BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-26-11

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

and

An Application by Terasen Gas Inc.
for Approval of a Gas Supply Mitigation Incentive Program
for the November 1, 2010 to October 31, 2013 Three-Year Period

BEFORE: L.F. Kelsey, Commissioner
D.A. Cote, Commissioner

February 23, 2011

O R D E R

WHEREAS:

A. The British Columbia Utilities Commission (Commission) by Order G-101-09 approved the continuance of the 2002/03 Gas Supply Mitigation Incentive Program (GSMIP) for the 2009/10 gas contract year with the understanding that the GSMIP be reviewed in 2010;

B. The 2009/10 GSMIP program expired on October 31, 2010;

C. On July 13, 2010 Terasen Gas Inc. (TGI) applied confidentially to the Commission for approval of a revised GSMIP for the November 1, 2010 to October 31, 2013 three-year period (the Application) and requested approval to include Southern Crossing Pipeline (SCP) related mitigation activities that accrue to the delivery margin. This change to GSMIP would impact transportation as well as sales customers of TGI;

D. Terasen Gas proposed a negotiated settlement process to deal with the Application and included a Proposed Regulatory Timetable in the Application;

E. By Order G-120-10, the Commission established a Regulatory Timetable which invited interveners to provide comments on the regulatory process;

F. In its Final submission dated September 27, 2010, TGI amended the Application by making a further revision to the Incentive Earned Formula;

G. By Order G-145-10, the Commission determined that the Application should proceed through a written hearing process;

H. TGI's Reply Submission on October 12, 2010 completed the written hearing process;

I. The Commission considers that the Application should be denied, that TGI should undertake a consultative review of GSMIP and that the GSMIP in effect for 2009/10 should be extended for one year commencing November 1, 2010 for the Reasons for Decision that are Appendix A to this Order.

NOW THEREFORE the Commission orders as follows:

1. The Application is denied.

2. The 2009/10 GSMIP as described in Order G-101-09 is continued for the November 1, 2010 through October 31, 2011 period.

3. TGI will establish a working group that will include representatives from TGI, Commission staff, and other parties which will meet commencing in March 2011 to discuss the objectives, Guiding Principles, structure and parameters of a GSMIP to commence November 1, 2011, and to explore ways to demonstrate, quantify and measure the extent to which the GSMIP objectives are achieved in order to determine the amount of future GSMIP incentive payments. Commission staff will be a full and active party in the working group.

4. Parties who have an interest in the matter and wish to participate in the working group should register with the Commission, in writing or electronic submission, by Friday, March 4, 2001. Parties should specifically state the nature of their interest in the matter and identify generally the nature of the issues that they intend to pursue during the working group discussion sessions.

5. Activities of the working group will be considered a proceeding for the purposes of the Participant Assistance/Cost Award (PACA) Guidelines and participants who intend to apply for PACA funding should file budgets for their participation in the working group by Monday, March 14, 2011.

6. TGI will file by April 1, 2011 terms of reference for the working group for review by the Commission and a schedule with milestones for the completion of the discussions.

7. If TGI wishes to apply for approval of a GSMIP commencing November 1, 2011, it will file an application with the Commission by August 2, 2011.

8. TGI will provide a copy of this Order to all parties that were registered interveners in the Terasen Gas Inc. 2010 and 2011 Revenue Requirements Application.

DATED at the City of Vancouver, in the Province of British Columbia, this 24th day of February 2011.

BY ORDER

Original signed by:

D.A. Cote
Commissioner

Attachments

IN THE MATTER OF

TERASEN GAS INC.

Gas Supply Mitigation Incentive Program
for the November 1, 2010 to October 31, 2013 Three-Year Period

REASONS FOR DECISION

February 23, 2011

BEFORE:

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D.A. Cote, Commissioner

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for Approval of a Gas Supply Mitigation Incentive Program
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REASONS FOR DECISION

1.0 DECISION OVERVIEW

In response to British Columbia Utilities Commission (Commission) Order G-101-09, in which the Commission determined that the Gas Supply Mitigation Incentive Program (GSMIP) should be reviewed in 2010, Terasen Gas Inc. (TGI or Terasen Gas or Company) submitted the subject GSMIP application on July 13, 2010 (Application). The proposed GSMIP contains an enhanced incentive formula to be applied to the Total Eligible Margin, includes all Southern Crossing Pipeline (SCP) net mitigation revenue in the calculation, and has a term of three years.

After a written hearing process to review the Application, the Commission determines that a properly structured GSMIP is likely to have benefits for customers as well as the shareholder of TGI. However, the Commission is not persuaded that the form of GSMIP proposed in the Application will have sufficient benefits, and denies the Application. The Commission directs that the GSMIP in effect for 2009/10 will be extended for one year commencing November 2010, and that TGI will establish a working group that includes representatives from TGI, Commission staff, and other parties to meet in early 2011 to revisit the objectives of GSMIP and to discuss the reformulation of the program to ensure alignment with the objectives. After the working group has completed its work, the Commission anticipates that TGI will file an application with the Commission by July 1, 2011 for a GSMIP commencing November 2011.

2.0 BACKGROUND

TGI has had a gas supply mitigation program in place since 1996 when Order G-98-95 approved a two year Off-System Incentive Program (OSIP). The current form of GSMIP has been in place since 2002 after TGI, British Columbia Public Interest Advocacy Centre (BCOAPO) and Commission staff negotiated an agreement on the methodology, terms and conditions for a gas supply mitigation incentive program for the 2002/03 gas contract year, which ran from November 1, 2002 to October 31, 2003. This GSMIP has been renewed with stakeholder support for subsequent years, and the 2009/10 GSMIP described in Order G-101-09 was substantially similar to the 2002/03 program. In this Decision, the 2009/10 GSMIP will be referred to as the current GSMIP.

From 2002/03 through 2008/09, TGI produced mitigation revenue that averaged $190 million per year, which was used to offset in part total gas supply costs that averaged $857 million per year (Exhibit B-2, BCUC 1.8.1). Most of the mitigation revenue results from the re-sale of excess gas supply, which generated an average of approximately $175 million per year over the period. Smaller amounts of mitigation revenue are produced using transportation, storage and other supply resources when they were not needed to serve TGI sales (core) customers (Exhibit B-1, pp. 22-27).

The incentive payment that TGI receives under the current GSMIP is not based on the total mitigation revenue produced in the year, but rather on the sum of the commodity re-sale margin (Eligible Commodity Re-Sale Margin) and the net revenue from the use of surplus transportation, storage and other mitigation activities (Eligible Transportation, Storage and Other Margin). This sum (Total Eligible Margin) is segmented into commodity re-sales, storage, transportation and other mitigation revenue. The Eligible Commodity Re-Sale Margin included in the Total Eligible Margin is based upon TGI's ability to exceed a market-based proxy for commodity costs. In this way, commodity re-sale revenue is normalized with respect to both the quantity of excess gas available for re-sale and gas market prices at the time. Except for some of the mitigation revenue associated with SCP, all net revenue from the use of surplus transportation, storage and other mitigation activities is included in the Eligible Transportation, Storage and Other Margin portion of the Total Eligible Margin.

In 2008/09, for example, commodity re-sales revenue was about $120 million, while the Eligible commodity re-sale margin was calculated to be $12.83 million. Adding transportation, storage and other mitigation revenue resulted in a Total Eligible Margin of $28 million and an incentive payment of $1.10 million. Over the 2002/03 to 2008/09 period, the Total Eligible Margin under GSMIP averaged $32 million per year and TGI received an incentive payment that averaged $1.14 million per year. (Exhibit B-1, pp. 24-5; Exhibit B-2, BCUC 1.8.1, 1.13.1)

The Objectives for the 2009/10 GSMIP were as follows:

1. **"Supply Security**: The plan should discourage any activity that might adversely affect the security of supply or total net gas costs.
2. **Alignment of Interests**: The plan should encourage Terasen Gas to maximize net revenues from its off-system business activities while maintaining security of supply.
3. **Fair and Reasonable Incentives**: The plan should be structured to encourage continued success in mitigation activities and to reward new substantial exertions by the company.
4. **Simplicity**: The plan should be structured in such a way that it minimizes administrative effort.
5. **Fair and Reasonable Performance Targets**: The plan should ensure that performance targets are just and reasonable, and that the level of incentive sharing corresponds to the level of excellence demonstrated by Terasen Gas' gas procurement and mitigation activities."

3.0 APPLICATION

By Order G-101-09, the Commission directed that the GSMIP "should continue unchanged for the 2009/10 gas year, considering that TGI proposes that GSMIP be reviewed in its entirety in 2010." The Application summarized the findings of TGI's review of GSMIP, and proposed an updated GSMIP to be put in place November 1, 2010. The proposed GSMIP was largely based on the structure of the 2009/10 GSMIP. It maintained the concept of basing the calculation of the incentive payment on Total Eligible Margin, and proposed no changes to how the commodity re-sales component of the Total Eligible Margin is calculated. The Application proposed the following key changes to the 2009/10 GSMIP:

- The sharing mechanism levels and percentages applied to the Total Eligible Margin will be changed.
- All net mitigation revenue generated using SCP and Westcoast Energy Inc.'s Transportation South (T-South) will be included in Total Eligible Margin.
- The term of the plan is extended from one to three years with a rolling three year renewal.

3.1 Sharing Mechanism Percentages

TGI proposed revising the Current Incentive Earned Formula shown below to the Proposed Incentive Earned Formula (Revised), which results is a higher incentive payment at higher levels of Total Eligible Margin.

Current Incentive Earned Formula

Total Eligible Margin	Incentive Payment
$0 to $20 million	5% of Total Eligible Margin
Amount greater than $20 million	1.25% of Total Eligible Margin

Proposed Incentive Earned Formula in Application

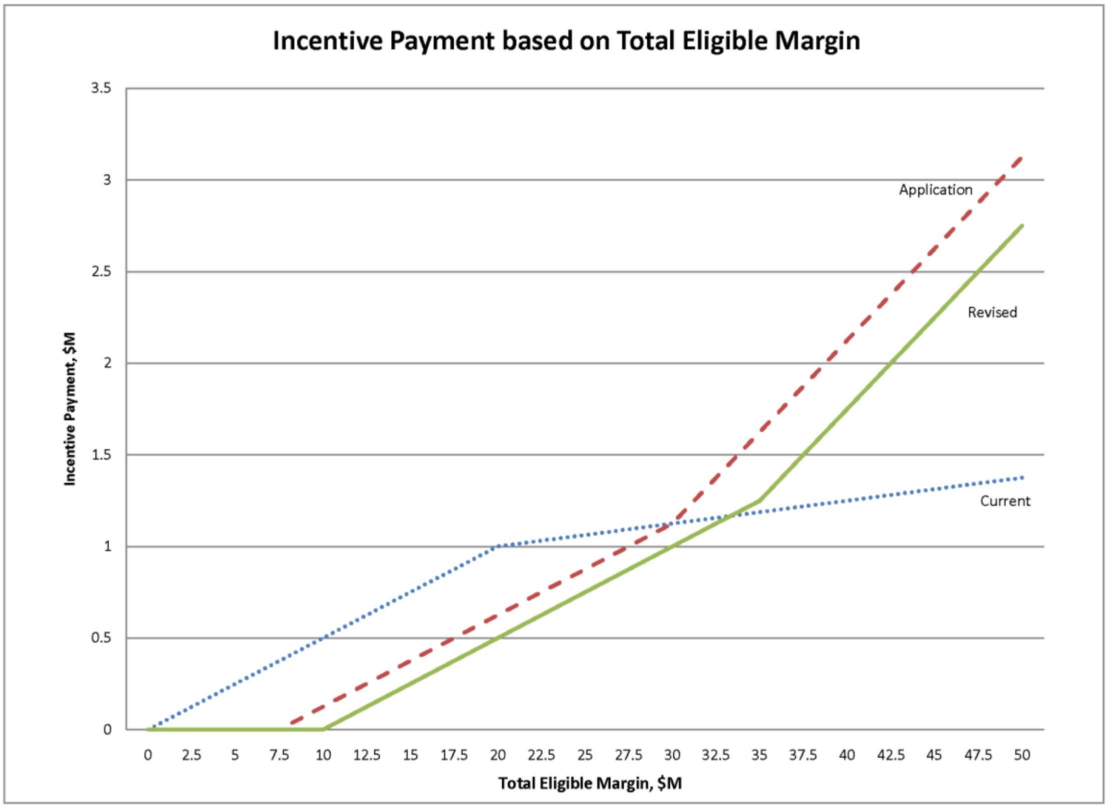
Total Eligible Margin	Incentive Payment
$0 to $7.5 million	0% of Total Eligible Margin
$7.5 to $30 million	5% of Total Eligible Margin
Amount greater than $30 million	10% of Total Eligible Margin

Proposed Incentive Earned Formula (Revised)

Total Eligible Margin	Incentive Payment
$0 to $10 million	0% of Total Eligible Margin
$10 to $35 million	5% of Total Eligible Margin
Amount greater than $35 million	10% of Total Eligible Margin

[Proposed Incentive Earned Formula (Revised) in TGI Final Submission dated September 27, 2010, article 34, pp. 17-18.]

The following graph shows the potential incentive payments under the three formulae.



TGI states that the proposed change to the current incentive sharing mechanism will allow TGI to earn a similar incentive payment if it delivers similar levels of savings through its mitigation activities, while improving the program's effectiveness in generating additional savings by providing an enhanced incentive for TGI if it is able to generate greater mitigation revenue.

In its Final Submission, TGI revised the Application by increasing the third step where the enhanced sharing starts to $35 million and by increasing the first step from $7.5 million to $10 million. Since 2002/03, the average Total Eligible Margin was about $32 million. TGI's revisions recognized that TGI generated an average of about $2.4 million from SCP and T-South related mitigation activities that accrued to the delivery margin which was not included in the Total Eligible Margin under the current GSMIP sharing mechanism.

3.2 Inclusion of all SCP and T-South Net Mitigation Revenue in GSMIP Sharing Mechanism

The net revenue generated by transportation mitigation that involves SCP and T-South is allocated between midstream credits and delivery margin. The current GSMIP mechanism includes only the midstream portion in the Total Eligible Margin. TGI does not suggest a change to the allocation between midstream and delivery margin but proposes that all net mitigation revenue from SCP and T-South be included in the Total Eligible Margin. The proposed change would mean that a portion of TGI's incentive payment would be recovered from the component of SCP and T-South revenue that goes to reduce delivery rates, and so would have an impact of a very small nature on transportation customers.

3.3 Extending the Term to Three Years with a Rolling Three Year Renewal Incentive

TGI states that a three year term encourages mitigation activities with a longer term incentive and reduces administrative burden for the Commission, TGI and stakeholders. TGI also submits that it provides better alignment between the Annual Contracting Plan (ACP) and the GSMIP.

The rolling three year term would be accomplished by extending the three year term by one year on an annual basis until such time as the Commission or stakeholders requested a review. In the alternative, at the end of three years, TGI would file an application to renew the program for a further three years. (BCUC IR 1.19.4)

4.0 NEED FOR GSMIP

The need for a GSMIP depends significantly on the extent to which TGI would undertake mitigation activities in the absence of an incentive program, since there is little reason to pay an incentive for activities that TGI would do as part of its normal business to serve customers. The effectiveness of a program to incent extra, desired actions by TGI would appear to depend on the structure of the program. Likewise, the value of a program to customers must balance the cost of the incentive payment against the incremental mitigation revenue generated as a result of the program, and hence also depends heavily on the structure of the program.

<u>TGI Position</u>

TGI states that its minimum mitigation requirement and responsibility, without an incentive, is to maintain the balance between contracted gas supply and customer demand on various interconnecting pipelines by selling excess commodity at the point of purchase. At this time, TGI performs beyond the minimum requirement and is actively engaged in transporting the gas to a market with the highest price and using other techniques such as recallable sales to extract maximum value. Under the current mitigation program, TGI also contributes valued added mitigation through transportation and storage. (Exhibit B-1, p. 17)

<u>Position of BCOAPO</u>

BCOAPO believes that the value of GSMIP to ratepayers in its present form is highly dubious, and TGI's proposals to enrich the incentive would further diminish its value. Nevertheless, BCOAPO believes that TGI serves its core customers well when it comes to gas supply mitigation, and that it may be possible to devise an incentive program that is tailored to address the evolving gas supply market in relation to TGI's gas supply function. (BCOAPO Final Submission, pp. 1, 2, 6)

BCOAPO submits that TGI has projected a very limited notion of the scope of its obligation to ratepayers, and that there is a pre-existing obligation on TGI to maximize ratepayer value of surplus gas supply, storage and transmission that has been contracted for on behalf of core customers. The purpose of GSMIP was to encourage greater effort to extract value on activities that were already a utility responsibility (BCOAPO Final Submission, p. 4).

In BCOAPO's view, it is common practice for utilities that do not have an incentive plan to mitigate costs. The compensation for these activities is already included in rates therefore ratepayers should not be paying more than full cost plus return for an activity that is a normal utility function. In summary BCOAPO contends that if

TGI made less effort to mitigate core gas supply costs or perform as it should, it would be the utility's shareholder that would be accountable for that dereliction through the intervention of the Commission when it comes to setting rates (BCOAPO Final Submission, pp. 7, 8).

TGI replies that it expects its employees to seek the best value for Annual Contracting Plan (ACP) resources that are in excess of customer requirements. TGI then supports this activity by providing the financial and legal capacity, governance and oversight to allow employees to engage in incentive activities. Since 1996 when TGI began operating under an incentive program, employees have developed significant expertise in the market to create savings for customers. TGI believes that BCOAPO's characterization of the baseline utility obligation as being to maximize ratepayer value for any surplus supply, storage or transmission it had contracted for on behalf of core customers is extreme. It is TGI's position that the inherent complexity of the market ensures that there is no maximum value because the maximum realizable value is changing with the market (TGI Reply Submission, pp. 9, 10).

TGI agrees with BCOAPO that securing upstream supply in a cost effective manner is expected by ratepayers and the Commission, and TGI does not contract for excess resources as part of the ACP for the purpose of generating mitigation revenue. However, TGI's mitigation does involve the purchase of additional resources outside of those required under the ACP. TGI is not aware of any other utility that engages in this action to crystallize additional customer savings (TGI Reply Submission, p. 12).

TGI submits that it is impossible to determine the value to ratepayers if the GSMIP was not in place, as the significance of incentives to create superior performance is well recognized by both the Commission and interveners. Gas cost mitigation activity is a constantly changing endeavor to capitalize on market opportunities as they may or may not unfold. At this time, there is no utility known to TGI that performs mitigation activities beyond the base requirement to balance customer requirements with available resources and TGI argues that its activities have gone beyond the statutory requirement as it sees it (TGI Reply Submission, pp. 13, 14).

Position of CEC

The Commercial Energy Consumers Association of British Columbia (CEC) is persuaded that the subject of gas supply mitigation is an area where it is appropriate to provide TGI with incentives and where customers can benefit from superior performance. However, it is not persuaded that the link between the GSMIP and TGI's role has been adequately supported by the evidence on the record. In fact, the CEC submits that there is no clear evidence to demonstrate that either the present or the proposed GSMIP represents an appropriate incentive mechanism design which would align customer and TGI interests. (CEC Final Submission, p. 3)

Although the CEC believes that TGI is contributing to gas supply mitigation in excess of the standard of prudent utility management, it is not able to clarify the extent and magnitude of these contributions. This information is necessary to be assured that an incentive mechanism is properly defined and aligned. CEC agrees that GSMIP has served to have TGI actively mitigating gas supply costs, but is not convinced that the evidence supports that customers have been well served by the GSMIP over the past 15 years. CEC believes that TGI is compensated for all of its contributions to GSMIP through its revenue requirements, except for the financial credit that TGI puts behind the transactions. (CEC Final Submission, pp. 6-8)

TGI replies that the role of counterparties and the financial credit behind transactions should not be used as a basis for the incentive, as the current methodology is fair and appropriate based on actual savings from TGI's mitigation activities (TGI Reply Submission, pp. 3-4). Although the formula for determining the eligible margin related to commodity re-sales does not directly measure the value added, the formula is conservative and does not overstate value. The determination of value for mitigation revenues generated from transportation and storage is more straight forward and not arbitrary. Overall the total incentive can be considered very modest with total savings on average of $37 per customer balanced against an incentive for TGI of about $1.37 per customer (TGI Reply Submission, p. 6).

Commission Determination

The Commission does not agree with TGI's very narrow view of its responsibility to carry out cost mitigation activities related to its gas supply costs. It believes that TGI needs to take all reasonable and prudent actions to employ surplus gas supply resources to achieve the largest amount of mitigation revenue possible. In fact, the Commission has not identified any current mitigation activities, such as buying and selling additional gas to recover better value from surplus transportation, that TGI would not be expected to continue with in the absence of an incentive program.

Nevertheless, the Commission recognizes that TGI may not have developed some mitigation activities, or may have implemented them more slowly and to a lesser degree, in the absence of an incentive program. The gas market is both complex and dynamic, and TGI should be encouraged to quickly recognize and aggressively pursue new opportunities as well as to effectively continue activities that it has used in the past. In the Application, TGI discusses several initiatives that it has implemented over the years (Exhibit B-1, pp. 24-8). The Commission also notes that GSMIP incentive payments have been relatively modest compared to the total mitigation revenue that TGI has generated.

Both BCOAPO and CEC recognize that an incentive program may have value for customers, although each has serious concerns about the structure of the current and proposed GSMIP. Incentive program structure is of prime importance, and will be addressed in a subsequent section. Nevertheless, for the reasons discussed above, the Commission concludes that past GSMIPs appear to have had benefits for customers, and that a properly structured GSMIP is likely to have benefits for customers as well as the shareholder of TGI.

5.0 GSMIP PROPOSED IN THE APPLICATION

The Commission determines that the proposed changes to GSMIP have not been shown to improve the program and have benefits, and denies the Application. However, consistent with the conclusion that past GSMIPs appear to have had benefits, the Commission directs that the 2009/10 GSMIP will be extended for one year commencing November 2010.

The proposed GSMIP is based on the current incentive program with a significant change to the sharing mechanism that is applied to the Total Eligible Margin, the addition of all net revenue from SCP and T-South to the Total Eligible Margin and an extension of the term of the program. The first two modifications would have the effect of increasing the incentive payment at current and higher levels of Total Eligible Margin.

TGI submits that GSMIP continues to create value for customers by incenting TGI to provide support and oversight for mitigation activities that can generate incremental gas cost savings for customers. The motivations that led to the creation of an incentive program 15 years ago remain valid in the current dynamic and sophisticated energy market. TGI believes that its proposed enhancements reflect the same principles of incentive regulation, and will also provide greater alignment of interests among customers and TGI (TGI Final

Submission, pp. 19, 20). TGI submits that if the Commission is not willing to approve the proposed GSMIP for three years, it should approve the program for one year. Nevertheless, TGI states that extending the existing GSMIP for a one-year term would be preferable to no incentive at all, as it would allow an enhanced program to be negotiated with stakeholders over the next year (TGI Reply Submission, p. 8).

BCOAPO believes the GSMIP in its current form should be terminated as it has dubious value and the changes proposed in the Application diminish its value even further. GSMIP "provides a double-payment to the utility for the provision of services to core ratepayers for which it is already adequately compensated through rates" BCOAPO states that it may be that a new incentive program could be arrived at but it would require a "fundamental re-think" and that this is not the "sort of task which can be accomplished through a formal adversarial hearing process, but rather lends itself to processes of consultation and negotiation." (BCOAPO Final Submission, pp. 1, 2)

BCOAPO believes there is no reason to enrich the incentive since there is no threat of non-recovery of midstream costs or non-recovery of the return on assets involved in mitigation and almost zero incremental operating and maintenance cost increase. BCOAPO strongly opposes TGI's proposal for a three year rollover. BCOAPO states that at most the present GSMIP should be rolled over for one year, in order to provide time to redesign the program (BCOAPO Final Submission, pp. 1, 7, 8).

TGI replies to BCOAPO that gas cost mitigation activity is a constantly changing endeavor to capitalize on market opportunities as they may or may not unfold. TGI believes a three year timeframe for GSMIP is in the best interests of ratepayers and shareholders. The longer term focus would encourage TGI to develop financial and legal support for a mitigation focus based on a longer term payout. It would not buffer the program from accountability as suggested by BCOAPO, as the same regulatory and management reporting would be required.

The CEC is not convinced that the proposed GSMIP is adequately justified. It believes the Application should be denied, and a consultative process should be undertaken to develop a GSMIP that fairly and more appropriately aligns ratepayer and shareholder interests. "The CEC recommends that the Commission reject the proposed GSMIP design and put in place a $1 million incentive payment for the next year as a temporary measure for one year and ask TGI to return with a more suitable design which better aligns incentives to rewarding the contributions and performance for which TGI really adds value." (CEC Final Submission, pp. 1, 9)

TGI replies to CEC that the changes to the Total Eligible Margin payout formula provide stepped thresholds and percentages that deliver savings to customers that match or exceed the historical average. In effect, it is a progressive incentive which increases the payout as it becomes more difficult to realize savings and encourages TGI to increase its efforts. In TGI's view, a $1 million payment without conditions does not provide the correct motivation.

<u>Commission Determination</u>

The Commission is not persuaded that the proposed changes are supported by a justified expectation that they will lead to higher levels of innovative activity. TGI provides submissions but little factual evidence to support that the proposed changes to the incentive sharing mechanism will produce desirable results and, in particular, that these changes are likely to result in greater mitigation savings for customers. TGI has also not provided sufficient evidence to persuade the Commission that the present GSMIP level of incentive is inadequate. The proposal to include all SCP and T-South revenue is a relatively small change, but likewise there is no factual evidence to support that the change is likely to do anything other than somewhat increase TGI's incentive payment. Lastly, like BCOAPO, the Commission is not persuaded that a three year term would have benefits that would outweigh the risks associated with establishing a program with new parameters, and which would not be subject to review and adjustment for three years. **For these reasons, the Commission denies the Application.**

Nevertheless, the Commission has concluded that past GSMIPs appear to have had benefits for customers, and that a properly structured GSMIP is likely to have benefits for customers as well as the shareholder of TGI. As alternatives to their preferred positions, TGI, BCOAPO and CEC each support the extension of the current program for one year. **Therefore, the Commission directs that the 2009/10 GSMIP as described in Order G-101-09 will be continued for the period November 1, 2010 through October 31, 2011.**

6.0 DEVELOPMENT OF AN ENHANCED GSMIP

Having extended the 2009/10 GSMIP for one year, in this section the Commission addresses steps that are needed to develop an enhanced and improved incentive program for the period starting November 2011. The Commission identifies the principles that it believes must guide the development of the enhanced incentive program, and orders TGI to establish a working group that is to revisit the objectives of GSMIP and to discuss the reformulation of the program to ensure alignment with the objectives.

Each of TGI, BCOAPO and CEC indicate that an enhanced GSMIP should be developed through discussions and negotiations. The Application can be considered to set out TGI's views at the time it was filed on how the program should be enhanced.

BCOAPO noted that its position on the objectives and principles for GSMIP continue to be the view that it set out in its submission in the 2008 GSMIP review, which stated that Objective 3 of the Objectives and Guiding Principles for the original 2002/03 GSMIP captured the ratepayer's perspective. As discussed earlier, this Objective stated that the plan should "reward new, substantial exertions" by TGI and "avoid paying incentives for activities and results that have already been achieved." In 2008, BCAOPO outlined the following three parameters for designing an incentive program:

- "The incentive paid to the utility should be the smallest possible amount required in order to obtain the desired core ratepayer benefit.
- The benefits to the utility's staff or shareholders should not be sufficiently large to incent it to depart from a prudent approach toward the triaging of surplus core customer gas supply.
- There should be a continuing onus of the utility to demonstrably improve its efforts and results in this activity each year, in order for the GSMIP to continue."

BCOAPO submitted that the appropriate benchmark is the incremental achievement, over and above what could otherwise be reasonably expected from Terasen as a quasi-trustee for core customers as purchaser and manager of their supply portfolio. The question in BCOAPO's view is how does that incremental "stretch" benefit compare with the cost of the incentive? (BCOAPO Final Submission, p. 3)

TGI agrees with BCOAPO that the function of GSMIP is to provide an incentive to "stretch" beyond the baseline obligation but disagrees with the definition of that baseline. TGI submits that BCOAPO's view that "in the context of midstream management, cost effectiveness must be synonymous with cost minimization" is without merit, arguing that cost minimization is an impossible standard that does not recognize the relevance of reliability, service quality or societal benefits. (TGI Reply Submission pp. 9, 14)

The CEC submits that there is no clear evidence to demonstrate that either the present or the proposed GSMIP represents an appropriate incentive mechanism design which would align customer and TGI interests (CEC Final Submission, p. 3). CEC outlines a number of points that it believes must be addressed in a reformulated incentive plan, including the following:

- The evidence indicates that the mechanism to calculate the Eligible commodity re-sale margin does not normalize the commodity margin as TGI suggests but caps Eligible Margin. The mechanism is not appropriate for the alignment of customer interests with company incentives and the Total Eligible Margin calculation is a highly arbitrary mechanism.

- The incentive mechanism does not need to be designed like a performance based rate mechanism where there is no reward for activity levels previously achieved.

- If there is proper alignment between ratepayer and shareholder interests, a severe upper limit on the incentive mechanism is not necessary.

- The contributions of TGI's credit lines to supporting gas mitigation activity are not recognized and compensated for directly but are indirectly recognized through GSMIP. The present design of GSMIP does not properly examine this contribution or adequately align incentives.

- Gas supply mitigation activities related to SCP, T-South and Mt Hayes facilities should be part of the incentive mechanism.

TGI replies to CEC that the role of counterparties and financial credit behind transactions should not be used as a basis for the incentive, as the current methodology is fair and appropriate based on actual savings from TGI's mitigation activities. Although the formula for determining the eligible margin related to commodity re-sales does not directly measure the value added, the formula is conservative and does not overstate value.
The changes to the Total Eligible Margin payout formula provide stepped thresholds and percentages that deliver savings to customers that match or exceed the historical average. In effect, it is a progressive incentive which increases the payout as it becomes more difficult to realize savings and encourages TGI to increase its efforts.

Commission Determination

For the reasons discussed earlier in this Decision, the Commission concludes that a re-examination of the overall objectives and structure of GSMIP is warranted to improve the alignment of interests between customers and shareholders. Consistent with the views of the participants, the Commission concludes that the appropriate next step is to establish a working group to discuss the matter.

The Commission's intention is that the working group assist TGI in developing a reformulated incentive program so that Terasen Gas can file an application with the Commission by August 2, 2011 for a GSMIP commencing November 1, 2011. The Commission believes that it will be helpful for TGI to engage the services of an outside consultant with expertise in incentive plans, and for the consultant to participate in the working group discussions for the purpose of informing the group members. The Commission also concludes that, based on the submissions of participants and other evidence in the proceeding, that it will be helpful for the Commission to identify Guiding Principles to guide the working group discussions. Therefore, the Commission identifies the following Guiding Principles for a GSMIP commencing November 1, 2011:

1. The incentive program must demonstratively deliver value to ratepayers and reward ongoing innovation and true value added over and above what is reasonably expected in the normal stewardship of TGI's business.
2. Execution of the incentive program must not put the prudently planned gas supply portfolio at risk nor promote a departure from prudent gas supply management for core customer's requirements.
3. The incentive plan should fairly and appropriately align ratepayer and shareholder interests.
4. There should not be an upper limit on TGI's potential to earn an incentive but there must be a test of reasonableness and the amount earned must be justified.
5. The incentive program should apply to all mitigation activities that use commodity supply resources that represent a cost and risk to ratepayers (i.e. gas supply, storage, transportation).
6. The incentive plan should reward TGI for its innovation rather than for opportunities that arise from events that impact the industry in general (e.g. hurricanes).
7. Any incremental administrative costs must be considered and charged against the benefits of the plan.
8. The incentive payment should be the smallest amount required to obtain the desired core customer benefit.

Therefore, the Commission directs that TGI will establish a working group that will include representatives from TGI, Commission staff, and other parties which will meet commencing in early 2011 to discuss the Guiding Principles, objectives, structure and parameters of a GSMIP to commence November 1, 2011, and to explore ways to demonstrate, quantify and measure the extent to which the GSMIP objectives are achieved in order to determine the amount of future GSMIP incentive payments. Commission staff will be a full and active party in the working group.

The objective of the working group is to achieve consensus on the objectives for the GSMIP program commencing November 1, 2011, and to discuss and where possible reach consensus on the structure of a reformulated incentive program that translates the objectives and Guiding Principles into quantifiable and measurable parameters that determine the amount of the incentive payment.

TGI will file by April 1, 2011 terms of reference for the working group and a schedule with milestones for the completion of the discussion. If TGI wishes to apply for approval of a GSMIP commencing November 1, 2011, it will file an application with the Commission by August 2, 2011.