



LETTER NO. L-31-95

ROBERT J. PELLATT
COMMISSION SECRETARY

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VIA FACSIMILE

July 5, 1995

Mr. D.M. Masuhara
Vice President
Legal and Regulatory Affairs
BC Gas Utility Ltd.
1111 West Georgia Street
Vancouver, B.C.
V6E 4M4

Dear Mr. Masuhara:

**Re: BC Gas Utility Ltd.
1995/96 Gas Contracting Plan**

This is to acknowledge receipt of your June 9, 1995 letter and the 1995/96 Gas Contracting Plan which was enclosed. Overall, the Commission accepts the information in the Plan and notes that the recommended changes to the supply portfolio for 1995/96 are consistent with the long-term strategy in the 1994 BC Gas Integrated Resource Plan, which favours storage and short term peaking and seasonal gas over additional baseload supplies.

However, there is concern about the lack of broad analysis of the sensitivity of the portfolio recommendations to changes in forecast economic parameters, particularly gas prices. A second concern is that Case 1 is recommended when lower cost portfolios are potentially possible. As noted in items 3, 4 and 5 which follow, BC Gas should actively explore these alternatives and adopt any measures that are effective from a cost and security point of view.

At the same time, the Commission recognizes that the significant contracting actions which are proposed in the Plan are common to all of the supply portfolio alternatives. Following are comments about specific actions, with any action plan approvals given on the understanding that all individual supply contracts and amendments, as well as any specific hedging activities, will continue to be filed in a timely fashion for Commission approval:

1. An increase in total peak day supply requirements of 29 TJ/d (2.4%) to 1227 TJ/d for the Lower Mainland, Inland and Columbia service areas is accepted. This includes 25 TJ/d of backstopping and equates to a peak day requirement for firm sales of 1162 TJ/d. It is anticipated that BC Gas' revenue requirement filing for 1996 will reflect the corresponding 2.9% increase in annual sales.
2. Subject to reduction as a result of receiving notification of new buy/sell deliveries, the contracting of approximately 55 TJ/d of replacement non-baseload supply from Alberta is approved. When individual contracts are filed for approval, BC Gas will be required to justify any price premiums relative to sourcing gas using the electronic trading boards in Alberta.

3. Subject to reduction as a result of receiving notification of new buy/sell deliveries, the contracting of approximately 53 TJ/d of non-baseload supply that is delivered through Westcoast/NW Pipeline is approved. However, recognizing that BC Gas appears to have a surplus of baseload supply, the utility is expected to make every effort to use some of this supply as part of, for example, its back-to-back backstopping arrangements.
4. The optional strategy to resell some or all of the US long term gas for one year and replace it with lower cost supply is encouraged, subject to providing economic justification and confirming security of supply when a transaction is filed for approval. Similar comments apply to the re-marketing or decontracting of some Canadian baseload gas, including buy/sell gas where appropriate.
5. The purchase of excess volumes of supply for resale under back-to-back agreements is approved providing no net costs to firm sales customers result and BC Gas demonstrates that it is unable to use existing contracts, such as baseload gas or US supply, for this purpose.
6. The Commission notes that BC Gas expects the portion of indexed pricing in its Canadian baseload portfolio will be higher than the current 30% and that the utility proposes to use fixed price contracts and price hedging instruments to establish a total fixed price component in its baseload portfolio in the 50% to 70% range. BC Gas will be required to justify the use of fixed prices rather than market sensitive prices when fixed price agreements are filed for approval. The Commission expects the burden of justification will become more onerous to the extent the fixed price component exceeds 50%, or, if more than 20% of the portfolio has fixed prices that extend beyond the 1995/96 gas year. Little if any volume should have fixed prices that extend beyond 1996/97.
7. The Commission generally accepts the information about the use of gas price risk management instruments as set out in Appendix C and which was developed in response to Commission Letter No. L-37-94. The Commission is not prepared to approve the use of these instruments at this time but requires BC Gas to seek specific approval for the activity via a filing that includes the following:
 - a definition of the level of volatility that is "unacceptable", which incorporates an analysis of the views of customers on rate volatility, as determined by market analysis, customer surveys or stakeholder group discussion.
 - an attempt to quantify the range around the 1995/96 price forecast within which actual prices are expected to fluctuate.
 - an analysis of the impacts that the recommended hedging actions are expected to have, if actual 1995/96 gas prices are (a) higher than forecast and (b) lower than forecast according to the foregoing analysis.
 - a description of the control, auditing and reporting mechanisms that will be put into place to limit financial exposures (including counterparty credit risk), the exposure limits that are proposed, the related experience of the individuals who will carry out the activity and the projected administration costs.
 - a proposal for reporting gas price risk management activities and the impact of such activities on gas costs to the Commission.
8. BC Gas' recommendation that it not hedge currency exchange rates at this time is accepted.

The list of 1994/95 supply contracts in Appendix D provides a helpful starting point for the 1995/96 Plan, but a review of it indicates some minor discrepancies with the Commission's records. By August 1, 1995, the list should be refiled showing the latest approval for each contract by Commission Order and identifying the contracts that will expire at the end of 1994/95. For each contract, the amount of Westcoast zone 3 and zone 4 capacity that BC Gas (a) holds or (b) has assigned to the supplier to transport the gas should be stated. The total amount of each category of firm zone 3 and zone 4 capacity that BC Gas will hold for 1995/96 should also be summarized. Westcoast capacity should be expressed in volume units.

BC Gas is requested to work with Commission staff to develop a revised format for the 1996/97 gas contracting plan. The Commission expects that the revised format will include an improved analysis of alternatives.

The Commission has accepted the filing on a "Confidential" basis, at the request of BC Gas, on the understanding that it contains commercially sensitive information related to energy supply contracts.

Yours truly,

A handwritten signature in black ink, appearing to read 'R. Pellatt', with a stylized flourish at the end.

Robert J. Pellatt

BW/lm