For Action

Diesel Fuel Contract

Date: January 24, 2019
To: TTC Board
From: Chief Financial Officer

Summary

The purpose of this report is to obtain procurement authorization for the supply and delivery of diesel fuel to TTC properties until December 31, 2019.

Recommendations

It is recommended that the TTC Board:

1. Authorize issuing a contract amendment to Suncor in the amount of $87,000,000 plus HST for the supply of diesel fuel to TTC properties, along with exercising the final contract extension option covering the period March 1 - December 31, 2019.

Financial Summary

Of the approximately $93 million which will be incorporated into the proposed 2019 TTC and Wheel-Trans Operating Budgets for diesel fuel, approximately $77 million will be allocated to requirements for the months of March through December 2019. Since TTC must pay market prices to Suncor, $10 million in requested additional authority is required to provide a contingency for market price fluctuations. As of December 18, 2018, the TTC has budget protection against market price fluctuations in the form of a separate fuel hedging program through which the TTC has hedged approximately 55% of its 2019 diesel fuel requirements.

The price of diesel fuel is a significant budget pressure for 2019. In 2018, the hedging program enabled the TTC to achieve average prices of approximately 87 cents per litre. Due to market price increases the TTC is currently expecting an average price of $1.03 per litre in 2019, resulting in an incremental budget pressure of as much as $14 million.

The Chief Financial Officer has reviewed this report and agrees with the financial impact information.

Equity/Accessibility Matters

No equity or accessibility impacts were identified.

Decision History

A competitive Request for Quotation (RFQ) was issued by the City of Toronto in 2015 for the physical supply and delivery of petroleum products that included quantities for TTC locations, City of Toronto Fleet Services, and the City's participating agencies, boards and corporations. The RFQ stated that the contract term would be for a two-year period with the option to renew the contract for two additional one-year periods at the City and the TTC's sole discretion.

At its meeting on November 23, 2015, the TTC Board authorized the award of the current contract for the physical supply of diesel fuel to Suncor with a total upset limit of $182,500,000 for the period from January 1, 2016 to December 31, 2017.

http://www.ttc.ca/About_the_TTC/Commission_reports_and_information/Commission_meetings/2015/November_23/Reports/Procurement_Authorization__Physical_Supply_of_Diesel_Fuel_to.pdf

At its meeting on November 9, 2015, the City of Toronto Government Management Committee granted authority to award its diesel fuel contract to Suncor for a two-year period.

http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2015.GM8.23

At its meeting on November 13, 2017, the TTC Board approved the issuance of a contract amendment to exercise the first contract option to Suncor in the amount of $86,000,000 plus HST for the period of January 1, 2018 to December 31, 2018.

http://www.ttc.ca/about_the_ttc/commission_reports_and_information/commission_meetings/2017/november_13/reports/13_diesel_fuel_contract.pdf

The TTC's contract with Suncor includes extension options to a final end date of December 31, 2019. Under staff authority, the TTC extended its contract from December 31, 2018 to February 28, 2019.

Issue Background

Diesel fuel is needed to operate the TTC's fleet of approximately 2,000 city buses, as well as Wheel-Trans buses, specialized subway and SRT rail service vehicles, standby emergency generators, certain non-revenue cars and trucks, and small equipment.

The TTC would not be able to provide daily service to the riding public without the regular supply of diesel fuel. The seven city bus garages (Malvern, Birchmount, Eglinton, Queensway, Arrow Road, Wilson, and Mount Dennis) which house the TTC's fleet of city buses, require routine daily delivery of diesel during the work week via tanker trucks to fill on-site storage tanks that, in turn, fuel the TTC's buses. Across the seven bus garages, during the Monday to Friday work week, the average daily consumption of diesel is approximately 280,000 litres.

In addition to the bus garages, storage tanks and fuelling equipment are located at other TTC facilities to enable fuelling of the TTC's vehicles and equipment, although the diesel consumption is much lower and deliveries are far less frequent compared to the bus garages.

Since 2011, the TTC's diesel fuel requirements have been combined with those of the City and its agencies, boards, and commissions so that the City could solicit competitive bids for fuel supply based on the combined higher volumes in order to leverage the aggregated purchasing power. In addition, joint contracting enabled the TTC and the City to share consultant purchasing expertise and resources, and to develop a fuel hedging program.

As the City and the TTC are large consumers of diesel fuel (combined annual volumes of over 100 million litres), there is a significant financial exposure and risk to rising petroleum prices. The risk can be mitigated through hedging, either by obtaining a fixed price contract from the petroleum supplier (physical hedging) or the purchase of financial futures with a counterparty, typically a bank (financial hedging).

The primary objective of price hedging is to provide price stability and cost certainty by fixing forward prices on at least a portion of the required volume, if it is forecast 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.

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. As part of the City's Fuel Purchasing Program, it was recommended that the City and the TTC purchase fuel on the spot market with a physical fuel supplier and implement a fuel hedging program with multiple counterparties to mitigate the price risk.

Under the program, the City uses a roster of counterparties (Royal Bank, CIBC and the Bank of Montreal) to perform the financial hedges. Ontario Regulation 610/06 under the *City of Toronto Act, 2006* provides the authority for the City to enter into commodity price hedging agreements. As the TTC cannot enter into such contracts directly, the City acts as an agent on behalf of the TTC executing fuel hedging contracts for the TTC, as directed by the TTC.

In June 2018, the diesel fuel being purchased by the TTC and the City was switched to B5 Biodiesel which contains 5% biodiesel and 95% Ultra Low Sulfur Diesel (ULSD) No. 2, which is refined to meet the latest federal fuel standards for the TTC's fleet. Prior to the switch to B5 Biodiesel fuel, the diesel purchased by the TTC and the City contained 4% Biodiesel, which is the minimum biodiesel content required by the Federal Fuel Standard and the Ontario Government.

The City has exercised all contract extension options with Suncor and the final expiry date of the City contract is December 31, 2019.

Comments

The RFQ issued by the City to establish the contract stated that the pricing for diesel would be based on the Bloomberg Oil Buyers Guide (BOBG) Canadian unbranded rack prices that are published each Friday, and bidders were requested to provide their discount ($/litre) off-the-rack price as well as their delivery cost ($/litre). Both the discount off-the-rack price and the delivery cost was firm for the duration of the contract, including the extension options. The switch to fuel with a 5% Biodiesel content had no effect on the price as the discounts and delivery costs from Suncor for this product remained the same as the 4% Biodiesel product.

The 2019 budgeted diesel volume is 90 million litres, of which 88 million litres are allotted for Operating and 2 million litres are allotted for Wheel-Trans.

Table 1: TTC City Bus Consumption & Cost for Physical Supply of Diesel

Year	Total Litres Consumed	Consumption Rate (Litres/km)	Total Cost - Physical Supply of Diesel (net of HST recoveries)
2014	86,596,592	0.647	$95,005,649
2015	85,200,951	0.635	$72,528,061
2016	88,618,955	0.628	$65,391,447
2017	88,406,472	0.613	$76,562,666
2018*	85,778,610	0.600	$89,106,799

*Projected as of December 2018.

Note: Wheel-Trans data is not included in the above table. The Wheel-Trans bus fleet consumes approximately 2 million litres of diesel annually and the total distance traveled is approximately 10 million kilometers. By the end of 2019, approximately 50% of the Wheel-Trans fleet will be comprised of gasoline-powered vehicles.

As the TTC has updated its bus fleet, it has realized increased efficiency in diesel consumption. The above table demonstrates a year-over-year increase of kilometres travelled per litre of diesel fuel. The TTC's future consumption of diesel fuel may be reduced if the TTC replaces its diesel bus fleet with electric buses. Other factors that will affect diesel demand include changes to service levels, the opening of the Eglinton Crosstown LRT line and subway expansion projects.

There are no further extension options remaining in the contract to allow for the continued supply of diesel beyond December 31, 2019. As part of a joint procurement, TTC staff, in conjunction with City staff, will issue a competitive RFQ to the industry in 2019 for diesel fuel requirements for the years 2020 and beyond. A staff report will follow in due course.

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Signature

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