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LETTER L-22-13

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VIA EMAIL
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April 5, 2013

Ms. Diane Roy
Director, Regulatory Affairs - Gas
FortisBC Energy Inc.
16705 Fraser Highway
Surrey, BC V4N 0E8

Dear Ms. Roy:

Re: FortisBC Energy Inc.
Gas Supply Mitigation Incentive Program for 2011/2012 Year

Further to the FortisBC Energy Inc. December 13, 2012 filing of the Gas Supply Mitigation Incentive Program Year End Report for the period from November 2011 to October 2012 (Filing), the British Columbia Utilities Commission (Commission) accepts the calculation of an incentive payment of $888,361 for the 2011/2012 gas year and issues the attached report entitled "Commission Staff Overview Report – Gas Supply Mitigation Incentive Program 2011/2012."

The Commission understands that FEI intends to meet with parties who were members of the Working Group to discuss the extension of the term of the current GSMIP. The Commission Staff Overview Report includes discussion of a number of potential modifications that the Commission staff believes should be addressed in discussions with stakeholders and considered in an application to extend the term of the current GSMIP.

To protect commercially sensitive information, the Commission will keep the spreadsheet model that is Appendix B of the Filing confidential as requested by FEI.

Yours truly,

Erica Hamilton

CM/cms
Enclosures
cc: The British Columbia Public Interest Advocacy Centre
(support@bcpiac.com)

The Commercial Energy Consumers Association of British Columbia
(dwcraig@allstream.net)

BRITISH COLUMBIA UTILITIES COMMISSION

COMMISSION STAFF OVERVIEW REPORT

FORTISBC ENERGY INC.

GAS SUPPLY MITIGATION
INCENTIVE PROGRAM (GSMIP)
2011/2012

April 4, 2013

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- **SUMMARY**

On December 13, 2012, FortisBC Energy Inc. (FEI) filed its Gas Supply Mitigation Incentive Program Year End Report November 2011 – October 2012 (2011/12 GSMIP Report) with the British Columbia Utilities Commission (Commission), pursuant to Order G-163-11. In the 2011/12 GSMIP Report, FEI recommended the Commission accept the calculation of the incentive payment of $888,361 for the November 1, 2011 to October 31, 2012 gas year (2011/12 Year).

The purpose of the Commission Staff Overview Report of the GSMIP (Staff Report) is to provide an overview of Commission staff's review and recommendation to the Commission as to whether or not the GSMIP incentive payment for the 2011/12 Year is calculated in accordance with the 2011-2013 GSMIP Term Sheet (Term Sheet) established by Order G-163-11. The review process also included written submissions from Commercial Energy Consumers Association of British Columbia (CEC), and British Columbia Public Interest Advocacy Centre on behalf of the British Columbia Pensioners' and Seniors' Organization, formerly known as the British Columbia Old Age Pensioners Organization (BCPSO), who together with FEI and Commission staff were members of the Working Group that developed the Term Sheet.

Commission staff conclude that FEI's calculation of an incentive payment of $888,361 is generally consistent with the model and methodology described in the Term Sheet and recommend the Commission accept the requested incentive payment for the 2011/12 Year. Commission staff also propose suggested modifications and items for consideration for GSMIP if the program is extended beyond the current two year term.

- **BACKGROUND**

An incentive program for rewarding the utility in maximizing revenue recovery from resources used in meeting its core load has been in existence since 1995. For the 1997/98 gas year, the program was named Gas Supply Mitigation Incentive Program (GSMIP), where mitigation could be defined as the activities that balance the objectives of the program to ensure customer load is met while maximizing the recovery of revenue from any surplus utility resources. The program objectives and guiding principles changed slightly over this period, but the model remained relatively unchanged until 2011.

In 2011, under Order G-26-11, the Commission denied FEI's application for a three year extension of the GSMIP under a model that was substantively the same as had been in place until that time. The Commission approved the extension of the previous GSMIP to the 2010/11 gas year, set out Guiding Principles to be applied and directed FEI to establish a Working Group to arrive at a mutually acceptable GSMIP program going forward. The Working Group established by FEI comprised of representatives from FEI, Commission staff, CEC, and BCPSO.

The Working Group arrived at a new GSMIP model and FEI applied for approval of the new GSMIP model for the two year period from November 1, 2011 to October 31, 2013. This GSMIP, as described by the Term Sheet appended to the Order, was approved by the Commission under Order G-163-11 dated September 22, 2011. The 2011/12 GSMIP Report represents the first request for an incentive payment under the new GSMIP approved in Order G-163-11.

- **GUIDING PRINCIPLES FOR THE 2011-2013 GSMIP TERM SHEET**

By Order G-26-11 and its Decision dated February 23, 2011, the Commission identified the following Guiding Principles for GSMIP to guide the Working Group discussions:

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 FEI's business (FEI was formerly known as Terasen Gas Inc., or TGI).

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 FEI'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 FEI 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.

- **2011-2013 GSMIP TERM SHEET**

The GSMIP model approved in Order G-163-11 and described in the Term Sheet appended to that Order incorporates a blended approach of eligible mitigation revenue and a comparison to a base benchmark. FEI's Total Incentive Payment amount is a function of the mitigation revenue achieved and the performance of FEI compared to a base benchmark for those mitigation activities where a benchmark applies. For the benchmarked activities, the more FEI can outperform the Base Benchmark, the greater the potential incentive payment.

The GSMIP model breaks down transactions into the following categories: Benchmarked Mitigation Activities, Non-Benchmarked Mitigation Activities, and New Mitigation Activities. Combined, these activities are referred to as Total Mitigation. The incentive payment structure for each category is as follows:

TABLE 1: INCENTIVE PERCENTAGE STRUCTURE

	Activity	Incentive Percentage
1	Benchmarked Activity	
	Market Performance Factor (MPF) between 100 and 131%	2.45% + 0.05%*(MPF – 100)
	MPF between 131 and 136%	4.00%
	MPF of 136 and greater	4.00% + 0.04%*(MPF – 136)
2	Non-Benchmarked Activity	4.00%
3	New Activity	12.00%

The incentive payment FEI receives under the GSMIP is reviewed for acceptance on an annual basis by the Commission. Commission staff note that FEI intends to meet in the spring of 2013 with the stakeholders who participated in the Working Group to discuss any adjustments to the GSMIP model for future years beyond the expiry of the current GSMIP on October 31, 2013.

- **2011/12 GSMIP YEAR END REPORT**

The 2011/12 GSMIP Report is the first year of the GSMIP approved in Order G-163-11 and as described in the Term Sheet. On June 19, 2012, FEI filed its GSMIP report for the 2011/12 Winter based on information ending March 31, 2012 (2011/12 Winter Report). On December 13, 2012, FEI filed the 2011/12 GSMIP Report based on information of the entire gas year from November 1, 2011 to October 31, 2012 (2011/12 Year).

a. Review Process

By way of letters dated December 4, 2012 and February 20, 2013, FEI's Director of Internal Audit gave assurance that the Internal Audit carried out a review of the methodology and calculation of the 2011/12 GSMIP incentive payment including a spot check of the market price indices used in the benchmarking.

BCPSO and CEC provided written comments as part of the review process on March 6 and March 8, 2013 respectively. FEI also filed reply comments subsequent to a teleconference meeting with CEC, BCPSO and Commission staff that took place on March 12, 2013. Both BCPSO and CEC indicated they have no objections to the 2011/12 GSMIP Report or the incentive payment of $888,361. At the teleconference the parties agreed that while there were no objections to the requested 2011/12 incentive payment, certain items should be reviewed when considering the extension of GSMIP beyond the current approved term.

Consistent with past practice of the GSMIP review process, this Staff Report is to provide stakeholders an overview of Commission staff's recommendation to the Commission, based on Commission staff's review of the filing, as to whether or not the GSMIP incentive payment for the 2011/12 Year has been calculated in accordance with the Term Sheet approved in Order G-163-11. Comments by BCPSO and CEC are noted throughout the Staff Report.

- **2011/12 GSMIP YEAR END PERFORMANCE**

In the 2011/12 Year, FEI reported $27.70 million in total mitigation revenue. The incentive earned based on allowed percentage of mitigation revenues is $1.04 million. After deducting the fixed incentive payment adjustment of $150,000 in accord with section J of the Term Sheet, FEI calculates the Total Incentive Payment at $888,361 for the 2011/12 Year.

Under Section K of the Term Sheet, a full review of the GSMIP mechanism is to be triggered if the Total Incentive Payment varies by more than $500,000 from the historical GSMIP payout of $1.1 million. As the requested Total Incentive Payment is within the prescribed tolerance a full review is not triggered at this time.

- **BENCHMARKED ACTIVITIES**

b. Benchmarked Activity Incentive Payment

FEI reported $23.02 million in net mitigation revenue under Benchmarked Activities. The Benchmarked Activity incentive payment is based in part on the Benchmarked Activity Incentive Percentage (BAIP). The BAIP is determined from the Market Performance Factor (MPF). Section I of the Term Sheet sets out provisions to calculate the BAIP and MPF. FEI reported a MPF of 125.6%. Accordingly with the incentive payment structure as noted in Table 1 above, FEI used a BAIP of 3.70% based on lookup tables to calculate its eligible incentive payment for the Benchmarked Activities.

Commission staff noted that the incentive payout for Benchmarked Activities could be calculated with more precise inputs, which would yield a BAIP of 3.73%. BCPSO also commented that FEI may be entitled to an incentive percentage of 3.75% depending on the rounding methodology employed. FEI in its reply comments noted that it had used a conservative approach in this calculation and suggested this item be included in discussions going forward.

FEI did not submit any requests to vary the requested incentive payment of $888,361 as a result of feedback from the parties.

c. NOVA Transportation

NOVA transportation falls under Benchmarked Transportation Mitigation activity. FEI generated about $0.44 million in mitigation revenue in NOVA transportation activities in the 2011/12 Year but recorded a negative benchmark.

Commission staff view that while the benchmark for the NOVA transportation is calculated in accordance with section G of the Term Sheet, it is unclear whether or not the formula contemplated the possibility of negative valued benchmarks at the time of design. The negative valued benchmark is primarily driven by the sales price at Empress being lower than the NIT purchase price. BCPSO commented that a negative benchmark does not conceptually make sense as it suggests gas was being transported in the wrong direction, from where it is more expensive to where it is less expensive. FEI explained that a number of market factors have contributed to this price fluctuation, and suggested further discussion on whether to keep this item as benchmarked or to classify it as non-benchmarked activity occur going forward in discussions regarding the next GSMIP.

Commission staff agree that the issue of a negative valued benchmark when mitigation revenue is positive, in cases such as the NOVA Transportation, should be revisited in discussions regarding the next GSMIP. Commission staff support the use of the negative benchmark for the 2011/12 Year as it is calculated in accordance with the Term Sheet.

d. Year End Price Performance Measure Calculation

The price performance measure is calculated as benchmarked revenue over base utility benchmark. FEI presented an annual price performance measure for each of the six Benchmarked Activities in the 2011/12 GSMIP Report. Staff note that in the working model spreadsheet, FEI included reporting of the base utility performance separately for the period November 2011 to March 2012 (Winter) and April 2012 to October 2012 (Non-winter). However, FEI then reported the price performance measure for the 2011/12 Year in the 2011/12 GSMIP Report by taking the simple average of Winter and Non-winter periods.

Commission staff note that the calculation of the price performance measure is not specified in the Term Sheet. For the purposes of a year-end report, Commission staff consider that reporting the weighted average based on the entire gas year would be more indicative to evaluate each Benchmarked Activity. Commission staff note that the overall performance measure of 125.6% calculated for incentive payment is indicative as it is based on a weighted average for all Benchmarked Activities for the whole year.

- **NON-BENCHMARKED ACTIVITIES**

e. Non-Benchmarked Activity Incentive Payment

An incentive percentage of 4% applies to Non-Benchmarked Activities mitigation revenue. Under Non-Benchmarked Activities, FEI generated $4.68 million of mitigation revenue, which equates to about $187,092 incentive payment. Commission staff consider the calculation of this incentive payment is generally consistent with sections D and I of the Term Sheet.

f. Storage Mitigation or Park and Loan Activity, Forward Commodity Resale

FEI reported $1.07 million mitigation revenue for storage/forward commodity activity, which included $0.215 million in carrying costs. BCPSO sought clarifications on Storage/Forward Commodity Activity. For the 2011/12 Winter Report this was presented as $1.08 million while the 2011/12 GSMIP Report in year end showed the lesser amount of $1.07 million.

In its response to BCPSO, FEI explained that it did not include the carrying cost of $0.215 million in the Winter Report, and there was additional Park/Loan revenue generated over the summer. Commission staff consider FEI's clarification to be reasonable. Going forward, Commission staff recommend reporting revenue breakdowns by park and loan, and forward commodity resale separately to assist in understanding the performance of the two distinct mitigation activities.

g. Storage Benchmark Evaluation

The Working Group agreed to have FEI actively evaluate storage potential during the two year period of the new GSMIP program for the purposes of gathering information to evaluate the possibility of benchmarking storage activities going forward. A benchmark was calculated for storage mitigation but as set out in the Term Sheet it was not used to determine the performance factor and was maintained for tracking purposes only. The storage benchmark evaluation relies on an internal determination of potential transactions, based on monthly load forecasts and the necessary storage injections or withdrawals to accommodate the load which produces the volumes possible to transact Park and Loan storage activity.

Commission staff agree that the storage benchmark in the 2011/12 GSMIP Report is for tracking purposes only and make no recommendations on the appropriateness of whether storage mitigation revenue can be considered as a Benchmarked Activity at this time. The expectation is that this item will be revisited in the development of a future GSMIP.

h. Non-Benchmarked NOVA and T-South Interior Forward Capacity Release

In the 2011/12 Year, FEI generated revenue in NOVA forward capacity releases and in Spectra T-South Interior forward capacity releases. In the 2011/12 GSMIP Report FEI moved the T-South Interior capacity release revenue to the non-benchmarked activity revenue category as there is no benchmark available for this capacity release activity. Commission staff note that NOVA also had no benchmark available as there are no forward market prices for Empress.

Section D of the Term Sheet does not specifically contemplate Non-Benchmarked Activities for the T-South Interior and NOVA forward capacity releases. Under section C of the Term Sheet under Benchmarked Activities, capacity release is established for Spectra T-South, Foothills and Intra-Alberta NOVA. In the 2011/12 GSMIP Report, FEI did not provide any discussion or explanations regarding the T-South Interior and NOVA forward capacity release activities. While there may be justifiable reasons to move these particular capacity release transactions from a Benchmarked activity to a Non-Benchmarked activity, Commission staff consider that FEI should have included an explanation in the 2011/12 GSMIP Report that the treatment of these two forward capacity releases have departed from the Term Sheet. Commission staff note that beyond the term of the current GSMIP, FEI should discuss with stakeholders whether or not any adjustments are warranted to accommodate situations where market benchmarking information is unavailable.

- **NEW ACTIVITY**

New Activities are defined in section E of the Term Sheet as mitigation activities that had not yet been developed at the time the Term Sheet was developed. New Activities must each be approved by the Commission to be included in GSMIP. FEI did not conduct any New Activities in the 2011/12 Year. In accord with section K of the Term Sheet, Commission staff note FEI are to provide a high level summary of any new activities for the 2012/13 gas year in the 2012/13 Winter report.

- **CONFIDENTIALITY**

Commission staff recommend that the electronic spreadsheet model attached as Appendix B of the 2011/12 GSMIP Report that provided a detailed account of individual transactions be held confidential as requested by FEI to protect commercially sensitive information.

- **CONCLUSION**

Commission staff reviewed the material provided in the 2011/12 GSMIP Report and the calculation of FEI's incentive payment of $888,361. Commission staff conclude the calculation is generally consistent with the Term Sheet and should be accepted by the Commission. Commission staff believe the first year under the new GSMIP model has demonstrated the new GSMIP model is functional and has yielded reasonable results.

As discussed in this Staff Report, the following aspects of the GSMIP model should be addressed by FEI and stakeholders when considering the renewal of GSMIP beyond the current approved term:

- Appropriateness of a negative valued benchmark and the methodology for calculation of a negative valued benchmark,
- The methodology for arriving at the Benchmarked Activity Incentive Percentage from the Market Performance Factor,
- Improved clarity in reporting requirements,
- A methodology for treatment of activities not previously identified as non-benchmarked,
- Review of the appropriateness of treating storage mitigation as a Benchmarked Activity, and
- Review of the experience, if any, with New Activities.

Section K of the Term Sheet states that any modification to the GSMIP model for the upcoming year would need to be presented in the Year End report of the previous year. FEI has not included any suggested modifications for the 2012/13 gas year. Commission staff do not suggest any changes to the GSMIP model at this time but note that some of the items identified for discussion going forward beyond the expiry of the current GSMIP, particularly those associated with reporting, should be considered by FEI for inclusion in the 2012/13 GSMIP Winter and Year End reports.