TORONTO TRANSIT COMMISSION
REPORT NO.

MEETING DATE: March 1, 2011

SUBJECT: PROCUREMENT AUTHORIZATION – SUPPLY OF DIESEL FUEL

ACTION ITEM

RECOMMENDATION

It is recommended that the Commission approve:

a) Issuance of a purchase order to Suncor Energy Products Partnership (Suncor) for the physical supply and delivery of diesel fuel to various TTC locations for the period commencing April 1, 2011 to December 31, 2015 in the total upset limit of $513,000,000; and

b) Staff entering into the required Agency Agreements subject to the approval of the General Counsel, to permit the City of Toronto (City) to process purchases of diesel fuel financial futures on behalf of the TTC from a roster of pre-qualified counterparties for a three-year term upon the City signing agreements with the counterparties.

FUNDING

Sufficient funds have been included in the 2011 TTC and Wheel Trans Operating Budgets and will be included in future Operating Budgets as required.

BACKGROUND

As directed by the City in November 2008, TTC staff began working jointly with City staff with respect to the feasibility of contracting jointly for the purchase of diesel fuel and the potential to develop a fuel hedging program similar to the existing TTC's and the City's current purchasing program for electricity and to share consultant purchasing expertise and resources.
Since 1998, the TTC has purchased its diesel fuel from a physical supplier through fixed price contracts for periods of three months up to two years based on the supplier purchasing futures. However, few companies currently offer this service and supplier mark-ups for this type of contract have increased substantially over the years. It appears that companies do not want to offer this service to its customers without charging a premium mark-up. The Commission currently has a contract with Suncor for the supply of No. 1 Ultra Low Sulphur diesel fuel in the upset limit amount of $379.4M, which expires on March 31, 2011. For the last nine months,

TTC has purchased its diesel fuel on the spot market with monthly price adjustments based on pricing posted on the Bloomberg Oil Buyers Guide.

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DISCUSSION

As a large purchaser of diesel fuel (approximately $76M in 2010), the TTC faces significant financial exposure/risk to rising petroleum prices. The TTC can offset this risk through hedging its financial exposure/risk to rising fuel prices either by obtaining a fixed price contract from its petroleum supplier (physical hedging) or the purchase of financial futures with a counterparty which is typically a bank (financial hedging).

Hedging is defined as a reduction of risk by the transfer of such risk to those with opposite risk profiles such as petroleum product producers or speculators. The primary objective of price hedging is to provide price stability/cost certainty by fixing forward prices on at least a portion of the required volume if it is forecasted that diesel fuel pricing may dramatically increase in the near or long term future. The secondary objective is to fix in "favourable" forward prices if and when it becomes available in the market place. The basic financial hedging premise is that the gains or losses on the financial hedging transactions are offset by the corresponding inverse pricing movements on the spot market. The hedging objective is to minimize financial risk through cost certainty/stability not cost reduction. Financial hedging has shown to be a lower cost alternative versus hedging with a physical supplier due to the increased premiums associated with fixed price contracts.

A. PHYSICAL SUPPLY

The TTC's requirement for the physical supply and delivery of diesel fuel was issued on October 28, 2010 in conjunction with and as part of the City's requirements in their Request for Quotation. The contract term was for three years with two additional one year options to be exercised independently at the City's and TTC's sole discretion. The TTC's volume for diesel fuel is expected to be approximately 88.1M litres in 2011 and the estimates for subsequent years while expected to increase, will be determined based on actual usage and future service requirements. Bidders were requested to provide pricing based on mark-up/discounts to the weekly or monthly spot pricing plus delivery for No.1 Ultra Low Sulphur diesel fuel posted on the Bloomberg Guide which will remain firm for the duration of the contract plus a mark-up for delivery to each TTC location.

Responses were received from four companies. Suncor Energy Products Partnership (Suncor), Ultramar Ltd. (Ultramar), Lambert Oil Ltd. (Lambert) and Alpha Oil Inc. (Alpha). All four companies bid on the City's requirements and only two companies, Suncor and Ultramar, submitting pricing for the TTC diesel requirements.

Suncor submitted pricing on both the weekly and monthly adjusted pricing options including the mark-up for delivery and had the lowest evaluated bid for both options. Their bid contained several qualifications concerning delivery to the required terms and conditions, which are considered acceptable. The bid received from Suncor is considered commercially and technically compliant. Suncor is the current contractor for the supply of diesel fuel to TTC locations and they have performed in a satisfactory manner on the current as well as past contracts.

Suncor is recommended to be awarded an approximate five year contract (57 months) for the physical supply of diesel fuel, which includes the 2 additional one year options for 2014 and 2015. The recommended upset limit of $513,000,000 for the 5 year contract is based on a yearly volume of 88.1M litres and on the current average monthly price for No. 1 Ultra Low Sulphur diesel fuel posted on the Bloomberg Guide and includes a contingency of 25% for increased usage or increases in the price of diesel fuel during the term of the contract.

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Suncor's discount for weekly adjusted pricing is approximately 14% higher than the current supplier discount, their discount for the monthly adjusted pricing is the same as the current contract, and their delivery charge is 23% lower than the current contract.

Ultramar submitted pricing on the weekly adjusted pricing option only as well as the delivery mark-up and was the second lowest bid for that pricing option. Their bid also contained qualifications which were considered to be acceptable and was found to be both commercially and technically compliant.

B. FINANCIAL HEDGING

A separate Request for Expression of Interest (REOI) was issued to establish a roster of up to 5 companies for petroleum fuel financial hedging services. Under this arrangement the City would act as an Agent on behalf of the TTC and as directed by TTC staff concerning the purchase of fuel hedging contracts act to enter into these contracts. This arrangement is required as based on its charter, the TTC cannot enter into such contracts directly. The City intends to enter into Master Agreements with qualified bidders to form the roster of acceptable counterparties with respect to providing diesel fuel contracts. The roster will be valid for a three year term and will be refreshed every three years through a similar process.

Bids were received from 5 firms, Scotiabank, Royal Bank of Canada (RBC), British Petroleum Canada (BP), the Canadian Imperial Bank of Commerce (CIBC) and the Bank of Montreal (BMO). All five submissions received were found to be acceptable to TTC and City staff. City legal staff then began the process of negotiating International Swaps and Derivatives Association (ISDA) Master Agreements with the five bidders to form a roster of counterparties. During the course of these negotiations an acceptable agreement could not be reached with BP. At the time of this report, City Legal staff is currently finalizing negotiations with the other four respondents (Scotiabank, RBC, CIBC and BMO) with respect to the ISDA Master Agreements who will make up the roster of counterparties.

Commission staff has an existing committee consisting of representatives from the Materials and Procurement and Finance departments that meet regularly to develop short and long term strategies for the purchase of diesel fuel. Under this new agreement, this committee will also meet with City staff as well as a consultant to develop appropriate purchasing strategies based on market conditions. The City and the TTC jointly intends to retain a consultant who will provide purchasing expertise. Any financial hedging will be done at the TTC's sole discretion when determined to be in the best interest of the TTC.

JUSTIFICATION

The supply of diesel fuel is required to ensure the uninterrupted supply for the Commission's operations from April 1, 2011 to December 31, 2015 and for providing the opportunity for financial hedging which should mitigate the potential financial risk associated with rising diesel fuel pricing.

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February 15, 2011
9-118-52
Attachment – Appendix 'A'

APPENDIX 'A'

PROCUREMENT AUTHORIZATION: SUPPLY OF DIESEL FUEL

A. PHYSICAL SUPPLY

BIDDERS	TOTAL BID PRICE (5YR.)**	EVALUATED PRICE***
Suncor Energy Products Partnership *	$314,861,000	$408,933,769
Ultramar Ltd.	$318,754,250	$410,775,059

* Recommended for Award

** The bid price is based on the posted rack pricing for #1 ULSD from the Bloomberg Guide on November 5, 2010.

*** The evaluated price is based on the current average monthly price for #1 ULSD from the Bloomberg Guide on February 4, 2011 over the 57 month term of the contract.

B. FINANCIAL HEDGING

PROPONENTS

Scotiabank
Bank of Montreal
Royal Bank of Canada
Canadian Imperial Bank of Commerce
British Petroleum Canada

EVALUATION CRITERIA

- ACCEPTABLE CREDIT RATING
- EXPERIENCE AND REFERENCES
- COMPANY PROFILE
- PERFORMANCE CAPABILITY