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BRITISH COLUMBIA UTILITIES COMMISSION

ORDER NUMBER G-167-07

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

and

An Application by Unocal Canada Limited for
Approval of the Disposition of its Interest in the Aitken Creek Storage Facility
to its Wholly-Owned Subsidiary

and

An Application by Aitken Creek Gas Storage ULC for
a Certificate of Public Convenience and Necessity and
Exemption Order in respect of its Ownership and Operation of
the Aitken Creek Storage Facility

BEFORE: L.F. Kelsey, Commissioner
P.E. Vivian, Commissioner

December 19, 2007

O R D E R

WHEREAS:

A. The Commission, by Letter No. L-47-06 dated August 25, 2006, advised Unocal Canada Limited ("Unocal Canada") that it had concluded that Unocal Canada, as owner and/or operator of the Aitken Creek Storage Facility, fell within the definition of a public utility under the Utilities Commission Act (the "Act"); and

B. By a submission dated October 24, 2006, Unocal Canada applied to the Commission, pursuant to Section 88(3) of the Act, for an order exempting it from all provisions of the Act; and

C. On May 14, 2007 the Commission issued its Reasons for Decision on the application for an exemption, and concluded that it would not be in the public interest to exempt Unocal Canada from all provisions of the Act, but that it would seek Lieutenant Governor in Council ("LGIC") approval to exempt Unocal Canada from certain provisions of the Act;

D. By letter dated June 8, 2007 Unocal Canada requested clarification of the Reasons for Decision and the accompanying draft Order, and by Letter No. L-47-07 the Commission responded to the request; and

E. The Commission, by Order No. C-6-07 dated July 6, 2007, pursuant to Sections 45 and 46 of the Act issued to Unocal Canada a Certificate of Public Convenience and Necessity ("CPCN") for the operation of the Aitken Creek Storage Facility; and

…/2

F. By Order No. G-135-07 dated November 7, 2007, pursuant to Section 88(3) of the Act and with the advance approval of the LGIC by Order in Council No. 688 dated October 25, 2007, the Commission approved an exemption for Unocal Canada from certain provisions of the Act in relation to the Aitken Creek Storage Facility; and

G. In Order No. G-135-07 and in this Order the term "Storage Facility" refers to the underground reservoir and contained natural gas, wells, on-site equipment and other components of the natural gas storage facility at Aitken Creek that Unocal Canada owns or operates, as they may be modified or expanded from time to time; and

H. Aitken Creek Gas Storage ULC ("Aitken Creek ULC") is a wholly-owned direct subsidiary of Unocal Canada. Aitken Creek ULC is also is an unlimited liability corporation ("ULC") incorporated on November 1, 2007 under the Alberta Corporations Act (Unocal Canada and Aitken Creek ULC are the "Applicants"). Aitken Creek ULC has been registered in British Columbia as an extraprovincial company; and

I. On November 16, 2007, Unocal Canada applied pursuant to Section 52 of the Act for an Order approving the disposition of its interest in the Storage Facility to Aitken Creek ULC (the "Unocal Canada Disposition Application"); and

J. On November 16, 2007, Aitken Creek ULC applied pursuant to Sections 45 and 46 of the Act for a CPCN for the operation of the Storage Facility (the "Aitken Creek ULC CPCN Application"); and

K. On November 16, 2007, Aitken Creek ULC applied pursuant to Section 88(3) of the Act for an Order exempting it from certain provisions of the Act for the same purposes and subject to the applicable terms and conditions set out in Order No. G-135-07 ("Aitken Creek ULC Exemption Application"); and

L. The Unocal Canada Disposition Application, Aitken Creek ULC CPCN Application, and Aitken Creek ULC Exemption Application (collectively as "the Applications") includes Schedule A (audited financial statements of Aitken Creek natural gas storage business and related operations, assets and liabilities) filed on a confidential basis to the Commission; and

M. The Applications without Schedule A have been provided to Registered Intervenors and Interested Parties of Project No. 368445, the previous proceeding regarding Unocal Canada's Application for an exemption pursuant to Section 88(3) of the Act for the Aitken Creek Storage Facility, and

N. By Order No. G-143-07, the Commission established a written process and regulatory timetable for the registration of intervenors and interested parties, the intervenor submission of comments on the Applications and the Applicants' reply comments. By Letter No. L-97-07, the Commission noted that the Applicants would be filing clarifying information requested by Commission staff and accordingly extended the deadline for intervenor comments and the Applicants' reply comments; and

O. On December 7, 2007, the Commission requested advance approval of the LGIC to issue an exemption Order to Aitken Creek ULC pursuant to Section 88(3) of the Act; and

P. The Commission has considered the Applications, the submissions received and has determined that approval of the Unocal Canada Disposition Application and the Aitken Creek ULC CPCN Application is in the public interest.

NOW THEREFORE the Commission orders as follows with Reasons attached as Appendix A:

1. The Commission approves the Unocal Canada Disposition Application effective January 1, 2008 subject to the condition that the Applicants confirm they will provide historical cost net book value information of the Storage Facility regulated assets at the Commission's request. The Applicants are to confirm their acceptance of this condition in writing to the Commission by January 31, 2008.

2. The Commission approves the Aitken Creek ULC CPCN Application and pursuant to Sections 45 and 46 of the Act issues a CPCN to Aitken Creek ULC for the operation of the Storage Facility effective January 1, 2008, subject to the Applicants accepting the condition required for approval of the Unocal Canada Disposition Application and completion of the transfer of the Aitken Creek Storage Facility to Aitken Creek ULC.

3. For ease of reference, the May 14, 2007 Reasons for Decision that were included in draft form to Exhibit A-12 are issued as Appendix B to this Order.

DATED at the City of Vancouver, in the Province of British Columbia, this 18th day of December 2007.

BY ORDER

Original signed by:

L.F. Kelsey
Commissioner

Attachment

An Application by Unocal Canada Limited for
Approval of the Disposition of its Interest in the Aitken Creek Storage Facility
to its Wholly-Owned Subsidiary

and

An Application by Aitken Creek Gas Storage ULC for
a Certificate of Public Convenience and Necessity and
Exemption Order in respect of its Ownership and Operation of
the Aitken Creek Storage Facility

REASONS FOR DECISION

1.0 APPLICATION

On November 16, 2007, Unocal Canada Limited ("Unocal Canada") applied (the "Unocal Canada Disposition Application") pursuant to Section 52 of the Utilities Commission Act (the "Act") for approval to dispose of its interest in the Aitken Creek Storage Facility ("Storage Facility") to its wholly-owned direct subsidiary Aitken Creek Gas Storage ULC ("Aitken Creek ULC" and "ACGS")) . Aitken Creek ULC is an unlimited liability corporation ("ULC") incorporated on November 1, 2007 under the Alberta Corporations Act (Unocal Canada and Aitken Creek ULC are the "Applicants"). Aitken Creek ULC has been registered in British Columbia as an extraprovincial company.

On November 16, 2007, Aitken Creek ULC applied pursuant to Sections 45 and 46 of the Act for a Certificate of Public Convenience and Necessity ("CPCN") for the operation of the Storage Facility ("Aitken Creek ULC CPCN Application").

On November 16, 2007 Aitken Creek ULC applied pursuant to Section 88(3) of the Act for an Order exempting it from certain provisions of the Act for the same purposes and subject to the applicable terms and conditions as set out in Commission Order No. G-135-07 ("Aitken Creek ULC Exemption Application").

The Unocal Canada Disposition Application, Aitken Creek ULC CPCN Application, and Aitken Creek ULC Exemption Application (collectively "the Applications") include Schedule A (audited financial statements of Aitken Creek natural gas storage business and related operations, assets and liabilities) filed on a confidential basis to the Commission. The Applications without Schedule A have been provided to Registered Intervenors and Interested Parties of Project No. 368445, the previous proceeding regarding Unocal Canada's Application for an exemption pursuant to Section 88(3) of the Act for the Aitken Creek Storage Facility. The requested effective date for the Applications is January 1, 2008.

2.0 BACKGROUND AND REGULATORY REVIEW PROCESS

A ULC has the characteristics of a limited corporation including a separate legal personality. The main difference is that the liability of shareholders of a ULC for any liability, act or default of the ULC is unlimited. A ULC can be created in Alberta by incorporation, amendment, continuation or amalgamation. To address the risk resulting from the unlimited liability of a ULC, the shares of a ULC may be held through a limited corporation or a limited partnership which may limit the assets to the shares of the ULC.

A ULC is treated for the purposes of the Canadian Income Tax Act as a taxable Canadian corporation. Like other Canadian corporations, a ULC is eligible for protection under the Canada-U.S. Tax Convention. It is possible for a United States investor to have the ULC treated as a flow-through entity of a branch or partnership for the purposes of the U.S. Internal Revenue Code.[1]

By Order No. G-143-07, dated November 28, 2007 the Commission established a written hearing process and a Regulatory Timetable to review the Applications. Intervenors and Interested Parties were to register with the Commission by December 3, 2007. Intervenors were to provide their written Submissions of Comments by December 5, 2007. The Applicants were to provide their comments by December 10, 2007. Subsequently, the Commission staff requested further clarifying information and by letter dated December 5, 2007, Unocal stated that it would file its response by December 6, 2007. By Letter No. L-97-07, the Commission extended the deadline for written submissions and required Intervenors to file written Submissions of Comment by December 10, 2007 and Unocal was to submit a written Reply Comment on December 13, 2007.

3.0 UNOCAL CANADA DISPOSITION APPLICATION

Further to Letter No. L-97-07, on December 6, 2007 the Applicants provided the following information on how Unocal Canada intends to maintain financial data and records within Aitken Creek ULC to facilitate any reporting or other requirements that the Commission may require in the future:

- "Unocal Canada became a wholly-owned indirect subsidiary of Chevron Corporation (Chevron) in August of 2005 when Chevron acquired Unocal Canada's corporate parent Unocal Corporation (Unocal).

- At the time of acquiring Unocal, Chevron retained Ernst & Young to assist in determining the fair values of Unocal's tangible and intangible assets for the purpose of allocating the aggregate purchase price to assets, including those at Aitken Creek, as required by U.S. accounting standards. The allocations were finalised by September 30, 2005.

- The financial statements of Unocal Canada identify the assets, liabilities, revenues and expenses directly attributable to the assets and operations that are proposed to be transferred to ACGS. The assets proposed to be transferred to ACGS will be identified and valued on the books of **ACGS** in the same manner as they have been on the books of Unocal Canada." (Exhibit B-3, p. 1)

It would appear that from the second preceding bullet point that upon acquiring Unocal, Chevron increased some or all of Unocal's assets from their depreciated historical cost basis to their fair values.

In Section 1.3 of the Reasons for Decision dated May 14, 2007 in response to Unocal Canada's application for exemption from all provisions of the Act, the Commission stated "Furthermore, this decision makes no evaluation as to whether cost-based or market-based rates are appropriate for the Storage Facility." In Section 2.3 of the Reasons for Decision, the Commission addressed whether Unocal Canada should be actively regulated. The Commission also discussed regulating rates for the Storage Facility on a cost of service basis compared to the current negotiated rates that reflect market conditions. The Commission found that active regulation of Unocal Canada in its operation of the Storage Facility is not warranted at this time and that regulation on a reporting or complaints basis is the appropriate method of regulation.

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[1] Lawson Lundell-The Benefits of Using an Unlimited Liability Company dated April 29, 2005 and the Business Law Group e-Communique, Vol 5, No. 3, November 2005

The Unocal Canada Disposition Application is filed pursuant to Section 52 of the Act. Section 52 reads as follows:

> **Restraint on disposition**
> **52** (1) Except for a disposition of its property in the ordinary course of business, a public utility must not, without first obtaining the commission's approval,
>
> (a) dispose of or encumber the whole or a part of its property, franchises, licences, permits, concessions, privileges or rights, or
>
> (b) by any means, direct or indirect, merge, amalgamate or consolidate in whole or in part its property, franchises, licences, permits, concessions, privileges or rights with those of another person.
>
> (2) The commission may give its approval under this section subject to conditions and requirements considered necessary or desirable in the public interest.

The Commission has reviewed other applications for disposition under Section 52 of the Act such as:

- A June 25, 1997 application by Squamish Gas Co. Ltd. ("Squamish Gas") to dispose of the assets of the Granisle Grid Propane Distribution System ("Grid System") to Pacific Northern Gas Ltd. ("PNG"), ("Granisle Grid Disposition"). The Asset Purchase Agreement allowed the assets of the Grid System to be transferred from Squamish Gas to PNG at its net book value, excluding product inventories less an identified Resort Discount. By Order No. G-80-97, the Commission approved the Granisle Grid Disposition.

- A June 8, 1999 Kanelk Transmission Company Limited ("Kanelk") application to dispose of its utility assets in British Columbia and assign the associated CPCN to British Columbia Hydro and Power Authority ("BC Hydro") ("Kanelk Disposition"). BC Hydro proposed to capitalize the Kanelk Line at the full purchase price of $4.322 million rather than the net book value of $3.618 million. By Order No. G-127-99, the Commission approved the Kanelk Disposition and the assignment of the associated CPCN to BC Hydro however the Commission did not accept BC Hydro's proposal to capitalize utility assets of Kanelk at the full purchase price. In the Commission's view, it was more appropriate to record the Kanelk utility assets at net book value. The Commission noted that this is the more normal regulatory accounting treatment which protects customers from utility assets previously paid for by customers being increased by a new utility owner.

- A December 21, 2001 application by BC Gas Utility Ltd. (now Terasen Gas Inc.) to dispose of its partially-completed Program Mercury and other customer care related assets to BC Gas Inc. (now Terasen Inc.) pursuant to an Asset Transfer Agreement where the capital expenditures for software and hardware were to be transferred at a book value that was estimated to equal fair market value ("Program Mercury Disposition"). By Order No. G-29-02, the Commission approved the Program Mercury Disposition.

The Commission also reviews applications to acquire utilities under a share acquisition under the reviewable interest provisions of Section 54 of the Act. Under Section 54(4) of the Act, a person has a reviewable interest in a public utility if (a) the person owns or controls, or (b) the person or the person's associates own or control, in the aggregate more than 20 percent of the voting shares outstanding of any class of shares of the utility.

By Order No. G-47-05 and pursuant to Section 54 of the Act, the Commission approved an April 20, 2005 application by Fortis Inc. ("Fortis"), Fortis West Inc. and Fortis Pacific Holdings for the approval of the acquisition by Fortis of a reviewable interest in Princeton Light & Power Company, Limited ("PLP") to purchase all of the issued and outstanding shares of PLP. Any premium that Fortis would pay to the vendors of PLP over the book value for the PLP shares will not be recoverable in regulated electricity rates set from time to time by the Commission.

The Commission also approved by Order No. G-116-05 and pursuant to Section 54 of the Act, the August 17, 2005 application by Kinder Morgan, Inc. ("KMI") and 0731297 B.C. Ltd. to acquire the common shares of Terasen Inc. which results in the indirect ownership of the wholly-owned regulated utilities of Terasen Inc. KMI acknowledged that it did not intend to apply to recover from the Terasen utilities ratepayers any premium that it was paying for the acquisition of the shares of Terasen Inc. (Exhibit B-16, p. 14).

The Commission has approved by Order No. G-49-07 and pursuant to Section 54 of the Act, the acquisition by Fortis of all of the issued and outstanding shares of Terasen Inc. which would cause Fortis to have indirect control of certain public utilities regulated by the Commission. Fortis also confirmed that the acquisition premium will not be recovered from Terasen Utilities' customers (Exhibit B-2, BCUC IR 1.12).

Intervenors' Submissions and Applicants' Reply

The British Columbia Old Age Pensioners' Organization et al. ("BCOAPO") notes that ULC incorporation when properly structured offers particular tax and transfer pricing benefits for the acquisition of a Canadian business by a U.S. investor. BCOAPO states that the onus is on the Applicant to demonstrate that this Application is in the public interest. BCOAPO's immediate concern is to ensure that the proposal will have no current or future adverse effects on natural gas ratepayers whose supply is stored at Aitken Creek. BCOAPO made reference to the commitments provided in Section 3.4 of the Application which would seem to address any potential concerns that it may have otherwise have had in this regard. As a result, BCOAPO does not oppose Unocal's Application. These commitments are:

> "Following completion of the Proposed Transaction:
>
> - the structural integrity of the Storage Facility assets and operation will be maintained;
> - there will be unaffected continuity of existing storage contracts with third parties;
> - there will be unaffected continuity in the quality of storage services offered and provided to third parties;
> - there will be no adverse impact on the ability of the owner/operator of the Storage Facility to operate and maintain the assets in terms of both financial strength and access to support services;
> - there will be continued compliance with applicable regulatory requirements respecting the safe and proper operation of the Storage Facility; and
> - Unocal Canada will be liable on an unlimited basis for any liability, act or default of Aitken Creek Gas Storage ULC." (Exhibit B-1, p. 6)

Terasen Gas Inc. ("Terasen Gas") submitted that it has no objection to the Unocal Canada Disposition Application. By letter dated December 13, 2007, the Applicants filed their Reply Comments and noted that Terasen Gas has no objections to the Applications and BCOAPO did not oppose them.

Commission Determination

The Commission has reviewed the Unocal Canada Disposition Application, the commitments provided by Applicants, the submissions made by the intervenors and determines that, with the condition discussed below, the Unocal Canada Disposition Application will not have a detrimental impact on the public interest.

In the May 14, 2007 Reasons for Decision the Commission found that the active regulation of Unocal Canada was not warranted at that time. The Commission appreciates the Applicants commitments in their December 6, 2007 letter that Unocal intends to maintain financial data and records within Aitken Creek ULC to facilitate any reporting or other requirements that the Commission may require. The Commission may at some time in the future decide to establish cost based rates for the Storage Facility. The Commission is of the view that cost based rates should be based on the historical cost net book value of the Storage Facility assets. The Commission considers that any acquisition premium paid by Chevron in the August 2005 acquisition of Unocal Corporation should not be recoverable if cost-based rates are established for the Storage Facility. **The Commission approves the Unocal Canada Disposition Application effective January 1, 2008 subject to the condition that the Applicants confirm they will provide historical cost net book value information of the Storage Facility regulated assets at the Commission's request. The Applicants are to confirm their acceptance of this condition in writing to the Commission by January 31, 2008.**

4.0 AITKEN CREEK ULC CPCN APPLICATION

Terasen Gas submitted that if the Commission approves the Unocal Canada Disposition Application, Terasen Gas has no objection to the Aitken Creek ULC CPCN Application. BCOAPO did not submit comments with regards to this Application.

The Commission approves the Aitken Creek ULC CPCN Application and pursuant to Sections 45 and 46 of the Act issues a CPCN to Aitken Creek ULC for the operation of the Storage Facility effective January 1, 2008, subject to the Applicants accepting the condition required for approval of the Unocal Canada Disposition Application and completion of the transfer of the Storage Facility to Aitken Creek ULC.

5.0 AITKEN CREEK ULC EXEMPTION APPLICATION

The Commission reviewed the Aitken Creek ULC Exemption Application and by letter dated December 7, 2007 requested advance approval of the Lieutenant Governor in Council to issue an exemption Order to Aitken Creek ULC pursuant to Section 88(3) of the Act.

Terasen Gas submitted that if the Commission approves the Unocal Canada Disposition Application and grants Aitken Creek ULC a CPCN for the operation of the Storage Facility then Terasen Gas has no objection to the Aitken Creek ULC Exemption Application, made pursuant to Section 88(3) of the Act, for an Order exempting it from certain provisions of the Act, so long as the exemption is for the same purposes and is subject to the same terms and conditions as set out in Commission Order No. G-135-07. BCOAPO did not provide comments on this Application.

By letter dated December 13, 2007, the Applicants filed their Reply Comments and noted that Terasen Gas has no objections to the Applications and BCOAPO did not oppose them. The Applicants noted that the required Order in Council ("OIC") regarding the exemption application is unlikely to be issued before early January. The Applicants confirmed their request that the Commission approve the disposition of the Storage Facility and grant the CPCN at its earliest convenience and issue an exemption order in due course once the OIC has been issued. Aitken Creek ULC anticipates that it will file its gas storage agreements as rates pursuant to Sections 59, 61, 90 and 91 of the Act on an interim basis pending issuance of the exemption order.

An Application by Unocal Canada Limited
for an Exemption from all Provisions of the Utilities Commission Act
for the Aitken Creek Storage Facility

REASONS FOR DECISION

1.0 INTRODUCTION

1.1 Application and Regulatory Process

Unocal Canada Limited ("Unocal") is the operator and majority owner of the natural gas storage facility located at Aitken Creek, which is approximately 120 km northwest of Fort St. John, British Columbia. Unocal has been offering third party storage services at the facility for more than fifteen years.

On August 25, 2006 the British Columbia Utilities Commission (the "Commission") concluded in Letter No. L-47-06 that Unocal, as the primary owner and operator of the Aitken Creek Storage Facility, comes within the definition of a public utility in the Utilities Commission Act (the "Act", "UCA"). On October 24, 2006 Unocal applied to the Commission for an exemption from all provisions of the Act for its Aitken Creek Storage Facility (the "Storage Facility") pursuant to Section 88(3) of the Act (the "Application"). In Order No. G-155-06 the Commission established a Written Public Hearing and Regulatory Timetable for the review of the Application. The Regulatory Timetable provided for one set of Information Requests followed by written submissions from the parties.

Six parties registered as Intervenors and two parties registered as Interested Parties in the proceeding. One of the Intervenors, BP Canada Energy Company ("BP"), holds a 6 percent interest in the Storage Facility. The capacity that BP owns is used for proprietary purposes only and none of it is contracted to third parties. BP also currently contracts for additional storage with Unocal (Exhibit C3-1).

On January 24, 2007 Unocal wrote to the Commission objecting to providing responses to certain Information Requests from the British Columbia Old Age Pensioners' Organization et a1. ("BCOAPO") and the Commission. Unocal requested that the Commission issue an order that Unocal is not required to disclose the information. On February 7, 2007 the Commission, after receiving written submissions from parties allowed some of Unocal's requests and denied others and issued Order No. G-12-07 requiring Unocal to submit responses to some of the Information Requests.

Three Intervenors filed Final Submissions: Powerex Corp. ("Powerex"), the BCOAPO, and Terasen Gas Inc. ("TGI"). The BCOAPO included as an appendix a "Critique of Evidence filed in the Unocal Canada Limited Application for an Exemption" written by James Wightman of Econalysis Consulting Services (the "Critique"). Unocal, in its Reply Submission, requested that the Commission strike the Critique, stating that BCOAPO had introduced new evidence. On April 4, 2007, after receiving submissions from the parties, the Commission denied Unocal's request to strike the Critique from the record. The Commission considered the Critique as part of the BCOAPO Final Submission and the Unocal observations on it as part of Unocal's Reply Submission.

1.2 Statutory Basis for the Application

Section 88(3) of the Act provides as follows:

> "The commission may, on conditions it considers advisable, with the advance approval of the Lieutenant Governor in Council, exempt a person, equipment or facilities from the application of all or any of the provisions of this Act or may limit or vary the application of this Act."

1.3 Issues to be Examined by the Commission

In most situations where an application has been made to the Commission for an exemption under Section 88(3) of the Act for a facility, the operator has clearly come within the definition of "public utility" under the Act. However, the exemption has been sought because the operational circumstances are unique, the user community is limited and user business safeguards are in place.

From time to time, after due consideration, on conditions it considers advisable, and, after having sought and received the approval of the Lieutenant Governor in Council ("LGIC"), the Commission has provided an exemption with respect to a facility from certain provisions of the Act. An exemption may be provided to a public utility when it can demonstrate that it is unable to exert market power because of the competitive marketplace that it operates in or because of the contractual arrangements that it has entered into.

Recent Orders granting full or partial exemptions from the provisions of the Act have encompassed the breadth of public utilities in B.C. By Order No. G-41-06 the Commission granted FortisBC Inc. and British Columbia Hydro and Power Authority an exemption from all provisions of the Act in respect of the Canal Plant Agreement ("CPA") and the CPA Subagreement. By Order No. G-144-06 the Commission granted Talisman Energy Canada

an exemption from Section 71 and Part III, except Section 22, of the Act; and Imperial Oil Limited and the Bullmoose Operating Corporation an exemption from Section 71 of the Act with respect to the sale of electricity power from the Bullmoose electrical substation. Part III deals with the regulation of public utilities and Section 71 provides for the filing of energy supply contracts.

Recent Orders granting partial exemptions from the provisions of Part III of the Act also include Order No. G-38-06 for the natural gas processing and gathering facilities in the West Stoddard area owned by Canadian Natural Resources Limited, and Order No. G-21-07 for the natural gas gathering and processing facilities in the Peggo, Midwinter and Tooga areas owned by the Pesh Facilities Holding Partnership. In both of these cases, the applicant had entered into service contracts with several customers who it proposed to serve through the use of pipelines, gas plants and related facilities which it owned, and stated that it intended to enter into additional similar contracts in the future.

The Commission Panel concludes that this Application differs from previous applications relating to Section 88(3) of the Act because the user community is not limited to contracting parties, but also includes the customers of TGI whose delivery charges to its customers reflect the recovery of the storage charges paid by TGI to Unocal.

The Commission has previously concluded that Unocal, as owner/operator of the Storage Facility, comes within the definition of a public utility under the Act (Letter No. L-47-06). Therefore, the status of Unocal as a public utility, with respect to the Storage Facility, is not an issue in this Application. Furthermore, this decision makes no evaluation as to whether cost-based or market-based rates are appropriate for the Storage Facility. The Application is restricted to whether or not to grant Unocal, with respect to its operation of the Storage Facility, an exemption from provisions of the Act. The issues for determination are:

1. What is the appropriate test for granting a Section 88(3) Exemption Order?
2. Does the Unocal Application for an exemption from all provisions of the Act satisfy the test for exemption?
3. Should Unocal, in its operation of the Storage Facility, be actively regulated?
4. What is an appropriate exemption for the Storage Facility in the circumstances?

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2.0 ISSUES

2.1 What is the appropriate test for granting an exemption?

2.1.1 Background

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This Section addresses Issue 1: "What is the appropriate test for granting a Section 88(3) exemption order?" In the Reasons for Decision attached to Order No. G-41-06, the Commission expressed its view that a Section 88(3) exemption order should be issued, with the advance approval of the LGIC, when such exemption serves the objects and purposes of the Act and it is in the public interest to grant the exemption. The parties commented on whether the test, as laid out in Order No. G-41-06, is appropriate for determining whether to grant an exemption to Unocal for its operation of the Storage Facility.

2.1.2 Positions of Parties

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Unocal agrees that the appropriate test that the Commission should apply is as set out in the Reasons for Decision attached to Order No. G-41-06 (Exhibit B-8, BCUC 1.1.1). Unocal also submits "the overall objects and purposes of the UCA are to establish a public regulator to efficiently administer the powers delegated to it by the legislature, which are intended to achieve a balance in the public interest between a person holding a monopoly, where a monopoly is accepted as necessary, and the customers of that monopoly as a proxy or surrogate for the protection to customers that would be provided by competition" (Unocal Final Submission, p. 3). Unocal submits that the Commission should apply the following criteria to determine whether the applied-for exemption would meet the test of serving the objects and purposes of the Act and be in the public interest (Exhibit B-8, BCUC 1.1.1, 1.1.2):

F

1. Does a natural monopoly for an essential service exist;
2. Can market power be exercised, and if so, is market power being exercised;
3. Will regulation of the price, terms and conditions of service have the effect of piece-meal confiscation of property without due compensation; and
4. Will regulation of the price, terms and conditions of service distort price signals in an otherwise competitive market?

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Powerex takes no issue with Unocal's characterization of the test to be applied to determine whether to grant a Section 88(3) exemption (Powerex Final Submission, p. 1).

TGI also agrees that the appropriate test the Commission should consider is the one set out in the Reasons for Decision attached to Order No. G-41-06. TGI also submits that the overall object and purpose of the Act is "to regulate rates and terms of service of public utilities so that customers receive safe and reliable service" (Exhibit C2-4, pp. 1-2).

The BCOAPO agrees that the appropriate test is the one set out in the reasons for decision attached to Order No. G-41-06 but does not accept Unocal's interpretation or its four part criteria, stating that they are inconsistent with the current state of the law as defined by the decision in *ATCO Gas Ltd. v. Alberta (Energy & Utilities Board)* (the "ATCO Decision"). The BCOAPO submits that the ATCO Decision indicates the proper purpose of regulation has been expanded to recognize the desirability of regulation as a means of preventing monopolistic behaviours by market participants who are public utilities providing certain essential services as defined by the Act (BCOAPO Argument, p. 3).

2.1.3 Commission Determination

The Commission Panel is of the view that the four part criteria proposed by Unocal, while offering a specific set of potential measures for determining whether the market for storage that Aitken Creek serves is competitive, is itself subject to a host of assumptions regarding the product and geographic markets. With regard to the first and second criteria, the Storage Facility provides a variety of services ranging from seasonal term supply, inter- and intra-day pipeline balancing, management of natural gas price volatility, and supply security; each with its own geographic market and substitutes. Consequently, an operator of a storage facility may be able to exert market power in some markets and not in others. Therefore, the Commission Panel does not accept that these two criteria adequately assess or reflect the particularities of the Storage Facility and the various storage services that it provides.

With regard to Unocal's third criterion, the Commission Panel notes that cost of service regulation does not necessarily result in rates that are higher than available alternatives. For example, the U.S. Federal Energy Regulatory Commission ("FERC") approved cost based rates for the Mist storage facility in Oregon that are currently higher than the market value for the storage service and, consequently, the storage owner and operator, Northwest Natural Gas, discounts the rate offered to non-core customers to the market value (Exhibit C2-3, p. 13).

Unocal's fourth criterion is premised on a workably competitive market and therefore can be viewed as a rhetorical question.

Regarding the BCOAPO's interpretation of the ATCO Decision, the Commission Panel notes that the ATCO Decision provided a narrow interpretation of the Alberta Energy and Utility Board's authority:

> "The Board's seemingly broad powers to make any order and to impose any additional conditions that are necessary in the public interest has to be interpreted within the entire context of the statutes which are meant to balance the need to protect consumers as well as the property rights retained by owners, as recognized in a free market economy. The limits of the powers of the Board are grounded in its main function of fixing just and reasonable rates ("rate setting") and in protecting the integrity and dependability of the supply system" (ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board), [2006] 1 S.C.R. 140, 2006 SCC 4, para. 7).

TGI noted that the British Columbia legislation is similar (Exhibit C2-4, p. 1). The Commission Panel agrees that it has a responsibility to balance the protection of consumers with the protection of the property rights of owners. **The Commission Panel concludes that the appropriate test is as set out in Order No. G-41-06 which states that "a section 88(3) exemption order should be issued, with the advance approval of the LGIC, when such exemption serves the objects and purposes of the Act and it is in the public interest to do so".**

2.2 Does the Unocal Application Meet the Test for an Exemption?

2.2.1 Background

This Section addresses Issue 2: "Does the Unocal Application for an exemption from all provisions of the Act satisfy the test for exemption?" The ATCO Decision provides a guide for the interpretation of the objects and purposes of the Act, namely, that its purpose is to strike a balance between the need to protect consumers and the need to protect the property rights of owners. The ATCO Decision also indicates that the main function of the regulator is to fix just and reasonable rates and to protect the integrity and dependability of the supply system. In achieving the balance between consumers and owners, the ability of a utility to exhibit market power may well be constrained. The Commission Panel must decide in determining to seek LGIC approval for an exemption under Section 88(3) for Unocal in respect of its operation of the Storage Facility from all or part of the provisions of the Act, whether or not such an exemption would leave Unocal in a position where it is able to exert significant monopoly or market power by discriminating on the basis of price or service, withdrawing service, or setting rates which are unreasonable.

The Commission Panel notes that a range of services are offered by physical storage facilities, each with its own geographic market, substitutes and barriers to entry. A storage operator may be found to exert differing amounts of market power in each segment. In particular, the services that gas storage provides are: (i) seasonal term supply, (ii) daily balancing, (iii) peaking, (iv) price hedging, and (v) alternative supply (supply reliability).

While the words "public interest" do not appear in Section 88(3) of the Act, the test for determining whether to grant the exemption applied-for in Order No. G-41-06 includes a consideration of the public interest. In the case of the services provided by Unocal in its operation of the Storage Facility, the public interest includes the interests of Unocal, storage contract holders, and customers of TGI who are directly affected by the bilateral agreement entered into by Unocal and TGI and yet have no opportunity to directly influence those negotiations. While these interests may at times conflict, all parties have a stake in the safe and reliable operation of the Storage Facility offering a host of storage related services at a fair and reasonable cost.

2.2.2 Positions of Parties

Unocal presented evidence, primarily in the form of two independent reports that it had commissioned (the "IGC" and "CEA" reports), to show that it is not a monopoly, that it lacks market power in the storage market that the Storage Facility serves, and that it operates in a competitive industry with many substitutes for the storage services it provides. The reports indicate that spot and seasonal term purchases from supply points transported through the Spectra Gas and Williams systems, alternative storage facilities in Alberta and the Pacific Northwest, and liquefied natural gas ("LNG") imports and peak shaving facilities are all substitutes for the services provided by the Storage Facility and these substitutes are largely available on an unregulated basis (Exhibit B-1, Appendix C, IGC Report; Appendix D, CEA Report).

Unocal submits that the Storage Facility should be treated as an alternative source of supply in the upstream producing region because of the competitive forces that determine the pricing of storage. As an example, Unocal cites spot gas purchases as a substitute to production area storage:

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> "… a market area customer would be indifferent, all else being equal assuming the same commodity price, purchasing spot gas in the production area and delivering such gas with its contracted pipeline capacity as it would be withdrawing gas from storage and delivering the withdrawn gas" (Exhibit B-8, BCUC 1.4.6).

In respect of its service to TGI:

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> "Unocal has been treated the same as any other supplier of natural gas to Terasen. Terasen has filed its contracts with Unocal pursuant to Section 71 as energy supply contracts and the Commission has accepted them as such" (Exhibit B-4, p. 3).

Moreover, since the Storage Facility represents only 10 percent of TGI's peak-day supply and since TGI uses other storage facilities, Unocal maintains that this is evidence of the Storage Facility's lack of monopoly power (Unocal Final Submission, p. 7).

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The conclusions of a market power analysis commissioned by Unocal state that:

> "…the Pacific Northwest is not a concentrated market as demonstrated by the fact that 6 of the 17 storage facilities can provide 40,000 MMcf or more of working gas and 7 of the 17 facilities have 450,000 Mcf/d or more of peak deliverability. In our opinion, no one facility could dominate the underground storage or peak shaving market in any area of the region."

and:

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> "While the storage-on-storage competition in the region demonstrates that no one storage facility can exercise market power for any significant period of time, alternatives to traditional underground gas storage further reduce any potential market power of the storage operators in the region" (Exhibit B-1, Appendix C, IGC Report, p. 3).

Unocal also notes that several storage expansions in the Pacific Northwest are being undertaken to meet growing demand and therefore, one of the conditions for a monopoly, namely barriers to entry, does not exist (Unocal Final Submission, p. 10).

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Unocal states that "regulation of Unocal's rates for storage services would pose an unnecessary cost and administrative burden on both Unocal and the Commission" and that it "would face significant additional costs to restructure so as to be able to comply with the UCA's significant requirements" (Exhibit B-1, p. 5).

Powerex supports the conclusions reached by Unocal (Powerex Final Submission, para. 4).

TGI submits that the Storage Facility forms an important part of its gas supply portfolio; a portfolio that has been tailored to meet the demand characteristics specific to the distribution utility and in which the Storage Facility, while supplying only 10 percent of its winter peak demand, represents a significant portion (26 percent) of the entire TGI winter gas supply into Station 2 (TGI Final Submission, para. 12, 14). In particular, an attribute of the Storage Facility that provides additional value to TGI is the:

> "Ability to make intra-day nominations (up or down) during both the injection and the withdrawal phases which serve as a balancing tool, allowing TGI to manage its balancing obligations with WEI. This balancing change is caused by changes in weather that drive the core market load requirements" (Exhibit C2-3, p. 2).

TGI submits that while some substitution between elements of the supply portfolio is possible, there are associated potential impacts on the cost and reliability of supply (TGI Final Submission, para. 12). The Storage Facility is used as an "alternative to seasonal supply at Station 2 during the period of higher winter demand from late October through early April" (Exhibit C2-3, p. 2). In the long run, the number of alternatives available to TGI is greater and includes expanding and building new pipeline capacity from the Nova Gas Transmission Limited ("NGTL") system to the Lower Mainland. Nevertheless, replacing more than 25 percent of the storage capacity currently held at the Storage Facility would require TGI to significantly alter its supply portfolio, both over the short and the long term (Exhibit C2-4, pp. 4-11).

TGI refutes Unocal's position that spot purchases of gas are a substitute for storage:

> "Spot purchases, which at Station 2 represent some level of uncertainty, are not a substitute for physical storage services and as such TGI has never relied upon spot purchases in lieu of contracting for storage services. It should be noted that it is very difficult to purchase significant volumes of gas intra-day at Station 2" (Exhibit C2-3, p. 6).

However, TGI does support Unocal's position that the Storage Facility is an alternative supply:

> "Thirdly, it diversifies the source of supply at Station 2 from solely field production. Approximately 80% of Station 2 supply emanates from just three gas plants. Aitken Creek provides a fourth significant supply source and also service that is not exposed to production well freeze-off or other upsets at processing plants" (Exhibit C2-4, p. 4).

The BCOAPO argues that due to the lack of evidence in the record, the questions of whether Unocal has exhibited monopolistic behaviours such as exercising market power and whether realistic substitutes to the Storage Facilty exist cannot be answered. Moreover, the alternatives presented in Unocal's market power analyses cite alternatives that are not feasible in B.C. or would result in potentially significant price increases (BCOAPO Argument, pp. 4-5).

2.2.3 Commission Determination

The results of market power analyses presented in both the CEA and IGC reports were submitted as providing evidence of the lack of market power related to the Storage Facility in a market defined as physical storage in B.C., Alberta and the Pacific Northwest. The IGC report points out that the Pacific Northwest is not a concentrated market because 6 of the 17 storage facilities can provide 40,000 MMcf (approximately 1,133 10^6m^3) or more of working gas and 7 of the 17 facilities have 450,000 Mcf/d (approximately 12,750 $10^3m^3/d$) or more of peak deliverability (Exhibit B-1, Appendix C, IGC Report, p. 3).

However, the Commission Panel notes that the ability to substitute one storage facility for another is dependent upon not only the volume and deliverability of storage contracted for, but also the availability of pipeline capacity to redeliver the gas to the market area. While all of the storage facilities in the Pacific Northwest may be available alternatives to third parties holding a small amount of capacity, they become less viable as the contracted capacity and deliverability increases. In the 2006/07 storage year TGI holds over 30 percent of the working gas capacity and over 20 percent of the deliverability of the Storage Facility (Exhibit C2-3, p. 10; Exhibit B-8, BCUC 1.3.1, 1.3.2).

The current level of TGI term storage at the Storage Facility of 134 TJ/d represents only a small fraction of the total Alberta storage deliverability (Exhibit C2-4, p. 6 states that one quarter of TGI's deliverability at Aitken Creek is approximately 1 percent of the total deliverability from Alberta storage). On that basis, the Alberta storage capacity is therefore adequate to serve as an alternative to storage at the Storage Facility. However, in order for Alberta storage to be a viable substitute for storage at the Storage Facility, the equivalent deliverability must be available to the B.C. market area. The physical pipeline capacity from NGTL to Gordondale is 210 TJ/d and from Gordondale to Station 2 is 220 TJ/d (Exhibit C2-4, p. 6). It is unclear how much, if any, of this capacity would be available on a firm basis to TGI. In other words, while TGI may be able to contract with alternative storage providers in Alberta, there is no evidence to confirm whether these volumes can be delivered to TGI's service area on a firm basis.

Not all storage in the Pacific Northwest can be considered as a viable substitute. Jackson Prairie Storage ("JPS") in Washington and Mist in Oregon have very limited, if any, uncontracted capacity available (Exhibit C2-4, p. 6). Furthermore capacity currently held at these facilities is at risk of non-renewal upon expiry:

> "TGI must also mitigate this risk with the possibility that third parties will retain the expiring storage contracts to meet their own load requirements. The risk of utilities retaining expiring storage contracts is significant since 75% of TGI and TGVI's Off System market area storage contracts are subject to recall over the next 8 years. Just this past year, TGI received notice from Avista Corporation ("Avista Corp") to terminate an existing JPS storage agreement requiring TGI to review alternative resource options" (Exhibit C2-5, TGI 2006 Resource Plan, p. 75).

In addition, increased transportation capacity from these facilities may not be available:

> "…all TF-2 capacity is currently fully contracted and NWP has stated that no incremental TF-2 capacity will be made available" (Exhibit C2-5, TGI 2006 Resource Plan, p. 75).

and:

> "Currently a majority of TGI and TGVI's shorter term redelivery from downstream storage consists of third party redelivery agreements that rely on displacement whereby gas destined for markets south of Huntingdon/Sumas is diverted to TGVI and TGI and replaced further south by the gas from downstream storage facilities. This implies that on a peak day, there is actually less gas available to flow south to NWP because it is being diverted for TGI and TGVI. However, on design peak and cold days NWP requires a minimum flow south through Huntingdon/Sumas onto the NWP pipeline system to satisfy Seattle area load requirements. If this minimum is not reached then NWP will issue an Operational Flow Order ("OFO") requiring certain shippers to flow supply south through the Huntingdon/Sumas market centre. This condition will place the ability of third parties to offer displacement contracts at risk" (Exhibit C2-5, TGI 2006 Resource Plan, p. 75).

and, consequently:

> "In recent discussions third party [displacement service] providers have indicated to TGI and TGVI a reluctance to transact long term displacement deals primarily due to the potential OFO issue on NWP" (Exhibit C2-5, TGI 2006 Resource Plan, p. 75).

The Commission Panel does not accept Unocal's submission that the storage expansions underway or planned in the Pacific Northwest indicate that the potential for new entrants limits the ability of any storage provider in the region to exercise market power (Unocal Final Submission, p. 10). Much if not all of this capacity is unavailable

as a viable substitute for the Storage Facility. The latest expansion at JPS is fully contracted for an average term of 32 years and Mist has limited capacity, if any, in its 2007 expansion (Exhibit C2-4, p. 6). Again, this capacity would only be a meaningful substitute if pipeline capacity were available.

In addition to their reference to a competitive environment for storage, the IGC and CEA reports identify close substitutes for gas storage which are available pipeline capacity, local production and LNG supplies (Exhibit B-1, Appendix C, IGC report, p. 3). However, the Commission Panel finds that neither report adequately addresses the availability of these substitutes in the quantities required to provide viable alternatives to all of the storage services that the Storage Facility provides.

The Commission Panel also finds that available pipeline capacity is not a viable substitute for production area storage. For example, TGI holds firm T-South capacity to deliver storage gas from Aitken Creek to the market areas. While the level of uncontracted T-South and T-North capacity suggests that additional capacity may be available to transport gas to fulfill peak-day market demand, it is important to note that the primary function of the Aitken Creek storage contract held by TGI is to provide a source of firm seasonal supply of gas in the winter at summer prices, rather than serve the seasonal peak demand. TGI has never reduced its contracted storage space and relied upon bidding for pipeline capacity during a winter peak period as a substitute for storage space (Exhibit C2-3, p. 8).

Further, the availability of an LNG terminal service as a viable alternative to storage will depend upon the terminal's capacity and deliverability. The LNG terminal and regassification facilities proposed for Kitimat and Prince Rupert are equivalent to alternative production sources and may provide a viable alternative to storage at the Storage Facility depending upon the quantity of, as well as the terms and conditions attached to, the available capacity when and if these facilities are constructed. However, these proposed facilities are not viable substitutes to storage at the Storage Facility for either peaking or term supply at this time.

TGI's market area LNG facility (Tilbury) serves the winter peak-day load and provides up to four days of service. Therefore, it is not a substitute for the seasonal term supply TGI sources from the Storage Facility (Exhibit C2-3, p. 7).

The Commission Panel notes that the Storage Facility provides a variety of functions to different customers ranging from an alternative source of production to daily balancing and peaking services. As previously noted, the substitutes to the Storage Facility depend in large part on both the nature of the service and on the quantity of gas contracted for. For example, the Commission Panel understands that while spot gas purchases at Station 2

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may be a viable alternative to storage for some customers, they are not to TGI due to the level of uncertainty of prices and the lack of liquidity making it difficult to purchase the significant volumes that would be required to satisfy the seasonal term supply portion of their portfolio.

This in contrast to the peak shaving function provided by storage where both Unocal and TGI have identified suitable substitutes such as a host of other storage facilities in Alberta and the Pacific Northwest, which are in fact currently contracted for by TGI for that purpose. Peaking supply (natural gas storage at JPS and Mist) and a needle peaking reserve (the reserves at TGI's LNG storage facility on Tilbury Island provide the incremental supply for a very high peak demand of a one to three day duration) are currently part of the TGI supply portfolio. The Storage Facility supplies only 10 percent of TGI's peak day requirement and, consequently, does not provide the majority of the incremental supply in TGI's portfolio that satisfies peak day demand. Instead it supplies seasonal term storage for up to 151 days per year, making up 25 percent of TGI's winter supply (Exhibit C2-3, p. 3). The Commission Panel is of the view that the JPS and Mist storage facilities and LNG reserves are therefore not viable substitutes for the seasonal term supply provided by Aiken Creek Storage.

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The Commission Panel notes that while the summer to winter gas forward price differentials provide one benchmark for the market value of gas storage, there are other considerations affecting the value of storage to a customer. Unocal states:

> "…ancillary terms and conditions of the contract for storage are fundamental considerations in determining the value of a storage contract to a particular customer. For example, customers will consider reliability, injection/withdrawal flexibility and other storage service characteristics in determining the value of a particular contract" (Exhibit B-8, BCUC 1.4.6).

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For example, there is TGI's use of the Storage Facility to provide daily balancing at low or even zero marginal cost through TGI's ability "to alter supply by changing daily and intra-day nominations to meet downstream demand" (Exhibit C2-4, p. 4). Moreover, the ability of TGI to hedge against higher winter prices by injecting summer gas into storage during the time of the lowest priced summer months provides an important value proposition to TGI and this value is determined by the summer/winter price differential.

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With respect to BCOAPO's interpretation that the recent 200 percent year over year price increase and TGI's inelastic response indicates that Unocal can exercise market power (BCOAPO Argument, Critique, p. 4), the Commission Panel notes that, in the case of the service provided to TGI, namely winter term service, the product is the gas supplying the seasonal average demand and TGI's alternative to purchasing this gas in the summer and

injecting it into storage is to purchase a forward contract. The Commission Panel notes that, in large measure, the price increase of the storage service reflected the cost of the forward contract.

In considering whether to grant Unocal's request for an exemption from all parts of the Act, the Commission Panel notes that an exemption may be provided to a public utility when it can demonstrate that it cannot exert market power because of the competitive marketplace that it operates in or because of the contractual arrangements that it has entered into.

The Commission Panel, in considering the CEA and IGC reports, is not persuaded that Unocal is neither a monopoly nor does it exercise market power in its operation of the Storage Facility as a provider of price hedging and short-term peaking service and as an alternate supply.

However, in considering both the CEA and IGC reports, and the Critique, the Commission Panel finds evidence for the existence of the ability to exert market power in serving the differentiated market of seasonal term supply and notes that, particularly in the quantities contracted for by TGI, there are no other viable alternatives in the short-term that would provide TGI with the same flexibility of supply.

While Unocal has not provided persuasive evidence for the existence of a competitive environment for all of the services that it provides, the Commission Panel nevertheless notes that the parties entering bilateral negotiations have at their disposal price information concerning substitutes and alternatives and that they base their decisions on whether or not to contract for service based on their analysis of this information.

An exemption from all provisions of the Act, if granted, would remove the opportunity for contracting parties to seek recourse from the Commission if their analyses shows that they are the subject of discrimination resulting from Unocal wielding market power. The Commission Panel concludes that it is in the public interest to preserve the ability for parties wanting to contract for service and parties, such as the ratepayers of TGI, that are directly and materially affected by the terms and conditions of the storage contracts entered into by Unocal and TGI to request intervention by the Commission if storage service at Aitken Creek is not provided at just and reasonable rates.

Accordingly, the Commission determines that the requested exemption from all provisions of the Act pursuant to Section 88(3) would not serve the objects and purpose of the Act and would not be in the public interest.

2.3 Should Unocal at Aitken Creek be Actively Regulated

2.3.1 Background

This Section will address Issue 3: "Should Unocal, in its operation of the Storage Facility, be actively regulated?" Active regulation refers to full regulation under the sections of Part III of the Act, which deals with the regulation of public utilities. An exemption under Section 88(3) from provisions of the Act would serve the objects and purposes of the Act if it can be shown that all customers will continue to receive safe and reliable service at rates that are just and reasonable. The Commission Panel acknowledges the different points of view on how rates are judged to be just and reasonable. Cost of service is the most widely accepted yardstick for judging whether or not rates are reasonable; rates found to be far in excess of cost are vulnerable to an allegation of unreasonableness. However, other factors, such as the value of the product or service may also be taken into account. While not referred to in argument in these proceedings, the following cited reference discusses the relevance of both points of view:

> "While the relevance of cost is conceded by economists and interest group representatives alike, the contention is also made that under certain conditions value also should be taken into account. According to these views, the very nature of a cost standard gives it limitations that preclude its acceptance as the sole measure of reasonable public utility rates" (Bonbright, Principles of Public Utility Rates, 1988, p. 125).

The Commission Panel accepts that the recent price increase of 200 percent does not by itself provide persuasive evidence that Unocal can exercise market power. However, it does raise the issue of whether it is in the public interest that Unocal, as operator of a low cost alternative to forward gas contracts, captures all of the value. Unocal has become the low cost provider of seasonal term supply to the customers of TGI by virtue of owning the only underground storage facility in B.C. The question for consideration then is whether or not the value of a unique resource that is able to offer a low cost seasonal term supply should flow in part to the storage contract holders as well as, ultimately, to the customers of TGI given that this value is only realizable through the continued availability and financial viability of storage at the Storage Facility.

To answer this question, the Commission Panel must weigh the potential benefits of active regulation; namely a re-distribution of the benefits that the only natural gas storage reservoir in B.C. confers to the producing sector, Unocal, storage contract holders, and the customers of TGI; with the cost, complexity and risk of establishing a regulatory framework, cost based or otherwise, that would achieve the objects and purposes of the Act and the public interest.

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2.3.2 Positions of Parties

Unocal submits that the Commission should consider whether regulation of Unocal, as owner and/or operator of the Storage Facility, and the consequent associated costs and administrative burden for Unocal, its customers and the Commission, would serve the objects and purposes of the Act and be in the public interest (Exhibit B-1, p. 3). Unocal further submits that the Commission:

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> "…does not need to form a view with respect to whether the natural gas market will become more or less competitive in the future because the question for the BCUC to consider is whether continued high reliability and energy security in the natural gas supply sector should be provided by market response or by BCUC regulation" (Unocal Final Submission, p. 8).

Unocal also states that "the Government has always treated the Aitken Creek Storage Facility as part of B.C.'s competitive upstream producing sector" and that the Minister of Energy, Mines and Petroleum Resources ("MEMPR") 2002 Energy Plan, Policy Action 7 highlights continued Government support for a competitive producing sector (Unocal Application, p. 10):

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> "Policy Action #7 (ongoing) – High reliability and energy security will be maintained through well-functioning natural gas markets and coordinated electricity planning."

With regard to safe and reliable service, Unocal accepts that regulation under Part III of the Act extends to safety and reliability matters. However, Unocal submits that the safety and reliability of the Storage Facility are already regulated by either the MEMPR or the Oil and Gas Commission under the Petroleum and Natural Gas Act and the existing Disposition Order (Exhibit B-1, pp. 6-9) and therefore regulation under the Act for this purpose would be unnecessary and duplicative.

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Finally, Unocal submits that the uncertainty and regulatory burden of active regulation as well as complaint based regulation could be detrimental to the willingness of Unocal and others to invest in storage facilities in B.C. and that the prospect of addressing unfounded complaints by direct and indirect customers would place an additional burden on the company (Unocal Reply, p. 10). Unocal further submits that "if it ever attempts, or has ever attempted, to exercise uncompetitive behaviour it would be subject to the provisions of the federal *Competition Act*" (Unocal Final Submission, p. 10).

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Powerex notes:

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> "…the absence of any evidence to suggest that regulation of the price, terms and conditions of service would serve to foster a fair and competitive natural gas market. In a competitive market, the Commission may be unable to set rates, terms and conditions of service while, at the same time, ensuring fair and reasonable compensation to Unocal" (Powerex Final Submission, para. 6).

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Powerex agrees with Unocal that it should be exempt from all provisions of the Act with respect to its operation of the Storage Facility.

TGI submits that there have not been significant enough changes in the natural gas markets or regional infrastructure to warrant active regulation by the Commission of Unocal in its operation of Storage Facility. TGI also submits that, should the facility be regulated on a cost of service basis, and should the effect of this result in prices for storage service that were less than the natural gas summer/winter differential, then TGI may find itself competing for storage contracts with natural gas marketers and producers who would capture the value of the storage as determined primarily by the summer/winter gas price differential (TGI Final Submission, para. 25). TGI gives as an example JPS, which is regulated by FERC on a cost of service basis. Because JPS is fully subscribed, shippers who hold storage capacity in excess of their requirements will typically bundle the excess capacity with transportation and offer a synthetic storage service at market based rates (Exhibit C2-3, p. 12). Finally, TGI submits that rates may be determined by market forces and yet remain just and reasonable:

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> "However, rates or prices need not be determined through a regulatory process and be cost-based to be reasonable. Cost based rates are only a surrogate for prices that would occur in a competitive market place, and prices (rates) that are set by competitive forces in a functioning competitive market are, as a result of [that] process, reasonable" (Exhibit C2-4, p. 2).

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The BCOAPO maintains that:

> "…regulation is a desirable and necessary default to ensure the protection of the public once a company like Unocal has been designated a public utility and that regulation is required unless an applicant puts forward compelling evidence satisfying the necessary preconditions for exemption (BCOAPO Argument, p. 5).

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The BCOAPO further submits that Unocal has not provided the evidence necessary to support its application for an exemption.

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2.3.3 Commission Determination

The Commission Panel notes that while the Storage Facility is unique in B.C. and that it does provide certain services, primarily seasonal term supply and balancing, which are not easily substituted for, the value of the service is itself determined in part by the unregulated forward summer/winter price differential of natural gas. Regulating rates on a cost of service basis therefore runs the risk of creating the mixed market conditions that TGI has described, with the effective result being that storage capacity priced below the summer/winter differential could, through a secondary market (and absent renewal rights embedded in existing contracts), be available to TGI and others at prices that reflect the summer/winter differential.

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The Commission Panel agrees with TGI that rates that are based on competitive forces may be just and reasonable. However, the Commission Panel notes that the existence of competitive forces may not, in and of itself, be sufficient to demonstrate that the rates are just and reasonable. Therefore, while the Commission Panel accepts that the summer/winter gas price differential is one determinant of the value of the storage services that Storage Facility provides, it does not accept that this differential alone is an appropriate basis for assessing whether rates are just and reasonable.

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In regards to whether active regulation is in the public interest as measured by safe and reliable service, the Commission Panel notes that "TGI has never experienced an unscheduled interruption of supply from Aitken Creek" (Exhibit C2-3, p. 2). The Commission Panel accepts the Unocal position that its regulation under the *Petroleum and Natural Gas Act* generally addresses concerns regarding the technical reliability and safety of Aitken Creek Storage at this time. However, the Commission Panel distinguishes this form of reliability from reliable access on a non-discriminatory basis which remains under its jurisdiction.

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In regards to whether the provisions of the *Competition Act* are adequate to prevent uncompetitive behaviour by Unocal, the Commission Panel notes that any corporation, wherever incorporated, that carries on business in Canada, is subject to the *Competition Act.* Further, the *Competition Act* is enforceable notwithstanding any other Act, provincial or federal (*Competition Act*, Sections 46, 68, 73). In terms of Canadian principle and practice, there is no novelty in Unocal being subject to both the provincial *Utilities Commission Act* and the federal *Competition Act*.

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Accepting the position of TGI that regulating rates on a cost of service basis runs the risk of creating mixed market conditions, recognizing that the summer/winter gas price differential is a determinant of the value of the services provided by Unocal in its operation of the Storage Facility, acknowledging the fact that the public

interest in regards to the safe operation of the facility is adequately preserved at this time by regulation under the *Petroleum and Natural Gas Act*, and in the absence of specific concerns regarding the availability and reliability of storage services, **the Commission Panel therefore finds that active regulation of Unocal in its operation of the Storage Facility is not warranted at this time. Rather, regulation on a reporting or complaints basis is the appropriate method of regulation.**

2.4 What is the appropriate exemption for Unocal at Aitken Creek?

2.4.1 Background

This Section addresses Issue 4: "What is an appropriate exemption for the Storage Facility in the circumstances?" The Commission Panel, in its determination of whether or not to grant Unocal its requested exemption from all provisions of the Act, relies upon the test applied in Order No. G-41-06. In its examination of the positions put forth by Unocal, Powerex, TGI and the BCOAPO, it determined that the exemption, as applied-for, would not serve the objects and purposes of the Act nor would it be in the public interest.

The Commission Panel has found that active regulation of Unocal in its operation of the Storage Facility is not warranted at this time.

Therefore, the issue for determination is the nature and extent of an exemption for Unocal, in respect to the Storage Facility, that would serve the objects and purposes of the Act and be in the public interest. If an exemption from all provisions of the Act is not approved, some more limited exemption may be appropriate. For example, as discussed in Section 1.3, the Commission previously granted Canadian Natural Resources Limited an exemption from Part III of the Act for the West Stoddart plant and facilities that are used to transport or process natural gas for other parties. The Commission has granted similar exemptions for a number of other midstream facilities that transport or process natural gas, and regulates these facilities on a reporting or complaint basis.

2.4.2 Positions of Parties

Unocal submits that:

> "…taken together, the absence of a natural monopoly or market power, the history of regulation of the Aitken Creek facility and the current provincial policy with respect to storage all support the conclusion that regulation of Unocal Canada in respect of the Aitken

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> Creek storage facility would not serve the objectives and purposes of the UCA or the public interest" (Unocal Final Submission, p. 15).

However, Unocal agrees with the Commission that:

> "the BCUC's regulation of certain gas transportation and processing facilities on a reporting or complaint basis is consistent with Unocal Canada's statement on Provincial policy of supporting a competitive unregulated upstream producing sector in B.C." (Exhibit B-8, BCUC 1.6.1).

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Unocal's position is that the alternative to active regulation is the Commission's existing complaint-based regulatory model as an alternative process to pre-filed rate approval with cost-based rates being the end result (Unocal Reply, p. 7; Exhibit B-8, BCUC 1.6.2).

Powerex supports Unocal's position that it be exempt from all provisions of the Act in its operation of the Storage Facility.

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TGI submits that if an exemption is granted to Unocal, the exemption will forever remove Unocal's operation of the Storage Facility from the possibility of regulatory oversight (TGI Final Submission, para. 31). Therefore, TGI requests that the Commission not grant an exemption to Unocal, but also requests that Unocal should not be actively regulated at this time. This would preserve the ability of a customer to file a complaint with the Commission if an abuse of market power occurred (TGI Final Submission, para. 33, 34). Furthermore, in examining such a complaint, TGI submits that the issue for determination should be whether or not Unocal's rates appropriately reflect competitive forces (TGI Final Submission, para. 36).

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The BCOAPO is opposed to an exemption stating that there is insufficient justification on record due to "Unocal's inability or unwillingness to provide information, which BCOAPO submits would be readily available were it operating as a price taker in a competitive market" (BCOAPO Argument, p. 6).

2.4.3 Commission Determination

The Commission Panel has determined that the requested exemption from all provisions of the Act would not serve the objects and purposes of the Act and would not be in the public interest.

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Previous Orders approving exemptions from some of the provisions of the Act have generally preserved the Commission's ability to make examinations and inquiries to keep itself informed about, among other things, the conduct of the public utility's business (Section 24) and to order improved service if it finds, either after a hearing on its own motion or after receiving a complaint, that the service of the public utility is unreasonable, unsafe, inadequate, or unreasonably discriminatory (Section 25). In cases where such an exemption has been granted for midstream facilities, the facilities have been production plants serving the needs of the upstream natural gas industry. While these facilities may be able to exercise market power, they do so in a limited market consisting of a limited number of relatively sophisticated participants. Moreover, since a producer whose gas is stranded behind a third party production facility has very few if any alternatives to processing his gas, the establishment of what constitutes fair and reasonable rates is more easily determinable. Previously, the Commission has determined that the complaint based regulation defined by an exemption from all provisions of Part III of the Act, except save for Sections 24 and 25, has been adequate to ensure that the interest of the public has been maintained.

It should be noted that since previous exemptions granted to midstream facilities have not required the filing of service contracts or rates nor has the Commission in those cases made any determination as to whether or not fair and reasonable rates should be either cost-based or market-based, it does not follow, as Unocal submits, that a complaint based regime will necessarily result in cost-based rates.

The Storage Facility differs from facilities previously granted exemptions in that it, through providing the majority of the seasonal term supply to the customers of TGI, has a broad user community. In addition, an evaluation of the nature and types of substitutes is more complex than those available to a customer of a gas transporter and processor.

While the Commission Panel finds that these differences do not rule out complaint based regulation, it finds that the complaint based regulatory regime applied previously must be adjusted in this case to address the circumstances unique to Storage Facility. The Commission Panel concludes that it will seek LGIC approval for granting a limited exemption and, subject to receiving LGIC approval, will institute a complaint based regulatory regime based on an exemption from certain provisions of Part III of the Act.

Recognizing that the Commission is to keep itself informed about the conduct of utility business, the following sections will not be included in the request for a partial exemption submitted to the LGIC for approval:

Section 24 Commission must make examinations and inquiries

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Section 43 Duty to provide information

While there is insufficient evidence to reach a determination about the overall existence, or lack of market power, it is clear that the Storage Facility provides a valuable service to the public and that TGI would find it difficult and expensive, if not impossible, to find viable alternatives to several of the variety of services that it obtains through its Aitken Creek storage service contracts. This is a significant factor which supports the Commission's decision to deny Unocal's request for an exemption from all provisions of the Act. For similar reasons, the Commission concludes that Unocal should not be exempted from the provisions of Part III that ensure that suitable storage service will remain available in the future. In the request to the LGIC for approval to exempt Unocal from certain provisions of Part III of the Act, the Commission will not seek approval to exempt Unocal from the following sections:

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Section 25	Commission may order improved service
Section 38	Public utility must provide service
Section 39	No discrimination or delay in service
Section 41	No discontinuance without permission
Section 42	Duty to obey orders
Section 52	Restraint on disposition
Section 53	Consolidation, amalgamation and merger
Section 54	Reviewable interests

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Section 41 refers to the situation where a public utility has been granted, or has been deemed to have been granted, a Certificate of Public Convenience and Necessity ("CPCN"). By Order No. G-107-06 dated September 8, 2006, the Commission granted Unocal "a CPCN on an interim basis for the operation of the Aitken Creek Storage Facility as it currently exists, with the CPCN to be effective until Unocal's exemption order application is resolved or the Commission makes another determination on the matter of a CPCN".

In the application leading to Order No. G-107-06, Unocal requested that the Commission delay any process on the application for a CPCN for the operation of the Storage Facility until the exemption order application is resolved. Therefore, the CPCN granted on an interim basis will continue in effect after the exemption order is resolved and until a further determination on the CPCN is made by the Commission.

Commission Orders that exempt midstream facilities transporting or processing natural gas from Part III regulation, usually exempt the public utility from the requirement for the filing and approval of service contracts as rate schedules, and also the requirement making the schedules available for public inspection, at least until a complaint is received from an interested party. The Commission concludes that this approach would be suitable for the service contracts and rates for most customers and potential customers of Unocal, as it generally avoids significant Commission oversight and disclosure of commercially sensitive information unless an interested party initiates a complaint.

Therefore, the Commission Panel will request LGIC approval to exempt Unocal from Sections 58 through 64 of Part III that deal with rates and rate schedules. In the event of a complaint from an interested party, it may be necessary for the Commission to consider varying or rescinding portions of the proposed exemption to be granted, pursuant to Section 99 of the UCA.

However, a concern arises with respect to the interests of persons who do not contract directly with Unocal, but nevertheless whose interests are affected by the rates and other terms of a storage contract with Unocal. For example, ratepayers represented by the BCOAPO whose interests are affected as TGI applies pursuant to Section 61(4) to flow through increases in its storage costs to end use customers. The Commission Panel considers that the mechanism for regulation on a complaint basis should provide parties whose interests are affected with the ability to initiate a complaint about the terms and conditions for storage service at the Storage Facility. However, the Commission Panel also recognizes the confidential nature of the commercial arrangements that Unocal has entered into with its customers and realizes that it must strike a balance between upholding this confidentiality, while at the same time granting affected parties, such as represented by the BCOAPO, access to

information that will allow them to make an informed opinion on the reasonableness of the storage charges that will be recovered through their TGI rates.

To deal with these concerns, the Commission Panel is of the view that the development of the details of this mechanism would benefit from further discussions and submissions from affected persons, and intends generally to leave the determination of the mechanism to a future Order if necessary.

The Commission concludes that it should approve an exemption for Unocal from Part III of the Act except for Sections 24, 25, 38, 39, 41, 42, 52, 53, and 54 for the Storage Facility. It otherwise denies the request for an exemption from the remaining sections of the Act. Unocal will continue to be subject to the Act with respect to the Storage Facility on a complaint basis.

In this Decision, the Commission Panel has expressed its intention to issue an Order responding to the Application exempting Unocal from some provisions of Part III dealing with the regulation of public utilities. It otherwise denies the request for an exemption from the remaining provisions of the Act. A draft Order is attached as Appendix I to this Decision. In Section 3.0 the Commission Panel discusses how the service agreements currently having interim approval are to be dealt with and clarifies the requirements of Unocal pursuant to the provisions of the interim regulatory regime effective until an Order responding to the Application and establishing a partial exemption for Unocal for its operation of the Storage Facility has been issued.

3.0 INTERM REGULATORY REGIME

Commission Orders No. G-107-06 and G-128-06 accepted for filing on an interim basis pursuant to Sections 59, 61, 90 and 91 several Firm Natural Gas Storage Agreements, effective September 1 and November 1, 2006, respectively. The requested exemption for Unocal is to be prospective from the date of the exemption Order. Therefore, the status of these agreements needs to be addressed under the provisions of Part III of the Act. The proposed Order responding to the Application provides persons who have contracted with Unocal under each of these service agreements and other persons whose interests are affected by the agreements, a period of 60 days from the date of the Order to file a complaint with the Commission regarding the terms of its agreement. If no complaint is received within 60 days, the rate schedule will be approved as a permanent rate. If a complaint is received within 60 days, the Commission will then consider the process to deal with the complaint.

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Until the draft order resulting from the determinations made in the Decision is approved by the Lieutenant Governor in Council, Unocal is to file new storage service agreements with the Commission pursuant to Sections 59, 61, 90 and 91 of the Act.

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