Presentation to the CEC Workshop on Natural Gas

Core and Non-core Procurement

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DGS Natural Gas Services:

How the California public sector buys natural gas:

What is Natural Gas Services?

- **An element of the California Department of General Services**

(Administration Division, Office of Risk and Insurance Management)

- **A non-mandated service program**

(Participation is voluntary & contractual)

Customers are state Executive Agencies and other political subdivisions of the state:

University of California
California State University
California Community College Districts
Counties
Cities
Special Districts

- But *only* for non-core accounts (>250,000 therms per year through a single meter)
- 135 different customers, 180 different accounts

FY 2008-09 (Projected):

- 323 million therms **(32.3 Bcf)**
- ~$260 million

Public Sector Gas Purchasing Goals

- **Dominated by the public sector budgeting process:**

  Biggest concern in natural gas purchasing is *extreme price volatility* – totally incompatible with a one year budget, set months ahead

  Annual cost dominates over monthly prices

- **Greatest fear is the price spike that leads to exceeding the annual budget**
- **Joy of being under budget is 1/10 the Pain of being over – You don't want to tell the Boss to give up program dollars to pay for gas**

So . . .

Savings are secondary

Not exceeding budget is primary

→ **The right strategy constrains price volatility within budgeted levels of costs.**

Public Sector Gas Purchasing Strategy

- **Risk Management: Hedging exposure to price volatility by select forward purchases of natural gas futures.**

- **When actual future prices are unknown, use the *portfolio approach* to diversify purchases, aiming for a maximum price ceiling rather than a profit point. Use multiple smaller purchases, spread out over time, rather than a single "big bet".**

Have & follow a Risk Management Protocol:

- Purchases limited no more than 75% per month
- Purchases limited to actual usage (no speculation)
- Purchase constraints and oversight

Special Purchases for individual customers

With Custom purchases comes individual liabilities

The Six Rules

1. Ultimately, it's about risk. Actual prices paid are the consequential outcome of choices made about risk (knowingly or unknowingly).

2. You cannot make risk disappear – you can, however, change the type of risk you face.

3. If you want a guarantee, you have to pay up front AND more than the cost of the risk to someone else (and then you have to watch his credit rating).

4. In non-speculative buying of an energy commodity in a volatile market situation, you have a choice of two basic purchasing strategies:

A) Aim to buy at a discount to market price, wherever the market goes.
<u>Reward</u>: Savings against the market benchmark
<u>Risk</u>: When the market goes to the moon, you go with it, just a few percentage points behind the rest of the crowd.

B) Aim to buy at some acceptable price range, regardless of where the market might go.
<u>Reward</u>: Even if the market peaks, you stay within your planned budget.
<u>Risk</u>: If the market falls, you are left hanging up there, paying well above a market price.

5. **TANSTAAFL**: **T**here **A**in't **N**o **S**uch **T**hing **A**s **A** **F**ree **L**unch.

6. People who can consistently beat the market tend to leave public sector employment.