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BRITISH COLUMBIA UTILITIES COMMISSION

ORDER NUMBER G-1-09

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

and

An Application by Stargas Utilities Ltd.
for Acceptance of a Transaction Confirmation
under its Natural Gas Supply and Management Services Agreement
with Direct Energy Marketing Limited

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

January 15, 2009

O R D E R

WHEREAS:

A. By Order G-163-06 dated December 18, 2006, the British Columbia Utilities Commission (the "Commission") approved changes to rates for Stargas Utilities Ltd. ("Stargas"), effective November 1, 2006; and

B. By Order E-16-07 dated August 23, 2007, the Commission accepted for filing a Natural Gas Supply and Management Services Agreement (the "Agreement") between Stargas and Direct Energy Marketing Limited ("DEML") dated July 26, 2007; and

C. On August 31, 2008 Stargas requested approval of a $0.71/GJ increase in its gas commodity charges, which would increase the commodity component of its rates to $10.31/GJ for residential customers and to $10.52/GJ for commercial customers, effective November 1, 2008. Stargas' variable rates would become $18.06/GJ for residential customers and $18.27/GJ for commercial customers; and

D. On September 8, 2008 Stargas revised its application to request an increase of $0.51/GJ in its commodity charges; and

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E. By letter dated September 15, 2008, the Commission requested further information from Stargas, and Stargas responded to the Information Request on September 23, 2008; and

F. In its September 23, 2008 letter, Stargas included a Natural Gas Transaction Confirmation (the "Transaction Confirmation") dated September 5, 2008 that is Schedule A.02 to the Agreement. The Transaction Confirmation established a fixed price for most of the gas deliveries to Stargas for the period November 1, 2008 to November 1, 2009; and

G. On October 3, 2008 DEML, on behalf of Stargas, provided further information which indicates that the fixed price in the Transaction Confirmation is made up of the forward market price of gas at Sumas as of September 5, 2008, plus a significant DEML "Margin"; and

H. By correspondence dated October 23, 2008, Stargas withdrew its application for a change to its commodity rates effective November 1, 2008, on the basis that the additional gas costs starting November 1, 2008 would accumulate in its Gas Cost Variance Account for recovery from ratepayers in subsequent years; and

I. By correspondence dated October 24, 2008, Stargas provided information regarding billings for gas deliveries while the Transaction Confirmation is under review by the Commission; and

J. By Order G-159-08 dated October 30, 2008, the Commission established a Written Public Hearing and Regulatory Timetable to review whether the Transaction Confirmation is in the public interest; and

K. DEML registered as an Intervenor in the proceeding; and

L. On December 8, 2008 Stargas filed its Final Submission. No Intervenor filed a Final Submission and Stargas did not file a Reply Submission; and

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M. The Commission has considered the evidence and submissions, and concludes that it should make a determination with regard to the Transaction Confirmation, and such Reasons for Decision that is attached as Appendix A to this Order.

NOW THEREFORE the Commission orders as follows:

1. The Commission does not accept the Transaction Confirmation as an Energy Supply Contract filed pursuant to Section 71 of the Utilities Commission Act (the "Act"), and finds, pursuant to subsection 71(2) of the UCA that the Transaction Confirmation is not in the public interest and, pursuant to subsection 71(3) of the UCA declares that the Transaction Confirmation is wholly unenforceable.

2. Stargas is directed, when in future it files a Fixed Price or a DEML Pool Price agreement for gas purchases, to explicitly state whether the price entirely and only represents market prices, to identify any fees or charges that are included in the price and to fully justify all components of the price.

DATED at the City of Vancouver, in the Province of British Columbia, this 15th day of January 2009.

BY ORDER

Original signed by:

Dennis A. Cote
Commissioner

Attachment

An Application by Stargas Utilities Ltd.
for Acceptance of a Transaction Confirmation
under its Natural Gas Supply and Management Services Agreement
with Direct Energy Marketing Limited

REASONS FOR DECISION

1.0 INTRODUCTION

On September 23, 2008, Stargas Utilities Ltd. ("Stargas") filed with the British Columbia Utilities Commission (the "Commission") a Natural Gas Transaction Confirmation (the "Transaction Confirmation") dated September 9, 2008 that is Schedule A.02 to the Natural Gas Supply and Management Services Agreement (the "Agreement") between Stargas and Direct Energy Marketing Limited ("DEML") dated July 26, 2007 (Exhibit B-2).

The Transaction Confirmation was filed in the Commission's review of Stargas' August 31, 2008 application to increase its gas commodity rates. As Stargas subsequently withdrew its request for a rate increase, Order G-159-08 established a written public hearing for the sole purpose of reviewing the Transaction Confirmation.

As background to the matter, Commission Letter L-62-06 dated October 5, 2006 was issued in response to a request by Stargas for guidance from the Commission regarding its plans to fix the price of a portion of its gas purchases. The Letter stated:

> "With regard to locking in commodity prices for up to 80 percent of purchase volumes for three to five years, the Commission considers this to be a relatively aggressive hedging strategy but accepts the strategy in the current market conditions, providing Stargas surveys the opportunities to fix prices that are available to it and confirms that the fixed price it obtains is market competitive."

2.0 TRANSACTION CONFIRMATION AND ISSUES

The Transaction Confirmation amends the terms of the Agreement for the period from November 1, 2008 to November 1, 2009 by establishing a fixed price of Canadian $8.98/GJ for the delivery of specified monthly quantities (Exhibit B-2). Stargas states that the monthly quantities represent 90 percent of 2008 deliveries (Exhibit B-1-1). Stargas also states that, with anticipated customer additions, the fixed price quantity is approximately 80 percent of expected 2009 deliveries. Stargas further observes that fixing the price of 80 percent was accepted in the 2008 hedging program (Exhibit B-2, p. 5).

Section 71 of the Utilities Commission Act (the "UCA") states that an energy supply contract for the sale of natural gas to a public utility must be filed with the Commission. The definition of energy supply contract in section 68 of the UCA includes an amendment to an energy supply contract. Section 71 is Attachment 1 to these Reasons for Decision. Subsection 71(2) states that the Commission may make an order under subsection 71(3) if, after a hearing, it determines that an energy supply contract is not in the public interest. Subsection 71(3) states that the Commission may declare the contract unenforceable in whole or in part, or make any other order it considers advisable.

Subsection 71(2.1) lists several factors that the Commission must consider when determining if an energy supply contract is in the public interest, including:

(e) the quantity of the energy to be supplied under the contract,

(h) in the case only of an energy supply contract that is entered into by a public utility, the price of the energy referred to in paragraph (e).

The Commission considers that fixing price for 90 percent or even 80 percent of expected gas purchases is certainly on the high end of prudent risk management. The events of fall 2008 when prices for natural gas and competing fuels like propane continued to fall strongly after September 5, 2008 provides a graphic illustration that a fixed price hedging strategy modifies but does not eliminate price risk. In future, as will be discussed later, Stargas should obtain Commission acceptance of its price risk management hedging plan prior to implementing the plan.

Nevertheless, in recognition of Letter L-62-06 and considering that the Commission did not raise objections when Stargas fixed the price of 80 percent of expected purchases for the period ending October 2008, the Commission does not take issue with the quantity of natural gas that Stargas hedged using the Transaction Confirmation. Therefore, the outstanding issue in this review is the fixed price that is set out in the Transaction Confirmation.

3.0 TRANSACTION CONFIRMATION FIXED PRICE

Under the Agreement and in the absence of the Transaction Confirmation, DEML commits to provide Stargas with the gas it requires at an Index Price (Exhibit B-7, BCUC IR 2.1, 2.2, 2.3). Stargas estimates that with current rates a Gas Cost Variance Account ("GCVA") credit balance of $597 will result at the end of May 2009 (Exhibit B-7, BCUC IR 3.2).

With the Transaction Confirmation in effect, Stargas forecasted that the GCVA would have a credit balance of $68 at the end of May 2009 (Exhibit B-2). However, the latter number includes Terasen Gas Inc. ("Terasen") charges of $48,985 for June 2008 through May 2009, calculated using a Delivery Charge of $0.0494/GJ for 2008. The response to BCUC IR 3.1 in Exhibit B-7 estimated Terasen charges of $66,263 for the same period using a Delivery Charge of $0.494/GJ for 2008. The Rate Schedule 25 Delivery Charge for the Terasen Inland Service Area for 2008 was in fact $0.494/GJ. Therefore, the Commission estimates that price in the Transaction Confirmation would result in a deficit balance in the GCVA of approximately $17,210 at the end of May 2009. That is, gas costs are forecast to be lower with indexed prices.

DEML filed evidence on behalf of Stargas that indicates the fixed price of $8.98/GJ in the Transaction Confirmation is made up of two components. The price of the actual physical block of gas that DEML purchased on behalf of Stargas on September 5, 2008 is $8.6142/GJ. This cost is the quantity-weighted average of the individual monthly prices for the period November 2008 through October 2009. The remaining difference of $0.3658/GJ is referred to as the DEML Margin (Exhibit B-3, Comparative Price Summary).

<u>Physical Purchase Price</u>

DEML provided information about the Sumas Monthly Index as of September 5, 2009 which indicates a weighted average price of $8.589/GJ (Exhibit B-3, Comparative Price Summary). This price is based on the posted NYMEX monthly indices, basis differential to the Sumas trading point and Sumas physical swap differential. DEML also adjusted the numbers for the conversion from MMBtu to gigajoules and for the US to Canadian dollar exchange.

The Commission accepts this as an acceptable methodology to estimate forward market prices for natural gas at Sumas at a point in time. There can be debate about the specific factors used in the calculation, but the Commission does not have reason to take issue with the Sumas Monthly Index price of $8.589/GJ that resulted from the calculation.

The weighted average price of $8.6142/GJ at which DEML contracted physical gas for Stargas is reasonably close to the calculated Monthly Index price. The Commission recognizes that an index price represents a range of actual transacted prices, and that a negotiated gas price should be consistent with, but may not necessarily be exactly equal to the corresponding price index for that day. Therefore, the Commission accepts the DEML physical price of $8.6142/GJ as representative of the weighted average market price of gas at Sumas on September 5, 2008.

<u>DEML Margin</u>

The Natural Gas Supply and Management Services Agreement between DEML and Stargas provides DEML with a Service Fee of $0.10/GJ. The Service Fee covers all the services provided by DEML (Exhibit B-3; Exhibit B-7, BCUC IR 1.1, 1.2).

Stargas submits that the $0.10/GJ fee is neither full nor fair compensation for the services provided by DEML. Stargas argues if the Transaction Confirmation is approved, DEML will receive a total fee of $15,229 for deliveries under that agreement, and that this is reasonable, if not yet sufficient, compensation for the services provided by DEML (Stargas Final Submission).

Stargas goes on to submit that the Commission should view the Transaction Confirmation arrangement on a prospective basis as at the time of September 5, 2008, and avoid an inappropriate use of hindsight. Stargas also argues that it acted in good faith in agreeing to the Transaction Confirmation, in the belief that it was insulating its customers from price volatility and the potential for hurricanes to result in higher gas prices. Stargas also expected that stable gas rates would strengthen its competitive marketing position and enable it to convince bottled propane customers in the area to convert to natural gas (Stargas Final Submission). DEML made similar submissions (Exhibit B-3).

The Commission is not persuaded that the fee for the services that DEML provides should be more than \$0.10/GJ. Stargas states that the Service Fees in the current marketplace range from \$0.05 to \$0.09/GJ. This is the range of Gas Management Fees under Terasen Rate Schedule 14A (Exhibit B-7, BCUC IR 1.3, 1.4). However, if Stargas and DEML believe the \$0.10/GJ Service Fee in the Agreement is no longer appropriate, Stargas can file an amendment to the Agreement to revise the fee. Such a filing should include proper justification of the new fee, relative to fees that are currently being charged in the gas marketplace. In order to test current market conditions, Stargas may wish to seek competitive bids for its gas supply business.

The issue in this review of the Transaction Confirmation is whether it is appropriate, necessary and prudent for Stargas to pay an additional fee to DEML that is not provided for in the Agreement. Moreover, neither the Agreement nor the Transaction Confirmation provide any hint that such a fee is included in the fixed price of \$8.98/GJ. It is not clear whether Stargas was aware that that the price included the additional DEML Margin. Certainly the Commission did not realize that a fixed price under the Agreement would include anything more than the market cost of arranging a fixed price supply. The Commission's views are clear in Letter L-62-06, which stated that Stargas was to confirm that a fixed price was market competitive.

It is clear that the role of DEML is broader than simply the sale of gas to Stargas. This is evident from the name of the Agreement and the services provided under it, and the extent to which Stargas relies on DEML for information about gas markets and advice about its gas supply activities. In this situation and considering the complexities of gas markets, DEML has a responsibility to be fully clear and transparent in its pricing policies. At this time, only public utilities are required to file natural gas energy supply contracts with the Commission, while commercial and industrial customers and municipalities are not. The Commission believes that DEML would be well advised to review its business practices, so that all fees are clear, transparent and explicit.

The Commission has concerns with the willingness of Stargas to accept and pay the additional DEML Margin, with the expectation that the additional cost will be fully recovered from its ratepayers. While relying on DEML's gas supply expertise, Stargas needs to maintain a critical oversight on its gas buying activities. In particular, gas commodity transactions and cost filings need to clearly distinguish between market costs and other charges that the utility will seek to recover. **Therefore, Stargas is directed, when in future it files a Fixed Price or DEML Pool Price agreement for gas purchases, to explicitly state whether the price entirely and only represents market prices, to identify any fees or charges that are included in the price and to fully justify all components of the price.**

One consideration when reviewing whether the arrangement is in the public interest is the situation that will result if the Commission does not accept the Transaction Confirmation for filing. It seems clear that the Agreement continues in effect, providing Stargas with the gas it requires at an Index Price (Exhibit B-7, BCUC IR 2.1, 2.2, 2.3). While customers will be at risk of future increases in gas prices, gas supply and supply reliability under the Agreement should not be affected.

The Commission cannot find sufficient justification for the fixed price of $8.98/GJ, particularly for the DEML Margin component. There is no reason for Stargas to agree to pay a fixed price that is higher than the market price that was current at the time the price was negotiated. It would not be in the public interest for Stargas to incur unnecessary costs to buy gas.

Under Section 71 of the UCA, the Commission is largely limited to accepting or rejecting the terms of an energy supply contract as filed; it cannot modify the contract. **Therefore, the Commission does not accept the Transaction Confirmation as an Energy Supply Contract filed pursuant to Section 71 of the UCA, and finds, pursuant to subsection 71(2) of the UCA that the Transaction Confirmation is not in the public interest and, pursuant to subsection 71(3) of the UCA declares that the Transaction Confirmation is wholly unenforceable.**

4.0 SITUATION GOING FORWARD

With the Transaction Confirmation not enforceable, the Agreement continues in effect and the Index Price terms are in effect. Current gas prices and forward prices are somewhat lower than September 5, 2008 prices, but ratepayers are exposed to the risk of price increases in the future. Stargas and DEML could negotiate a new fixed price agreement and file it for Commission acceptance. However, the price in a new agreement would need to be consistent with current lower forward market prices.

At the same time, the Commission accepts the submissions of both Stargas and DEML that they were acting in the best interests of Stargas customers when they agreed to the fixed price arrangement on September 5, 2008. Furthermore, the Commission notes Stargas' desire to avoid an additional financial burden (Stargas Final Submission). Since its basis for finding that the Transaction Confirmation is not in the public interest relates to the DEML Margin, in these particular circumstances the Commission anticipates that it would be prepared to accept for filing an agreement similar to the Transaction Confirmation providing it includes a fixed price that does not exceed $8.62/GJ and is submitted within 30 days of the date of the Order that accompanies these Reasons for Decision.

Stargas also requests clarification of the Commission's regulatory requirements (Stargas Final Submission). The regulatory requirements for the approval of the commodity components of gas utility rates are summarized in the Commission's September 15, 2008 letter, and Section 71 of the UCA and the Rules for Natural Gas Energy Supply Contracts were enclosed with the letter.

Larger gas utilities like Terasen file annual Gas Contract Plans and Price Risk Management Plans for Commission acceptance prior to entering into contracts with suppliers. It would be helpful if Stargas were to adopt a much abbreviated form of this practice, particularly with respect to its hedging plans. As an example, Stargas sought the Commission's guidance in 2006 regarding its plans to fix prices for a portion of its purchases and the Commission responded with Letter L-62-06.

If Stargas has further questions regarding the Commission's regulatory requirements, it should raise the questions with Commission staff or formally with the Commission Secretary.

Energy supply contracts

71 (1) Subject to subsection (1.1), a person who, after this section comes into force, enters into an energy supply contract must

(a) file a copy of the contract with the commission under rules and within the time it specifies, and

(b) provide to the commission any information it considers necessary to determine whether the contract is in the public interest.

(1.1) Subsection (1) does not apply to an energy supply contract for the sale of natural gas unless the sale is to a public utility.

(2) The commission may make an order under subsection (3) if the commission, after a hearing, determines that an energy supply contract to which subsection (1) applies is not in the public interest.

(2.1) In determining under subsection (2) whether an energy supply contract is in the public interest, the commission must consider

(a) the government's energy objectives,

(b) the most recent long-term resource plan filed by the public utility under section 44.1, if any,

(c) whether the energy supply contract is consistent with requirements imposed under section 64.01 or 64.02, if applicable,

(d) the interests of persons in British Columbia who receive or may receive service from the public utility,

(e) the quantity of the energy to be supplied under the contract,

(f) the availability of supplies of the energy referred to in paragraph (e),

(g) the price and availability of any other form of energy that could be used instead of the energy referred to in paragraph (e), and

(h) in the case only of an energy supply contract that is entered into by a public utility, the price of the energy referred to in paragraph (e).

(2.2) Subsection (2.1) (a) to (c) does not apply if the commission considers that the matters addressed in the energy supply contract filed under subsection (1) were determined to be in the public interest in the course of considering a long-term resource plan under section 44.1.

(2.3) A public utility may submit to the commission a proposed energy supply contract setting out the terms and conditions of the contract and a process the public utility intends to use to acquire power from other persons in accordance with those terms and conditions.

(2.4) If satisfied that it is in the public interest to do so, the commission, by order, may approve a proposed contract submitted under subsection (2.3) and a process referred to in that subsection.

(2.5) In considering the public interest under subsection (2.4), the commission must consider

(a) the government's energy objectives,

(b) the most recent long-term resource plan filed by the public utility under section 44.1,

(c) whether the application for the proposed contract is consistent with the requirements imposed on the public utility under sections 64.01 and 64.02, if applicable, and

(d) the interests of persons in British Columbia who receive or may receive service from the public utility.

(2.6) If the commission issues an order under subsection (2.4), the commission may not issue an order under subsection (3) with respect to a contract

(a) entered into exclusively on the terms and conditions, and

(b) as a result of the process

referred to in subsection (2.3).

(3) If subsection (2) applies, the commission may

(a) by order, declare the contract unenforceable, either wholly or to the extent the commission considers proper, and the contract is then unenforceable to the extent specified, or

(b) make any other order it considers advisable in the circumstances.

(4) If an energy supply contract is, under subsection (3) (a), declared unenforceable either wholly or in part, the commission may order that rights accrued before the date of the order under that subsection be preserved, and those rights may then be enforced as fully as if no proceedings had been taken under this section.

(5) An energy supply contract or other information filed with the commission under this section must be made available to the public unless the commission considers that disclosure is not in the public interest.