



**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER G-174-08**

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IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473

and

An Application by Pacific Northern Gas Ltd.
for Approval of a Term Sheet Between Pacific Northern Gas Ltd. and LNG Partners LLC

BEFORE: L.F. Kelsey, Commissioner
D.A. Cote, Commissioner
P.E. Vivian, Commissioner

November 27, 2008

O R D E R

WHEREAS:

- A. On September 25, 2008, Pacific Northern Gas Ltd. ("PNG") filed with the British Columbia Utilities Commission (the "Commission") a Term Sheet (the "Term Sheet") describing a proposed natural gas transportation agreement between PNG and LNG Partners LLC ("LNG Partners"). The Term Sheet and a supplementary PNG submission (the "Submission"), propose an agreement to transport natural gas over the PNG system to a floating LNG terminal to be operated by LNG Partners in the vicinity of Kitimat, BC; and
- B. The Term Sheet proposes that LNG Partners will pay a non-refundable fee of \$1.5 million ("Initial Option Fee") for transportation services over the PNG network. Services to LNG Partners would utilize currently unused PNG capacity. The option allows LNG Partners a period of six months, commencing from the date of Commission approval of the Term Sheet (the "Option Period"), to contract for firm pipeline capacity on PNG's pipeline system, for at least 75 MMcf/day; and
- C. The Option Period may be extended for a further six month period in consideration of the payment by LNG Partners to PNG of an additional non-refundable fee of \$1.5 million ("Option Extension Fee"); and
- D. If LNG Partners exercises its option to contract for firm gas service, PNG will file with the Commission a fully-executed, definitive firm gas transportation service agreement that is materially the same as the agreement contemplated under the Term Sheet. The Term Sheet proposes a unity demand charge of \$0.50/GJ, applicable during the initial three to five year term, to be escalated by inflation for an optional second term. LNG Partners will supply four percent of their gas requirements to PNG for pipeline operations; and

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- E. The Submission proposed that the Commission approve recovery from the Option Fee and Option Extension Fee, and eventually from any annual firm revenue from LNG Partners, the foregone return to date on facilities previously deactivated as a result of the loss of load and revenue due to the closure of the Methanex methanol/ammonia plant in November 2005; and
- F. On October 2, 2008, Commission Order G-149-08 established an initial regulatory review process. The process included one round of Information Requests from the Commission and Registered Intervenor, and invited Interested Parties to make written submissions on the subsequent regulatory review process. The Order requested Interested Party input on the process for considering the allocation of revenues from LNG Partners: whether they should be severed from the request for Commission approval of the Term Sheet, and instead be considered as part of the proceeding to review PNG's next rate design application; and
- G. By letter dated October 7, 2008, PNG submitted that the Commission's preliminary regulatory timetable would provide more than enough time for all Interested Parties to fully address the revenue allocation between customers and shareholders based on the foregone return proposal that was initially proposed by PNG in its 2006 Revenue Requirements Application. PNG also proposed a timetable for the balance of the regulatory proceeding; and
- H. By letter dated October 9, 2008, the British Columbia Old Age Pensioners Organization ("BCOAPO") registered as an Intervenor and submitted that the Term Sheet should be considered first, with any revenue allocations left to a subsequent rate proceeding. BCOAPO also expressed concerns regarding the treatment of both depreciation and proposed returns related to PNG assets that are currently idle; and
- I. Information Requests were submitted to PNG by the Commission on October 9, 2008 and by BCOAPO on October 20, 2008. On October 31, 2008, PNG responded to the Information Requests of BCOAPO and the Commission; and
- J. On November 6, 2008, Commission Order G-163-08 established that the Term Sheet would be reviewed through a Written Hearing. The Commission determined that issues concerning the Option Fee revenues and cost matters related to deactivated PNG assets will be reviewed by the Commission as part of the next PNG revenue requirements proceeding; and
- K. On November 13, 2008, BCOAPO submitted its comments concerning the Term Sheet. Overall, with respect to the issues in the scope of this proceeding, BCOAPO supports approval of the proposed Term Sheet. BCOAPO expressed concern relating to the possibility that, should future capacity expansion be necessary as the result of services to LNG Partners, the rate impact on existing customers could negate any benefits associated with the project. Therefore, BCOAPO requested PNG's assurance that no such risk existed, be incorporated into the Commission decision. BCOAPO also observed that the inflation factor applicable to the LNG Partners demand charge had not been determined, and advocated the use of compounded inflation; and

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- L. On November 17, 2008, PNG made its final submission in support of the Application. PNG submitted that approval of the Term Sheet must be made without specifying a rate-making principle that would somehow be applied by the Commission in subsequent proceedings. PNG acknowledged BCOAPO's comments regarding the use of compounding in the eventual inflation factor. PNG stated its intention to be mindful of that point in negotiating the service agreement with LNG Partners; and
- M. The Commission has considered the Term Sheet, the submissions and letters from PNG and the BCOAPO and PNG's responses to the Information Requests made by the Commission and Intervenors.

NOW THEREFORE the Commission determines as follows:

1. The Commission approves the Term Sheet between PNG and LNG Partners, dated September 18, 2008, subject to the following:
 - The Initial Option Fee is to be recorded in an interest-bearing, non-rate base deferral account for future disposition as directed by the Commission's future determinations with respect to PNG's 2009 Revenue Requirements Application.
 - If LNG Partners extends the option period by a further six months, the Option Extension Fee is to be recorded by PNG in an interest-bearing, non-rate base deferral account for future disposition, as directed by the Commission's future determinations with respect to PNG's 2009 Revenue Requirements Application.
 - If LNG Partners exercises its option to contract for firm pipeline capacity, PNG is required to submit an executed firm gas transportation service agreement, materially the same as the agreement contemplated by the Term Sheet, for Commission approval.
 - Once service to LNG Partners commences, the revenue received under the firm gas transportation service agreement will be included in the PNG Industrial Customer Deliveries Deferral Account.

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2. For the reasons attached, the Commission declines to incorporate an explicit assurance or make a determination with respect to any possible future expansions of the PNG system or to establish a cap on future rates, as requested by BCOAPO.

DATED at the City of Vancouver, in the Province of British Columbia, this 28th day of November 2008.

BY ORDER

Original signed by

L.F. Kelsey
Commissioner

Attachment

PACIFIC NORTHERN GAS LTD.

**APPLICATION FOR APPROVAL OF A TERM SHEET BETWEEN
PACIFIC NORTHERN GAS LTD. AND LNG PARTNERS LLC**

REASONS FOR DECISION

Pacific Northern Gas Ltd. (“PNG”) proposes that the transportation agreement with LNG Partners LLC (“LNG Partners”) will be advantageous to existing customers. PNG submits that the combination of the Option Fee(s) and the stream of revenues from LNG Partners will reduce the cost burden on other customers.

As noted in the Term Sheet and Submission, future system expansion may be required as the result of services to LNG Partners. The BC Old Age Pensioners Organization *et al.* (“BCOAPO”) expressed concern that such expansion may cause rates for existing customer classes to increase more than they otherwise would. BCOAPO noted that PNG considers there to be no risk that the core distribution system customers would have to pay rates higher than existing rates to fund the cost of such reinforcements. BCOAPO submits that PNG’s assurance should be explicitly incorporated into the Commission’s decision to facilitate holding the utility or any successor to this principle should a controversy arise at some future point.

PNG submits that “It is clearly inappropriate for the Commission to fetter its discretion in this regard by attempting to establish a rate making principle that would apply in future reviews of capital work proposed by PNG.” (Exhibit B-5, PNG Written Submission, p. 2)

The Commission notes that PNG is not anticipating volume growth over the long-term that would require system reinforcements to sustain firm service requirements, including LNG Partners firm demand (Exhibit B-3, Response to BCUC 1.2.1). PNG has also stated its expectation that, if LNG Partners becomes a customer of PNG and operates for ten years, the incremental revenue would far exceed the cost of financing potential system reinforcements to meet increased firm service requirements (Exhibit B-3, Response to BCUC 1.3.1). There is no evidence in the proceeding of competing bids for the capacity on the PNG system, nor has another customer requiring significant firm capacity been identified. Therefore, the Commission concludes that the immediate expected benefit to PNG’s existing customers outweighs the risk of exposure to future system expansion costs.

Further, the Commission agrees with PNG’s view that the Commission should not fetter its discretion by establishing a rate-making ruling on the basis of a hypothetical future occurrence, and consequently declines to make such a ruling at this time.

As the Commission determines that the proposed Term Sheet is in the public interest, it is approved.