TO:  HONORABLE CITY COUNCIL
FROM:  CITY MANAGER  DEPARTMENT:  UTILITIES
DATE:  MAY 21, 2007  CMR: 253:07
SUBJECT:  ADOPTION OF RESOLUTION OF THE COUNCIL OF THE CITY OF PALO ALTO APPROVING CHANGES TO THE ENERGY RISK MANAGEMENT POLICY THAT WOULD PERMIT THE CITY TO TRANSACT IN CONGESTION REVENUE RIGHTS PRODUCTS AND APPROVING THE EXECUTION OF ONE OR MORE CONTRACTS IN REGARD TO THESE PRODUCTS WITH THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION EITHER DIRECTLY OR INDIRECTLY THROUGH THE NORTHERN CALIFORNIA POWER AGENCY

RECOMMENDATION
The Utilities Advisory Commission and staff recommend that City Council adopt a resolution to:
1) Approve changes to Section XI of the City’s Energy Risk Management Policy, to add Congestion Revenue Rights (CRR) products to the list of approved electric portfolio products; and
2) Authorize the City Manager to sign required contracts with the California Independent System Operator (CAISO) and/or Northern California Power Agency (NCPA) to obtain and manage CRRs for the purpose of mitigating the potential electric transmission congestion costs’ impact on the City’s retail electric customers.

BACKGROUND
Following the 2000-2001 wholesale electricity market crisis in California, the CAISO, under the direction and approval of the Federal Energy Regulatory Commission (FERC), has been developing a new electric transmission market design. This new market design, officially named Market Redesign and Technology Upgrade (MRTU), is scheduled to start on January 31, 2008. One of the main objectives of the MRTU design is to allow the CAISO to more effectively manage electric transmission and congestion. To accomplish this congestion management goal under MRTU, the CAISO will implement a new market pricing mechanism entitled Locational Marginal Pricing (LMP), which will be used to determine the most cost-effective use of resources to resolve power transmission bottlenecks. As a result of the CAISO’s implementation of LMP, the City could be assessed congestion costs when the City’s resources are delivered across the CAISO-controlled transmission grid to serve the City’s load obligations. These
congestion charges are new costs resulting from MRTU implementation and are additional to the City’s existing contractual energy costs and transmission access charges.

As part of the new market design, the CAISO has also developed a tool named Congestion Revenue Rights (CRR), an insurance-like product designed to mitigate transmission congestion costs that Load Serving Entities (LSE) like the City will be subject to upon the implementation of MRTU. Under MRTU, the CRRs will be allocated, free of charge, to LSEs that pay for the embedded capital improvement cost of the CAISO transmission grid. The City as an LSE is eligible to acquire the CRRs through the CAISO allocation process free of charge. It is being proposed that NCPA act on behalf of the NCPA pool members, of which the City is one, for the purposes of requesting and administering the acquired CRRs.

BOARD/COMMISSION REVIEW AND RECOMMENDATIONS
The attached report, Attachment 2, was presented to the Utilities Advisory Commission at its May 2, 2007 meeting. The UAC had some questions to clarify certain technical aspects of the MRTU design and CRR product. Excerpts of the UAC meeting minutes approving the staff recommendation are in Attachment 3. The UAC voted unanimously to approve the staff recommendation.

RESOURCE IMPACT
Operating under new MRTU paradigm in 2008 is expected to increase costs. These cost elements have been included in the FY 07-07 budget. However, the CRRs that the City anticipates requesting from the CAISO are expected to have a positive value and are expected to reduce the City’s congestion costs under MRTU. Participation in the CRR allocation and management process is expected to reduce the cost of serving the City’s retail electric load.

POLICY IMPLICATIONS
CRRs are a form of ‘financial product,’ a class of product that is currently prohibited under Section XI of the Energy Risk Management Policy approved by the Council in February 2006 (Resolution No. 8591). The prohibition was directed at the purchase of financial derivative energy products, such as financial options and futures, compared to a CRR product which is allocated free of charge to LSEs to protect against congestion costs. Based on this analysis, the Utilities Risk Oversight and Coordinating Committee (UROCC) voted to approve the CRR product on April 16, 2007 and has recommended it for Council approval. Proposed changes to the Risk Management Policy are highlighted in the UAC Report Attachment B.

ENVIRONMENTAL REVIEW
Adoption of the resolution to change the energy risk management policy and to authorize the City Manager to sign contracts to obtain and manage CRRs does not constitute a project for the purpose of the California Environmental Quality Act.
ATTACHMENTS
A: Resolution Approving Changes To The Energy Risk Management Policy That Would Permit The City To Transact In Congestion Revenue Rights Products And Approving The Execution Of One Or More Contracts In Regard To These Products With The California Independent System Operator Corporation Either Directly Or Indirectly Through The Northern California Power Agency
B: UAC Report of May 2, 2007 with Attachments A and B
C: Excerpts of the UAC Meeting Minutes of May 2, 2007 - Draft

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