

# Procurement Authorization Amendment - Supply Of Bio-Diesel Fuel

Meeting Date: July 10, 2008

Subject: Procurement Authorization Amendment - Supply Of Bio-Diesel Fuel

## **Recommendation**

It is recommended that the Commission authorize;

1. the issuance of an amendment to the contract with Suncor Energy Products Inc. (Suncor) for the supply and transportation of Bio-Diesel Fuel to increase the total contract upset limit by \$50,000,000 to \$329,400,000; and
2. the Chief General Manager to approve locking in a fixed price for the purchase of Bio-Diesel Fuel for 2009 and report back to the Commission once a fixed price has been established.

## **Funding**

Sufficient funds will be included in the 2009 TTC and Wheel-Trans Operating Budgets as required.

## **Background**

The current contract with Suncor was approved for award at the Commission meeting of November 28, 2005 for the period to December 31, 2007 in the upset limit amount of \$114.4M, and included an option for a two year extension to December 31, 2009, which was exercised at the Commission meeting of May 8, 2007, increasing the upset limit amount by \$165M to \$279.4M. The increase for the 2 year extension was based on the estimated usage of 76,000,000 litres for each year.

Staff locked in the purchase price of Bio-Diesel with Suncor on August 21, 2007 for the period of January 1, 2008 to December 31, 2008, at a blended price of \$0.8752 per litre, including delivery and taxes. The Bio-Diesel blend consists of 95% No. 1 Ultra Low Sulpher diesel and 5% virgin vegetable oil (soybean) based bio-fuel.

## **Discussion**

The price for crude oil has been increasingly volatile over the last several months particularly since crude oil first broke through the \$100 per barrel plateau in early 2008. The cost for crude oil as of June 19, 2008 was approximately \$136 per barrel. Further, the cost for soybean oil has tripled over the last three years and is projected to continue to increase along with crude oil as demand is increasing.

Staff has finalized the projected 2009 usage requirements for the Bio-Diesel at 86,900,000 litres, which is approximately 10.9M litres or 14% higher than 2008 (76M litres), mainly due to the additional service added throughout the system.

Consequently, if the Commission were to lock in its 2009 requirements for Bio-Diesel at this time based on current market pricing (\$1.46 per litre), it would represent an increase of approximately 67% over the 2008 locked-in pricing (\$0.8752 litre).

Based on estimated usage of Bio-Diesel for the balance of 2008, approximately \$90M will be available under the Suncor contract for fuel purchases in 2009. Based on this and the projected increased usage of fuel in 2009, the price of Bio-Diesel would have to fall to approximately \$0.98 per litre, otherwise staff could not lock in pricing for 2009 as there would be insufficient funds remaining in the contract. While it is possible that crude oil futures could drop sufficiently to make that pricing available, staff do not consider that it is likely based on current market conditions.

The value of Bio-Diesel purchases for 2009 would be \$140M if staff were to lock in pricing for Bio-Diesel based on current market pricing and the higher usage for 2009 (including a 10% allowance). As only approximately \$90M will be remaining in the Suncor contract at the end of 2008, staff is requesting approval of an additional \$50M for the purchase of Bio-Diesel for 2009 in the event market pricing does not decrease.

Staff do not recommend locking in the Commission's 2009 Bio-Diesel requirements during this period of pricing volatility. Staff is of the opinion that the current market pricing is over inflated due to market speculators and that such pricing may not be sustainable as the market fundamentals do not appear to support the current price of oil. Staff believe there is the possibility for a significant market correction in the future, potentially related to an anticipated general softening in the pricing for a broad range of commodities, including crude oil, once the 2008 Olympics are completed in China. However, this correction will need to be of sufficient duration to cause the pricing of crude oil futures for 2009 to drop significantly.

If this situation does not occur prior to 2009, staff recommend purchasing the 2009 diesel and bio-fuel requirements on the available spot markets through Suncor based on monthly average pricing established through an independent pricing index in accordance with the contract. Staff will continue to monitor the market for diesel and bio-fuel pricing and attempt to establish an acceptable lock-in price target for 2009 pending market changes in the future, if and when acceptable pricing becomes available.

The recommended increase in the upset limit contract with Suncor for 2009 is based on the current

futures pricing for Bio-Diesel and usage of approximately 86,900,000 litres. The recommended upset limit also includes a 10% allowance for variation in usage and price fluctuations over the period from January 1, 2009 to December 31, 2009.

While the recommended amendment value is based on the purchase of bio-fuel, staff is currently reviewing the value of the continued use of bio-fuel in consideration of the \$1.5M to \$2.0M premium in the cost of bio-fuel versus the actual environmental benefits as well as the impact that the use of bio-fuel is having on food prices and availability. As a result, there is the possibility that the Commission may not purchase bio-fuel for 2009.

### **Justification**

The existing Bio-Diesel fuel contract with Suncor expires on December 31, 2009 and the increase in the upset limit contract amount is required to ensure the uninterrupted supply of Bio-Diesel for the Commission's operations throughout 2009 in the event that market pricing remains high.

July 2, 2008

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