



LETTER L-6-12

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VIA EMAIL

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February 7, 2012

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 2010/11

Further to the FortisBC Energy Inc. December 22, 2011 filing of the Gas Supply Mitigation Incentive Program Year End Report for the period from November 2010 to October 2011, the Commission accepts the calculation of an incentive payment of \$1,237,093 and issues the attached report entitled "Commission Staff Overview Report - Gas Supply Mitigation Incentive Program (GSMIP) 2010/11."

Yours truly,

Alanna Gillis

TS/dg

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)
2010/2011**

January 31, 2012

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APPENDICES:

APPENDIX 1	FortisBC Energy Inc. Confidential - Gas Supply Mitigation Incentive Program Year End Report: November 2010-October 2011 dated December 22, 2011
APPENDIX 2	FortisBC Energy Inc. Confidential - Service Quality Indicator and Gas Cost Information Report: November 1, 2010-October 31, 2011 dated December 22, 2011
APPENDIX 3	Commission Order G-101-09 dated September 3, 2009
APPENDIX 4	FortisBC Energy Inc. Letter from FEI Internal Audit dated December 20, 2011

1.0 SUMMARY

On December 22, 2011, FortisBC Energy Inc. (FEI) filed its “Gas Supply Mitigation Incentive Program Year End Report: November 2010 – October 2011” (2010/11 GSMIP Report) pursuant to Order G-26-11 based on the 2009/10 GSMIP calculation methodology approved by Order G-101-09. In the 2010/11 GSMIP Report, FEI seeks Commission approval for an incentive payment of \$1,237,093 for the November 1, 2010 to October 31, 2011, gas contract year (2010/11 Year).

Commission staff have reviewed the material provided in the 2010/11 GSMIP Report and the calculation of FEI’s incentive payment of \$1,237,093 and finds it to be consistent with the methodology approved by Order G-101-09. In addition, Commission staff agree that although FEI did not fully meet expectations for the PRMP SQI as defined, that this did not influence or impact FEI’s performance or duties in mitigating gas supply resources for the benefit of its customers and therefore, should not cause FEI to be denied the GSMIP incentive payment. The 2010/11 GSMIP Report and Service Quality Indicator Report adequately support FEI’s view that it has met the requirements for receiving the incentive payment and therefore, Commission staff recommend approval of the incentive payment as requested for the 2010/11 Year.

Commission staff further note that the challenges inherent in the GSMIP design, for which this is the final year, with respect to measuring and quantifying the level of innovation and exceptional performance over and above competent performance should be addressed in large part by the recently approved updated GSMIP program. The new GSMIP program was developed through a working group process in collaboration with other interested stakeholders and was approved by Commission Order G-163-11 and will be used to determine any incentive payment for the 2011/12 gas year.

According to the information presented in the 2010/11 GSMIP Report, total mitigation revenue is \$117.8 million (\$158 million for 2009/10); \$87 million of which is revenue from re-sales of some 23 petajoules (PJ) of excess commodity (30 PJ in 2009/10). The margin eligible for sharing between the core market and FEI (Total Eligible Margin), as defined and set out in Order G-101-09 is calculated as \$39.0 million, an increase of 19 percent over the previous year’s Total Eligible Margin. The total incentive payment is calculated using the approved sharing mechanism of 5 percent for Eligible Margins up to \$20 million and 1.25 percent for Eligible Margins above \$20 million to arrive the calculated incentive payment of \$1,237,093.

2.0 BACKGROUND

A form of incentive program for rewarding the utility in maximizing revenue recovery from resources used in meeting its core load has been in existence since 1995. In 1997/98 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 have changed slightly over this period, though the methodology and calculation have been adjusted from time to time. For the 2002/03 GSMIP, parties including the British Columbia Public Interest Advocacy Centre, FEI (then BC Gas) and the Commission met and agreed to include Service Quality Indicators (SQI’s) and certain market reports in order to better assess performance with the ability to disapprove the incentive should overall gas supply service be deemed unacceptable.

In 2010, FEI submitted a revised GSMIP application to the Commission. After a hearing, the Commission by Order G-26-11 denied the Application and ordered that the 2009/10 GSMIP as described in Order G-101-09 be

continued for the November 1, 2010, through October 31, 2011, period. Order G-26-11 also ordered FEI (then TGI) to establish a working group and set out the guiding principles for the Working Group to arrive at a mutually acceptable GSMIP program going forward. On September 22, 2011, a revised GSMIP application, endorsed by the Working Group, was approved by the Commission for the November 1, 2011 to October 31, 2013, period.

3.0 GSMIP OBJECTIVES

The GSMIP Objectives approved in Order G-101-09 remain unchanged for the 2010/11 Year and are re-stated below as:

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 FEI to maximize net revenues from its off-system business activities while maintaining supply security.
3. **Fair and Reasonable Incentives:** The plan should be structured to encourage continued success in mitigation activities and to reward substantial new 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 the level of incentive sharing corresponds to the level of excellence demonstrated by FEI's gas procurement and mitigation activities.

4.0 2010/11 GSMIP MECHANISM

The GSMIP sharing mechanism calculates the incentive payment to FEI as a percentage of the Total Eligible Margin. The Total Eligible Margin is defined as the sum of the Eligible Commodity Re-sale Margin plus the Eligible Transportation, Storage and Other Margin.

The sharing formula for the 2010/11 GSMIP remains as follows:

<u>Total Eligible Margin</u>	<u>Incentive Payment</u>
\$0 to \$20 million	5%
Greater than \$20 million	1.25%

5.0 COMMODITY RE-SALE MARGIN

5.1 2010/11 Commodity Re-Sale

When the commodity resources contracted pursuant to the Annual Contract Plan (ACP) exceed actual customer demand, FEI mitigates the contracted resources by re-selling the excess commodity. The intent is to maximize the re-sale price and therefore, revenues by re-selling at the various market hubs using available contracted and company owned transmission capacity. FEI notes it also uses techniques such as forward sales and recallable sales to maximize the mitigation revenues when it can be done without compromising the security or reliability of supply for customers. For the 2010/11 Year commodity re-sale volumes are 23.2 PJ, representing a decrease of 23 percent or 7.0 PJ from 2009/10. Commodity re-sale revenues for 2010/11 are \$87 million, down by \$49

million or 36 percent from 2009/10. Revenues dropped more severely than volumes due to lower commodity prices for the 2010/11 year.

Table 1: Commodity Re-sale Revenue and Volume

	Units	2009/10	2010/11	(+/-)	(+/-) %
Gross Revenue	\$MM	\$ 136	\$ 87	\$ (49)	-36%
Volume	PJ	30.2	23.2	(7.0)	-23%
Price	\$/GJ	\$ 4.51	\$ 3.75	\$ (0.76)	-17%
Eligible Margin	\$MM	\$ 16.7	\$ 16.6	\$ (0.1)	-1%

Volumes for the 2010/11 Year are down from the previous year primarily due to cooler weather. The 2010/11 winter was 5 percent colder than 'normal' unlike 2009/10 which was near normal.

The primary market centres are: Huntingdon, Kingsgate, and Empress with the bulk of the sales revenue realized at Huntingdon (~\$72M of the \$87M). Alberta supply is moved to these higher priced market centres using contracted transmission capacity on third party and company owned Southern Crossing Pipeline (SCP) capacity depending on market centre prices.

FEI notes that Sumas traded well above Kingsgate for November through January and March through April. During the summer months, Kingsgate which is more of a seasonal market driven by summer demand, traded above Sumas and so FEI moved commodity to Kingsgate for re-sale using available transportation capacity contracted under the ACP.

FEI also notes that it generated an additional \$17 million of commodity re-sale revenues on behalf of FortisBC Energy (Vancouver Island) Inc. which is not included in the Eligible Margin calculations for GSMIP.

5.2 Eligible Re-sale Margin

The commodity Re-sale Margin that is eligible for incentive sharing is determined according to the following Eligible Commodity Re-sale Margin formula:

$$\text{Eligible Re-sale Margin} = \text{Re-sale Price} - (\text{Sumas Monthly Index} - \text{Hurdle Discount})$$

Where:

$$\begin{aligned} \text{Re-sale Price} &= \text{Weighted Average Annual Re-sale Price} \\ \text{Sumas Monthly Index} &= \text{Weighted Average Annual Sumas Monthly Index} \\ \text{Hurdle Discount} &= \$1.00 \times (17 \text{ PJ} / \text{Annual Re-sale Volume}) \end{aligned}$$

The Eligible Re-sale Margin formula is structured with the intent of normalizing commodity re-sales to offset the impact of factors such as weather on customer load and making the incentive independent of the absolute gas market price levels.

For the 2010/11 Year the annual re-sale volume was lower due to cooler weather; the Hurdle Discount increased accordingly. The Sumas Monthly Index was lower than the previous year reflecting the general trend in bearish market factors including increased production and storage levels, and decreased demand.

As shown in Table 2, the Eligible Commodity Re-sale Margin for the 2010/11 Year was \$16.59 million, a decrease of only \$0.1 million from 2009/10.

Table 2: Eligible Commodity Re-sale Margin Calculation

	Units	2009/10	2010/11
Resale Price	\$/GJ	\$ 4.51	\$ 3.75
Sumas Monthly Index	\$/GJ	\$ 4.52	\$ 3.77
Volume	PJ	30.2	23.2
Hurdle Discount	\$/GJ	\$0.56	\$0.73
Eligible Margin	\$/GJ	\$0.55	\$0.72
Eligible Margin	\$MM	\$16.69	\$16.59

Based on the information provided by FEI on a daily total basis, Commission staff confirm the correct calculations were used and is in agreement with the 2010/11 Eligible Commodity Re -sale Margin total of \$16.59 million.

6.0 ELIGIBLE TRANSPORTATION, STORAGE AND OTHER MARGIN

FEI reports an incremental gross margin of \$30.8 million from mitigating transportation, storage and other resources. Of this gross margin, \$5.7 million of T-South/SCP margin and \$2.7 million of T-South Enhanced Service margin is allocated to delivery margin and therefore, removed from the calculation of Eligible Margin. The resultant Eligible Margin totals \$22.4 million (\$30.8 - \$8.4). Gross Margin and Eligible Margin increased 47 percent and 39 percent respectively over the prior year as can be seen in table 3 below. The majority of this increase in margin can be attributed to an increase in mitigation volume on T-South (46.7 PJ up from 32.5 PJ in 2009/10) and slightly greater mitigation margin earned (\$0.33/GJ up from \$0.29/GJ in 2009/10). T-South mitigation margin alone accounts for \$15.3 million of the gross margin, an increase of nearly \$6 million from 2009/10.

Table 3: Eligible Transportation and Other Margin

	2009/10	2010/11	(+/-)	(+/-) %
Transportation & Other				
Gross Margin (\$MM)	\$20.9	\$30.8	9.8	47%
Eligible Margin (\$MM)	\$16.2	\$22.4	6.2	39%

FEI explains this increase in T-South mitigation margin largely as a result of a decision to reduce T-South summer assignments that FEI typically transacts prior to the summer thereby increasing mitigation opportunities in the day market for FEI through the summer period. A smaller part of the increase in 2010/11 transportation mitigation margin was related to implementing more daily transportation assignments on NGTL to third parties.

The difference between Eligible Margin and Gross Margin is the amount from T-South and T-South/SCP and T-South Enhanced Service margins that is allocated to SCP delivery margin instead of Midstream Cost Reconciliation Account (MCRA). According to the existing allocation methodology 23 percent of winter and 71 percent of summer mitigation margin was assigned to MCRA as Eligible Margin.

Transportation mitigation activity relates to both contracted and company owned transportation assets, including SCP, that form part of the gas supply portfolio outlined in the ACP. Buy/sell and capacity assignment transactions are performed by FEI to reduce the fixed transportation costs of the ACP portfolio. This mitigation activity is done through daily, monthly and seasonal contracts in the summer and some mitigation on a daily basis in the winter.

Additional or “Other” mitigation activities include natural gas liquid (NGL) extraction revenue, park/lend transactions, and new starting in the 2009/10 Year, the introduction of T-South Enhanced Service with Spectra Energy. Other Eligible Margin totaled some \$7.2 million for 2010/11 up from \$6.7 million for 2009/10. The current year was the first full year that the T-South Enhanced Service was in place. The T-South Enhanced Service, introduced in May 2010 and recently extended to end of October 2014, provides shippers the option to access the Kingsgate market. This service was developed in conjunction with Spectra Energy as a regional energy solution to increase the value of Spectra’s T-South service by utilizing un-contracted capacity on Spectra’s T-South system together with FEI’s interior transmission system and SCP. As the T-South Enhanced Service was not fully contracted during the summer period, FEI took advantage of unused capacity to generate mitigation revenues flowing on average at 70 – 80 percent load factor during June through August 2011 (west to east). In the winter months FEI employs T-South and SCP to meet customer demand leaving little to no surplus to mitigate (east to west).

7.0 INCENTIVE PAYMENT

The Total Eligible Margin used in the GSMIP incentive calculation is the sum of the Eligible Commodity Re-sale Margin (\$16.59 million) plus the Eligible Transportation, Storage and Other Margin (\$22.4 million). For the 2010/11 GSMIP, the Total Eligible Margin is \$39 million, representing an increase of 19 percent over the previous year. Based on the approved incentive sharing mechanism, the incentive payment is the sum of 5 percent of the first \$20.0 million plus 1.25 percent of remaining \$19 million resulting in a **total incentive payment of \$1,237,093 to FEI**, an increase of 6.5 percent from the 2009/10 incentive payment. Commission staff reviewed the methodology and calculations and is satisfied that the calculation was done correctly according to the methodology approved by Orders G-26-11 and G-101-09.

Table 4: Total Mitigation Revenues, Eligible Margin and Incentive Payment

2010/11	\$millions
Commodity Resales	\$16.6
Transportation & Other	\$22.4
Total Eligible Margin	\$39.0
Incentive Payment	\$1.24

8.0 AUDITOR’S REVIEW

By way of a letter dated December 20, 2011, Terry McMillan, Director of Internal Audit at FortisBC Inc., gave assurance the Internal Audit carried out a review of the methodology and calculation of the GSMIP Total Eligible Margin and determined, based on the review, the Total Eligible Margin and the FEI share of \$1,237,093 was determined in accordance with Commission Order G-26-11.

9.0 UNIQUE MARKET INITIATIVES

FEI performed approximately 7,675 transactions over the 2010/11 Year of which around 20% were commodity re-sales and the balance were transportation and storage related. The cooler than normal weather reduced the amount of commodity resale activity compared to the previous year. The majority of the increase in Eligible Margin for 2010/11 compared to 2009/10 was associated with greater T-South mitigation revenues, as a result of FEI reducing the amount of T-South summer assignments that it typically transacts prior to the summer. The T-South Enhanced Service program generated \$5.5 million in total revenues for 2010/11 being the first full year of the service (up from \$2.4 million in 2009/10).

FEI took advantage of some Spectra Energy un-planned plant outages to assist other counterparties by implementing Park/Loans and sell gas in Alberta during some cold weather periods in Alberta without compromising the security of supply for FEI customers.

10.0 REGULATORY AND MANAGEMENT REPORTING

10.1 Performance Measurement

In order to provide the Commission with a means to assess performance, Order G-101-09 identifies certain regulatory and management reporting requirements that provide an appropriate level of disclosure and audit capability with minimum administrative burden. Commission staff examine the calculation of any recommended incentive payments received under the GSMIP along with SQIs performance and make their determination regarding the approval of the incentive payment. FEI filed its “Service Quality Indicators and Cost and Market Pricing Information Report: November 1, 2010 – October 31, 2011” (SQI Report) on December 22, 2011.

In its SQI Report, FEI submits that it “fully met expectations for the SQI performance targets for the 2010/11 gas year, with the exception of the SQI related to the PRMP.” FEI submits that it was not successful in receiving full Commission approval for its proposed enhanced hedging strategy including in its PRMP filing, however argues that the PRMP has no impact or influence on FEI’s performance in creating value through its gas supply mitigation activities that are measured by the GSMIP. Commission staff concur that although FEI did not fully meet expectations for the PRMP SQI as defined, this did not influence or impact FEI’s performance or duties in mitigating gas supply resources for the benefit of its customers and therefore should not, on its own, cause FEI to be denied the GSMIP incentive payment.

10.2 Service Quality Indicators

1. **Annual Contracting Plan (ACP):** The performance target for the ACP requires that the ACP be provided in a timely fashion meeting the expectations of the Commission for approval. The approved ACP, including any revisions throughout the year, must be successfully implemented over the contracting period recognizing those market conditions that may arise.

The ACP was submitted on July 7, 2010, and accepted by Commission Order L-62-10 on August 26, 2010. Specific directions contained in the Commission Order L-58-09 which accepted the 2009/10 ACP where submitted in the 2010/11 ACP. Additionally, all relevant ACP contracts for the 2010/11 Year were filed by FEI and accepted by Commission Orders E-2-11 and G-89-11 for the winter and summer portfolio contracts, respectively. These contracts effectively implemented the ACP as approved by the Commission.

2. **Price Risk Management Plan (PRMP):** The PRMP performance measure requires FEI to provide the PRMP in a timely fashion meeting the expectations of the Commission for approval. Under the PRMP SQI, FEI is to implement the PRMP including any approved revisions within the guidelines presented in the plan including any provisions or understanding about transaction volumes within stated timelines.

In 2010 and 2011 FEI undertook a comprehensive review of the PRMP which ultimately resulted in a Commission decision that the majority of the proposed hedging activities described in the PRMP were not in the interests of customers with the exception of the Sumas/AECO Basis swaps. However, FEI notes that it has largely met the requirements of this SQI by conducting all PRMP activities in accordance with Commission approvals and in a timely and accurate manner.

3. **Counterparty Risk and Credit Exposure Management:** FEI is to show that it has effectively managed credit exposure for Firm customers prudently avoiding non-recoveries if deemed reasonably preventable.

FEI states that it retains a strong internal control environment and processes and has avoided non-recoveries amidst volatile and fluctuating financial and gas markets.

4. **Commodity Supply Reliability:** The performance target for commodity supply reliability is 100 % delivery of Firm customer demand.

FEI states that it met 100 percent of its firm customer demand in the 2010/11 gas year despite significant plant disruptions at Pine River Plant (on Nov 22nd, coldest day) and Pine River and McMahon plants from January 13, 2011, to January 18, 2011. FEI was able to use its market area storage resources to help preserve Westcoast's linepack and pressures while ensuring that FEI's core customers were not affected by the business cuts. In addition FEI notes that it successfully backstopped supply for Commodity Unbundling Marketers in 80 incidents of supply cuts of 7,000 GJ's of gas.

Commission staff concur with FEI that it has met expectations on all four SQIs for the 2010/11 Year with the exception of the approval of its PRMP.

10.3 Gas Cost and Market Price Comparisons

As required, FEI has provided a summary of FEI's gas costs in comparison to daily and monthly indexes and other utilities in the Pacific Northwest. The data provided showed FEI to be competitive with the other utilities in the region falling generally within the range between the higher and lower band when looking at commodity cost only. FEI has also provided data to demonstrate that its monthly gas costs, excluding fixed costs and hedging and adjusted for the cost of marketer gas, are competitive with daily and monthly index prices for the 2010/11 gas year. In addition, comparisons with notional monthly and daily portfolios also demonstrate the value of the diversified portfolio approach to contracting taken in the ACP.

11.0 OTHER REGULATORY AND MANAGEMENT REPORTING

FEI filed the required winter and Year-End reports on the GSMIP and SQIs in the format and timeframe as required by the Commission.

12.0 CONCLUSION

Commission staff have reviewed the material provided in the 2010/11 GSMIP Report and the calculation of FEI's incentive payment of \$1,237,093 and find it to be consistent with the methodology approved by Order G-101-09. In addition, Commission staff agree that although FEI did not fully meet expectations for the PRMP SQI as defined, that this did not influence or impact FEI's performance or duties in mitigating gas supply resources for the benefit of its customers and therefore should not cause FEI to be denied the GSMIP incentive payment. The 2010/11 GSMIP Report and SQI Report adequately support FEI's view that it has met the requirements for receiving the incentive payment and therefore, Commission staff recommend approval of the incentive payment as requested for the 2010/11 Year.

Commission staff further note challenges inherent in the GSMIP design, for which this is the final year, with respect to measuring and quantifying the level of innovation and exceptional performance over and above competent performance should be addressed in large part by the recently approved updated GSMIP program. The new GSMIP program was developed through a working group process in collaboration with other interested

stakeholders and was approved by Commission Order G-163-11 and will be used to determine any incentive payment for the 2011/12 and 2012/13 gas years.