AUGUST 27, 2003

Metropolitan
Transportation
Authority

One Gateway Plaza
Los Angeles, CA
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TO: BOARD OF DIRECTORS

THROUGH: ROGER SNOBLE
CHIEF EXECUTIVE OFFICER

FROM: LONNIE MITCHELL
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PROCUREMENT & MATERIAL MANAGEMENT

SUBJECT: FUEL CONTRACTS

ISSUE

At the Finance Committee meeting on August 21, 2003, committee members raised several questions regarding the MTA's procurement of diesel fuel and natural gas.

This report addresses those questions regarding (1) the purchase of diesel fuel, (2) the purchase of natural gas, (3) natural gas versus diesel fuel energy equivalents, and (4) hedging/option purchasing.

DISCUSSION

1. The MTA is currently under a two-year contract with British Petroleum (formerly ARCO) for the purchase of ultra low sulfur diesel fuel. The contract was awarded by the Board of Directors in July 2002 and will expire in June 2004. The pricing is subject to weekly adjustments based on the current price of diesel fuel #2 as reported in the Oil Price Information Services (OPIS) index for the Los Angeles area.

   Because we are buying ultra low sulfur diesel fuel which costs more to produce, the MTA is paying an additional charge of $.05 per gallon over the price of diesel fuel #2 as reported in OPIS. The total price paid for fuel by the MTA also includes a fixed transportation charge, state mandated fees and sales tax.

   Note: The MTA is currently under contract for unleaded gasoline; however, award of a new contract for unleaded gasoline will be presented to the Board in September.

2. The purchase of natural gas is made through the Southern California Gas Company. The pricing is based on an index referred to as the Weighted

Average Cost of Gas (WACOG). The Gas Company provides special pricing for Core Transportation Customers such as the MTA which includes the WACOG commodity price plus the transmission charge plus state mandated charges. The WACOG serves as an index to report on a monthly basis the price that SoCalGas paid for their current purchases of gas from producers and marketers at the best possible price on the open market

In October 2000, the MTA Board awarded a one-year contract with two one-year options for natural gas to the single bidder, Sempra Energy, the parent of SoCalGas. The pricing was based on a discount of $.01581 off of the WACOG. Sempra was not willing to extend the contract's discount price beyond the one year period of performance. However, based on review of the various indexes, the MTA is receiving very favorable pricing for natural gas used in the revenue fleet.

3. The energy equivalent of natural gas versus diesel fuel is as follows:

   - 1 Therm of gas = 100,000 British Thermal Units (BTU)
   - 1 Gallon of diesel fuel = 125,000 BTUs
   - 1 Therm of gas = .80 gallons of diesel fuel

4. In the past MTA has performed a type of hedging referred to as "wet barrel" hedging where fuel is purchased for a fixed term and at a fixed price regardless of changes in the market price. However, because of the petroleum market's volatility, fuel suppliers are not inclined to commit to a fixed price for an extended period of time. That is why our Invitations For Bid for diesel fuel and gasoline have been structured around the OPIS index in order to provide price protection for both the suppliers and the MTA in an unstable market.

   We have completed preliminary review of "paper hedging" strategies in which typically no fuel is actually delivered and have found it can be highly complex. Factors in any decision include: a fair amount of up front costs; requirements for long term commitment; degree of risk we would be willing to accept, since at times the hedge program is profitable and at other times unprofitable, and need for decisions on the amount of fuel placed in a hedging program since it will vary by season and market conditions.

NEXT STEPS

Staff will continue reviewing opportunities for long-term business arrangements which are responsive to our needs.

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