CITY OF LONG BEACH
Gas & Oil
DEPARTMENT

R-17

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HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

RECOMMENDATION:

Authorize the City Manager to enter into a Physical Gas Commodity Option Agreement pursuant to the International Swap and Derivatives Association (ISDA) Master Agreements to provide 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 $8.00 per MMBtu. (Citywide)

DISCUSSION

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 on behalf of its customers, monthly gas bills are exposed to large fluctuations if gas purchases are not protected by risk management practices. 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 in 2000 through 2001.

On February 17, 2009, to increase LBGO's market flexibility, the City Council approved entry into International Swap and Derivatives Association (ISDA) Master Agreements (Agreements). Counterparties to the Agreements currently include Merrill Lynch, Freepoint, J. Aron (Goldman Sachs), BP Energy, and ConocoPhillips. Under these Agreements, LBGO can enter into Physical Gas Commodity Option Agreements to financially hedge the price paid for physical gas deliveries. Current low-priced market conditions offer very favorable opportunities for utilities to ensure customers are protected against significant price increases. LBGO proposes to hedge its winter season gas purchases when customer gas demand peaks and, therefore, has the greatest vulnerability to high gas prices.

Authorization is requested to enter into one or more Physical Gas Commodity Option Agreements for up to a three-year term, price indexed to the Southern California Border, and a market price ceiling of no more than $8.00 per MMBtu. City Council authorization is sought in advance of the finalization of the actual terms of the hedging contract to allow the agreed-upon price to be immediately locked in through the financial trading market. Once the Physical Gas Commodity Option Agreements are finalized, LBGO will return to City Council with the specific agreed upon pricing terms, on an informational basis.

This matter was reviewed by Deputy City Attorney Richard Anthony and Budget Management Officer Victoria Bell on September 24, 2012.

TIMING CONSIDERATIONS

City Council action is requested on October 16, 2012, 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 most beneficial to its customers.

FISCAL IMPACT

The cost of natural gas, including any cost of hedging, is passed through to customers, therefore, there will be an offsetting revenue and expense effect in the Gas Fund (EF 301) in the Long Beach Gas and Oil Department (GO). Implementing price protections through financial instruments should help LBGO's ability to maintain rates that are comparable with those of other like utilities pursuant to Section 1502 of the Long Beach City Charter. There is no impact to the General Fund or to local jobs.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,

CHRISTOPHER J. GARNER
DIRECTOR OF LONG BEACH GAS AND OIL

CJG:CAB:LAF

APPROVED:

PATRICK H. WEST
CITY MANAGER