City Council Report

Date: November 16th, 2020

To: City Council

Through: Karolyn Kent/Assistant 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 (Mesa) secures firm supplies of natural gas and associated administrative services (Associated Services) to schedule and manage transportation of those supplies to Mesa's delivery points on the El Paso Natural Gas Company interstate pipeline. Firm supplies must be available and sufficient to meet customers' demand for natural gas.

Requests for Proposals (RFP) for both supply and Associated Services are issued every two to five years. RFP 2021011 was issued with Mesa's gas supply broken into three distinct supplies and sent to over fifty contacts at natural gas supply firms. Mesa has evaluated the responses to the RFP and recommends execution of North American Energy Standards Board's Master Enabling Agreements (NAESB Agreements) with those parties with whom Mesa has not yet executed NAESB Agreements. Mesa recommends entering supply confirmations (Confirms) after receiving best and final offers from those bidders who provided responsive bids to the RFP for up to five years (Supply Period).

Mesa also recommends entering into short term supply confirmations (not to exceed 6 months in term) on an ad-hoc basis as market conditions are favorable from time to time during the Supply Period with any of those suppliers which have been determined responsive to the RFP.

Background

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 approximately 1,400 miles of distribution mains and, as of October, 2020, served approximately 68,700 customer accounts.

Mesa's historic annual natural gas supply requirements range between 2.8 and 3.6 million Dekatherms (DTh), depending most significantly on weather. The budgeted natural gas supply requirement for FY 20/21 is approximately 3,563,000 DTh at a projected cost of $11.4 million. The current natural gas supply and ASA contracts were acquired through an RFP process in 2015. The initial 36 month term of the existing agreement expired December 31, 2018 and the first optional renewal term was extended through December 31, 2019. The second renewal term was then extended through December 31, 2020.

Natural gas market conditions are constantly changing. The City of Mesa's access to the Permian basin through calendar years 2018 and 2019 has provided extremely low priced natural gas supplies. This was a result of extensive oil production which produced natural gas as a byproduct with very few places for the natural gas to go other than towards the west coast and through Arizona. This glut of 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 flowing east towards the Gulf of Mexico with the completion of the Gulf Coast Express pipeline in September 2019. Plans continue to add further capacity eastwards out of the Permian basin with at least six more pipelines all in some stage of development (but largely on hold or delayed due to the COVID19 pandemic).

Proposals were solicited via an RFP process that would continue to provide the flexibility to manage transportation services and acquire natural gas supplies at advantageous prices while ensuring the adequacy and security of the supply and delivery. Bids were requested on three products:

1. Base Daily Quantity 1: 2,000 Dth/day of natural gas in every month on a fixed price basis. This gas would have supplied 22% of the gas supplies from 2017 to 2020.
2. Base Daily Quantity 2: The quantities listed in the table below which was based on seasonal natural gas demand. This gas would have supplied 27% of the gas supplies from 2017 to 2020:

Month	Quantity
January	7,500 Dth/Day
February	6,000 Dth/Day
March	4,000 Dth/Day
April	3,000 Dth/Day
May	-
June	-
July	-
August	-
September	-
October	-
November	4,000 Dth/Day
December	5,500 Dth/Day

3. Balancing Daily Volumes and Associated Services: The successful respondent to this product would be purchasing the remainder of Mesa's gas supply needs on a daily or monthly basis and would be responsible for scheduling all of Mesa's gas supply needs on the natural gas transportation pipeline and balancing those supplies against Mesa's demand.

Discussion

Proposals were submitted by BP Energy Company (BP), Energy Transfer Operating LP (Energy Transfer), Shell Energy North America LP (SENA), World Kinect Energy Services (WFS) and ConocoPhillips Company (Conoco). The bid from Conoco was received after the submittal deadline and so will not be considered for further evaluation. Mesa already has signed NAESB Agreements with SENA and BP.

As expected, due to the increasing pipeline capacity leaving the Permian basin, the indicative bids from the suppliers show that the historic low prices seen by Mesa through 2018 and 2019 for natural gas supplies will not be continuing through 2021. While the COVID19 pandemic did temporarily decrease natural gas demand, particularly the commercial sales volumes for Mesa, by late May the majority of that demand had returned. This has continued to return natural gas prices in the southwest closer to the national average. In FY19/20, Mesa's total natural gas supply cost fell to a total of just over $6 million; a stark contrast to only three years prior (FY16/17) when Mesa purchased 14% less natural gas for just over $11 million. 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").

Mesa has structured this RFP to:

1. Fix the pricing on a base quantity of natural gas. This will ensure price stability throughout the year and is an attractive product to bidders because it is a constant, non-variable supply.
2. Set a price cap ("ceiling") on the second base quantity of gap. This allows Mesa to take advantage of low market pricing while limiting Mesa's risk for price spikes on the high side.

This creates price stability on approximately half of Mesa's natural gas supply. The remaining supply will be procured on an *ad hoc* basis by the successful bidder, however, 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.

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 and ASA 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.