City Council Report

Date: November 6, 2023

To: City Council

Through: Marc Heirshberg, Deputy City Manager

From: Scott Bouchie, Energy and Sustainability 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.

ERD has evaluated the responses to a competitive request for proposals (RFP) for natural gas supplies and services and recommends entering North American Energy Standards Board's Master Enabling Agreements (NAESB Agreements) as necessary, an 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 up to the following supply periods (Supply Period):

Product	Supply Period
Annual natural gas base supply ("BDQ")	November 2023 to October 2028
Supplemental delivered natural gas supply (Dec. & Feb.)	December 2023 to February 2028
Asset Management Agreement & Balancing Daily Volumes	April 2024 to March 2026

ERD also recommends entering into short term (up to 6 month) seasonal supply confirmations on an ad-hoc basis as market conditions are favorable for up to 5,000 Dekatherms per day (Dth/Day) ("Seasonal Supply") for up to two (2) years with any of Mesa's enabled natural gas suppliers.

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 1,481 miles of distribution mains[1] and serves 74,353 customers[2].

Mesa's historic annual natural gas supply requirements have ranged between 2.8 and 3.9 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 "Base Daily Quantity 2" or "BDQ2", is a base quantity of natural gas that 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.

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 which, combined with very few places for the natural gas to flow, lead to 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, planned expansions are expected to add further capacity eastwards out of the Permian basin, increasing competition for Permian gas. Local transmission pipeline constraints can also cause upward pressure on gas prices as well. For example, after EPNG's gas main explosion (on their Line 2000) in Casa Grande in August 2021, access to natural gas from the Permian basin by Arizona and California was reduced by about 30%. This reduction in capacity over the 2022/2023 winter season caused an extremely volatile natural gas market in the southwest, which was slightly dampened for Mesa's customers thanks to the procurement of fixed price base quantities. After EPNG placed the damaged gas main back in service in February 2023, this price spiking phenomena was significantly dampened.

In 2022, Mesa issued an RFP for BDQ1, BDQ2, Balancing Daily Volumes, and AMA service. Through an AMA, Mesa contracts with a supplier to maximize the value of Mesa's unused pipeline capacity (the "Asset Manager"). The Asset Manager markets that unused capacity to other natural gas users on a daily basis to capture some previously unrealized value from that capacity. That value is passed back to Mesa in the form of a monthly payment. BP Energy Company ("BP") was awarded with products from Mesa's 2022 RFP with various contract terms as shown in the table

---

1 As of Mesa's last annual report, issued March 2023

2 Active Customer Information System billing customer accounts as of July 2023

below:

Product	Contract Term
BDQ1	January 1, 2023 to December 31, 2024
BDQ2	November 1, 2022 to March 31, 2024
Asset Management Agreement & Balancing Daily Volumes	January 1, 2023 to March 31, 2024

Discussion

PRODUCTS SOLICITED:

RFP 2024026 was issued for a total of five (5) products:

1. <u>An additional fixed-price annual base supply (BDQ3)</u>

Mesa requested bids between three (3) and five (5) years of base daily quantity natural gas supplies of 2,000 Dth/day (BDQ3). The BDQ3 supply is timed to overlap with Mesa's current BDQ1 contract with BP which expires on December 31, 2024. Mesa intends to stagger the expiration dates of BDQ's so that Mesa is not seeking all of its base natural gas supplies on the market at the same time; helping to minimize risk and providing rate stability to Mesa's natural gas customers.

2. <u>A supply of Delivered Gas for the months of December and February</u>

As Mesa's natural gas demand continues to grow, additional pipeline capacity on the interstate gas transportation system is required to continue reliable delivery of gas to Mesa's system and to avoid expensive penalties. When Mesa uses more gas than its contracted pipeline capacity, EPNG can assess a penalty on the excess flowed volumes. Mesa is at the highest risk of incurring these penalties in the months of December and February. One strategy to increase Mesa's ability to receive gas supplies without incurring these penalties is to request that suppliers use their own pipeline capacity and bring the gas all the way to Mesa's gate stations ("Delivered Gas"). Mesa requested bids between one (1) to five (5) seasons of Delivered Gas supplies for the months of December and February at quantities up to 4,000 Dth/day.

3. <u>Scheduling and balancing services and balancing volumes in the form of an Asset Management Agreement</u>

Mesa has historically outsourced the management of its daily natural gas supply scheduling and balancing. All natural gas supplies above the Base Quantities must be purchased daily to deliver the same quantity of natural gas that Mesa's customers are using on that day. In 2023 Mesa began utilizing an Asset Management Agreement to both perform the scheduling and balancing and to maximize the value of Mesa's transportation assets. This arrangement has worked well for Mesa and the savings generated through the AMA have been passed on to Mesa's customers. The current AMA expires March 31st, 2024 and so a replacement AMA for up to two (2) years was bid through this RFP.

4. <u>Interstate natural gas transmission capacity or long-term delivered natural gas supplies</u>

Additional pipeline capacity will facilitate the growth in Mesa's natural gas systems and so Mesa solicited offers for interstate natural gas transmission capacity and/or long-term delivered gas supplies.

No favorable bids were received for this product so no award will be made under this RFP.

5. Renewal Natural Gas (RNG) projects

RNG is a carbon neutral (or in some cases, carbon-negative) source of methane that has been cleaned and treated to meet pipeline natural gas standards. Certain RNG projects can have the benefit of providing natural gas locally which alleviates the requirement for interstate natural gas transmission capacity. Being carbon neutral, RNG is expected to play an important role in Mesa's Mesa Climate Action Plan (MCAP) which targets a reduction of CO_2 emissions from City facilities by 50% by the year 2030 and complete carbon neutrality by 2050.

No favorable bids were received for this product so no award will be made under this RFP.

SOLICITATION RESULTS:

The first three products were solicited as follows:

Product	Supply Period
Annual natural gas base supply (BDQ)	November 2023 to October 2028
Supplemental delivered natural gas supply (Dec. & Feb.)	December 2023 to February 2028
Asset Management Agreement & Balancing Daily Volumes	April 2024 to March 2026

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

The indicative bids Mesa received from the Suppliers for the first two (2) products show that current prices are some of lowest within the past two years. Additionally, ERD expects favorable pricing for Seasonal Supply for up to two (2) years with Mesa's enabled natural gas suppliers and therefore recommends authorizing additional Confirms on such terms. By procuring a portion of Mesa's gas supply at a relatively lower cost, Mesa can reduce the fluctuation in customers' bill for the next several years. 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 will be able to request bids, and ultimately purchase those natural gas supplies to stabilize prices for customers.

The Asset Management Agreement proposals received through the RFP indicate that Mesa may be able to significantly offset its forecasted pipeline expenses to EPNG for the next two years. Since natural gas transportation cost is part of the cost of natural gas supply passed through to customers, a reduction in this expense will also be a passed through as a cost savings 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. Additionally, without the supplemental delivered gas supply, Mesa is also exposed to greater risks of penalties by EPNG due to inadequate pipeline capacity to meet customers' demand. Penalties are assessed at levels that are multiple(s) of the market's spot price, which is typically at a time when the market price is escalated due to higher demand.

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.