City Council Report

Date: August 25, 2022

To: City Council

Through: Marc Heirshberg, Deputy City Manager

From: Frank McRae, Energy Resources Department Director
Anthony Cadorin, Energy Resources Program Manager

Subject: Approval of Natural Gas Master Agreements and Supply Confirmations Citywide

Purpose and Recommendation

The City of Mesa Energy Resources Department (ERD) secures firm supplies of natural gas, and natural gas scheduling and balancing services on the Kinder Morgan El Paso Natural Gas interstate pipeline (EPNG). Firm supplies must be available and sufficient to meet customers' demand for natural gas.

A Request for Proposals (RFP) for both supply and scheduling and balancing services is issued every two to five years. RFP 2023037 was issued to supply firms for Mesa's (i) fixed-price annual base supply, (ii) seasonal winter natural gas supply, and (iii) for scheduling and balancing services and balancing volumes in the form of an Asset Management Agreement. ERD has evaluated the responses to the RFP and recommends entering North American Energy Standards Board's Master Enabling Agreements (NAESB Agreements) as necessary, Asset Management Agreement (AMA), and entering supply confirmations (Confirms) after receiving best and final offers from those bidders who provided responsive bids to the RFP for the following supply periods (Supply Period).

Product	Supply period
Annual natural gas base supply	January 2023 to December 2024
Seasonal natural gas supply	November 2022 to April 2025
Asset Management Agreement	January 2023 to December 2024

Background

City of Mesa (Mesa) operates a natural gas utility that provides service to two major service areas: 1) the City area which is approximately 90-square miles primarily within City limits, and 2) the Magma area which is approximately 236-square miles located southeast of the City in Pinal County. Mesa's combined natural gas system is comprised of 1,445 miles of distribution mains[1] and serves 71,374 customers[2].

1 As of Mesa's last annual report, issued December 2021
2 Active Customer Information System billing customer accounts as of January 2022

Mesa's historic annual natural gas supply requirements have ranged between 2.8 and 3.6 million Dekatherms (DTh), depending most significantly on weather. Mesa has broken its gas supply up into three separate supplies that are all competitively bid to reduce costs to its customers and manage market risk. The first supply is a fixed amount of natural gas that flows the same amount every day of the year which is referred to as "Base Daily Quantity 1" or "BDQ1." The second supply, called BDQ2, is a specific supply of natural gas that only flows during the winter months and provides price stability during those months (when market volatility is most likely to affect Mesa's natural gas customers). The last supply is a combination of gas supply (known as Balancing Daily Volumes) and a service to schedule and balance all of the gas supplies, including the BDQs on EPNG's pipeline. Balancing Daily Volumes are those volumes needed to fill in the gap between Mesa's actual daily natural gas demand and the total of the BDQs. As a result of Mesa's fluctuating system demand, the Balancing Daily Volumes also vary significantly day by day. As such, Mesa combines the Balancing Daily Volumes with services to schedule all of the gas and balance it with Mesa's demand. This has historically been done through an Administrative Services Agreement, however, changes in the market have now created an opportunity to take a different approach to this third supply with what is known as an Asset Management Agreement or AMA. Through an AMA, Mesa contracts with a supplier to maximize the value of Mesa's unused pipeline capacity and market that to other natural gas users on a daily basis. This captures some previously unrealized value from that capacity and that value is passed back to Mesa in the form of a monthly payment.

The current annual natural gas supply and Administrative Services Agreement contracts were acquired through an RFP process in 2020. After Winter Storm Uri in February 2021, Mesa negotiated certain disputed pricing with its two BDQ gas suppliers. Mesa successfully resolved the dispute with its BDQ2 supplier; however, the BDQ2 agreement was terminated as part of that resolution. Another RFP was issued in late 2021 and the BDQ2 supplies were secured for the 2021/2022 winter season (terminating in April 2022). Because the BDQ2 supplies have already terminated and the BDQ1 supplies are scheduled to terminate on December 31, 2022, this RFP was issued to replace the expiring supplies and expiring Administrative Services Agreement.

Natural gas market conditions are constantly changing. The City of Mesa's access to the Permian basin through calendar years 2018 and 2019 provided historically low-priced natural gas supplies. This was a result of extensive oil production which generated natural gas as a byproduct, with very few places for the natural gas to flow. This favorable supply meant record low prices for Mesa and those savings were passed on to Mesa's natural gas customers. Market pressures have been increasing, however, with more natural gas now flowing south to Mexico for power generation and significantly more natural gas flowing east towards the Gulf of Mexico with the completion of the Gulf Coast Express pipeline in September 2019 and the Permian Highway Pipeline in January 2021. Additionally, plans continue to add further capacity eastwards out of the Permian basin, though these projects have encountered delays due to the COVID19 pandemic. Winter Storm Uri caused a temporary but drastic price increase in the natural gas markets of the west coast and central plains in February 2021, however, prices returned to "normal" shortly thereafter. Since February 2022, a global natural gas crisis has emerged, primarily in Europe, which is impacting pricing across all markets including in the southwest.

With Permian production still ramping up to pre-pandemic level, markets are expected to remain elevated across the United States through the 2022-2023 heating season.

Bids were requested on two years of supply at 2,500 Dth/day for Mesa's BDQ1 and three seasons of natural gas for Mesa's BDQ2. The quantities listed in the table below are based on Mesa's seasonal changes natural gas demand during the winter:

Month (2022, 2023 and 2024)	Quantity
November 2022, 2023 and 2024	4,000 Dth/Day
December 2022, 2023 and 2024	5,500 Dth/Day
January 2023, 2024 and 2025	7,500 Dth/Day
February 2023, 2024 and 2025	6,000 Dth/Day
March 2023, 2024 and 2025	3,950 Dth/Day
April 2023, 2024 and 2025	3,000 Dth/Day

Proposals were also requested for the third product which is comprised of Balancing Daily Volumes and an Asset Management Agreement.

Discussion

Proposals were submitted by BP Energy Company ("BP"), ConocoPhillips Company ("ConocoPhillips"), Sequent Energy Management, A Williams Company ("Sequent"), Spotlight Energy, LLC ("Spotlight"), and Tenaska Marketing Ventures ("Tenaska") (collectively, the "Suppliers"). Mesa already has a signed NAESB Agreement with BP and Sequent.

As expected, due to the increasing pipeline capacity leaving the Permian basin, continuing natural gas crisis in Europe, and high summer demand for natural gas fired power generation, the indicative bids from the Suppliers show that prices continue to rise from the historic low prices seen by Mesa through 2018 and 2019 for natural gas supplies due to increased demand and export. This cost of natural gas is funded as a pass-through to the customers on a monthly basis known as the Purchased Natural Gas Cost Adjustment Factor ("PNGCAF").

Through this supply structure, Mesa retains the options to look for other supplies of natural gas as necessary. For instance, if pricing is looking favorable for a three-month period, Mesa would still be able to request bids, and ultimately purchase those natural gas supplies to stabilize prices for customers.

The Asset Management Agreement proposals proposed a 30% to 100% reduction in Mesa's forecasted expenses to EPNG for the next two years. Since natural gas transportation cost is part of PNGCAF, a reduction in this expense will also be a pass-through discount to Mesa's gas customers.

Alternatives

Mesa could reject all bids and issue another RFP; however, this would push the RFP timing into the winter (peak demand months) which could result in increased pricing due to market uncertainty.

Fiscal Impact

The costs of natural gas supplies provided through these agreements are recovered though the PNGCAF and are adjusted as frequently as monthly as costs increase or decrease throughout the year.

Coordinated With

This RFP was coordinated with Purchasing and the City Attorney’s Office.