

Natural Gas Supply Arrangements

Date:	April 3, 2008
To:	Government Management Committee
From:	Chief Corporate Officer; Director of Purchasing & Materials Management
Wards:	All
Reference Number:	P:\2008\Internal Services\ Gm08034F&RE – (AFS 7163)

SUMMARY

The purpose of this report is to seek an amendment to existing authorities in order to permit an improved management of the City's natural gas supply arrangements by enhancing the diversification of the City's natural gas portfolio.

RECOMMENDATIONS

The Chief Corporate Officer and the Director of Purchasing & Materials Management recommend that:

1. the Chief Corporate Officer or his designate be authorized to issue and award quotation requests as described in this report in amounts ranging up to \$40 million for the supply of natural gas for terms not exceeding five years, from a roster of qualified suppliers, selected in consultation with the Director of Purchasing & Materials Management;
2. the Chief Corporate Officer be authorized to execute new or amending gas transportation agreements, new or amending master agreements with gas suppliers, new or amending master services and gas delivery agreement(s) with Enbridge Gas Distribution Inc. and new or amending agency agreements with the Toronto Community Housing Corporation and the City's participating agencies, boards and commissions, all as required, on terms and conditions satisfactory to the Chief Corporate Officer and the City Solicitor;

3. all administrative costs, including any consulting costs, be included as part of the costs to be passed on to all natural gas end users included in the natural gas arrangements;
4. the appropriate City officials be authorized to take any action necessary to give effect to the foregoing.

Financial Impact

Approving the recommendations would enhance City staff's ability to better manage the City's overall natural gas costs, along with its exposure to market risks. Although there will be some administrative costs associated with the management of the City's natural gas supply arrangements, such as consulting costs, they are expected to be relatively insignificant (approximately \$15,000 per year). The resultant potential annual cost avoidance ranges from \$200,000 to \$300,000, based on current estimates and current market conditions.

Funding for the cost of natural gas will continue to be addressed in the annual operating budgets of City divisions, agencies, boards, commissions, and of the Toronto Community Housing Corporation.

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact statement.

DECISION HISTORY

At its meeting on May 21, 22 and 23, 2003, City Council approved a confidential report regarding the assignment of the City's current contract to a new supplier. (Report No 4, Clause 26 of the Policy and Finance Committee).

<http://www.toronto.ca/legdocs/2003/agendas/council/cc030521/pof4rpt/cl026.pdf>

The report included that:

- “(4) Council authorize City staff to issue a request for proposals in order to select up to three natural gas suppliers to enter into Master Agreements with the City for the period November 1, 2004 to October 31, 2007, in order to obtain the best pricing on a portfolio basis as detailed in this report;
(5) City staff report back to Council regarding the results of the request for proposals and proposed natural gas purchasing strategy.”

At its meeting of March 1, 2 and 3, 2004, Council approved the City entering into master natural gas supply agreements with three suppliers, for a three-year term, commencing November 1, 2004;

<http://www.toronto.ca/legdocs/2004/agendas/council/cc040301/pof2rpt/cl014.pdf>

Subsequently, City Council directed the extension of its natural gas arrangements for an additional three- year term, from November 1, 2007 to October 31, 2010.

<http://www.toronto.ca/legdocs/2005/agendas/council/cc050517/pof5rpt/cl007.pdf>

Council also approved a Natural Gas Purchasing Strategy, set forth in the 2004 report, which includes oversight of the City/ABC Natural Gas Purchasing Program by a Natural Gas Team, comprised of representatives from key natural gas cost stakeholders (Toronto Community Housing Corporation (TCHC), the City's Water and Waste Water Division, Energy and Waste Management Office, Legal Services and Finance Division).

COMMENTS

Natural Gas Purchases

The City (Energy & Waste Management Office) purchases approximately 95 million cubic metres of gas per year, for use by City Divisions, various Agencies, Boards and Commissions (ABCs), and the Toronto Community Housing Corporation (TCHC), at a total estimated commodity cost (ie not including distribution and transportation costs) of approximately \$40 million per year at today's natural gas prices.

Total natural gas use may be broken-down as follows: TCHC (40 percent); the City's Water and Waste Water Division (19 percent); other City Divisions (36 percent), and ABCs (5 percent). The Toronto Transit Commission has its own supply arrangement and is not covered under this natural gas arrangement.

Aside from the commodity purchase, other arrangements are required in order to take delivery of the natural gas, including arrangements that allow suppliers to ship the commodity to the City via the Trans-Canada Pipeline, to Enbridge, who in turn distributes the commodity to each user location. Recommendations included in this report would allow the Chief Corporate Officer to execute the underlying transportation arrangements and services, gas delivery agreements and agency agreements with City participants in the program.

Furthermore, this report recommends that administrative costs, including internal staff time, outside supportive consulting services, and Enbridge direct purchase fees, be included as part of the costs to be passed on to the natural gas end user group. This would be consistent with current arrangements.

Portfolio Strategy

1. Current Strategy

Natural gas buyers are price takers within the volatile North American marketplace. Therefore, the City's current Natural Gas Purchase Strategy involves the structuring of a "portfolio" of natural gas supply transactional contracts in a manner that allows for price minimization while enhancing price certainty, and permits an appropriate level of risk management.

The City purchases its natural gas from a roster of suppliers, thereby allowing City staff the ability to obtain competitive price quotes on an ongoing basis. The competitive pricing has saved the City approximately \$1 million over the last 5 years.

The City's current strategy was intended to also allow for the efficient management of the City's natural gas portfolio by enabling a diversification of the terms-to-maturity (e.g. 1-5 years) of transactional contracts within the portfolio. Structuring an optimal mix of short and medium-term transactions is an important tool for mitigating the City's exposure to market pricing volatility.

The City's outside energy advisor (Energy Advantage) has recommended that the City's natural gas portfolio include terms-to-maturity of up to five years on an ongoing basis.

Furthermore, staff seeks to fix pricing (i.e. through transactional contracts) for a percentage of natural gas volume in accordance with the advisor's ongoing recommendations. The table below demonstrates the advisor's recent recommendations given current market conditions.

Recommended Natural Gas Portfolio	
Term	Percentage of Volume at Fixed Price*
Year 1	85-90%
Year 2	70-80%
Year 3	50-60%
Year 4	30-40%
Year 5	10-20%

* revised in consideration of market conditions

As structuring an optimal portfolio mix is a fluid exercise, market conditions are continually monitored by City staff (in conjunction with the City's advisor), and percentage allocations are adjusted as appropriate.

2. Amendment to Portfolio Strategy

It is important to have the ability to enter into commitments of up to five years, on an ongoing basis. However, previous Council authorizations have allowed for commitments

of up to three years, with all transactions in the portfolio ending on the same specified date.

Furthermore, as the expiry of arrangements with each natural gas supplier in the City's roster have become linked with the expiry of transactional contracts, the availability of diversified transactional contract terms becomes increasingly restricted over time. The end result is that City staff's ability to properly manage natural gas cost and supply risk becomes increasingly diminished over time.

In order to enhance the City's ability to manage its market risk exposure, this report recommends that the City amend its natural gas purchase strategy, in order to de-link the City's ability to enter into transactional contracts from the ongoing selection of natural gas suppliers that may participate in the City's roster. The amended strategy would permit staff to seek and accept natural gas purchase bids from those in its supplier roster, for terms of up to five years.

Selection of a Roster of Natural Gas Suppliers

In accordance with the City's purchasing by-law and purchasing policies and procedures, a pre-qualification call will be issued by the Purchasing and Materials Management Division to all potential suppliers, including the City's current roster of suppliers (to re-qualify their status). The call will also be advertised on the City's website.

The City's Chief Corporate Officer, in consultation with Natural Gas Team and the Director of Purchasing and Materials Management, will review, analyze and rate the proponents in accordance with evaluation criteria that will include credit rating, performance capabilities, contract terms and conditions, security of supply, and experience and references.

Pursuant to the results of the pre-qualification evaluation, the City will negotiate and enter into master natural gas supply agreements with no more than five firms obtaining the highest scores, and which therefore meet the City's pre-qualification requirements. Once the master natural gas agreements are in place, these firms will form the City's roster of natural gas suppliers, which will be given the opportunity to provide natural gas supply pricing quotations as required and requested by the City.

The roster of suppliers will be refreshed every three years following the same procedure.

Price Quotation: Timing

With the arrangements as outlined in this report in place the City (Energy & Waste Management Office), in consultation with its natural gas advisor (Energy Advantage), will issue price quotation requests for a specific volume and term to each supplier on the roster. The quotation requests are issued by email and close on a specific date and time. Due to market volatility the lowest bidder will be contacted by phone to confirm the quoted price. As an industry practice in the natural gas market, the suppliers are required

to tape the detail of each transaction. The successful bidder then issues a written confirmation to the City of the transaction.

It is critical to note that due to the volatility of the natural gas market, the industry practice is that price quotations are generally not held open for longer than approximately ten (10) minutes. Therefore, it is important to continue to have the flexibility to act in a timely manner. For this reason, this report recommends that the Chief Corporate Officer be authorized to issue and accept price quotations.

Although a review of recent City natural gas purchase activity indicates that transactions have generally ranged from \$3-\$20 million, as the energy marketplace has proven itself to be of a volatile and changing nature, this may not be representative of future transactional requirements. It is possible that the value of future individual transactions may range anywhere up to \$40 million, dependent on underlying volume, price and term. The higher end amount would correspond to locking-in a significant portion of the City's gas requirements over a longer contract term, in response to possible market conditions.

This report was prepared in consultation with the City Solicitor, and the Deputy City Manager & Chief Financial Officer.

CONTACT

Jim Kamstra, Manager, Energy & Waste Management, Business and Strategic Innovation, Facilities and Real Estate Division, 392-8954, jkamstra@toronto.ca.

Victor Tryl, Manager, Purchasing,
Purchasing and Materials Management Division, 397-4801, vtryl@toronto.ca

SIGNATURE

Bruce Bowes, P. Eng.
Chief Corporate Officer

Lou Pagano
Director, Purchasing & Material
Management