Administrative Officer), Chief Financial Officer, Assistant General Manager-Power Generation, Director of Power Supply Operations, and Director of System Planning and Projects or their functional business equivalents. The Chief Financial Officer is the chair of the Committee.

Decisions and recommendations made by this Committee shall be based on achieving a consensus among members of the Committee. To the extent that the Committee cannot reach a consensus, the Chair of the Committee shall forward such matter to the General Manager for a final decision.

The Committee shall be responsible for overseeing the Power System's natural gas risk management program; formulating risk management policies, procedures and strategies; and recommending such policies, procedures and strategies to the General Manager for consideration. The Committee shall also be responsible for establishing necessary internal controls to ensure compliance with approved policies and procedures, and shall furnish periodic reports, at least quarterly, of all natural gas risk management activity to the Board and General Manager.

**Chief Financial Officer**

The Chief Financial Officer or his/her designee shall be responsible for entering into Financial Transactions for natural gas as authorized by the General Manager.

**Assistant General Manager-Power Generation**





The Assistant General Manager-Power Generation, or his/her designee, shall be responsible for entering into Contracts for natural gas as authorized by the General Manager.

## VI. AUTHORIZED TRANSACTIONS

The Department is authorized to enter into Contracts and Financial Transactions for natural gas used in the production of electricity to serve its retail customers subject to the following parameters:

1. Contracts for the purchase, sale or exchange of natural gas for terms of up to one year from date of execution [(Section 10.1.1(b) of the LAAC)].
2. Contracts for the purchase of natural gas for terms greater than one year, but not to exceed five years from the date of execution (Section 10.5.3 of the LAAC).
3. Financial Transactions for natural gas for terms not to exceed five years from the date of execution (Section 10.5.3 of the LAAC).  
Financial Transactions shall be limited to the following types:
  - Delivery Point Swaps: Fixing the price of transporting natural gas from one delivery point to another delivery point.
  - Variable to Fixed Price Swaps: Fixing the price of natural gas at a specified delivery point.
  - Purchase Ceilings: Establishing a maximum price for natural gas by purchasing, but not selling, a ceiling or call option.
  - Purchase Collars: Buying a ceiling or call option to establish a maximum price for natural gas, and simultaneously selling a put option to establish a floor price for the same quantity of natural gas.

Financial Transactions shall not be reversed or offset without prior approval by the Board pursuant to Section 10.5.3 of the LAAC.



Contracts involving the physical delivery of natural gas can be sold or exchanged by the Department to meet Power System operating requirements pursuant to Section 10.1.1(b) of the LAAC. Contracts shall not be sold or exchanged for any other purpose, except as specified above, without prior approval by the Board pursuant to Section 10.5.3 of the LAAC.

## VII. TRANSACTION LIMITS AND REQUIREMENTS

### 1. Price Limits

#### a. Short-Term Contracts for Natural Gas (terms of up to one year)

The price of natural gas purchased for delivery at the Southern California Border<sup>1</sup> with terms of up to one year from the date of execution shall not exceed \$20.00 per million British Thermal Units ("MMBtu").

#### b. Long-Term Contracts for Natural Gas (terms greater than one year and less than or equal to five years)

The price of natural gas purchased for delivery at the Southern California Border<sup>1</sup> with terms greater than one year and less than or equal to five years from the date of execution, shall not exceed \$7.50 per MMBtu, including broker's fees, if any.

#### c. Financial Transactions for Natural Gas (terms of up to five years)

The purchase price derived from Financial Transactions for natural gas indexed at the Southern California Border<sup>1</sup> for terms of up to five years shall not exceed \$7.50 per MMBtu, including broker's fees, if any.

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<sup>1</sup> Excludes the cost of transporting such gas wherein the Department has secured long-term transportation rights on specific interstate natural gas pipelines.



## 2. Volumetric Limits

Prior to entering into any Contracts or Financial Transactions for natural gas, the Board, by resolution, shall adopt a budget for each fiscal year, that sets forth the projected volume of natural gas to be used in the production of electricity to serve the Department's retail customers.

The aggregate volume of natural gas purchased for delivery (i.e., Contracts) and derived from Financial Transactions in any fiscal year shall not exceed seventy five percent (75%) of the volume of natural gas set forth in the budget approved by the Board with respect to such year, subject to the following limitations:

- The aggregate volume of natural gas purchased for delivery (Contracts) shall not exceed fifty percent (50%) of the volume of natural gas set forth in such budget for each respective fiscal year.
- The aggregate volume of natural gas derived from Financial Transactions shall not exceed seventy-five (75%) percent of the volume of natural gas set forth in such budget.

At times, it may be more cost-effective to purchase energy on a forward basis instead of producing such energy from the Department's own generation resources. Forward electricity purchases by the Department may reduce the projected volume of natural gas set forth in the budget approved by the Board. As such, recommended forward electricity purchase strategies shall be submitted by the Committee in writing, to the General Manager for consideration.

## 3. Expenditure Limits

The General Manager is authorized by the Board to obligate the Department to a maximum of fifteen million dollars (\$15,000,000) in any fiscal year, not to exceed seventy five million dollars



(\$75,000,000) over any five-year period with respect to Financial Transactions that have been entered into by the Department. Such dollar limits apply to the purchase cost of options, including broker's fees, if any.

4. Other Requirements

All Contracts and Financial Transactions for natural gas entered into by the General Manager of the Department shall specify the payment, security, default, remedy and other terms and conditions, as determined and authorized by the Board.

In accordance with Section 10.5.3 of the LAAC, the Department shall only enter into Contracts and/or Financial Transactions after the Committee has submitted a written recommendation for entering into such Contracts and/or Financial Transactions to the General Manager for consideration; and the General Manager has authorized such Contracts and/or Financial Transactions in writing.

VIII. COUNTERPARTY CREDIT

The Department shall only enter into Contracts and Financial Transactions for natural gas with creditworthy counterparties. All Contracts and Financial Transactions for natural gas shall comply, at the minimum, with the applicable rules set forth in the Wholesale Marketing Counterparty Evaluation ("Credit") Policy approved by the Board on August 17, 1999.

IX. RISK CONTROLS

1. Independent Monitoring and Reporting

The General Manager shall ensure that all Contracts and Financial Transactions for natural gas used in the production of electricity to serve retail customers are independently monitored. Periodic reports with respect to such activities shall be provided to the Committee, at least, on a quarterly basis.

2. Transaction Controls



All Contracts and Financial Transactions entered by the Department shall be independently reviewed by appropriate personnel, confirmed in writing with counterparties, and tracked in the Department's risk management system.

#### **X. REPORTING AND MONITORING**

Reports summarizing natural gas risk management activity shall be distributed to the General Manager, the Committee and other interested parties at least quarterly. The nature and frequency of such reports shall be determined by the Committee.

All Contracts and Financial Transactions shall be independently monitored by the Department for compliance with this Policy. Any deviations shall be documented and promptly reported to the Chair of the Committee for appropriate action.

#### **XI. RISK ANALYSIS**

The Department shall measure its exposure to natural gas price volatility on a regular basis using appropriate valuation and risk measurement model(s). In addition, an analysis of the retail risk management program shall be performed on a periodic basis by an independent third party. User access to the Department's energy risk management systems and the extent to which access is granted shall be established and monitored on a regular basis.

#### **XII. INDEPENDENT ANNUAL AUDIT**

The Department shall retain an independent auditor or comparable third party to conduct an annual audit and prepare a report relating to the risk management activities authorized in this Policy. The scope of such audit shall include an assessment of the adequacy of the Department's natural gas risk management controls and compliance with this Policy.

The General Manager of the Department shall distribute the audit report by personal delivery or first class mail to the Board, City Council, and Mayor within 5 days after receipt of the audit report by the Department.



### **XIII. POLICY REVIEW**

This Policy shall be adopted through a Board resolution. This Policy shall be reviewed at least annually to ensure its consistency with the overall objectives of the Natural Gas Risk Management Program, as well as its relevance to current law, and financial and economic trends. Any amendments to this Policy shall be submitted to the Board for consideration.

## Five-Year Retail Customers Natural Gas Consumption and Expenditures Budget

	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Consumption (Billion Cubic Feet)	51.8	51	44.5	49.8	51.1
Expenditures (in millions)*	\$209.2	\$212.4	\$181.7	\$196.7	\$199.5

\* Includes \$15 million for purchase price of financial transactions and brokers fee, if any.