City of Long Beach

411 West Ocean Boulevard
Long Beach, CA 90802

Legislation Details (With Text)

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Title: Recommendation to authorize City Manager to execute International Swap and Derivatives Association (ISDA) Agreements with several energy market risk management product providers to allow various physical and financial natural gas transactions to protect against natural gas price spikes for customers of Long Beach Gas and Oil. (Citywide)

Sponsors: Long Beach Gas and Oil

Indexes: Agreements

Code sections:

Attachments: 1. 101811-R-15sr.pdf

Date	Ver.	Action By	Action	Result
10/18/2011	1	City Council	approve recommendation	Pass

Recommendation to authorize City Manager to execute International Swap and Derivatives Association (ISDA) Agreements with several energy market risk management product providers to allow various physical and financial natural gas transactions to protect against natural gas price spikes for customers of Long Beach Gas and Oil. (Citywide)

Natural gas, like other petroleum products, is subject to volatile commodity market pricing. Since the California energy crisis of 2000-2001, when natural gas prices increased nearly seven fold with residential monthly gas bills reaching $300-$400, Long Beach Gas and Oil (LBGO) has entered into price hedge structures to protect customers from large price spikes and provide price stability. The current price hedge agreement, with Shell Energy North America, terminates in March 2012.

Prior to seeking approval to continue the practice of hedging gas commodity prices, LBGO solicited interest from energy market risk management product providers. Respondents included British Petroleum, ConocoPhillips, Freepoint Commodities, Goldman Sachs, J.P. Morgan, MacQuarie Energy, Merrill Lynch, and Shell Energy. LBGO has met with each of these respondents for discussions on market outlooks, hedging strategies, and potential pricing structures. Discussions indicate that the recent low price stability provides attractive hedging opportunities resulting from abundant new shale gas production and reduced demand from the economic downturn.

All respondents have indicated the advantages of having industry standard ISDA agreements in place for the flexibility that will allow for prompt execution of competitive bids at the times of best possible pricing. Hedge bids would otherwise have to include a substantial premium over market prices to cover the risk bidders would assume in offering a firm price hedge for an extended length of time while approval was being sought. ISDA agreements by themselves would not obligate LBGO to enter into any transactions, but merely set common terms for potential transactions between the executing parties and allow for prompt confirmation when favorable pricing opportunities arise. The ISDA agreements have no expiration, but may be terminated by either party with advance written notice. City Council authorization is, therefore, sought to enter into ISDA agreements with selected respondents offering acceptable terms to allow for both financial hedge transactions and physical gas transactions within the parameters stated in the next paragraph.

Natural gas price hedges would be sought primarily to protect against price spikes during winter seasons (when residential gas consumption peaks and price exposure is greatest) with terms meeting or exceeding the following conditions: 1) pricing terms indexed to the Southern California Border price; 2) market price ceilings possibly combined with price floors in hedge structures designed to prevent the average peak winter residential monthly gas bill from exceeding $100; and 3) hedges transacted incrementally in steps of no less than 25 percent, and not to exceed 100 percent cumulatively, of forecast monthly demand depending on market conditions. Once each winter's price hedge structure is in place, LBGO can return to City Council to provide the name of the successful provider(s) and the specific finalized price hedge structure. Additionally, ISDA agreements will expand the pool of energy marketers with which LBGO can purchase or sell physical gas to balance monthly demand at the best price possible.

This matter was reviewed by Deputy City Attorney Richard Anthony on September 26, 2011, and by Director of Financial Management John Gross on September 28, 2011.

City Council action is requested on October 18, 2011, to put in place agreements that will allow the flexibility to promptly establish natural gas price protections for LBGO residential and commercial customer when favorable pricing opportunities arise.

There will be no net fiscal impact to the City, as the cost of natural gas is passed through to LBGO customers. Implementing price protections through financial hedge transactions should help LBGO maintain rates that are comparable with those of other like utilities pursuant to Section 1502 of the Long Beach City Charter. LBGO residential and commercial customers will realize substantial price protection in exchange for the possibility of paying a relatively small premium for such protection when commodity prices are low. The requested action should have no impact on local jobs.

Approve recommendation.

CHRISTOPHER GARNER
DIRECTOR, LONG BEACH GAS & OIL

APPROVED:

PATRICK H. WEST
CITY MANAGER