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Recommendation to authorize City Manager to enter into an International Swap and Derivatives Association (ISDA) Master Agreement that provides natural gas price protection with terms that meet or exceed the following conditions: 1) a term of no more than three years; 2) pricing terms indexed at the Southern California border; and 3) a market price ceiling of not greater than $10.50 per MMBtu and/or a fixed price of no greater than $8.20 per MMBtu. (Citywide)

Natural gas is sold and purchased in an extremely volatile commodity market. Because Long Beach Gas and Oil (LBGO) purchases its natural gas supply in this unstable market, its customers may be exposed to large fluctuations in the commodity price component of their monthly gas bill. Therefore, one of LBGO's primary gas supply objectives is to ensure that LBGO's 500,000 customers are adequately protected from large price swings.

For a perspective of this potential exposure, Long Beach residents and businesses experienced a nearly $70 million increase in their natural gas bills during a six-month period during the California energy crisis of 2000/01. Since that time, LBGO has successfully put price hedge structures in place that have protected its customers from exposure to price increases of that nature. The current price hedge agreement, with Shell Energy North America (Shell Energy), terminates March 31,2009.

To replace the existing Shell Energy agreement, LBGO has solicited interest from the major energy-trading providers. Respondents were British Petroleum (BP), Goldman Sachs, J.P. Morgan, Merrill Lynch, Royal Bank of Canada (RBC), RBS/Sempra, and Shell Energy. By February 6, 2009, LBGO had met with each of the respondents for in-depth discussions on hedging strategies and potential pricing structures. Each of the companies stressed that the dramatic downswing in oil and natural gas prices from last summer's peak makes the current market a strategic time to lock in very favorable pricing structures.

Within specified parameters, City Council authorization is sought in advance of the finalization of the actual terms to allow the price to be immediately locked in based upon the current market pricing at the time of the conclusion of the negotiations. The alternative would be to require a provider to offer a specific firm price hedge that would be valid for an extended length of time while City Council approval was sought, resulting in a much less attractive offer as a premium would be included to protect against interim price fluctuations.

Therefore, City Council authorization is requested for the City Manager to lock in the pricing terms provided that the terms meet or exceed the City Council-approved parameters. Once the negotiations are concluded and the pricing provisions finalized, LBGO would return to the City Council to provide the name of the successful provider and the specific finalized pricing terms.

This matter was reviewed by Deputy City Attorney Richard Anthony on February 11, 2009 and Budget Management Officer Victoria Bell on February 10, 2009.

City Council action is requested on February 17, 2009, in order to establish financial price protections during the current low-priced and relatively stable natural gas market. By taking advantage of the current market conditions, LBGO will be able to implement a financial program that would be the most beneficial to its customers.

Because the cost of natural gas is passed through to customers, there will be no net fiscal impact to the City. However, there will be an offsetting revenue and expense effect in the Gas Fund (EF 301) in the LBGO Department (EN). Implementing price protections through financial instruments should help LBGO's ability to maintain rates that are comparable with those of other like utilities pu rsuant to Section 1502 of the Long Beach City Charter.

Approve recommendation.

CHRISTOPHER J. GARNER
DIRECTOR OF LONG BEACH GAS & OIL

APPROVED:

PATRICK H. WEST
CITY MANAGER