ATCO Gas South

Determination of the Fair Market Value of Uncontracted Carbon Storage

March 11, 2003

Alberta Energy and Utilities Board

ALBERTA ENERGY AND UTILITIES BOARD
Decision 2003-021: ATCO Gas South
Determination of the Fair Market Value of Uncontracted Carbon Storage
Application No. 1286912

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1 INTRODUCTION

1.1 The Application

By letter dated December 17, 2002 ATCO Gas South (AGS), a division of ATCO Gas and Pipelines Ltd. (AGPL), filed an application (the Application) with the Alberta Energy and Utilities Board (the Board) requesting approval pursuant to section 26(2)(d) of the *Gas Utilities Act*, R.S.A. 2000, c. G-5 (GUA), section 101(2)(d) of the *Public Utilities Board Act*, R.S.A. 2000, c. P-45 (PUB Act) and section 15(3) of the *Alberta Energy and Utilities Board Act*, R.S.A. 2000, c. A-17, to tender the uncontracted capacity of the Carbon storage facility (Carbon) for the 2003/2004 natural gas storage year. The Application was also presented pursuant to the Board's Direction in Decision 2002-072, dated July 30, 2002, that dealt with an application by AGS for the transfer of Carbon to an affiliated company, ATCO Midstream Ltd. (Midstream).

More particularly, AGS requested the Board's approval to determine the fair market value (FMV) of the uncontracted storage capacity at Carbon for the 2003/2004 natural gas storage year by the use of a Request for Bids (RFB) process. In the proposed RFB process, AGS would tender the full storage capacity of Carbon, less existing long-term storage commercial commitments of 9.5 petajoules (PJ) with associated deliverability, and not reserve any of the Carbon storage capacity for operation of a physical hedge on behalf of core customers. AGS stated that it gave consideration to reserving some of the capacity of Carbon for its customers and to operate a storage plan similar to the plan recently approved by the Board in Decision 2002-092, dated October 29, 2002, but determined that customers would be better served by tendering the entire storage capacity. Accordingly, AGS requested confirmation from the Board that maintenance of the 16.7 PJ last used for physical hedging purposes was not needed. However, AGS proposed that if the Board should direct that the hedge be maintained, AGS would proceed to determine a means of providing that capacity from all storage service providers in the market.

AGS considered that the proposed RFB process would not result in a "disposition" within the meaning of section 26(2)(d) of the GUA or section 101(2)(d) of the PUB Act and that it was not the type of transaction that requires Board approval. However, AGS stated that "because the Carbon RFB approach is new and untested and because of the friction surrounding the use of Carbon," that AGS was requesting approval of the proposed process in advance of its initiation.

AGS included with the Application copies of the proposed RFB process, the proposed Carbon Storage Service Agreement (CSSA), which would be executed by the successful bidder and AGS, and the proposed confidentiality agreement which would be necessary to allow potential bidders to view the confidential and/or commercially sensitive information necessary for them to complete their due diligence prior to submitting a bid. AGS also proposed that Midstream be permitted an opportunity to match the highest third party offer received through the RFB process

and, in the absence of any bid being received from qualified parties, the highest bid would be deemed to be four million seven hundred thousand dollars ($4,700,000). In addition AGS reserved certain rejection rights under the RFB process, including to: (i) amend or terminate the RFB process; (ii) decline to permit any party to participate in the process; (iii) reject any or all bids; (iv) accept, subject to the right to match, a bid other than the highest bid; or (v) negotiate with any party with respect to a transaction without any liability to AGS.

In the Application AGS also referenced a Board Direction issued in Decision 2001-110, dated December 13, 2001, compelling AGS to file a study (the Optimization Study) in which it would examine the options in order to develop a contingency plan or to restate the operating parameters for storage. In this Decision the Board also directed AGS, at the next general rate application (GRA), to provide the revenue requirement attached to each alternative in order for interested parties to gain an appreciation of the differing complexities and consequences of the choices available. AGS stated that, as it was unable to complete the study prior to issuing the RFB process, it proposed to initiate the study prior to tendering Carbon capacity for the 2004/2005 storage period.

1.2 Process for the Proceeding

By letter dated January 13, 2003, the Board advised all interested parties registered on the distribution list for the Transfer of the Carbon Storage Facilities Application, which led to Decision 2002-072, that it proposed to hold a written proceeding to deal with the Application and invited comments from these parties on the merits of the Application. Any party wishing to make a submission was required to do so by January 24, 2003. AGS was permitted until January 31, 2003 to reply to any submissions made by interested parties.

The Board notes that the parties to whom the Board's letter of January 13, 2003 was distributed included intervenors that would normally participate in the examination process involving this type of proceeding. The Board considers that the distribution, in this instance, provides an adequate degree of public notice. The Board received six submissions from interested parties, namely BP Canada Energy Company (BP), the City of Calgary (Calgary), the Consumers' Coalition of Alberta (CCA),[1] the Consumer Group (CG),[2] CrossAlta Gas Storage & Services Ltd. (CrossAlta), and EnCana Gas Storage (EnCana).

2 Issues

2.1 Jurisdiction

At issue was whether or not the RFB process proposed by AGS falls within the Board's jurisdiction. More particularly, the question involved whether or not the proposed process would effectively result in a form of disposition of Carbon for the benefit of Midstream.

[1] The CCA is comprised of the Alberta Council on Aging and the Consumers' Association of Canada (Alberta).
[2] Members of the CG are the Aboriginal Communities, the Alberta Irrigation Projects Association, the Alberta Urban Municipalities Association, the Federation of Alberta Gas Co-ops Ltd. and Gas Alberta Inc., and the Public Institutional Consumers of Alberta.

2.1.1 Views of Intervenors

Calgary

Calgary disagreed with AGS's contention that its proposed RFB process to deal with Carbon would not be subject to regulatory oversight. Calgary submitted that leasing all of the capacity to third parties and retaining none for AGS would not be in the normal course of business and would be a lease or encumbrance. Calgary stated that a related preliminary issue that should have been dealt with prior to any application being made was whether it was appropriate to encumber the asset with a right of first refusal to Midstream. Calgary considered that such a right of first refusal is also clearly an encumbrance within the meaning of the statutes.

CCA

The CCA disagreed with the position taken by AGS in the Application that the proposed RFB process is not a disposition, lease or encumbrance of its property, privileges, rights or any part of them. The CCA submitted that the types of transactions that are contemplated by the language used in the GUA include exactly the transaction that the RFB process will, if consummated, cause to occur and that the Board's jurisdiction over the proposed transaction is not limited. Further, the CCA submitted that as the RFB process is not in the ordinary course of AGS's business it is captured in the spirit of the legislation and requires Board approval.

2.1.2 Views of AGS

AGS disagreed with Calgary and the CCA that the RFB process involved a lease or an encumbrance. AGS submitted that the RFB process represents a contracting out of a portion of the output or capacity of Carbon for one year only and is no different than the contracts for storage capacity that AGS has concluded on an annual basis with other parties on numerous occasions in the past.

AGS stated that, in any event, it was seeking the Board's prospective approval of the proposed RFB process. AGS was concerned that without such approval, it will be subject to a prudence review based on hindsight given the continuing friction surrounding the use of Carbon.

2.1.3 Views of the Board

The Board considers that the tendering of all or a substantial portion of the capacity at Carbon, through the proposed RFB process, would give a third party rights to the capacity and deliverability of Carbon beyond that which would be considered as being in the ordinary course of AGS's business. This position is reinforced given the Board directions in previous decisions that a portion of the capacity be set aside for the use of AGS's utility customers. The Board notes that Carbon is included in the rate base of AGS, on which a regulated rate of return is provided, and it is a regulated asset. Consequently, the Board considers that the transactions proposed in the Application are subject to its review.

2.2 Timing of the Application

A gas storage year commences on April 1. Of concern was whether or not the Application was filed in sufficient time to allow interested parties to properly assess the implications inherent in the proposed RFB process prior to the start of the 2003/2004 storage year.

2.2.1 Views of Intervenors

Calgary

Calgary considered that, with the necessarily abbreviated timing allowed to deal with the Application, its ability to fully examine the materials provided was impacted. Calgary noted that it would have put forth witnesses had a more comprehensive proceeding been directed. Calgary stated that the timing of the Application and the Board process did not allow for it to provide more detailed information at this time on tendering practices in other jurisdictions, or the type of tendering options that could be explored.

Calgary submitted that the Application for dealing with the 2003/2004 storage season was contrary to the Board's orders arising out of Decision 2002-092 and cannot be appropriately dealt with in the timetable being put forward by AGS. Calgary also submitted that, as AGS at no time approached customer representatives for purposes of collaboration, the Application should not even be considered and should be refused or denied. Calgary also noted that AGS should have been well aware of the need to deal with the 2003/2004 storage period before the release of Decision 2002-092, dated October 29, 2002, which dealt with its 2002/2003 winter storage plan.

CCA

The CCA was concerned that the timing of the Application did not allow for full or adequate discovery of the assertions that AGS made in the Application. The CCA noted that the release of Decision 2002-072, in consequence of which Carbon would physically operate in the Alberta gas market in the 2003/2004 storage year, should have provided incentive for AGS to file an application to deal with the Carbon early in the fall of 2002, which would have allowed for a proper hearing schedule. The CCA submitted that, at a minimum, the following steps are required to properly deal with an application of this significance:

a. an oral hearing be held on the issue,
b. a process of information requests be allowed, and
c. intervenor evidence should be permitted.

The CCA stated that a more comprehensive proceeding was necessary because of the magnitude of assets involved in the Application and the effects on customers in 2003 and 2004. Further the CCA submitted that the very design of the RFB process by AGS left an asymmetrical risk, with greater risk falling to the customer, if the process fails to establish an appropriate FMV. The CCA noted that the late filing of the Application leaves little time for residential customers to effectively react to the changes proposed by AGS.

CG

The CG noted that there was a very limited time available to develop a comprehensive Carbon storage plan for 2003/2004. The CG considered that the underlying cause for the situation was the unilateral decision of AGS not to have any discussions with customers as to its plans for the 2003/2004 storage year followed by a late filing of the Application, which essentially put the Board and customers in a very difficult "take it or leave it" position. The CG recommended that the Board not approve the Application in the form sought.

2.2.2 Views of AGS

AGS submitted that the Application was filed as soon as it was possible to do so. AGS noted that it was engaged in the 2002/2003 Winter Storage Plan Proceeding in the fall of 2002 and that Decision 2002-092 with respect to that proceeding was not issued until October 29, 2002. AGS considered receipt of the Board's guidance on the 2002/2003 storage year to be essential to developing its plan for the 2003/2004 storage year and further noted that the Application was made in just over one and a half months after Decision 2002-092 was issued. AGS also submitted that the timing of the Application was reasonable given its busy hearing schedule, including the 2003/2004 GRA, the Generic Return Hearing, various compliance filings and other matters.

AGS submitted that problems with time constraints are demonstrative of the fact that a competitive storage business cannot be operated in a regulated environment. AGS stated that Carbon must be operated in a manner that responds to the market conditions of the day but that this is very difficult where public consultation and a full hearing process must take place prior to the start of each storage year. AGS noted that the regulatory requirement applies only to Carbon, which is one of seven commercial storage facilities in Alberta.

AGS reiterated its position that there was no time in which to allow the use of a collaborative process prior to filing the Application and, citing basic disagreements with intervenors, that the probability of successful consultations was remote. AGS believed that the present proceeding would have likely been required in any event and that this process would provide the direction required in a less costly and more efficient manner.

2.2.3 Views of the Board

In Decision 2002-092, the Board specifically set out its expectation concerning AGS's application for its 2003/2004 storage year, notably in Orders (2), (3) and (4). The Board notes that the Decision was not released until October 29, 2002. However, given the importance of planning for the 2003/2004 storage year, the Board agrees with intervenors that AGS could likely have filed the Application on a more timely basis, thereby allowing for a more comprehensive proceeding.

2.3 Use of Capacity at Carbon

The 2002/2003 Winter Storage Plan for Carbon, set out in Decision 2002-092, provided for 16.7 PJ of storage to be set aside for the use of AGS's core customers. In the RFB process AGS proposed that this capacity would no longer be reserved for that purpose.

2.3.1 Views of Intervenors

Calgary

Calgary submitted that the long-term value of Carbon to customers due to summer/winter price differentials should be beyond dispute, given the evidence filed in many previous proceedings, and in Board decisions issued in respect of this matter. Calgary considered that the Application was another attempt by AGS to dispose of Carbon, with preferential treatment to an Affiliate.

Calgary recommended that the Board should instruct AGS to, at least, maintain the status quo and utilize 16.7 PJ of Carbon storage for the benefit of utility core customers. Calgary stated that

it had presented evidence in the Carbon Transfer Proceeding that supported both the need for and value of utility owned storage and which suggested that an appropriate storage capacity for the AGS core customers was about 22 PJ. Calgary adopted that evidence as part of this proceeding.

Calgary further submitted that the failure of AGS to examine options for the 2003/2004 year supported its view that the status quo of utility core customer use should be preserved. Calgary suggested that the most appropriate direction to take at this time is to immediately begin a collaborative process to address the summer injections for 2003 and noted that the withdrawal strategies for 2003/2004 can still be discussed concurrently with the 2004/2005 plan with enough time, should the collaborative process be unsuccessful, to allow for a full adjudication process to take place.

Calgary referred to the significant benefits to utility core market customers arising out of using storage to capture the value of the summer/winter price differential. Calgary estimated that, based on the gas cost materials available on the ATCO Gas website, the current winter will continue this trend, with potential benefits to customers in the $40 million to $50 million range. Calgary concluded that with benefits to customers of that magnitude, any decision to change utility use of the asset should only be made after very careful study.

Furthermore, Calgary submitted that AGS's assertion that customers can bid for Carbon capacity fails to recognize that the core market customer is not in a position to individually contract storage with any party. Calgary noted that the majority of AGS's core market customers currently rely on AGS, as the public utility, to look after their best interests, which include the use of Carbon.

CCA

The CCA submitted that AGS did not show any compelling reason why its past practices regarding storage should be changed and therefore AGS should continue to hold a minimum of 16.7 PJ of storage at Carbon for its utility customers.

The CCA was concerned that utility customers will be exposed to significant risk and possible harm by the proposed RFB process through the loss of the physical hedge provided by storing gas at Carbon. The CCA noted that current natural gas price forecasts indicate supply and demand imbalances for the remainder of the 2002/2003 gas year and for the 2003/2004 gas year, with significant upward pressure on price. The CCA submitted the risk involved is asymmetrical in that it is borne by utility customers.

CG

The CG considered that 2003/2004 will continue to be a period of volatile and high gas prices and submitted that 16.7 PJ of physical hedge provided by Carbon storage should be maintained. The CG submitted that the historic practice of a combination of physical hedge storage and contracting out of remaining excess capacity represents a type of hedge that helps reduce risk for utility customers. The CG noted that in recent years, when unprecedented high gas prices have occurred, the existence of physical hedge storage represents very important insurance for customers against the prospect of very high price spikes. The CG referred to previous Board decisions related to Carbon, from which it interpreted that the Board expected AGS to continue to operate Carbon on behalf of customers.

The CG also noted that the gas retail market was under development and that an announcement was made that the gas retail operations of AGPL have been sold. Given these circumstances, the CG considered that it would seem appropriate to maintain the status quo operation of Carbon for at least the next year.

2.3.2 Views of AGS

AGS disagreed with intervenors that the status quo capacity of 16.7 PJ of storage should be retained for the benefit of utility customers. With respect to Calgary's recommendation that 22 PJ should be used, AGS submitted that Calgary was attempting to rely on an illustrative example, which was never intended for the purpose and which was never fully tested, to justify the amount and therefore the proposal must be rejected outright.

AGS submitted that there is a plethora of evidence on the record in prior proceedings with respect to Carbon to indicate that the tendering of uncontracted capacity should be preferred to the use of Carbon as a physical hedge on behalf of customers. In particular AGS submitted that in the Carbon Transfer Proceeding it had provided evidence to demonstrate that:

1. the operation of Carbon as a physical hedge on behalf of customers will not yield financial benefits over the long run,
2. non-regulated storage operators are better equipped to maximize the value of storage, and
3. strategies historically designed to maximize the benefits of Carbon through its use as a physical hedge and implemented by AGS in response to intervenor and Board recommendations have in fact had the opposite effect.

AGS considered that not only should the tendering process yield a greater benefit for customers, it is a substantially less risky strategy than is maintenance of a physical hedge. AGS stated that there is considerable authority for the proposition that hedging is an activity involving unacceptable levels of risk that the benefits will not cover the owning and operating costs of Carbon and in which it should not be engaged, notwithstanding the contrary positions of a variety of intervenors. AGS further submitted that, if the use of a physical hedge was deemed appropriate, it could always contract for storage to meet natural gas requirements in the open competitive market that exists for storage in Alberta, quite possibly at prices less than the owning and operating costs of Carbon.

AGS submitted that it did not have to physically operate Carbon in order to comply with directions issued by the Board in previous decisions concerning Carbon. AGS further submitted that by tendering the uncontracted storage capacity to third parties and flowing the benefits to customers through the company-owned storage rider mechanism, it is in compliance with the Board's directions.

With respect to the proposed sale of its retail gas function, AGS submitted that unless and until the retail sale is approved, parties must proceed on the basis of the market of the day, incorporating the flexibility to adapt to the future. AGS stated that it has thus proposed a process covering one storage year only, with the belief that this will allow for future adaptation should circumstances in the market change.

2.3.3 Views of the Board

In Decision 2002-092, the Board directed that 16.7 PJ of capacity at Carbon should be reserved for utility use. The Board stated in that Decision with respect to the use of Carbon for utility customers that it wished:

> … to make it clear that AGS's interpretation is not correct. The Board expects AGS to operate the Facility for the benefit of customers, and one benefit associated with ownership of a storage facility is the ability to utilize the storage facility as a physical hedge with respect to the natural gas requirements of the utility.[3]

The Board considers that AGS has not provided any additional evidence for the Board to conclude that Carbon should not be used in such a manner. The Board notes that intervenors representing customers submitted that, at a minimum, the status quo should be maintained for the upcoming storage year. The Board agrees.

2.4 RFB Process

The RFB process sets out the terms under which AGS proposed to solicit bids for the uncontracted capacity at Carbon for the 2003/2004 storage year.

2.4.1 Views of Intervenors

BP

BP supported the use of an open tendering process to determine the FMV and specifically for the type of transaction being contemplated for the 2003/2004 natural gas storage year. However, BP contested AGS's assertion that in Decision 2002-072, the Board gave an affiliate of AGS the right to match the highest bid, rather the Board said:

> … if the process were to permit an affiliate to match the highest bid, it would be in keeping with the general sense of satisfying the Board's concerns with respect to affiliate transactions.[4]

BP submitted that if Midstream had the right to match, an opportunity should be provided for other bidders to refresh their bids if necessary, and/or the response time for Midstream to exercise the right to match should be reduced to a few hours. However, BP recommended that it would be easier to simply eliminate the right to match provision.

BP suggested that a more appropriate tendering process would require Midstream to actively participate in a fully non-arm's length manner and be subject to all the same restrictions, covenants, confidentiality provisions and contractual terms and conditions established for the RFB process.

BP argued that AGS's demand for a non-refundable qualification fee is unacceptable and inconsistent with standard industry practice. However, if the Board determined that a fee should be included, BP Canada indicated that at a minimum the fee should be refunded to all unsuccessful participants that submit bona fide bids.

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[3] Decision 2002-092, p.18
[4] Decision 2002-072, p.46

BP suggested that all bids should be sealed and opened at the same time by a non-affiliated third party to determine which bid will be accepted. BP submitted that AGS should file a report from the non-affiliated third party with the EUB showing the number of bids, the range of the bids and identifying the successful bidder, plus a copy of the relevant CSSA.

BP noted that AGS proposed to deem the highest bid to be $4.7 million. BP indicated that it was unsure of exactly the genesis or relevance of the $4.7 million. BP suggested that if the $4.7 million is being proposed as representative of some minimum level of acceptable bid, then that should be made clear in the terms of the RFB process documentation so that all participants understand that there is a floor below which bids will be deemed unacceptable.

BP noted that under the RFB process AGS reserves certain rejection rights with respect to acceptance of bids. BP stated that these rights as proposed are unacceptable in that they are far too open-ended, provide a high degree of discretion to AGS, add an unacceptable degree of risk and uncertainty to the process and serve only to frustrate the efficacy of the process.

BP argued that the requirement to reach a zero inventory by March 31, 2004 could negatively affect the level of any bids as it will limit flexibility and increase costs for the successful participant and the users of storage services. With respect to the zero inventory strategy, BP noted Decision 2002 – 092 wherein the Board stated:

> The Board believes that this objective should not be set in stone, but should be flexible enough to adapt to changing circumstances… The Board will not compel AGS to consider this change in strategy during the 2002/2003 storage season, but will expect AGS to address the matter the next time AGS makes a similar application.[5]

BP suggested that it would be beneficial if the terms and conditions of the CSSA allowed the successful bidder to roll over some portion of its volumes at least through the summer. If however the process is approved with this restriction, then BP expected that Midstream would be subject to the same restriction if successful.

Given that the capacity at Carbon would be shared with the existing contracts, BP argued that any interruptions should be shared on a pro rata basis, and stipulated in the CSSA. BP also argued that the definition of "Confidential Information" is unreasonable.

In conclusion, BP argued that for it to consider bidding for the capacity being offered through this tender, then the changes proposed with respect to the right to match, the fee, the timelines, the reservations, the bid award process, the zero inventory condition, the operational concerns (nominations and interruptions) and the confidentiality agreement must be made to the process. BP submitted that if the Board decides to approve the applied for process for the 2003/2004 natural gas storage year, then this process should not be a proxy for any future similar transaction at Carbon.

[5] Decision 2002-092, p.19

Calgary

Calgary disagreed with AGS's assertion that a collaborative process to determine the use of Carbon for the 2003/2004 storage year would not have been helpful. Calgary stated that its submissions in the 2002/2003 proceeding leading up to Decision 2002-092 detailed the background of the 2002/2003 discussions, and the context of any discussions for 2003/2004 would obviously have been different given that Decision 2002-072 had refused the application to transfer Carbon, evidence had been filed by Calgary in August 2002 on what a collaborative process would have been expected to achieve, and Decision 2002-092 had recognized the time lines and value of a collaborative process.

Calgary submitted that the issue of tendering storage as proposed in the 2003/2004 storage plan was not introduced by AGS during the discussion preceding the 2002/2003 application. Calgary stated that it had recommended the discussion of a tendering process for unutilized storage capacity in its evidence during the 2002/2003 Winter Storage Plan Proceeding and that using the results of a discussion prior to the first plan to dismiss the use of a collaborative process was not appropriate and did not support filing the Application on a prospective basis.

Calgary further submitted that encumbering Carbon with a right of first refusal to Midstream is a preliminary issue that should have been dealt with long before asking the Board and interested parties to deal with the Application on an expedited basis and is detrimental to maximizing the value of the storage being tendered. Calgary contended that a third party would be hesitant about preparing a competitive bid knowing that another party maintains the right to match its bid, with the result that fewer parties would be willing to put forward bids. Calgary stated that while Decision 2002-072 did discuss allowing an affiliate to match the highest bid, it was in the context of the Carbon Transfer Proceeding, not the current Application.

Calgary noted that Article 11.1 of the proposed CSSA stated that AGS requires the bidder to acknowledge that AGS may appoint Midstream as agent to operate Carbon. Calgary suggested that this requirement would be cause for concern to any bidder contemplating a bid for capacity in which Midstream has a right of first refusal.

Calgary was concerned that the RFB process provided only for the tendering of all of the uncontracted capacity at Carbon. Calgary submitted that any tendering process must involve a variety of bidding options by third parties that deal with variable volumes and contract periods to not only provide the option for third parties to bid for 100% of the uncontracted capacity for a one year period but also for lesser amounts over longer periods of time. Calgary suggested that the result of such a process would allow AGS an opportunity to assess an aggregate of bids that could provide a greater benefit than the RFB process proposed.

Calgary agreed with virtually all of the business concerns expressed by EnCana with respect to the RFB process. Calgary stated that there is an inherent conflict of interest in the RFB process in which Midstream manages the storage operation, determines the information to be made available, has access to all the data since inception of the field, does not advise AGS on whether to accept the bid or not, and has a right of first refusal.

CCA

The CCA submitted that the RFB process was potentially very flawed and that the likelihood of this flaw was increased because the tender proposed includes the whole of the uncontracted capacity of Carbon. The CCA was concerned about the impact of that much storage coming onto the market in one tranche. Further the CCA was concerned about the reservation to an AGS affiliate in that the $4.7 million price placeholder to Midstream may further corrupt the process and result in a price at less than FMV being established. The CCA also submitted that tendering all uncontracted capacity at Carbon at one time, with essentially a reserve price, could very likely have a sub-optimal result that would be borne by consumers.

CG

The CG considered that the RFB process was flawed and provided the potential for considerable risk to customers. The CG submitted that the RFB process as proposed by AGS required significant modification.

The CG was concerned that under the RFB process Midstream would effectively have a right of first refusal. The CG submitted that the existence of this right would discourage interested parties from making a bid proposal and would significantly reduce the prices tendered. The CG also submitted that such right should be limited to half of whatever uncontracted capacity is put out for tender in order to provide much more assurance that a true FMV would be achieved.

The CG disagreed that the deemed highest bid, if no third party bids are received, should be $4.7 million. The CG suggested that a much more appropriate deemed highest bid would be a value based on the most recently determined value of $0.41/gigajoule (GJ) set by the Board, which would result in a deemed value of $13.9 million.

The CG was also concerned that the RFB process only provided for the tendering of the uncontracted capacity at Carbon as a single package as this would exclude those parties who may well have an interest in storage capacity, but who have no need for the full amount. The CG noted that since AGS already administers separate contracts for the existing 9.5 PJ of contracted capacity there should be no reason why further capacity contracts could not be similarly packaged and administered in smaller increments to assure that the best total price is captured.

CrossAlta

CrossAlta agreed with the submission made by EnCana regarding impact of AGS allowing Midstream the right to match, the problems associated with the RFB process put forward by AGS, and that the proposed 2003/2004 RFB process, if approved, should not be viewed as a proxy for any future FMV determinations respecting Carbon.

EnCana

EnCana noted that in Decision 2002-072 the Board allowed Midstream the opportunity to match the highest bid in connection with the determination of the appropriate amount of storage fees for storage years subsequent to 2002/2003.[6] EnCana submitted that this contrasted with the Board's decision on the process to be followed to determine the FMV in the case of a disposition of

[6] Decision 2002-072, p.46

Carbon. In the latter situation, EnCana noted that the Board agreed with the intervenors that Midstream could be an eligible bidder, but should be afforded no special treatment.[7] EnCana suggested that the Board should reconsider whether a right to match for Midstream is appropriate for the disposition of the 2003/2004 capacity.

EnCana stated that Carbon has been operated by Midstream on behalf of AGS over the last few years and Midstream would continue in this role during the 2003/2004 gas storage year. EnCana argued that bidders must have equal access to both the historical and operating information respecting Carbon as does the operator, Midstream, prior to the submission of any bids and to the bidder throughout the 2003/2004 gas storage year, if FMV is to be achieved.

EnCana noted that AGS has existing capacity commitments of 9.5 PJ and that the remaining capacity of approximately 34 PJ (based on an estimated total capacity of 43.5 PJ) is being placed on the market as a single block. EnCana argued that the effect of offering a single large block of capacity is to further reduce the number of potential bidders. EnCana suggested that blocks of 1-5 PJ of storage capacity would likely increase the number of potential bidders and achieve FMV.

EnCana stated that the amount of capacity actually allocated to the bidder is never clearly defined in the CSSA. EnCana suggested that "the Bidder Capacity" should entitle it to a withdrawal rate, injection rate and storage capacity of no less than a certain specified amount, e.g., 30 PJ of storage capacity.

EnCana argued that AGS provided no justification for the $4.7 million amount and no explanation as to how this default number was determined. EnCana noted that based on 34 PJ of capacity, the $4.7 million represents $0.138/GJ of capacity, significantly less than $0.41/GJ which the Board found to be appropriate in Decision 2002-072 (p. 46) for the 2001/2002 and 2002/2003 storage years. EnCana recommended that the RFB process should require AGS to accept the highest bid provided that it is over $4.7 million, and that it should not have the opportunity to abandon the process.

EnCana argued that the qualification payment of $10,000 paid to AGS by potential bidders to be provided access to the data room would limit the number of potential bidders, and the prospect of receiving the highest FMV for the 2003/2004 storage capacity. EnCana submitted that the cost of carrying out any RFB process should be netted off of the amount received by AGS for Carbon storage and directed to the AGS Company Owned Storage Rider mechanism.

EnCana considered that the proposed CSSA has been structured so that the bidder's capacity, injection and withdrawal rights are subject to, and rank behind, AGS's existing storage obligations, injection and withdrawal rates, as set out in Schedule B to that Agreement. EnCana maintained that all customers should share any curtailments on a pro rata basis based on their respective firm rights.

EnCana submitted that AGS should not retain numerous rejection rights given other aspects of the RFB process, for example, that it essentially limits the bid evaluation criteria to the highest monetary amount that a bidder is willing to pay, Midstream has the right to match a bid and there

[7] Ibid, p.32

is a deemed value of $4.7 million if no bids are received. EnCana suggested that the usual balance of rights and obligations allocated each party pursuant to a gas storage agreement is skewed against the bidder under the terms of the pro forma CSSA. In addition, EnCana argued that the pro forma confidentiality agreement is unduly burdensome and would further dissuade parties from participating in the bidding process designed by AGS.

EnCana requested that the Board clearly indicate that any approved RFB process is only for the 2003/2004 capacity, and should not be viewed as necessarily appropriate for future gas storage years or an outright disposition of Carbon.

2.4.2 Views of AGS

AGS disagreed with intervenors' submissions that Midstream should not be allowed to match the highest bid in the RFB process, or that this right should be restricted in any way. AGS submitted that the Board specifically authorized affiliate matching of bids, without limitation, for Carbon uncontracted capacity in Decision 2002-072 and noted that restriction of the amount to be matched would be impractical due to real time operating parameters at Carbon. AGS further submitted that the ATCO Group policy of choosing to do business with an affiliate, as long as that affiliate can perform the function and do so at FMV, is designed to permit the corporate entity to obtain economic efficiencies wherever possible, in order to enable it to grow and survive.

AGS considered that Midstream's right to match would not affect the number of legitimate bidders in the RFB process and concluded that if no bids are received pursuant to the proposed process, it would be because the FMV is below $4.7 million and bidders believe Midstream would exercise its right at that level, even if it is above FMV. AGS submitted that since there is no assurance that Midstream would exercise its right and all bids are binding, potential bidders would need to decide on an acceptable bid price based on their respective forward views of the market and risk tolerances. In AGS' view this situation would ensure that the RFB process would obtain at least FMV for the uncontracted capacity.

AGS concluded from intervenor submissions that the purpose of the non-refundable $10,000 qualification payment for bids was not readily apparent to intervenors. AGS stated the only purpose of the payment was to limit the number of interested parties accessing commercially sensitive information, and it would not limit the number of bidders as Calgary suggested. AGS hoped that the qualification payment would serve to discourage those parties whose only purpose was to access commercially sensitive information on Carbon and the Alberta storage market at low or no cost.

AGS stated that, in the event that it should receive no bids, it determined that a reasonable deemed highest bid of $4.7 million should be based on the marginal cost of operating and maintaining Carbon for one year, adjusted to take into account AGS's other commitments for 9.5 PJ of reservoir capacity. AGS noted that the $0.41/GJ currently charged to Midstream was an average of $0.17/GJ paid by AGS for third party storage contracts for the 2001/2002 storage year and $0.65/GJ based on the AECO C storage rate calculator. AGS considered the $0.41/GJ was not reflective of FMV for the 2001/2002 and 2002/2003 storage years in which it was applied, and not determinative of what FMV will be for 2003/2004. AGS also considered that the Board did not contemplate the application of the $0.41/GJ fee beyond 2002/2003 to be appropriate, as evidenced by its direction to AGS to conduct a tendering process for the purpose of revealing

FMV. Accordingly, AGS considered that $0.41/GJ was not an appropriate benchmark for 2003/2004.

With respect to confidential information, AGS submitted that it would provide the necessary information on the Carbon storage operation to all qualified parties in the data room, such that all parties, including Midstream, could make an informed decision on Carbon capabilities. However, AGS also submitted that there was no need to provide information broken out by contract, as such information is commercially sensitive and there is no requirement for the bidder to provide details of their contracts. AGS disagreed with intervenors that the terms included in the confidentiality agreement are unduly restrictive. AGS submitted that all terms of the confidentiality agreement are necessary given the business risk inherent in disclosing all material information related to Carbon in a data room.

With regard to rejection rights, AGS submitted that such rights, as set out in the RFB document, are standard, commercially reasonable terms, found within the bid documents of any private or government bid process. AGS noted that by requesting bids it could be placed in a situation where it is deemed to have a binding and legally enforceable contract with each bidder, and can be liable for damages if it inadvertently breaches this contract. AGS submitted that, as such, in order to minimize potential liabilities to the company requesting bids, it has become standard practice in Canadian bid processes to include such rejection rights as AGS has included in its RFB. AGS stated that without such rights, the risk of potential liabilities as a result of undertaking a bid process for the contracting out of Carbon capacity would be unacceptable.

In reference to the capacity and associated deliverability of Carbon that would be actually allocated to bidders, AGS submitted that, as the operating parameters of Carbon are very complex, a simple definition of the capability of Carbon is not possible. While it utilizes a mathematical reservoir and surface network model to estimate theoretical facility performance, AGS stated that actual performance of Carbon could only be known under real time operating conditions and that actual performance can be greater or less than theoretical performance, depending on the assumptions taken. AGS confirmed that its existing storage obligations would rank ahead of a bidder's capacity rights because a successful bidder under the CSSA is in the best position to manage any curtailments.

2.4.3 Views of the Board

The Board notes that there is a significant divergence of positions between intervenors and AGS concerning the proposed RFB process. While the Board approves in principle the approach taken by AGS, it considers that, given the circumstances and the timing involved, it cannot approve the process in the proposed form and content.

The Board notes the concern of intervenors that, with a right to match the highest bid, Midstream is effectively given a right of first refusal on the uncontracted capacity at Carbon, which could be construed as providing preferential treatment to an affiliate of AGS and which may not consequently produce FMV for the capacity. However, the Board concluded in Decision 2002-072 that in a bid process, if an affiliate was permitted to match the highest bid "it would be in keeping with the general sense of satisfying the Board's concerns with respect to affiliate transactions." The Board will therefore not interfere with the right to match, as a concept, at the present time. Nevertheless, the Board emphasizes that the objective is to achieve FMV for the uncontracted capacity. Should an RFB process, which contains a right to match by an affiliate, be

either used or proposed in any subsequent application, the Board reserves the ability to direct alternative processes to determine FMV should it be demonstrated that the right to match materially reduced the value to be obtained for the uncontracted capacity.

Further, given that the 2003/2004 storage year commences April 1, the Board considers that there is insufficient time to fully address and adjudicate the concerns of the intervenors and the position of AGS. The Board thus directs AGS to implement a plan for the 2003/2004 storage year that carries forward the storage plan last approved in Decision 2002-092. AGS is directed, by March 31, 2003, to file with the Board for acknowledgement an outline of such plan. The Board continues to recommend that AGS collaborate on a timely basis with customer representatives prior to submitting the next storage season application.

Should AGS wish to continue with an RFB process, it should file such an application for the 2004/2005 storage year by August 1, 2003, taking into account comments and concerns expressed by intervenors. In particular, the Board recommends that AGS address in the application the following specific concerns of the intervenors in this proceeding, including:

- provision of an ongoing reservation of capacity for utility customers;
- clarification in the CSSA of the amount of Carbon capacity available for tender;
- an RFB process that auctions smaller blocks of Carbon capacity to achieve the highest potential FMV and bid participation;
- rejection rights reserved by AGS;
- the affiliate right to match the highest bid in a manner in keeping with the achievement of fair market value for the capacity;
- the zero inventory requirement for Carbon at end of the storage year, and the provision of flexibility to the successful bidder if there is an overrun into the next storage year;
- the nature of the confidentiality agreement as compared to ordinary commercial terms for these agreements;
- justification for the rationale behind a reserve or deemed highest bid, including the basis of the reserve bid amount;
- whether all customers should share in curtailments on a pro rata basis based on their respective firm rights;
- the need for appropriate access to data room information and a reasonable time for due diligence;
- provision of sufficient time for the regulatory process;
- provision of a refund of the fee to the successful bidder and for the flow through of the balance of the fees to the Company-Owned Storage Rate Rider.

The Board makes no determination at this time regarding the merits of any of the above matters in a future RFB process.

In addition, the Board requests that AGS provide clarification in any filing in respect of the 2004/2005 storage year on the impact of the potential sale of the retail portion of its business on the future use of Carbon by AGS or others.

The Board also notes in particular that intervenors expressed concern about the deemed highest bid of $4,700,000 that would be accorded to Midstream in the absence of receipt of qualified

bids by AGS. The Board considers that AGS did not provide conclusive evidence from which the Board could determine that the rate to be charged to Midstream for uncontracted capacity should be less than the $0.41/GJ as set out in Decision 2002-072. The Board thus considers that the said rate should continue to apply during the 2003/2004 storage season for such capacity at Carbon that is contracted with an affiliate of AGS, until such time that AGS demonstrates to the Board's satisfaction that a different rate would be in order, or unless the rate is otherwise changed by the Board.

The Board agrees with AGS's request to delay to August 1, 2003 the filing of an Optimization Study in which it would examine the options in order to develop a contingency plan or to restate the operating parameters for storage. The Board reminds AGS that the study referred to is to compare the revenue requirements of various options that could be used to alter the existing storage capacity as compared to that of maintaining the present volume of base gas.

The Board notes that in Decision 2002-072 AGS was directed to file in its 2001/2002 Phase II GRA a study to determine the costs incurred in providing the uncontracted capacity service, in order to establish the cost of service benchmark whereby AGS should monitor how the FMV compares to the cost of providing the service. The Board expected that the costs allocated to the uncontracted storage capacity in the cost of service study would recognize usage based on the appropriate ratios of capacity and deliverability. In the event that AGS's Phase II does not take place, the Board directs that the study be included with its application for a storage plan for the 2004/2005 storage year.

3 ORDER

IT IS HEREBY ORDERED THAT:

(1) The storage plan for ATCO Gas South for the Carbon storage facility for the 2003/2004 storage year shall follow the plan last approved in Decision 2002-092. Specifically, the following shall continue to apply:

   (a) Storage capacity of 16.7 PJ shall be reserved for utility use for the 2003/2004 storage year.
   (b) The gas procurement and injection strategy used in the summer of 2002 shall be applied in the summer of 2003.
   (c) The gas withdrawal plan for winter 2002/2003, as modified by the Board in Decision 2002-092 shall be applied in the winter of 2003/2004.
   (d) The risk mitigation strategies approved for the 2002/2003 storage year shall be applied in the 2003/2004 storage year.

(2) By March 31, 2003, ATCO Gas South shall file, for acknowledgement by the Board, an outline of the 2003/2004 storage plan in conformity with this Decision.

(3) ATCO Gas South shall continue to reflect revenues from ATCO Midstream Ltd. for uncontracted capacity at the Carbon storage facility based on a fee of $0.41/GJ until such time that ATCO Gas South demonstrates to the Board's satisfaction that a different rate would be in order, or unless the rate is otherwise changed by the Board.

(4) In its next storage application ATCO Gas South is to submit a modified methodology that will require ATCO Gas South to actively manage the benefits and costs to customers of possibly carrying an inventory balance beyond the end of the storage year.

(5) ATCO Gas South is to make its storage application for the 2004/2005 storage year by August 1, 2003 to allow sufficient time for a review of any issues that could not be agreed to during a collaborative process.

Dated in Calgary, Alberta on March 11, 2003.

ALBERTA ENERGY AND UTILITIES BOARD

(original signed by)

B. T. McManus, Q.C.
Presiding Member

(original signed by)

C. Dahl Rees
Acting Member

(original signed by)

Michael. J. Bruni, Q.C.
Acting Member