SUBJECT: Local Authority Services (LAS) (PW05106) - (City Wide)

**COMMENDATION:**

(a) That the City of Hamilton participates in the Local Authority Services (LAS) Natural Gas Procurement Program (GASAMO), subject to Legal review.

(b) That the City of Hamilton participates in the Local Authority Services (LAS) Electricity Procurement Program, subject to Legal review.

(c) That the Director of Fleet and Facilities or his designate be granted the authority to execute all documentation in a form acceptable to the City Solicitor related to recommendations (a) and (b) above.

Scott Stewart, C.E.T.
General Manager
Public Works

EXECUTIVE SUMMARY:

The Association of Municipalities (AMO) through its subsidiary company Local Authority Services (LAS) is mandated to work with Ontario municipalities to assist them in reducing the cost of their expenditures through principles of economies-of-scale and cooperative procurement efforts. The City of Hamilton’s interest is primarily the procurement of natural gas and electricity for its corporate and community facilities. In-house resources lack the skill sets and expertise required to manage the complex energy portfolio in a manner that guarantees the City the best overall value. Furthermore, the LAS offers the City of Hamilton, the ability to access information, in the
area of general energy trends and forecasts, as well as, specific information related to
energy use for the affected facilities. LAS provides two programs in which staff
recommends the City of Hamilton participate in; (1) The LAS GASAMO Natural Gas
Program, and (2) LAS Electricity Procurement Program.

The City’s Corporate Facilities Management Section has managed the natural gas
procurement responsibilities for approximately 15 years. As energy procurement has
become increasingly complex and therefore exposing the City to greater risk, staff has
used outside experts to assist and advise in the ongoing management of the daily
transactions and reporting. The City’s Natural Gas Advisors have been assisting and
working with City staff since 2002 at a cost of approximately $25,000 annually.

Effective April 1, 2005, the Province of Ontario established prices for electricity that
were designed to better reflect the true cost of producing electricity. The Ontario
Energy Board Act 1998 and the associated regulations under the Act established
customer categories for eligibility for the Two Block Price Plan. The established
customer categories for the Plan included municipalities. Consequently, municipalities
under the revised rates are eligible for the Regulated Price Plan from April 1, 2005
extending for three full years. Beginning April 1, 2008, eligibility for the Regulated Price
Plan will be limited to residential customers and general service customers under 50
kilowatts, thereby excluding municipalities.

While some may view the certainty of the Two Block Price Plan as beneficial to
municipalities, it appears that there may be both financial and operational savings and
efficiencies in opting out of the Regulated Price Plan in the case of a variety of
Corporate facilities and their associated accounts. With respect to electricity, the City of
Hamilton receives the majority of its power through the Local Distribution Company
(LDC) Hamilton Hydro. The opportunity exists to join in the efforts that LAS is
establishing in developing an Electrical Procurement Program offered to all interested
Ontario municipalities. It is anticipated that substantial savings for municipalities will be
realized from the program because of the ability of LAS to leverage economies-of-scale
in a co-operative municipal environment. If the City were to opt out of the Regulated
Price Plan in favour of the LAS Electrical Procurement Plan, the City of Hamilton would
continue to receive it’s power through the LDC.

Similar to the Natural Gas advisor scenario, if the City chooses to pursue procuring its
electricity on the open market with in-house staff, it would be prudent to retain market
experts to assist staff in managing the electrical procurement process. As stated above,
municipalities will be subject to the market rates for electricity effective April 1, 2008,
therefore municipalities will be required to establish a strong understanding of their use
of electricity as well as a strong understanding of market trends and forecasts, and all
the associated influencing factors. Procuring electricity is far more complex in
comparison to the procuring of natural gas, that being said, it is estimated the cost of
outside expertise in the energy field would range $40,000 to $50,000 annually, this is in
addition to the current cost of retaining the Natural Gas Advisor. These costs would be
avoided if the City participated in the LAS Electricity and Natural Gas Procurement
Programs.

Deregulation of the energy markets has provided insight into how volatile and
unpredictable energy prices can be in a competitive market environment. Deregulation
has also made energy an increasingly complex issue. It simply can no longer be
incorporated into another job/function and treated as a bill payment process. Financial
derivative products including swaps, forward and options are now part of the energy landscape. Energy costs have been unbundled, turning bills into puzzles for all but the most informed. Increase market complexity speaks to the need to stay fully informed about market developments and develop policies and strategies in tune with the changes that are occurring today.

The City of Hamilton is an active member of AMO and accordingly the services provided by the LAS, the procurement of natural gas and electricity would be at no cost to the City. Consequently, the City could redirect the efforts of the Natural Gas Advisor to ensure the greatest financial and operational savings and efficiencies are achieved as a result of joining the LAS.

To reduce the risk associated with the extremely volatile commodities, staff is recommending support for the approach considered in this report.

BACKGROUND:

Local Authority Services Ltd. (LAS) was created in 1992 by the Association of Municipalities of Ontario (AMO) and is a wholly owned subsidiary company of AMO, with AMO being its sole shareholder. It is incorporated under the laws of Ontario to conduct business in this province.

LAS is mandated to work with all 445 Ontario municipalities to assist them in reducing the cost of their expenditures and to increase their revenues through the principles of economies-of-scale and co-operative procurement efforts. LAS does this by offering innovative products and services to Ontario’s municipalities.

(LAS) - GASAMO Natural Gas Program

The GASAMO program is designed to achieve savings for municipalities through the bulk procurement of natural gas. Utilizing the expertise of industry experts, the GASAMO program has become a large player in the natural gas Market – the program purchases gas for about 180 municipalities and other public sector organizations and services a total of about 1,800 physical locations.

The GASAMO program seeks to provide the lowest possible net gas costs to program members. Being a commodity that is heavily influenced by market conditions, no one knows with certainty where gas costs will fall, but by tendering on behalf of all program participants, using combinations of fixed and indexed pricing contracts, the GASAMO program is able to offer a more uniform cost from year to year for program participants. This price is almost always lower than gas prices paid by individual municipalities.

The GASAMO strategy is simple:

1. Prices Below Market Prices - program members have saved almost $7.5 million over the past three years.
2. Budgetability - blended prices allows municipalities to better anticipate energy costs.
3. Maximize Purchasing Power - continue to hedge majority of required gas utilizing futures contracts.

The current daily requirement for the program is about 7,000 GJ/day, which results in significant purchasing power. As a result of being able to leverage economies-of-scale, the GASAMO program is able to provide significant savings to member municipalities.
According to information provided by LAS, on their own, most municipalities could expect prices that are 1.5 to 5 cents per m³ higher than by GASAMO members.

Price assurance is an important component of GASAMO as the program provides members with a blended price that reflects the cost of natural gas for the entire one-year block (usually beginning on November 1st of each year). This blended price provides stability for program members and allows them to better anticipate energy costs throughout the year.

What makes the GASAMO program so competitive is the utilization of a hedging strategy to provide the best possible prices to program participants while mitigating the risk involved with spot market purchases?

An advisory committee comprised of representatives of varying specializations from member municipalities provides oversight for the GASAMO program. The committee has a mandate to advise on the directions of the program, to monitor program performance, to ensure accountability, and to provide advice regarding the future supply and price of natural gas to help direct program purchases. City staff would be members of the committee.

(LAS) - Electricity Procurement Program

LAS is establishing a bulk Electricity Procurement Program for all interested Ontario municipalities because of the need and desire of local governments to achieve financial savings and operational efficiencies.

It is anticipated that savings for municipalities will be realized from the LAS Electricity Procurement Program because of the ability of LAS to leverage economies-of-scale to purchase blocks of electricity en masse as opposed to the “one-off” and spot market purchases often undertaken by many municipalities.

The principle behind this program is simple: the greater the number of municipalities involved in the program, the greater the savings will be for all program participants. That said, interest in the program has been substantial – over 100 municipalities, including comparator municipalities, have contacted LAS to learn more about the program.

An RFP was distributed to potential candidates by LAS and the closing date was May 2005. The program is expected to commence in the Fall of 2005.

After the completion of the RFP process, a load profile will be completed to determine the amount of electricity that will be needed to satisfy the requirements of participating municipalities. LAS will then work with the successful RFP candidate to develop the most competitive procurement program for all program members.

To assist in the development of a conservation culture, it is planned that after the initiation of the procurement program, participating municipalities will be provided with software that will enable them to analyze load profiles, monitor and manage electricity usage on a daily basis, view facilities and specific meters for consumption usage, and make real-time decisions on how to control electricity costs.
Analysis of Alternatives:

Natural Gas

The City of Hamilton purchases 2000 gigajoules (GJ) per day from gas marketers or producers, called a “direct purchase”. Natural gas is primarily used for space heating, transit fuel and for the sewage treatment process. The natural gas flows at some 200 separate locations in the City delivered by the local distributor, Union Gas Limited. The City has an Agency Billing and Collection Services (ABC) agreement in place with Union Gas to administer the monthly billings for its facilities. Gas supplied to the Hamilton Street Railway is delivered under a T1 contract, which is also managed by City staff and the City’s Natural Gas Market advisor, Aegent Energy Advisors Inc.

Through a tendering process the natural gas procurement contract for the years 2004-2007 was awarded to a roster of three (3) suppliers (gas marketers): Superior Energy Management, a division of Superior Plus Inc (“Superior”), WPS Energy Services of Canada Corp. (“WPS”), and Sempra Energy Trading Corp (“Sempra”). The City has entered into a Natural Gas Master Agreement with one of the three suppliers - Superior, for a term of 3-years commencing November 1, 2004. Despite ongoing, diligent and good faith negotiations on the part of the City, there have been no Agreements executed with WPS or Sempra to date. The intent of the (3) three supplier scenario was to promote competitive bidding in order that the City would achieve the lowest rate possible. This has not been achieved due to the lack of a signed Natural Gas Master Agreement with WPS and Sempra. There are no obligations to the City to deal with either Superior or the other 2 suppliers as part of this roster or via the Natural Gas Master Agreement. The Master Agreements are in place only in the event that the City procures natural gas from any one or all (3) three suppliers.

Through the active management of gas costs with the current supplier (Superior), the City has managed its exposure to gas price changes reasonably well during the recent period of extreme gas prices. City staff continues to use the external Natural Gas Market Advisor to assist in the procurement process at a cost of approximately $25,000 annually.

Electricity

The City receives the majority of its power through the Local Distribution Company (LDC) Hamilton Hydro. Municipalities in Ontario are deemed eligible for the Province’s Two Block Price Plan, from the period April 1 2005 through to March 31, 2008, under the Ontario Energy Board Act 1998 and the associated regulations under the Act. In the case of the City of Hamilton, effective April 1, 2005, the City’s facilities are subject to the following rates and monthly thresholds.

<table>
<thead>
<tr>
<th>Monthly Threshold</th>
<th>Commodity Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 750kwh</td>
<td>5.0¢/kwh</td>
</tr>
<tr>
<td>Greater than 750 kwh</td>
<td>5.8¢/kwh</td>
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</table>

In the spring of 2006, and every six months after that, the electricity commodity rates may change based on an updated Ontario Electricity Board (OEB) forecast and any difference between the amount customers paid for electricity and the amount paid to generator.
Since 2003, municipalities in Ontario have experienced significant commodity rate increases. The following table below highlights those changes.

<table>
<thead>
<tr>
<th>Threshold</th>
<th>2003 Commodity Rates</th>
<th>2004 Commodity Rates (effective April 1, 2004)</th>
<th>2005 Commodity Rates (effective April 1, 2005)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 750kwh</td>
<td>4.3¢/kwh</td>
<td>4.7¢/kwh</td>
<td>5.0¢/kwh</td>
</tr>
<tr>
<td>Greater than 750kwh</td>
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<td>5.8¢/kwh</td>
</tr>
</tbody>
</table>

The complexity of the deregulated natural gas market and its growing interrelationship with electricity markets that also are moving towards deregulation have increased the need for coordination among market participants. The City’s in-house resources lack the expertise required to manage the energy portfolio proficiently and require external assistance in the ongoing management of daily transactions and reporting.

The City procuring energy which includes natural gas and eventually electricity, on its own will not maximize its purchasing power. Joining the LAS will provide a number of benefits such as the ability to purchase energy and leverage economies-of-scale with other Ontario municipalities in a co-operative manner.

With no cost to the City, LAS offers resources which have the expertise, understanding and vast knowledge of the energy markets providing the insight the City requires to effectively manage the energy portfolio.

Financial/Staffing/Legal Implications:

Financial Implications

Currently the City uses an external Natural Gas Advisor to assist staff in the ongoing management of the natural gas procurement process. Joining LAS will result in future savings by reducing the scope of work of the Natural Gas Advisor’s role. External assistance will still be required to manage Transit’s natural gas portfolio and in the short term, the Natural Gas Advisor will be redirected to analyse and verify that LAS provides the City the best value. Furthermore, the City will avoid future costs of pursuing the electricity market, it is estimated the cost of external services in the energy field would range from $40,000 to $50,000 annually.

Staffing Implications

N/A

Legal Implications

Any legal implications would be addressed via Legal review, as well as via any documentation to be executed in order to facilitate membership in LAS and the procurement of natural gas and/or electricity.

Policies Affecting Proposal:

N/A
CONSULTATION WITH RELEVANT DEPARTMENTS/AGENCIES:

Fleet & Facilities Division, Public Works Department
Legal Services & Corporate Counsel, City Manager's Office
Budgets & Finance, Corporate Services Department

There have been preliminary discussions with Hamilton Housing Corporation who has expressed interest. Further discussions and meetings are required.

CITY STRATEGIC COMMITMENT:

Support for the recommendations in this report will ensure that the City gets the best value in its energy purchases and therefore is in a competitive position with respect to the delivery of services to the community.

This is consistent with Council’s goal of being "A City that spends wisely and invests strategically."