File #: 09-0240, **Version:** 1

Recommendation to receive and file communication from the Director of Long Beach Gas and Oil (LBGO) regarding final negotiated terms of International Swap and Derivatives Association (ISDA) Master Agreement with Shell Energy North America (SENA). (Citywide)

On February 17, 2008, the City Council authorized the City Manager to enter into an ISDA with one of seven respondents to a Request for Proposal (RFP) to provide LBGO's natural gas customers with protection against significant increases in natural gas commodity prices. This authorization was contingent upon final terms being negotiated that met or exceeded the following parameters: 1) a term of no more than three year; 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 no greater than $8.20 per MMBtu.

On the morning of February 18, 2008, LBGO received pricing offers from six of the RFP respondents based upon market prices on that date. LBGO exercised its option to reject all offerings and requested the three most competitive respondents to resubmit pricing the next morning reflecting lower price parameters. On the morning of February 19, 2008, LBGO reviewed the new submittals and determined that the pricing offer by SENA offered the best overall pricing protection for LBGO's customers. With natural gas prices decreasing along with oil prices since last summer, it is believed that prices are currently at or near the bottom of the long-term market (Attachment A). As such, LBGO considers this an ideal time to lock in favorable pricing. The final accepted pricing terms, all below the City Council preapproved parameters, are shown on Attachment B.

In summary, LBGO locked in fixed (swap) pricing for some of its winter supply purchases and a three-way pricing mechanism for some volumes in LBGO's peak purchasing periods of summer (June - September) and winter (November - February). A three-way pricing mechanism allows LBGO to have a price floor (put strike sold), an initial price ceiling (call strike purchased), and a secondary price ceiling (call strike sold). If market prices fall below the price floor, LBGO's net price paid will equal the price floor. If market prices fall between the price floor and the initial price ceiling, LBGO's net price paid will be equal to market price. If the market prices fall in between the initial price ceiling and the secondary price ceiling, LBGO's net price paid will be at the initial price ceiling price. If the market prices fall above the secondary price ceiling, LBGO's net price paid will equal the market price less the price difference between the initial and the secondary price ceilings. On Attachment B, the column titled "Resulting 3-Way Price" is indicative of what the resulting price would be using actual NYMEX future prices on the morning the deal was transacted.

Attachment C demonstrates how the 3-way pricing mechanism will work using the actual price terms for Winter 2009/10 against a range of potential market prices. The chart demonstrates that in exchange for paying slightly higher prices if market prices are low, our customers will have the benefit of price stability and pay lower than market prices if the market exceeds $5.50 per MMBtu (for historical perspective, our customers paid a price of over $16 per MMBtu during the California energy crisis of 2000101).

The result will be that LBGO will have a portfolio of supply that will be partially fixed priced, partially market priced, and partially marked priced with price ceilings and guaranteed market discounts. Using this approach, LBGO believes its customers will be better protected against potential price increases than customers of any California gas utility.

This item was reviewed by Deputy City Attorney Richard Anthony and Budget Management Officer Victoria Bell on February 24, 2009.

City Council action on this matter is not time critical.

There will be no net impact to LBGO as the commodity price is passed through completely to the customer, including the costs and savings resulting from the price hedging in this agreement.

Approve recommendation.

CHRISTOPHER J. GARNER, DIRECTOR
LONG BEACH GAS AND OIL DEPARTMENT

NAME
TITLE

APPROVED:

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PATRICK H. WEST
CITY MANAGER