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ORDER NUMBER
G-165-17

IN THE MATTER OF
the *Utilities Commission Act*, RSBC 1996, Chapter 473

and

Pacific Northern Gas Ltd.
Application for Approval of a New Sharing Arrangement
for the Period May 1, 2017 to April 30, 2018

BEFORE:
B. A. Magnan, Commissioner
D. J. Enns, Commissioner
R. D. Revel, Commissioner

on November 16, 2017

ORDER

WHEREAS:

A. On June30, 2017, Pacific Northern Gas Ltd. (PNG) filed with the British Columbia Utilities Commission (Commission) an Application for Approval of a New Sharing Arrangement (Application);

B. PNG contracts with a third party, Tenaska Marketing Canada (Tenaska), for its energy management services (EMS). By Order E-18-16 dated September 2, 2016, the Commission accepted a five year energy management services agreement (2016 EMS Agreement) between PNG and Tenaska;

C. Optimal utilization of PNG's storage and transportation assets generates revenue for the utility (Optimization Value), which mitigates PNG's gas portfolio costs and flows through to PNG's sales customers.

D. By Order E-18-16, the Commission approved a sharing arrangement to share a percentage of PNG's portion of the Optimization Value with PNG's shareholder for the period from May 1, 2016 to April 30, 2017;

E. PNG filed the June 30, 2017 submission on a confidential basis, which includes (i) a report on the Optimization Value in compliance with Order E-18-16 and (ii) the Application to establish a new Sharing Arrangement for the period from May 1, 2017 to April 30, 2018. PNG submitted the Optimization Value in confidence due to its commercially sensitive nature;

F. On July 21, 2017, PNG filed the Application portion separately on a non-confidential basis and submitted that it was not necessary to keep the general concepts of its Application confidential;

G. In the Application, PNG indicates that it is evaluating a strategy in the transportation market to increase Optimization Value. Under a new Sharing Arrangement, to reward PNG's strategic efforts, PNG applies for approval to pass 90 percent of PNG's portion of the Optimization Value that exceeds a performance benchmark onto PNG's sales customers, with the remaining 10 percent accruing to PNG's shareholder;

H. On September 6, 2017, PNG filed additional information in response to Commission staff questions on the Application;

I. On October 5, 2017, the Commission invited stakeholder comments regarding the Application. The Commission did not receive any stakeholder comments. On October 26, 2017, PNG filed a reply submission; and

J. The Commission reviewed the Application and supporting documents.

NOW THEREFORE for reasons cited in Appendix A to this Order, the Commission denies the Application for a new Sharing Arrangement between PNG's sales customers and PNG's shareholder for the period from May 1, 2017 to April 30, 2018.

DATED at the City of Vancouver, in the Province of British Columbia, this 21st day of November 2017.

BY ORDER

Original signed by:

B. A. Magnan
Commissioner

Pacific Northern Gas Ltd.
Application for Approval of a New Sharing Arrangement
for the Period May 1, 2017 to April 30, 2018

REASONS FOR DECISION

1.0 Background

On June 30, 2017, Pacific Northern Gas Ltd. (PNG) filed an Application (Application) for Approval of a New Sharing Arrangement for the Period May 1, 2017 to April 30, 2018 (2017/18 Sharing Arrangement). Optimal utilization of PNG's storage and transportation assets generates revenue for the utility (Optimization Value), which mitigates PNG's gas portfolio costs and flows through to PNG's sales customers.

In these reasons, the Commission will address PNG's proposal to pass 90 percent of PNG's portion of the Optimization Value that exceeds a performance benchmark onto PNG's sales customers, with the remaining 10 percent accruing to PNG's shareholder to reward PNG's strategic efforts.

Order E-18-16

PNG contracts with a third party, Tenaska Marketing Canada (Tenaska), for its energy management services (EMS). Tenaska is responsible for PNG's (i) gas supply planning and resource selection analysis; (ii) gas supply contract negotiation and administration; (iii) daily energy management services; and (iv) to monitor and report on credit, hedging positions, and gas prices.[1]

By Order E-18-16 dated September 2016, the Commission accepted a five year EMS Agreement between PNG and Tenaska dated May 1, 2016 (2016 EMS Agreement). Under the 2016 EMS Agreement, Tenaska pays PNG a monthly fixed charge (Fixed Charge) and partakes in a sharing mechanism whereby Tenaska retains the right to any revenues up to the annual amount of the Fixed Charge and shares with PNG any Optimization Value realized that exceeds the annual amount of the Fixed Charge. The 2016 EMS Agreement was kept confidential due to its commercially sensitive nature. PNG was also directed to file a report with the Commission by July 1st of each year on the Optimization Value.

Also by Order E-18-16, as a separate request, the Commission approved a sharing arrangement to share a percentage of PNG's portion of the Optimization Value with PNG's shareholder for the period from May 1, 2016 to April 30, 2017 (2016/17 Sharing Arrangement). The Commission approved the 2016/17 Sharing Arrangement considering the one-time nature of PNG's actions to deliver incremental value to ratepayers with the 2016 EMS Agreement when compared to the previous agreement. However, the Commission found that the potential for PNG to add material value on an ongoing basis over and above what is reasonably expected in the normal stewardship of PNG's business is limited during the term of the 2016 EMS Agreement because Tenaska conducts the day-to-day mitigation activity rather than PNG itself. Therefore, the Commission denied PNG's request for the 2016/17 Sharing Arrangement term to extend beyond April 30, 2017.[2]

1.1 Application

On June 30, 2017, on a confidential basis, PNG filed a report on the Optimization Value in compliance with Order E-18-16 and the Application to propose the 2017/18 Sharing Arrangement. PNG submitted the Optimization

[1] Exhibit B-2, PNG responses to staff question 1.1
[2] Order E-18-16, Appendix A, pp. 2-3

Value in confidence because it includes Tenaska's portion of the Optimization Value, as set out in the 2016 EMS Agreement, which is considered commercially sensitive information.

On July 21, 2017, PNG filed the 2017/18 Sharing Arrangement Application separately on a non-confidential basis as PNG submitted that it was not necessary to keep the general concepts of its Application confidential. PNG submits that the purpose of the 2017/18 Sharing Arrangement is to provide a modest incentive to PNG to undertake, using its own staff resources, initiatives extracting additional value from its T-South transportation capacity.[3]

Review process

On September 5, 2017, PNG filed additional information in response to Commission staff questions on the Application.

On October 6, 2017, recognizing that the proposed 2017/18 Sharing Arrangement could have benefit and cost implications to PNG's sales customers, the Commission invited stakeholder comments as to whether or not the Commission should approve or deny PNG's proposed on the Application. By October 19, 2017, the Commission did not receive any submissions from stakeholders. On October 26, 2017, PNG filed a reply submission.

Rationale for new 2017/18 Sharing Arrangement

In the Application, PNG states that it is evaluating ways of addressing the impact of the Enbridge (formerly Spectra Energy) Winter Firm Service (WF Service) on interruptible downstream diversions and restoring the ability of Tenaska to generate Optimization Value related to PNG's T-South capacity. PNG expects that the introduction of WF Service on T-South will severely curtail, if not eliminate altogether, Tenaska's ability to generate Optimization Value through PNG's T-South capacity during the period from November 1 through March 31.[4]

PNG submits that its efforts in this regard fall outside of the scope of services provided by Tenaska pursuant to the 2016 EMS Agreement. The responsibility for these strategic activities falls solely on PNG as owner of the firm capacity on T-South, and not on Tenaska. PNG clarifies that its efforts are entirely different from the day-to-day monitoring of market conditions at Station 2 and at Sumas, and of the daily scheduling of firm and interruptible gas volumes that is carried out by Tenaska. However, PNG declines to provide additional details of its efforts to improve the ability of Tenaska to generate Optimization Value as PNG is of the view that it may hamper PNG's ability to carry out its strategy.[5]

When asked to clarify if there are any compensation adjustments between PNG and Tenaska as a result of PNG's additional efforts, PNG explains that "[n]othing in the 2016 EMS Agreement specifies additional compensation by Tenaska to PNG related to any of PNG's efforts to increase the Optimization Value generated by Tenaska's mitigation activities. To the extent that PNG is successful in its efforts to create conditions that increase the Optimization Value, these associated revenues will continue to be shared as specified in the 2016 EMS Agreement."[6]

Benchmark

As part of the 2017/18 Sharing Arrangement, PNG proposes to establish benchmarks (Benchmarks) that define thresholds for the 2017/18 Sharing Arrangement between PNG and its shareholder. PNG submits that the

[3] July 21, 2017 Application, pp. 6-7, October 26 Reply Submission, p. 2.
[4] July 21, 2017 Application, p. 4; September 6, 2017 PNG responses to staff question 2.1.
[5] September 6, 2017 PNG responses to staff questions 1.2 and 1.4.
[6] September 6, 2017 PNG responses to staff question 1.5.

Benchmarks set performance and reflect the Optimization Value generated through activities solely under the control of PNG. PNG states that these Benchmarks "are a demarcation between Optimization Value generated by Tenaska during the normal course of managing PNG's storage and transportation assets, and Optimization Value generated by Tenaska as a result of extraordinary efforts by PNG to create conditions that enhance Tenaska's ability to optimize PNG's assets."[7]

PNG proposes the following Benchmarks for 2017/2018 (Table 1) and the sharing arrangement between PNG sales customers and PNG shareholders (Table 2).

Table 1 New Sharing Arrangement – 2017/2018 Benchmark

Sharing Arrangement Benchmark for 2017/18	
Storage Benchmark (2017/18)	Not applicable
T-North Benchmark (2017/18)	Not applicable
T-South Benchmark (May - Oct 2017, April 2018)	Not applicable
T-South Benchmark (Nov 2017 - Mar 2018)	$ -
Total of Benchmarks	$ -

Table 2 New Sharing Arrangement Mechanism

	Sharing Arrangement (12 mos ending April 30, 2018)	
	PNG Sales Customers	PNG Shareholder
Annual Fixed Charge paid to PNG	100%	nil
PNG Share of Annual Optimization Value Above 2017 Benchmark	90%	10%

PNG explains that the Benchmark for Optimization Value generated by its T-South capacity during the period when WF Service is in effect (November 2017 – March 2018) is set to zero. PNG does not expect to be able to influence the generation of Optimization Value from its T-South capacity during the non-winter months (May 2017 – October 2017, April 2018) and therefore does not propose to establish a Benchmark during this period.[8]

PNG clarifies that any Optimization Value generated by T-South during the winter will be subject to the 2017/18 Sharing Arrangement where 10 percent of the Optimization Value generated by T-South during the period November 1, 2017 through March 31, 2018 will accrue to PNG's shareholder.[9]

2.0 Commission discussion

In Order E-18-16, the Commission found that certain guiding principles (Guiding Principles) are particularly applicable to PNG's sharing arrangement. The Commission stated:

> "The Commission finds that the specific aspects of the Guiding Principles that are particularly applicable in the review of PNG's proposed Sharing Arrangement are that it should demonstratively deliver value to ratepayers, it should reward innovation and true value added over and above what is reasonably expected in the normal stewardship of PNG's business, it should fairly and appropriately align ratepayer and shareholder interests and it should deliver the smallest amount required to obtain the desired benefit for ratepayers."[10]

[7] July 21, 2017 Application, p. 3.
[8] July 21, 2017 Application, p. 5.
[9] September 6, 2017 PNG responses to staff question 4.1.2.
[10] Order E-18-16, Appendix A, p. 2.

The proposed 2017/18 Sharing Arrangement is intended to provide an incentive for PNG to generate additional Optimization Value. Thus, the Commission finds that the Guiding Principles cited in Order E-18-16 continue to be relevant and applicable in making a determination on this Application.

As noted in the October 6, 2017 letter, the Commission identified generally the three issues with respect to the Application.

1. PNG's rationale regarding its WF Service efforts as a basis to share PNG's portion of the Optimization Value with PNG's shareholder, rather than giving the full amount to PNG's sales customers;
2. the ways in which the Optimization Value of T-South transportation can be attributed to PNG's additional efforts versus Tenaska's normal scope of services. For example, whether the proposed performance benchmark is appropriate;
3. whether the 90/10 allocation between PNG's sales customers and PNG's shareholder is reasonable.

3.0 Commission determination

The Commission reviewed the evidentiary record related to the Application and conclude that the 2017/18 Sharing Arrangement should be denied. The sections below discuss the Commission's findings of the issues in the Application in the context of the Guiding Principles.

Delivering value to ratepayer; innovation and true value added over and above what is reasonably expected in the normal stewardship of PNG's business

PNG aims to generate additional Optimization Value by strategically creating opportunities for Tenaska. While PNG did not provide the specific details on how PNG could increase opportunities for Tenaska to increase Optimization Value in the T-South transportation asset, the Commission accepts conceptually that some incentive for PNG's shareholder is reasonable to compensate for the incremental Optimization Value that will in turn be allocated to PNG ratepayers.

PNG has shown initiative to seek additional Optimization Value in the T-South transportation asset. The Commission observes that PNG's strategic efforts to create opportunities for Tenaska are beyond PNG's normal course of business. Assuming the cost of carrying out PNG's strategies are negligible, the Commission accepts that PNG's WF Service strategy has the potential to add more value than what is reasonably expected in the normal stewardship of PNG's business.

The next step is to examine whether the 2017/18 Sharing Arrangement fairly and appropriately align ratepayer and shareholder interest, and the amount PNG's shareholder receives in the 2017/18 Sharing Arrangement.

Align ratepayer and shareholder interests, smallest amount required to obtain desired benefit for ratepayers

The Commission is not persuaded that the 2017/18 Sharing Arrangement fairly and appropriately align ratepayer and shareholder interests. There is no conclusive evidence to ensure that PNG's sales customers will be better off in the 2017/18 Sharing Arrangement as compared to otherwise no sharing arrangement.

The 2016 EMS Agreement stipulates an Optimization Value sharing mechanism between PNG and Tenaska, which serves as a compensation scheme for Tenaska for its energy management services to PNG. The Commission views that having Tenaska as a beneficiary of the Optimization Value adds to the complexity of the incentive sharing mechanism because the Commission must consider ratepayer and shareholder interests in light of Tenaska. As PNG noted, there will be no additional compensation by Tenaska to PNG related to any of PNG's efforts for Tenaska to increase the Optimization Value. Thus, if PNG invests in its own resources to create opportunities for Tenaska, and based on the current sharing mechanism under the 2016 EMS Agreement, Tenaska will be made better off at the expense of PNG's strategic efforts and own resources.

On another note, the Commission is of the view that it is challenging to differentiate what is PNG's strategic effort or otherwise Tenaska's efforts in generating Optimization Value. PNG proposes a benchmark that is intended to separate the efforts between PNG and Tenaska. However, the Commission finds that a benchmark of zero is inadequate. The Commission is concerned that PNG's shareholders will take 10 percent of T-South winter Optimization Value, which suggests that PNG's shareholders are being compensated by both its own efforts to assist Tenaska, and also Tenaska's efforts that should not benefit PNG's shareholders.

To illustrate, suppose the Optimization Value for Nov 2017 – Mar 2018 T-South is $100,000, and suppose Tenaska's share is $30,000 and PNG's share is $70,000. PNG proposes to pass 10 percent of the annual Optimization Value above the benchmark, which is zero, onto PNG's shareholder. Based on the proposed 2017/18 Sharing Arrangement, PNG's shareholder would receive $7,000 (i.e. 10 percent of $70,000). However, the $7,000 PNG's shareholder receives out of the $70,000 PNG portion would include all T-South Optimization Value in the winter, which would include any PNG efforts in creating opportunities for Tenaska and other efforts by Tenaska under its obligation and incentive under the 2016 EMS Agreement. Therefore, the Commission views that PNG's sales customers are at risk of overcompensating PNG's shareholders if the 2017/18 Sharing Arrangement is approved. Likewise, as discussed earlier in this section, the Commission is not convinced that PNG ratepayers should compensate PNG shareholders when Tenaska is receiving the same percentage of Optimization Value for any value that is attributable to PNG's strategic efforts in the WF Service.

The Commission concludes that PNG in the 2017/18 Sharing Arrangement cannot clearly demonstrate the separation of efforts attributable to PNG or Tenaska. The benefits allocated to PNG sales customers, PNG shareholders, and Tenaska are also disproportionate. For the reasons discussed above, the Commission denies the 2017/18 Sharing Arrangement.