City Council Report

Date: August 19, 2024

To: City Council

Through: Marc Heirshberg, Deputy City Manager

From: Scott Bouchie, Energy and Sustainability Director
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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 system 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	January 2025 to December 2035
Seasonal natural gas base supply	November 2024 to April 2029
Supplemental delivered natural gas supply (Dec. & Feb.)	December 2024 to February 2029
Asset Management Agreement	April 2025 to March 2028

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 1,521 miles of distribution mains[1] and serves 77,050 customers[2].

1 As of Mesa's last annual report, issued March 2024
2 Active Customer Information System billing customer accounts as of July 2024

Mesa's historic annual natural gas supply requirements have ranged between 3.7 and 4.3 million Dekatherms (DTh) within the past five years, depending most significantly on weather. Mesa has broken its gas supply up into several separate quantities and volumes 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[3]." The second supply, called BDQ2[4], 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 gas pricing).

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.

More recently, Mesa has utilized an AMA where Mesa contracts with a supplier to maximize the value of Mesa's unused pipeline capacity (the "Asset Manager") while still scheduling and balancing all of Mesa's gas supply. The Asset Manager markets that unused capacity to other parties with natural gas transportation needs 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.

Discussion

Natural gas market conditions are constantly changing. 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 and its customers thanks to the procurement of fixed price base quantities by ERD staff. After EPNG placed the damaged gas main back in service in February 2023, this price spiking phenomena was significantly dampened. Following that, downward pressure was put on the natural gas markets in spring of 2024 due to i) a warmer than average 2023/2024 winter season resulted in higher level of gas storage and ii) temporary LNG plant outage.

At a macro level, demand for natural gas is increasing 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

3 Mesa currently has BDQ1A and BDQ1B to split up the base supply and diversify risk. This RFP is soliciting supplies under BDQ1A.

4 Mesa currently has a BDQ2 supply and a Delivered BDQ supply to split up the seasonal supply, diversify risk, and lessen transportation requirements.

2021. Additionally, planned expansions are expected to add further capacity eastwards and westward out of the Permian basin, increasing competition for Permian gas.

In 2023, Mesa issued an RFP for BDQ1, Supplemental Delivered Gas, Balancing Daily Volumes, and AMA service. BP Energy Company ("BP"), ConocoPhillips "COP", and Tenaska were awarded contracts for products from Mesa's 2023 RFP with various terms as shown in the table below:

Product	Awarded Vendor	Contract Term
BDQ1	BP	December 1, 2023 to October 31, 2028
Supplemental Delivered Gas	COP	December 2023 and February 2024
AMA and Balancing Daily Volumes	Tenaska	April 1, 2024 to March 31, 2025

PRODUCTS SOLICITED:

RFP 2024190 was issued for a total of six (6) products:

1. <u>A fixed-price annual base supply (BDQ1)</u>

Mesa requested bids between three (3) and five (5) years, and an open extended term, of base daily quantity natural gas supplies of 2,500 Dth/day (BDQ1). The BDQ1 supply is to replace Mesa's current BDQ1 contract with BP, which expires on December 31, 2024.

2. <u>A fixed-price seasonal base supply (BDQ2)</u>

Mesa requested bids between three (3) and five (5) years, and an open extended term, of base daily quantity natural gas supplies between 3,000 to 7,500 Dth/day, depending on the month (BDQ2). The BDQ2 supply is to replace Mesa's current contract with BP which expired on April 31, 2024.

3. <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 needed to continue delivery of gas to Mesa's system and to avoid expensive penalties. When Mesa flows more gas than its contracted pipeline capacity, EPNG can assess a penalty on the excess 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 and reduce the chance of 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 2,000 Dth/day for each month.

4. Scheduling and balancing services and balancing volumes in the form of an Asset Management Agreement

Mesa has historically outsourced the management of its daily natural gas supply scheduling and balancing. This allows the City to avoid the costs associated with operating a trading desk. 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 AMA 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, 2025 and so a replacement AMA for up to three (3) years was bid through this RFP.

5. Interstate natural gas transmission capacity or long-term delivered natural gas supplies

Additional pipeline capacity will be critical to facilitating possible 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.

6. 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 CO2 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 four products were solicited as follows:

Product	Supply Period
Annual natural gas base supply	January 2025 to December 2029 or an open extended term.
Seasonal natural gas base supply	November 2024 to April 2029 or an open extended term.
Supplemental delivered natural gas supply (Dec. & Feb.)	December 2024 to February 2030

Asset Management Agreement	April 2025 to March 2028

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

The indicative bids Mesa received from the Suppliers for the first three (3) products show that current prices are among the lowest seen within the past three years. Additionally, Mesa received a proposal for BDQ1 supply for a term up to ten (10) years, a duration which has been less common in more recent years. By procuring a portion of Mesa's gas supply at a relatively lower cost, Mesa can reduce the fluctuation in customers' bills 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").

The Asset Management Agreement proposals received through the RFP indicate that Mesa may be able to significantly offset its forecasted pipeline expenses for the next three 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.