



**IN THE MATTER OF**

**FortisBC Energy Inc.  
2015 Price Risk Management**

**DECISION  
and Order E-10-16 and Letter L-15-16**

**June 17, 2016**

**Before:**

**D. A. Cote, Commissioner/Panel Chair  
B. A. Magnan, Commissioner  
R. D. Revel, Commissioner**

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**APPENDIX A – Exhibit List**

## 1.0 INTRODUCTION

On December 23, 2015, FortisBC Energy Inc. (FEI, the Company) filed with the British Columbia Utilities Commission (Commission) confidential and non-confidential versions of the FEI 2015 Price Risk Management Application (Application), which included requests for approval of the following:

- a) Implementation of enhancements to the quarterly commodity rate setting mechanism, as it applies to FEI; and
- b) Implementation of a medium-term hedging strategy for FEI based on pre-defined market price targets and maximum volume limits.

### 1.1 Background and legislative authority

#### 1.1.1 Legislative authority

Commodity rate changes are made pursuant to section 61(4) of the *Utilities Commission Act (UCA)*. Section 61(4) provides that a public utility may file for approval of rate changes “made necessary by a rise in the price, over which the utility has no effective control, required to be paid by the utility for its gas supplies, other energy supplied to it, or expenses and taxes, ...”<sup>1</sup>

Energy supply contracts are required to be filed with the Commission for acceptance as being in the public interest pursuant to section 71 of the UCA. A public utility may submit a proposed plan for entering into energy supply contracts setting out the terms and conditions, and the process the utility intends to use to acquire the supply under those terms and conditions. Under subsection 71(2.4), the Commission can approve the proposed contract if it determines it is in the public interest. With regard to requests for confidentiality, under subsection 71(5) the Commission may determine that the disclosure of the energy supply contract is not in the public interest.<sup>2</sup>

#### 1.1.2 Commission guidelines for quarterly rate setting mechanism and management of commodity cost deferral account balances

The Commission established guidelines for reviewing the quarterly gas cost reporting and management of FEI’s Commodity Cost Reconciliation Account (CCRA) and Midstream Cost Reconciliation Account (MCRA) balances and the Gas Cost Reconciliation Account (GCRA) that predated these two accounts. These guidelines for setting the respective gas cost rates were established through public processes and are as set out in Commission Letters L-5-01 and L-40-11, together referred to as the Guidelines in this decision.<sup>3</sup>

Prior to 2001, gas cost rates had been set once a year effective January 1<sup>st</sup> as part of annual revenue requirements applications. However in 1999 and 2000 gas costs were higher than forecast leading to large balances in the GCRA and the need to reset gas cost recovery rates more frequently. L-5-01 established guidelines for a quarterly gas cost reporting process and the conditions under which BC Gas Utility Ltd. (BC Gas,

<sup>1</sup> [http://www.bclaws.ca/EPLibraries/bclaws\\_new/document/ID/freeside/00\\_96473\\_01#section61](http://www.bclaws.ca/EPLibraries/bclaws_new/document/ID/freeside/00_96473_01#section61).

<sup>2</sup> [http://www.bclaws.ca/EPLibraries/bclaws\\_new/document/ID/freeside/00\\_96473\\_01#section71](http://www.bclaws.ca/EPLibraries/bclaws_new/document/ID/freeside/00_96473_01#section71).

<sup>3</sup> The Guidelines are posted on the Commission website as the Gas Cost Reconciliation Account Guidelines at <http://www.bcuc.com/Guidelines.aspx>.

now FEI) would generally be expected to apply for changes to commodity cost recovery rates. In establishing the Guidelines, the Commission took into account rate stability, price transparency, implications for the expected size of the deferral account and efficiency of process.

Under the rate setting mechanism established in L-5-01, the utility is expected to file for gas cost rate changes if the ratio of expected 12 month gas cost recovery revenue to the sum of expected gas costs for the upcoming 12 month period plus the outstanding GCRA balance is outside the +/- 5 percent deadband. In L-5-01 the Commission stated that although the Guidelines were developed with specific reference to BC Gas it believed the Guidelines would also be appropriate for other provincial gas utilities.

The Commission issued Order G-25-04 on March 12, 2004, establishing for Terasen Gas Inc. (now FEI), the CCRA and the MCRA to replace the GCRA as part of the implementation of Phase 1 of the FEI Customer Choice Program. The Commodity Cost Recovery Charge (CCRC) was established for recovery of CCRA balances. The Commission approved Terasen Gas Inc.'s proposal that the Guidelines continue to apply with respect to the quarterly gas cost reporting and rate setting process for the CCRA.<sup>4</sup>

On May 19, 2011, following a public consultation process,<sup>5</sup> the Commission issued Letter L-40-11 which approved certain modifications to the Guidelines as established in Letter L-5-01. With respect to the CCRA quarterly gas cost rate setting mechanism, a second rate change parameter was added to reflect current gas market conditions. Specifically, L-40-11 established a minimum commodity rate change threshold of \$0.50 per gigajoule (GJ) to provide more price stability by avoiding minor CCRC rate changes during times of low gas prices. The Commission stated in L-40-11 that it anticipated that the Guidelines as revised in L-40-11, in addition to applying to FEI, would also generally apply for other natural gas and propane utilities.

### 1.1.3 2011 FEI Price Risk Management Decision

On July 22, 2010, the Commission, by Orders E-23-10 and E-24-10, denied the 2010 Price Risk Management Plans (PRMPs) submitted by FEI and FortisBC Energy (Vancouver Island) Inc. (FEVI) respectively. In letters which accompanied the orders, the Commission directed FEI and FEVI, in consultation with Commission staff, to conduct a review of the PRMP's primary objectives in the context of the *Clean Energy Act* and increased domestic natural gas supply. On January 27, 2011 FEI filed, on a confidential basis, its "Review of the Price Risk Management Objectives and Hedging Strategy" (2011 PRMP Review) and "Price Risk Management Plan Effective April 2011–October 2014" (2011 PRMP) for approval of the objectives and key elements of the 2011 PRMP including measures for programmatic, defensive, and value hedging as well as basis swaps to hedge price exposure at the Sumas trading hub. The Commission directed FEI to file a non-confidential version of the 2011 PRMP and established a written public hearing to review the objectives of the 2011 PRMP.

On July 12, 2011, the Commission issued Order G-120-11 and accompanying Reasons for Decision in review of the 2011 PRMP (2011 PRMP Decision) denying the request to implement a hedging program with the exception of the Sumas/AECO basis swaps element. With regard to the objectives, the Commission determined that moderation of volatility of natural gas prices to stabilize customer rates is a reasonable goal for FEI to pursue,

<sup>4</sup> Commission Order G-25-04, Directive 5.

<sup>5</sup> The report prepared by FEI as part of this process "March 10, 2011 Commodity Cost Reconciliation Account and Midstream Cost Reconciliation Account Deferral Accounts and Rate Setting Mechanisms Report" is Exhibit A2-1 in this proceeding.

but rejected the notion that it necessarily follows that the 2011 PRMP was the most cost-effective approach or solution. With regard to the objective related to the competitiveness of natural gas with other energy sources, the Commission determined that the need had not been established.<sup>6</sup>

#### 1.1.4 Past quarterly gas cost recovery rate decisions

Twice in recent years, in its quarterly gas cost rate setting reports, FEI has applied to have the standard 12 month amortization period extended to 24 months. In the 2014 first quarter gas cost report FEI applied for approval of a CCRC rate increase of \$0.868 per gigajoule (GJ) based on a 24 month amortization rather than a rate increase of \$1.368 per GJ based on the standard 12 month amortization set out in the Guidelines.<sup>7</sup> In the 2015 first quarter gas cost report FEI requested approval of a CCRC rate decrease of \$1.091 per GJ rather than the indicated 12 month amortization calculated decrease of \$1.295 per GJ “[I]n the interest of rate stability, referring to both frequency and the size of the rate change.”<sup>8</sup>

However, in each of the two cases, in Orders G-37-14 and G-39-15 respectively, the Commission found that FEI had not presented a compelling reason to depart from the standard commodity rate setting mechanism set out in the Guidelines and denied FEI’s request to determine the commodity rate change on the basis of a 24 month amortization period rather than the standard 12 month amortization period. In the Reasons for Decision appended to G-39-15 the Commission acknowledged that, as stated in L-40-11, it retains the discretion to deviate from the mechanistic approach to quarterly gas cost rate adjustment and give consideration to “factors such as the current deferral balances, and based on the forecast costs, the appropriateness of any rate proposals over a 24 month timeframe.”<sup>9</sup>

#### 1.1.5 FEI Price Risk Management Review Report and stakeholder consultation workshops

On October 20, 2014, FEI filed with the Commission the Price Risk Management Review Report (PRM Review Report) which is filed as Exhibit A2-2 in this proceeding. The PRM Review Report included recommendations by FEI for price risk management strategies meeting FEI’s stated primary objectives of mitigating market price volatility to support rate stability, and capturing opportunities to provide customers with more affordable and competitive rates for core sales customers that purchase their commodity supply directly from FEI.

The PRM Review Report also included a proposal for a consultation process through a workshop approach led by FEI for the purpose of discussing issues and concerns with stakeholders with the goal of developing mutually acceptable price risk management strategies and plans. FEI conducted the proposed consultation process during the first half of 2015 through a series of workshops (Stakeholder Consultation Workshops) and, on October 27, 2015, filed with the Commission the Price Risk Management Workshop Summary Report (2015 Workshop Report). The complete 2015 Workshop Report including background information, workshop presentation material and meeting notes is filed as Exhibit A2-3 in this proceeding.

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<sup>6</sup> Commission Order G-120-11, Appendix A - Reasons for Decision, p. 5.

<sup>7</sup> Commission Order G-37-14 dated March 13, 2014, Appendix A, - Reasons for Decision, p. 1.

<sup>8</sup> Commission Order G-39-15 dated March 16, 2015, Appendix A – Reasons for Decision, pp. 1-2.

<sup>9</sup> Ibid, p. 3.

## 1.2 Orders sought

In the Application FEI is seeking Commission approval to implement specific price risk management tools and strategies for customers who receive commodity supply from FEI. The specific approvals sought are:

1. Implementation of enhancements to the Guidelines which includes the following components;
  - a. Commodity rate change cap of \$1.00 per GJ, applicable to rate increases or decreases, provided the deferral account balance is maintained within a reasonable range:
    - i. Implementing a commodity rate change cap, plus or minus \$1.00 per GJ, would be utilized for a maximum of two consecutive quarters provided that the rate changes subject to the cap have been in the same direction; and
    - ii. The cap is removed for the third consecutive quarter if the rate change is in the same direction.
  - b. Criteria for consideration of using a prospective period beyond the 12-month outlook to determine a new effective commodity rate. A 24-month prospective period may be used in specific situations to maintain the CCRA deferral account balance within a reasonable range over the full duration of the 24 month period, which includes:
    - i. When a commodity rate change is indicated using a standard 12-month prospective period;
    - ii. When there is a difference of \$0.75/GJ or more between the CCRA weighted average cost of gas (WACOG) for year one versus year two of the 24-month prospective period; and
    - iii. The direction of the commodity rate change indicated using a standard 12-month prospective period is opposite to the direction of the CCRA WACOG for year two compared to the CCRA WACOG for year one (for example, if the indicated commodity rate change was an increase, the CCRA WACOG for year two would need to be lower than the CCRA WACOG for year one).
2. Implementation of a medium-term fixed-price hedging strategy, which includes the following components:
  - a. Execute hedges when forward AECO/NIT market prices are at or below ██████████ for up to ██████████ of the FEI commodity supply portfolio;
  - b. Execute hedges when forward AECO/NIT market prices are at or below ██████████ for up to ██████████ of the FEI commodity supply portfolio;
  - c. Maximum hedging for any term is 50 percent of the FEI commodity supply portfolio;
  - d. Hedges can include fixed price financial swaps or physical fixed price purchases;
  - e. Price targets apply to each winter or summer term or one-year term within the three-year horizon of April 2016 to March 2019, and
  - f. No hedging is executed if the price targets in (a) or (b) above are not reached.

In the confidential portion of FEI's Final Argument, FEI expanded the approvals sought to include further details regarding execution of the hedging strategy.<sup>10</sup>

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<sup>10</sup> FEI Confidential Final Argument, pp. 1-2

### 1.3 Confidentiality

FEI filed a confidential version of the Application together with a public version with certain information redacted and, in the cover letter to the Application, requests confidentiality in accordance with the Commission's Practice Directive on Confidential Filings. FEI states that it redacted the sensitive details of FEI's hedging strategy as FEI believes that this market sensitive information should be protected and not publicly disclosed in order to preserve and not impair FEI's ability to negotiate and obtain favourable commercial terms for any future natural gas hedging. FEI made the confidential version available to the parties involved in the Stakeholder Consultation Workshops as the hedging strategy and price targets were a topic of discussion at the workshops. FEI requests these parties keep the details of the hedging strategy confidential.<sup>11</sup>

In the request for confidentiality FEI referenced the Commission's Practice Directive on Confidential filings. This practice directive was replaced by the Commission's Rules of Practice and Procedure according to Order G-1-10 dated January 15, 2016.<sup>12</sup>

In a response to Scope B Confidential Commission Information Request (IR) No. 1, FEI provided additional confidential details regarding the execution of the hedging strategy<sup>13</sup> and in the confidential portion of FEI's Final Argument, FEI expanded the approvals sought to include these execution details.<sup>14</sup>

No parties objected to FEI's request for confidentiality.

#### Commission determination

The Panel has reviewed FEI's request for confidentiality and agrees that release of details regarding the hedging strategy would potentially impair FEI's ability to obtain favourable commercial terms in the proposed hedging program. **Pursuant to section 71(5) of the UCA the Commission will hold confidential the hedging price targets, volumes and execution details as requested by FEI.**

**The Panel considers the use of confidential information to be important in writing a clear and concise Decision. Because of this, the Decision has been written to include confidential information the Panel considers to be relevant. However, to ensure confidentiality, only a redacted version of the Decision will be made available to the public.**

### 1.4 Regulatory process

The Commission reviewed the nature of the approvals requested and considers review of the two main components of the Application through parallel written regulatory review processes is warranted. By Order G-10-16 dated January 27, 2016, the Commission divided the review of the Application into Scope A and Scope B in order to accommodate parties who might wish to participate in the review of only one of the two main components. Scope A is FEI's proposed revisions to the quarterly gas cost reporting and commodity rate

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<sup>11</sup> Exhibit B-1, cover letter, pp. 1-2.

<sup>12</sup> Exhibit A-1.

<sup>13</sup> Exhibit B-5, Confidential Scope B BCUC IR 1.4.

<sup>14</sup> FEI Confidential Final Argument, pp. 1-2.



setting guidelines as currently set out in Commission Letters L-5-01 and L-40-11. Scope B is FEI's proposed medium-term hedging strategy. The Regulatory Timetable set out one round of IRs for each of Scope A and Scope B followed by written submissions from the parties in regard to the need for further process.

In Order G-10-16, the Commission directed FEI to provide copies of the Application to all registered interveners in the 2011 PRMP proceeding, participants in the 2015 price risk management consultation process, gas marketers in the FEI Customer Choice program and Commission-regulated natural gas and propane utilities.

Commercial Energy Consumers Association of British Columbia (CEC) and British Columbia Old Age Pensioners' Organisation *et al.* (BCOAPO) were accepted as registered interveners. No other parties participated as interveners or interested parties and no letters of comment were filed. CEC and BCOAPO submitted IRs for both Scope A and Scope B.

Following FEI's response to IRs and the submissions on further process, the Commission issued Order G-38-16 on March 21, 2016, and established a regulatory timetable moving directly to final arguments. All parties made final arguments and FEI filed a reply argument on April 22, 2016.

## **2.0 SUMMARY OF KEY DETERMINATIONS**

The Panel makes the following determinations with respect to FEI's Scope A proposed enhancements to the commodity rate setting mechanism:

- 1. The Panel approves FEI's proposal to implement a commodity rate change cap of +/- \$1.00 as an enhancement to the Commission's Guidelines with the following two provisions that will apply with respect to the FEI CCRA rate and the CCRA deferral account:**
  - **The \$1.00/GJ cap is restricted for use in two consecutive quarterly review periods where the rate change has been in the same direction. The cap cannot be applied for the third quarter once it has been applied for the preceding two quarters.**
  - **A requirement for use of the \$1.00/GJ cap is that the CCRA deferral account does not exceed the plus or minus maximum of \$60 million after tax.**
- 2. The Panel approves FEI's proposed three criteria to assist the Commission when considering timeframes of 24-month rather than the standard 12-month prospective period with the proviso that all of the criteria are met. The approved criteria are as follows:**
  - **When a commodity rate change is indicated using a standard 12-month perspective period;**
  - **When there is a difference of \$0.75/GJ or more between the average CCRA WACOG for year one versus year two of the 24-month prospective period; and**
  - **When the direction of the commodity rate change indicated using a standard 12-month perspective period is opposite to the direction of the CCRA WACOG for year two compared to the CCRA WACOG for year one.**

The Panel makes the following determinations with respect to FEI's Scope B proposed medium-term three year hedging strategy:

1. **The Panel determines that it is in the public interest to approve a medium-term three-year hedging strategy as proposed by FEI in its Application. The Panel therefore approves implementation of the following specific components as described in the Application:**
  - a) **Execute hedges only when forward AECO/NIT market prices are at or below [REDACTED] for up to [REDACTED] of the FEI commodity supply portfolio;**
  - b) **Execute hedges only when forward AECO/NIT market prices are at or below [REDACTED] for up to [REDACTED] of the FEI commodity supply portfolio;**
  - c) **Maximum hedging for any term is 50 percent of the FEI commodity supply portfolio;**
  - d) **Hedges are limited to fixed price financial swaps or physical fixed price purchases; and**
  - e) **Price targets apply to each winter or summer term or one-year term within the three-year horizon of April 2016 to March 2019.**
2. **The Panel denies extension of the hedging program beyond March 31, 2019.**

### 3.0 PRICE RISK MANAGEMENT OBJECTIVES

FEI identifies its objectives for price risk management as follows:

- To mitigate market price volatility to support rate stability; and
- To capture opportunities to provide customers with more affordable rates.

FEI considers these objectives to be drivers of its proposed strategies to provide enhancements to the commodity rate setting mechanism and its medium term fixed price hedging strategy as set out in the Application (Proposed Strategies). FEI has pointed out that we are currently in a low market gas price environment which provides an opportunity "to help meet the price risk management objectives of mitigating market price volatility to support rate stability and capturing opportunities to provide customers with more affordable rates."<sup>15</sup> It states that in order to create value for customers these objectives should be met in a cost effective manner and deferral account balances kept in a reasonable range.<sup>16</sup> In support of these objectives FEI provided the following metrics for the evaluation of the success of the objectives:

- Reduce the magnitude and/or frequency of rate changes.
- Limit the impact of significant price spikes (e.g. above \$4/GJ).
- Capture low pricing opportunities (e.g. below \$2.50/GJ).
- Maintain some rate variability to provide price signals to customers.
- Transparent and predefined strategies and implementation.
- Any strategy costs should be minimal.
- Continue to manage deferral account balances (e.g. within +/- \$50 million band).<sup>17</sup>

<sup>15</sup> Exhibit B-1, p. 5; Exhibit B-4, BCUC IR 7.1.

<sup>16</sup> Exhibit B-1, p. 1; FEI Final Argument, p. 5.

<sup>17</sup> Exhibit A2-3, p. 17.

Unlike the 2011 PRMP, FEI has not requested specific approval of its stated objectives but has relied upon them to provide context to the Application. With this in mind the Panel will refrain from making a determination on whether the stated objectives are accepted or rejected. However, given their importance in providing a framework for the proposed enhancements to FEI's quarterly commodity rate setting mechanism and its proposed medium term fixed-price hedging strategy, the Panel will examine these objectives in some detail and provide comment on whether we consider them to be appropriate.

FEI submits that its first objective of supporting rate stability through the mitigation of market price volatility is consistent with the Commission's previous determination in the 2011 PRMP Decision. In that decision it was stated "that moderating the volatility of natural gas prices is a reasonable goal for FEI's price risk management." FEI further submits that the second objective related to providing more affordable rates by capturing opportunities is consistent with the first objective and considers it to be a reasonable price risk management objective.<sup>18</sup>

There was little disagreement among the parties with respect to the value of managing natural gas price volatility to stabilize rates. There was nonetheless a number of IRs directed at FEI concerning the second objective of capturing opportunities to provide more affordable customer rates. Related primarily to the hedging strategy, FEI responses to interrogatories included the following assertions:

- The objective of capturing opportunities to provide customers with more affordable rates is related to the maintenance of low natural gas rates for customers relative to where they have been in the past regardless of energy rates of competing sources.<sup>19</sup>
- The objectives and related strategies outlined by FEI are best described as a risk view as opposed to a market view which can be described as "While all market participants have equal access to data regarding consumption, production, storage and other factors, and they have reached a consensus on next year's future price, I know better." The objective is about helping to maintain low but not necessarily the lowest customer rates as compared to the past. Price risk management is not about "beating the market" as the direction or magnitude of future up or down price changes in the market are not known.<sup>20</sup>
- FEI's proposed hedging strategy is an opportunistic strategy designed to capture favourable market price opportunities if they become available.<sup>21</sup>

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<sup>18</sup> FEI Final Argument, p. 5.

<sup>19</sup> Exhibit B-4, BCUC IR 1.1.2.

<sup>20</sup> Exhibit B-4, BCUC IR 2.1; Gettings, M. "Natural Gas Utility Hedging Practices and Regulatory Oversight: An Inquiry into Local Natural Gas Distribution Companies' Hedging Practices and Regulatory Oversight" (WUTC, July 2015) quoted in the preamble to BCUC 2.1.

<sup>21</sup> Exhibit B-9, CEC IR 15.1.

## Intervener arguments

BCOAPO did not comment on FEI's specific objectives for its price risk management. However, BCOAPO has identified mitigation of short-term rate volatility and medium-term price escalation as what it terms to be "key values." BCOAPO supports FEI's efforts to reduce the risk of price escalation and provide stable rates while identifying low and affordable rates as being most important and favours keeping rates low in those cases where low rates must be traded off against volatility and price escalation risk.<sup>22</sup>

Likewise, CEC did not take a position on the objectives laid out by FEI with respect to price risk management. However, it did submit that the "objectives of mitigating commodity price increases are to the benefit of consumers and should be pursued where possible."<sup>23</sup>

## Commission discussion

The Panel acknowledges the Commission has previously found that moderating the volatility of natural gas prices is a worthy objective for the utility and accepts this objective remains equally important in the present proceeding. However, the Panel is not persuaded the capture of opportunities to provide customers with more affordable rates as outlined in the second objective is appropriate in all cases.

The Panel accepts there currently exists what has been described by FEI as a "low market gas price environment" and its assertion that natural gas prices are at their lowest in over a decade.<sup>24</sup> The Panel also accepts this low price environment provides FEI the opportunity to mitigate market price volatility and, at the same time, potentially capture opportunities to provide customers with more affordable rates. In addition, we accept the downside risk to consumers of undertaking to prolong some of the benefits of the current pricing environment through hedging is minimal, given the current pricing environment.

Our concern is not whether the objective of capturing opportunities to provide customers with more affordable rates is appropriate at this time, but rather, whether it is appropriate to apply it in a natural gas pricing environment that is higher than it is today. FEI has stated the goal of price risk management is not to beat the market and clearly points out that it "does not know the direction or magnitude of future market price changes or whether the market prices may fall further than current levels."<sup>25</sup> Therefore, while the objective as stated may apply in an instance where there is limited downside risk, it has much less application in cases where the downside risk increases due to an overall increase in market pricing. In a higher price environment the implementation of a hedging program such as that proposed, may result in FEI shifting from a risk view to a market view where the decision to purchase hedges is far more speculative with the results being far less predictable. Given these concerns, the Panel is not persuaded that the objective of capturing opportunities to provide customers with more affordable rates has application beyond the current market-pricing environment.

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<sup>22</sup> BCOAPO Final Argument, p. 1.

<sup>23</sup> CEC Final Argument, p. 2.

<sup>24</sup> Exhibit B-1, p. 5.

<sup>25</sup> Exhibit B-4, BCUC IR 2.1.

#### 4.0 EXISTING PRICE RISK MANAGEMENT TOOLS

To assist the reader and provide context for evaluating the new price risk-management tools as applied for in the Application, this section briefly reviews the current price risk management tools available to FEI.

FEI has a broad range of existing strategies and tools that are currently employed for managing gas supply price risk and provides a comprehensive listing in the IR responses.<sup>26</sup> Existing tools can be grouped into four broad categories:

1. Physical gas contracting strategies used to assemble the CCRA commodity portfolio;
2. Rate setting mechanisms through the use of deferral account balances;
3. Optional programs available to customer to help manage volatility and risk; and
4. Financial tools.

A brief description of each follows.

##### **Physical gas contracting strategies**

The CCRA commodity portfolio contracting strategies include the use of storage, sourcing gas supply from multiple trading hubs, contracting with multiple counterparties, allocating purchases between daily and monthly index priced contracts, entering into long term index price purchases and negotiating fixed AECO-Station 2 basis differential contracts.<sup>27</sup> Many strategies can be used to address price risk in more than one way. An example of this is storage which is used in a number of ways; to take advantage of summer-winter price differentials, to reduce exposure to market price disconnections or spikes during peak winter demand and to enhance reliability of supply.<sup>28</sup>

FEI's contracting strategies are set out in FEI's annual contracting plan which is reviewed by the Commission on an annual basis.<sup>29</sup> When constructing the annual contracting plan, FEI adjusts the strategies to respond to changing gas market conditions. An example of this was the recent case when FEI re-allocated the commodity portfolio receipt point percentages effective November 1, 2013, to eliminate Huntingdon as a receipt point. This served to reduce exposure to volatile market prices at the Sumas trading hub.<sup>30</sup>

##### **Use of deferral accounts**

As set out in the Guidelines FEI uses deferral accounts as a rate setting mechanism to smooth rates.<sup>31</sup> These mechanisms include the use of a quarterly reporting period, a 12-month amortization of the CCRA deferral account balance, a 0.95 to 1.05 cost to recovery ratio deadband threshold and a minimum rate change threshold of \$0.50 per GJ.

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<sup>26</sup> Exhibit B-3, BCUC IR 1.1.

<sup>27</sup> Ibid.

<sup>28</sup> FEI Final Argument, pp. 2-3.

<sup>29</sup> Exhibit A2-2, p. 31.

<sup>30</sup> Ibid., p. 34.

<sup>31</sup> Exhibit B-1, p. 1.

The Guidelines also provide for the consideration of the full circumstances prevailing at the time a quarterly commodity rate report is filed including the use of a 24-month period rather than a 12-month prospective period.<sup>32</sup> However, as discussed further in Section 5.2, the current Guidelines lack specific criteria for when a 24-month prospective period would be appropriate.

### **Optional programs for customers**

Optional programs for customers and rate offerings are made available to customers to assist in managing price volatility and price risk. Sales customers can choose to purchase the gas commodity from Customer Choice marketers under fixed price contracts and/or may elect to enrol in FEI's Equal Payment Plan program.

In addition, commercial and industrial sales customers also have the option to move from sales service to transportation service and work with a Shipper Agent to construct a price risk management plan specific to their needs.<sup>33</sup>

### **Financial tools**

FEI also received approval in the 2011 PRMP Decision for the use of one specific financial tool; Sumas-AECO/NIT swaps. This tool is not currently in use as FEI no longer allocates any CCRA purchases to the Huntingdon receipt point.<sup>34</sup>

FEI states the current rate setting mechanism provides customers with appropriate market price signals and manages deferral account balances within what it describes as a reasonable range. FEI also reports that at the Stakeholder Consultation Workshops stakeholders agreed that the current quarterly rate setting and deferral account mechanism is working as intended. There was also some agreement that enhancements to the rate setting mechanism, like those requested in this Application, could be made that would meet the objectives and benefit customers.<sup>35</sup>

In response to information requests, FEI has outlined the relative order that tools are layered in or used. When assembling its price risk management strategy FEI notes that there are numerous factors it must take into consideration. These include managing supply risk, managing market price risk, managing deferral account balances, sending price signals to customers and monitoring counterparties and credit exposure under different market price conditions. When considering the various tools FEI takes a comprehensive approach as no single tool effectively addresses these factors and meets the objectives on its own.<sup>36</sup>

### **Intervener arguments**

None of the interveners provided specific comments with respect to the suitability or effectiveness of existing price risk management tools.

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<sup>32</sup> Exhibit B-3, BCUC IR 1.1.

<sup>33</sup> Ibid.

<sup>34</sup> Exhibit B-3, BCUC IR 2.1.

<sup>35</sup> Exhibit B-1, p. 16.

<sup>36</sup> Exhibit B-3, BCUC IR 1.2.

## Commission discussion

The Panel has reviewed the evidence and notes that there have been no concerns raised with respect to the price risk management tools that are currently in place. The Panel also notes in FEI's report that the parties in the Stakeholder Consultation Workshops agreed the current quarterly rate setting and deferral account mechanism is working as intended. In addition, we note the annual contracting plan and quarterly gas cost reports are filed and reviewed by the Commission on a regular basis providing an opportunity for further inquiry where necessary. Given these factors, the Panel accepts that FEI's current portfolio of comprehensive price risk management strategies and tools are working well from the perspective of managing volatility, sending appropriate market signals and managing the CCRA deferral account balances within a reasonable range. However, the Panel is mindful that the development of effective price risk management tools is an iterative process and the application of these tools will continue to evolve as market conditions change.

### 5.0 SCOPE A – ENHANCEMENTS TO COMMODITY RATE SETTING MECHANISM

As outlined in Section 4.0, the current FEI quarterly rate setting and deferral account mechanism is working well in that it manages volatility, sends appropriate market price signals to customers and manages the CCRA deferral account balances within a reasonable range. Nonetheless, FEI submits that the workshop process revealed there was some agreement among stakeholders that some enhancements could be made to the rate setting mechanism that would benefit customers. Included among these are the implementation of a rate change cap and agreement on criteria used to determine when consideration is to be given to use a 24-month as opposed to a 12-month prospective period when setting rates.<sup>37</sup>

#### 5.1 Commodity rate change cap

FEI proposes to implement a commodity rate change cap of +/- \$1.00, thereby limiting the amount the commodity rate can be increased or decreased. FEI states this limit would come into play in the case of a short-term market event where there is a temporary increase in demand driving up market prices and outlines a recent example from April, 2014, where prices increased sharply due to a cold weather event and decreased in the period following this event.<sup>38</sup> In preparing its proposal FEI reviewed two potential options for caps; a \$0.75/GJ cap and a \$1.00/GJ cap. Aether Advisors LLC (Aether) prepared simulations covering a five-year period from April 2010 to April 2015 for consideration. FEI states that the simulation results show that either rate cap would have reduced the magnitude of the April 2014 increase. However, the \$1.00/GJ cap resulted in lower rate increase amounts and less time where rates were increased. Further, during periods of low volatility having a rate change cap had no impact.

Recognizing this strategy may not work as well in sustained periods of market price increases and potentially lead to under-recovery of gas costs through customer rates thereby inflating deferral accounts to unacceptable levels, FEI has proposed additional conditions governing the use of this rate change cap. First, it is proposed that the \$1.00/GJ rate change cap will only be used for two consecutive quarterly review periods where the rate change has been in the same direction. The rate change cap would not be applied for a third quarter. Second, FEI proposes that an underlying principle for use of this rate setting strategy will be a requirement that deferral

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<sup>37</sup> Exhibit B-1, p. 16.

<sup>38</sup> Ibid, p. 17.

accounts be maintained within what it describes as a reasonable range. FEI subsequently confirmed that the reasonable range for the CCRA deferral account balance is between +/- \$60 million and does not change with the market price of gas.<sup>39</sup> The +/- \$60 million range incorporates the addition of Vancouver Island baseload volumes (and deferral account range of +/- \$10 million) with amalgamation, and other volume adjustments which include customers returning from the Customer Choice program to FEI's standard commodity rate offering.<sup>40</sup>

FEI reports that some stakeholders expressed support for the rate change cap during the workshop process. Notably BCOAPO observed that their client group values rate stability. The BC Non-Profit Housing Association, a workshop participant observed that their client base cannot afford large rate/bill increases and supported either a commodity rate ceiling or a rate cap program. CEC also supported the rate change cap concept but proposed it be based on a percentage rather than a fixed amount such as \$1.00/GJ.<sup>41</sup>

FEI submits the proposed cap at a fixed level of \$1.00/GJ offers better protection than alternatives. A percentage rate change cap would result in higher absolute rate cap changes as rates increased and lower when they decreased. As a result, customers in the higher rate scenario would be faced with higher rates and at the same time receive a lower level of protection than provided by the fixed rate cap. In addition, FEI provided further reasons why the rate change cap should be approved as proposed. Included among these are:

- During periods of short-term market price volatility, it will reduce significant commodity rate increases and decreases.
- The conditions governing the use of the rate cap will minimize potential under-recovery of gas costs during periods of sustained gas price increases.
- Utilization of the cap is likely to be limited to short-term market events.<sup>42</sup>

### **Intervener arguments**

BCOAPO supports what it describes as a modest change to the current commodity price setting guidelines pointing out that the proposed commodity rate change cap will potentially smooth out short-term volatility and has little or no downside. BCOAPO also is in support of maintaining the proposed \$50-\$60 million range for the CCRA deferral account and a limit on the number of consecutive quarters where the cap could be applied. In its view these restrictions will help to ensure deferral account balances will not grow exceedingly large and ratepayers will not face a very large increase in price following a period where rate caps are employed.

BCOAPO acknowledges the CEC suggestion to express the rate cap change as a percentage, and notes this approach could be beneficial in that it further limits the potential downside effect of a fixed rate cap in the event of large sustained market price changes, and would have more impact in periods of higher prices and less impact where periods of lower prices prevail. However, BCOAPO supports the implementation of FEI's proposal of a

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<sup>39</sup> Exhibit B-1, pp. 17-18; Exhibit B-3, BCUC IRs 3.2 and 5.3.

<sup>40</sup> Exhibit B-3, BCUC IR 5.3.

<sup>41</sup> Exhibit B-1, p. 19.

<sup>42</sup> FEI Final Argument, pp. 10-11.



fixed amount rate change cap acknowledging that expressing a rate change cap as a fixed amount would be easier for customers to understand and noting that during periods of high commodity costs, the fixed amount could limit rate changes more than a percentage cap would.<sup>43</sup>

CEC submits the \$1.00 quarterly rate change cap as proposed by FEI is reasonable and beneficial as it will mitigate short-term price volatility while not unduly affecting the CCRA deferral account. CEC supports the Commission approving the proposed rate change cap.<sup>44</sup>

### **Commission determination**

**The Panel approves FEI's proposal to implement a commodity rate change cap of +/- \$1.00 as an enhancement to the Commission's Guidelines with the following two provisions that will apply with respect to the FEI CCRA rate and the CCRA deferral account:**

- **The \$1.00/GJ cap is restricted for use in two consecutive quarterly review periods where the rate change has been in the same direction. The cap cannot be applied for the third quarter once it has been applied for the preceding two quarters.**
- **A requirement for use of the \$1.00/GJ cap is that the CCRA deferral account does not exceed the plus or minus maximum of \$60 million after tax.**

The Panel agrees with BCOAPO that the implementation of a rate change cap of \$1.00 represents a modest change to the existing guidelines, and has the potential to limit volatility over the short term with little or no downside. Further, setting the CCRA deferral account cap at a plus or minus maximum of \$60 million rather than the \$50-\$60 million range and restricting use of the \$1/per GJ to two consecutive quarters will create greater clarity and limit the impact of sustained periods of market price increases on the potential to under-recover costs. This is because the approved maximum CCRA deferral account maximum of \$60 million may be exceeded during such periods, and where this occurs, use of the cap will be suspended. Further, use of the \$1.00/GJ cap can be applied for a maximum of two quarters thereby restricting the impact on the under-recovery of costs from ratepayers.

As part of the IR process, the issue of whether to increase the maximum range of the CCRA deferral account from the current \$50-\$60 million was raised. This will be discussed further in Section 7.1.

### **5.2 Criteria for 24-month commodity rate setting**

The current Guidelines do not preclude the use of a 24-month period for commodity rate setting. Nor do they provide any direction or criteria for when a deviation from the standard 12-month rate-setting period to a longer 24-month period, would be appropriate. The Panel notes FEI has, in 2014 and again in 2015, made application to apply a 24-month amortization period but was denied this longer amortization period.

Based on comments received during the workshop process, the need for clearer criteria determining when to consider a 24-month outlook when setting commodity rates was discussed. FEI states establishing such rules and criteria might be helpful for the Commission when considering variances from a 12-month outlook in the future.

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<sup>43</sup> BCOAPO Final Argument, p. 2.

<sup>44</sup> CEC Final Argument, p. 4.

Accordingly, FEI recommends the Commission adopt the following three criteria when considering rate proposals using a 24-month prospective period rather than the standard 12-month outlook:

- When a commodity rate change is indicated using a standard 12-month prospective period;
- When there is a difference of \$0.75/GJ or more between the average CCRA WACOG for year one, versus year two of the 24-month prospective period; and
- When the direction of the commodity rate change indicated using a standard 12-month prospective period is opposite to the direction of the CCRA WACOG for year two compared to the CCRA WACOG for year one.

FEI provided a scenario in its Application where all three criteria were met and in response to CEC Scope A IR 2.2 confirmed “All three conditions described in the scenario must be met to support a commodity rate proposal over a 24-month timeframe.”

FEI asserts it is seeking to provide some clarity regarding criteria for the current rate setting guideline rather than changing it. The Company considers the quarterly rate setting process and current thresholds to work reasonably well in providing appropriate price signals and rate smoothing for customers. Further, it acknowledges that in workshops the Aether simulations demonstrated using a 24-month rate-setting period may result in unacceptable deferral account balances. However, FEI believes there are particular situations where it would make sense to utilize a 24-month rate setting period. An example of this would be when projected gas costs caused by an event for 12 months out differ significantly from those for the following 12 months. In this instance utilization of a 24-month rate setting period may help to keep the commodity rate more stable and help mitigate volatility while managing the deferral account within a reasonable range.<sup>45</sup>

FEI submits that its proposed criteria outlined above should be approved for the following reasons:

- (a) The 24-month prospective period proposal is based on feedback from the Stakeholder Consultation Workshops and is intended to provide more explicit criteria, which the current Guidelines contemplate but do not specify;
- (b) All three conditions would have to be met to support a commodity rate setting beyond the 12 months for the described set of circumstances; and
- (c) The 24-month timeframe will be used only in limited circumstances. An example of this is when the projected gas costs caused by an event for 12 months out differ significantly from those for the following 12 months. In this instance, a 24-month prospective period could help to mitigate rate volatility and stabilize the commodity rate for a longer period and at the same time manage the deferral account balance within a reasonable range.<sup>46</sup>

### **Intervener arguments**

BCOAPO supports the proposal pointing out it provides clarity to when it is appropriate to use the 24-month prospective period. In addition, having these criteria would eliminate disputes related to whether to use a 24-month perspective in a particular price setting process, and result in increased regulatory efficiency.

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<sup>45</sup> Exhibit B-1, p. 20.

<sup>46</sup> FEI Final Argument, p. 12.

In response to suggestions that the smoothing of rates creates inappropriate price signals for customers, BCOAPO states “short term price signals to consumers, which inevitably lag behind market price changes, do not have a significant impact on residential customer use patterns.” In its view, residential customer behaviour is much more likely to be influenced by consistent price signals over a sustained period of time than they are by periodic short-term price changes.<sup>47</sup>

CEC submits FEI’s “proposed guidelines for the use of a 24 month period for rate-setting are reasonable and can provide potential rate-smoothing benefits without any undue risk to ratepayers, particularly as the Commission retains the opportunity to consider the full circumstances.” CEC recommends approval of the guidelines as proposed by FEI.<sup>48</sup>

### **Commission determination**

**The Panel approves FEI’s proposed three criteria to assist the Commission when considering commodity rate change proposals using timeframes of 24-month rather than the standard 12-month prospective period with the proviso that all of the criteria are met. The approved criteria are as follows:**

- **When a commodity rate change is indicated using a standard 12-month prospective period;**
- **When there is a difference of \$0.75/GJ or more between the average CCRA WACOG for year one versus year two of the 24-month prospective period; and**
- **When the direction of the commodity rate change indicated using a standard 12-month prospective period is opposite to the direction of the CCRA WACOG for year two compared to the CCRA WACOG for year one.**

The Panel accepts the purpose of adding these criteria is to provide clarity as to those circumstances where it may be appropriate for the Commission to consider rate changes utilizing a 24-month outlook. These criteria are being added for greater regulatory efficiency and in no way are intended to bind future panels by fettering their discretion.

## **6.0 SCOPE B - MEDIUM TERM FIXED PRICE HEDGING STRATEGY**

### **6.1 Current gas market price environment**

As noted in Section 3.0, the current gas market has been described as a low market gas price environment. FEI asserts that while there is uncertainty in terms of how low market prices will settle, the available market information which includes historical price movements, gas producer break-even costs and coal-gas fuel switching price levels indicates further downside price movements are limited. FEI has considered these market factors in developing its proposed hedging price targets.

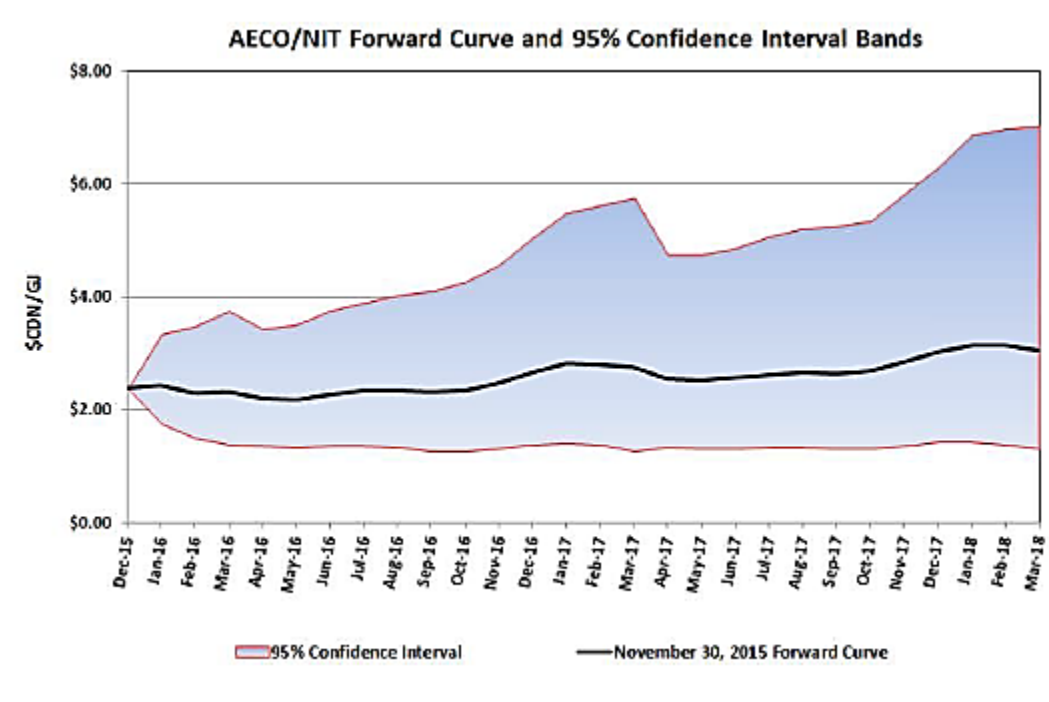
FEI reports that while the AECO/NIT historical market prices have settled at a level below \$2.00/GJ in a number of past instances, they have not stayed at these levels over a sustained period of time. This is also true of forward market prices over the past ten years where only once did AECO/NIT prices for terms within the upcoming year fall below this amount.

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<sup>47</sup> BCOAPO Final Argument, p. 3.

<sup>48</sup> CEC Final Argument, p. 5.

Figure I - Potential Range for AECO/NIT Prices



Source: Exhibit B-1, p. 7.

Figure I shows the potential range for the AECO/NIT prices through March 2018, based on the November 30, 2015 forward curve and illustrates the downside for market prices as being limited as compared to potential upside prices. FEI also points out that break-even costs for gas producers have come down as producers have been able to reduce costs and improve production output levels of shale gas plays. Acknowledging the contribution of high prices for crude oil and natural gas liquids to low break-even costs for gas producers in some areas, FEI notes that this is changing as recent producer break-even cost projections and estimates “suggest that market prices are beginning to impact gas production levels.” As a result, the growth of production is flattening or declining in some areas. Another factor is the fuel switching by those power producers that are able to switch between natural gas and coal-fired generation thereby using the lowest fuel source to produce electricity. Demand for either coal or gas switches when the price of one fuel falls below the other and helps set “a soft floor for market prices.” This additional demand for natural gas when it is at a lower price boosts gas prices and keeps them from falling any further. FEI explains that this “coal-to-gas switching demand helps explain why natural gas prices have remained close to coal prices in recent years.”<sup>49</sup>

FEI states that in response to various market factors, supply and demand balances can change quickly and price volatility continues in spite of the abundance of shale gas. FEI provides a graphic illustration of severe market price spikes in recent years in its Application and comments that “as recently as winter 2013/14, gas market prices spiked due to a winter polar vortex, with regional Station 2 and AECO/NIT daily spot prices climbing to near \$20/GJ and Sumas reaching \$28/GJ.”<sup>50</sup> No assertion was made as to whether any gas was actually

<sup>49</sup> Exhibit B-1, pp. 5-9.

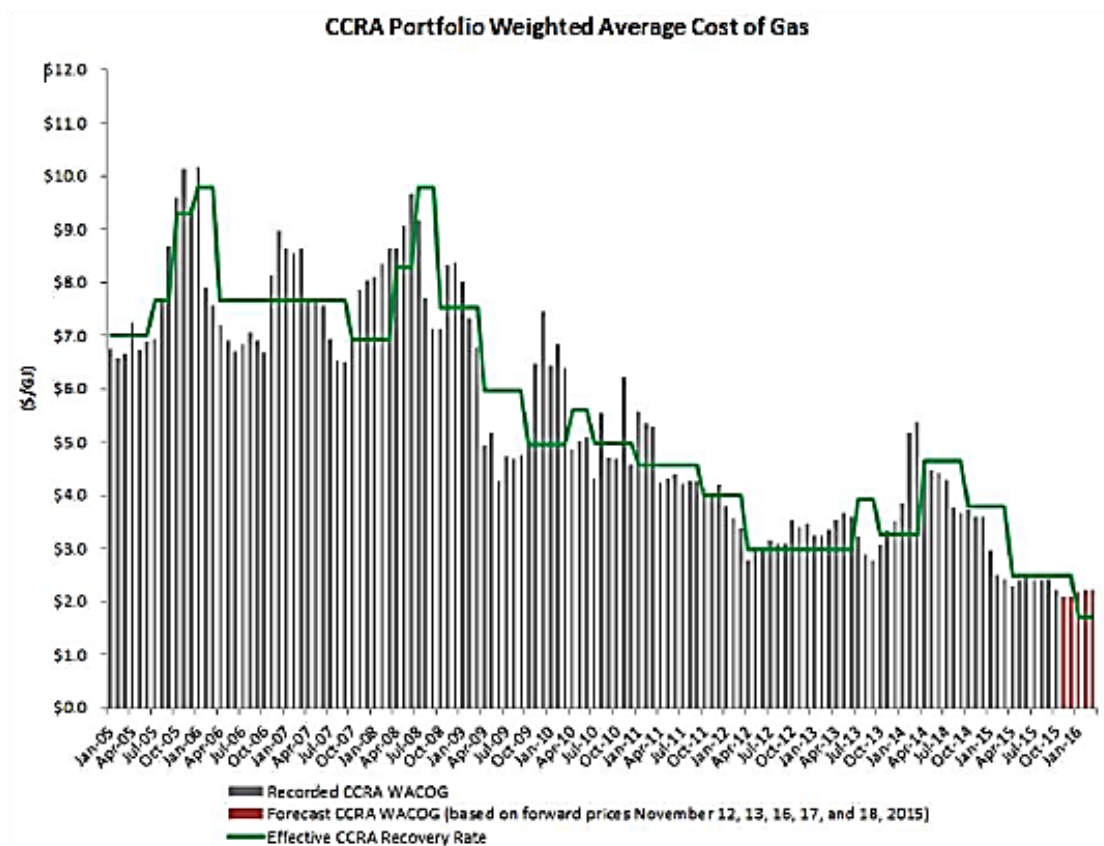
<sup>50</sup> Ibid., pp. 10-11.

purchased at these extremely high price spikes. However, FEI does report that during the winter 2013/14 market price spikes, the commodity rate for FEI customers did increase from \$3.27/GJ to \$4.64/G by April 2014 (as shown in Figure II) explaining that this resulted from two factors; the impact of market price increases on the WACOG and the fact that the commodity deferral account was in a significant debit position.<sup>51</sup>

## 6.2 The need for the proposed hedging program

Figure II provides a historical view of the CCRA portfolio weighted average cost of gas starting in 2005.

**Figure II: Historical FEI CCRA WACOG and Commodity Rate**



Source: Exhibit B-1, p. 12.

FEI states the “figure shows that, even in recent periods with abundant shale gas supply, market prices have continued to remain volatile and FEI’s CCRA WACOG and commodity rate has fluctuated significantly.” During workshops with stakeholders, the impacts of medium-term hedging strategies versus the current no hedging base strategy on commodity rates over a five-year test period from April 2010 to March 2015 were explored through simulations performed by Aether. These simulations were based on a target price of \$3.25 in summer and \$3.50 in winter with a volume hedge limit of 50 percent of the commodity portfolio. FEI states the “hedging strategy resulted in fewer commodity rate changes, kept the commodity rate in a narrower band and also avoided the significant increase in the base case commodity rate due to the winter 2013/14 market price spike event.”<sup>52</sup>

<sup>51</sup> Exhibit B-1, p. 11.

<sup>52</sup> Ibid., p. 12.

FEI states that it is not proposing price risk management strategies to “beat the market.” Its strategy is to take advantage of opportunities to lock in prices when they are favourable to historical market price levels. With reference to the current pricing environment, FEI states “if the hedges are executed, this would keep FEI’s cost of gas close to current levels and near the lowest it has been in a decade.”<sup>53</sup> FEI acknowledges its current commodity rate of \$1.719 per GJ is the lowest commodity price since 2004. While acknowledging that natural gas prices could move lower, FEI believes there is more room for prices to increase than to decrease in the current market environment.<sup>54</sup>

FEI reports that recent customer survey results conducted in 2012 are consistent with the objective of its medium-term hedging strategy to provide more rate stability. This research revealed the following information:

- There is a preference among most customers for some rate stability to help with household budgeting and limit surprises;
- Most customers don’t desire a fixed locked in rate; and
- If rate increases are limited most customers are willing to accept smaller rate decreases.<sup>55</sup>

### **6.3 Proposed hedging strategy**

#### **6.3.1 Application of the hedging strategy**

The medium term hedging strategy as outlined by FEI is limited to fixed price hedging which will be applicable in specified market conditions and be in place for a period of three years. FEI describes this approach as “a limited version of a more dynamic hedging strategy, based on market price conditions and using predefined market price targets such that hedges are only implemented if the price targets are reached.” This differs from the Company’s previously proposed hedging programs that were less responsive to differing market price environments and were programmatic in that they layered hedges periodically over time.<sup>56</sup>

As noted in Section 1.2, FEI seeks Commission approval for its fixed price hedging strategy which includes fixed price physical purchases and/or fixed price financial swaps both of which effectively provide the same result in terms of managing market price risk. Fixed price financial swaps are described as follows:

A fixed price financial swap transaction is purely a financial transaction between FEI and a counterparty, such as a bank. There is no physical purchase or sale of natural gas. FEI would enter into an agreement with the counterparty to pay the counterparty a fixed price in exchange for the counterparty paying FEI the AECO/NIT monthly index price upon its monthly settlement.

Typically, these two payments are netted off against each other so that one party pays the other the net amount. In order to execute the swap, FEI would call the counterparty and enter into the swap transaction based on the forward market prices at the time according to the approved market price targets and maximum hedging volumes.

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<sup>53</sup> Exhibit B-1, p. 13.

<sup>54</sup> Exhibit B-4, BCUC IR 7.1.

<sup>55</sup> Exhibit B-1, p. 14.

<sup>56</sup> FEI Final Argument, p. 13.

In a separate transaction, unrelated to this financial transaction, FEI would arrange to purchase physical gas supply from a gas producer or marketer and pay this counterparty the settled AECO/NIT monthly index price. This physical transaction would be done regardless of whether or not a financial transaction takes place as FEI needs the commodity supply. This payment by FEI of the AECO/NIT monthly index price would offset the payment by the financial transaction counterparty.<sup>57</sup>

FEI describes the process for physical fixed price purchases as follows:

FEI would purchase gas supply at Station 2 and negotiate the fixed price based on two main components – the forward AECO/NIT market price plus a premium or discount factor for Station 2 supply. There is typically also a small premium for physical delivery of the gas by the seller. The hedging price targets are based on the equivalent AECO/NIT price component. Therefore, the Station 2 discount, or premium, component of the transacted price may put the total transacted price above or below the hedging price targets. While Station 2 prices currently trade at a discount to AECO/NIT prices, they have, in the past, traded at a premium to AECO/NIT prices.<sup>58</sup>

FEI describes three term periods for the hedge purchases; winter term from November to March, summer term from April to October, and a one-year term or a 12-month period started in either April or November. The Company submits that the implementation of its hedging strategy will be subject to three conditions being met:

1. Forward AECO/NIT market prices must be at or below defined market price targets.
2. Hedging transaction amounts will not be higher than FEI's monthly indexed supply within the commodity supply portfolio (currently 60 percent monthly index and 40 percent daily index).
3. Maximum hedging transacted through the fixed price hedging strategy will not exceed 50 percent of FEI's commodity portfolio.<sup>59</sup>

When determining how much of the portfolio to contract for at monthly index pricing, FEI considers a number of factors including pricing volatility, the level of migration between gas marketers and FEI's variable rate offering and the amount of excess commodity resale.<sup>60</sup>

FEI explains it has established two different price targets, one at [REDACTED] and one at [REDACTED] because of concerns raised in the workshops that the price target is set low enough to allow customers to continue to benefit where prices decrease further. When the first price target is reached up to [REDACTED] of the portfolio is hedged, and if the price falls at or below the second price target, up to [REDACTED] will be purchased.<sup>61</sup> FEI reports that hedging these amounts would equate to [REDACTED] for [REDACTED] or [REDACTED] for [REDACTED] of the portfolio. The Company submits that setting a 50 percent maximum of the portfolio as a hedging limit is an appropriate balance between providing customers with pricing signals, capturing low market prices and

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<sup>57</sup> Exhibit B-4, BCUC IR 10.1; BCUC IR 12.2.1.

<sup>58</sup> Ibid., BCUC IR 12.1.

<sup>59</sup> FEI Final Argument, p. 13.

<sup>60</sup> Exhibit B-4, BCUC IR 11.3.

<sup>61</sup> Exhibit B-5, BCUC Confidential IR 1.1.

reducing potential hedging costs.<sup>62</sup> Price targets have been determined with consideration given to how low prices have been in the past, the break even costs for gas producers and other market-based factors. AECO/NIT market prices have been selected as reference points. AECO/NIT was selected for two primary reasons:

- It is easy to transact hedges because the AECO/NIT trading market is highly liquid with numerous buyers and sellers.
- The alternative, Station 2 is highly illiquid where buyers and sellers typically purchase physical supply based on a premium or discount to the AECO/NIT monthly index.<sup>63</sup>

It is FEI's intent to roll over the same implementation plan each year to cover the next three years. FEI states that it "plans to file an application each year that includes a rolling three-year hedging horizon (as in previous price risk management plans) and appropriate hedging targets."<sup>64</sup>

#### 6.1.2 Potential costs and savings

At the time of the Application, the selected price targets of Table I depicts an update of these forward prices showing forward AECO/NIT market prices by season as of February 1, 2016.

**Table I: Forward AECO/NIT market prices as of February 1, 2016 (in \$Cdn/GJ)**

Term	Price
Apr16-Oct16	\$ 2.15
Nov16-Mar17	\$ 2.64
Apr17-Oct17	\$ 2.59
Nov17-Mar18	\$ 2.94
Apr18-Oct18	\$ 2.70
Nov18-Mar19	\$ 3.19
Apr19-Oct19	\$ 2.97

Source: Exhibit B-4, Scope B BCUC 1.5.1.

<sup>62</sup> Exhibit B-5, BCUC Confidential IR 1.2; FEI Final Argument, p. 15.

<sup>63</sup> Exhibit B-9, CEC IRs 1.3 and 1.4; 11.3.

<sup>64</sup> Exhibit B-4, BCUC IR 6.2.1.

<sup>65</sup> Exhibit B-5, BCUC Confidential IR 4.1.



AECO/NIT market prices [REDACTED]

[REDACTED] As noted in Section 3.0, FEI asserts that the objective of its hedging strategy is to mitigate rate volatility and to take advantage of opportunities to keep costs to customers low. FEI acknowledges that hedging gains or costs are a result of where the market price settles relative to the hedge prices and provides some examples. Relying on the information in Figure I (the potential range for AECO/NIT prices over time) depicted on page 17, FEI explains that current market expectations indicate prices ranging from \$1.50 to \$6.00 over the next few years. Thus, if the downside risk is \$1.50 as indicated in Figure I and the first hedge is for [REDACTED] of the supply portfolio and transacted at the [REDACTED] target price, the impact of the potential hedging cost on the commodity rate would be approximately [REDACTED] or [REDACTED] a year. This would increase to [REDACTED] or about [REDACTED] per year in the event that the [REDACTED] hedging was executed at the second hedging target. FEI explains that this can also create a hedging gain. If, as indicated in Figure I, the potential upside for market prices is approximately \$4.50/GJ and [REDACTED] of the portfolio is hedged at the first price target, it would result in a savings of approximately [REDACTED] or about [REDACTED] per year. If [REDACTED] hedging is executed at the second price target, the potential saving would rise to [REDACTED] or approximately [REDACTED] per year.<sup>66</sup>

FEI considers there to be more upside risk than downside risk given the current market price environment. In addition to this, FEI asserts it is important to keep some of the other benefits of implementing the hedging strategy in mind. These benefits include a reduction in the number of commodity rate changes, mitigation of market price volatility and spike impacts through reduction in the number of price changes.<sup>67</sup>

FEI acknowledges that implementation of its hedging program could result in some hedging costs. This will depend upon where market prices ultimately settle relative to implemented hedges. Nonetheless, FEI's expectation is that any costs associated with its proposed hedging strategy would be much lower than in past hedging programs and argues it is cost effective in that it benefits customers in terms of mitigating volatility. More specifically, FEI makes the following arguments in favour of its proposed strategy:

- “The market prices are currently significantly lower than they were in the past and so the risk of significant hedging costs is reduced.
- The proposed hedging tools are limited to circumstances of capturing opportunities in a low price environment (i.e. will only be implemented if certain downside price targets are met).
- It is possible that there could be periods of hedging gains...., given the greater upside market price potential than downside potential in the current price environment.”<sup>68</sup>

### **Intervener arguments**

BCOAPO accepts the downside for market prices is relatively limited compared to the upside price potential in the current low price environment, and acknowledges hedging offers an opportunity at potentially small additional cost, to extend the low price environment to periods that may be volatile. BCOAPO takes the position that there is no generic customer tolerance level for bill impacts due to volatility. However, the organization is

<sup>66</sup> Exhibit B-1-1, Confidential Application, p. 15.

<sup>67</sup> Exhibit B-1, p. 16.

<sup>68</sup> FEI Final Argument, p. 18.

made up of client organizations representing customers where the downside impact of price escalations is more severe to customers than is the upside impact of price reductions. Therefore, BCOAPO supports a hedging strategy taking advantage of the current low historical prices.

BCOAPO submits that FEI needs to be constrained in its ability to lock in supply if the market were to return to sustained higher price levels as it could result in customers paying high rates for reduced volatility. BCOAPO therefore supports FEI's hedging proposal only when the market price is near to or at a level close to the breakeven cost of gas production. BCOAPO also submits that a different price limit than that proposed by FEI in the Application may be more appropriate and suggests its own price limits.<sup>69</sup>

CEC concludes it is satisfied that FEI's proposed hedging strategy can provide benefits for customers pointing out that the risk is more limited than it has been in the past. It submits that a dynamic approach to hedging relying upon predefined market targets is more responsive to changing market price conditions than a programmatic approach where hedges are layered in periodically with no regard for where market price levels and hedging prices are. CEC notes FEI's previous lack of success in its hedging programs but accepts the current hedging proposal as having lower risk than there was in the past. CEC recommends approval of the Price Risk Management proposal, but makes its recommendation subject to the program costs and benefits being reviewed annually. It is CEC's view that it is important to have ongoing measurement of the results achieved by implementing the hedging strategy as opposed to those that would be achieved without it. It considers an annual review of strategies as an appropriate mechanism to determine how they are working and whether refinements need to be made.<sup>70</sup>

### **FEI reply argument**

FEI submits that while it continues to believe its proposed price targets are reasonable, [REDACTED]  
[REDACTED]

### **Commission determination**

**The Panel determines that it is in the public interest to approve a medium-term three-year hedging strategy as proposed by FEI in its Application. The Panel therefore approves implementation of the following specific components as described in the Application:**

- a) **Execute hedges only when forward AECO/NIT market prices are at or below [REDACTED] for up to [REDACTED] of the FEI commodity supply portfolio;**
- b) **Execute hedges only when forward AECO/NIT market prices are at or below [REDACTED] for up to [REDACTED] of the FEI commodity supply portfolio;**
- c) **Maximum hedging for any term is 50 percent of the FEI commodity supply portfolio;**
- d) **Hedges are limited to fixed price financial swaps or physical fixed price purchases; and**
- e) **Price targets apply to each winter or summer term or one-year term within the three-year horizon of April 2016 to March 2019.**

<sup>69</sup> BCOAPO Final Argument, p. 4.

<sup>70</sup> CEC Final Argument, pp. 5-14.

<sup>71</sup> FEI Confidential Reply Argument, p. 1.

The Panel also approves [REDACTED]

- [REDACTED]
- [REDACTED]
- [REDACTED]

In addition, the Panel approves [REDACTED]

- [REDACTED]
- [REDACTED]
- [REDACTED]

**The Panel denies extension of the hedging program beyond March 31, 2019.**

The Panel’s decision to approve the three-year hedging strategy is made with consideration to the low-price commodity environment which exists at this point in time. As noted by FEI in response to BCUC IR 1.6.1, its “proposals set out in the Application are not meant to apply to all market conditions, only in the current market conditions.” FEI further clarifies this by stating that “[B]y ‘current market conditions’ FEI is referring to the market price environment which is characterized by an abundance of gas supply with slow growth in demand such that market prices are relatively low compared to historical values.” FEI provides further clarification by noting that during periods of high demand the current market environment could also include periods of market price volatility.<sup>72</sup> The Panel considers this to be an apt description of the current market situation and given these conditions is persuaded the limited medium term hedging program proposed by FEI to be an appropriate approach to taking advantage of opportunities if and when they present themselves with potential risks being manageable.

The Panel acknowledges that BCOAPO proposed different price targets for implementation of the hedging strategy and FEI [REDACTED]. However, our concern with the targets proposed by BCOAPO is they may have limited application even in the current low-price environment and BCOAPO has not indicated how these price limits are supported by the evidence. We note the target prices as suggested by BCOAPO are lower than the February 1, 2016 forward AECO/NIT market prices. Therefore, if its proposed price targets were to be accepted, it could result in potential opportunities being missed. Because of this, the Panel has approved the price targets as outlined in the Application.

The Panel notes FEI’s stated intent to roll over the same implementation plan and potentially set new targets each year, and are reluctant to consider extension of this program beyond the three-year horizon contemplated in the Application. In our view a three-year horizon is a reasonable timeframe to properly assess the approved hedging program. As outlined in Section 4.0, our concern with extending the program beyond three years is not whether capturing hedging opportunities is appropriate in the current environment, but whether it is appropriate to apply a similar methodology in a higher pricing environment than exists today. Put more simply,

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<sup>72</sup> Exhibit B-4, BCUC IR 6.1.

there is no evidence on the record attempting to define exactly what a “low-price market environment” is and at what price point a low-price market environment ceases to exist and there is a shift from a risk view to a market view. Given this circumstance, the Panel is of the view that if FEI wishes to make any change to the term, the price targets or the methodology as outlined in its application, it must do so by a formal application.

## **7.0 OTHER ISSUES**

### **7.1 Appropriate maximum size for the CCRA deferral account**

In Section 5.1 the CCRA deferral account amount was set at a maximum not to exceed \$60 million net of tax. However, as part of the IR process, the issue of whether amounts higher than FEI’s recommended \$50-\$60 million range for the CCRA deferral account, was raised by the Commission and examined in some detail. While not specifically proposed by FEI, the Panel considers there to be value in reviewing this information within the context of this decision.

#### **7.1.1 Background**

Prior to 1999, gas cost recovery rates for FEI’s predecessor, BC Gas, were set once per year effective January 1. During 1999 and 2000, natural gas prices increased dramatically and mid-year rate changes were required. The approved gas cost recovery rates, however, continued to under-recover the gas costs incurred and the balance in the GCRA grew to a deficit of approximately \$180 million<sup>73</sup> by the end of 2000.<sup>74</sup> In response to this Commission staff prepared a report on the method of establishing gas cost recovery rates for BC Gas and amortizing the deferral balance, which was circulated to BC Gas and other parties in late 2001. This resulted in Letter L-5-01 establishing the “Guidelines for Setting Gas Cost Recovery Rates and Managing the Gas Cost Reconciliation Balance.” The quarterly review and rate setting guidelines as set out by the Commission provided the mechanism to manage gas cost deferral account balances and the recovery of gas costs through rates that are in place today.<sup>75</sup>

The CCRA deferral account was set by L-5-01 as +/- \$50 million.<sup>76</sup> Since 2001 the size of the utility has increased significantly, including consolidation with other gas operations within the province and more recently the amalgamation with the Vancouver Island and Whistler gas utilities. FEI explains that the current reasonable deferral account range is between +/- \$60 million. This range incorporates the addition of Vancouver Island base load volumes (and deferral account range of +/- \$10 million) with amalgamation, and other volume adjustments.<sup>77</sup>

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<sup>73</sup> Total in 2000 included both the MCRA and CCRA deferral accounts.

<sup>74</sup> Exhibit B-3, BCUC IR 1.3.3.

<sup>75</sup> Ibid., BCUC IR 1.3.3.

<sup>76</sup> Ibid., BCUC IR 4.1.

<sup>77</sup> Ibid., BCUC IR 5.3.

### 7.1.2 Implications of increased CCRA balances

FEI was asked a series of questions concerning the impacts and implications resulting from a potential change to the maximum balance allowed in the CCRA deferral account. Included among FEI's responses are the following statements:

- The limitations and costs of growing deferral accounts during volatile periods as a means to smooth out commodity rates depend on factors such as the circumstances, the market event duration, and the level of the CCRA account before the event.<sup>78</sup>
- FEI did not appear to receive a credit rating downgrade as a result of the large GCRA balances in 2001.<sup>79</sup>
- As a percentage of rate base, the highest net-of-tax GCRA actual balance around January 2001 divided by the average net rate base of the utility in 2001 was 5.7 percent of the \$2,209 million average net rate base. A \$50 million deferral account balance divided by FEI's ending net rate base for December 2015 results in 1.4 percent of the \$3,661 million average net rate base.<sup>80</sup>
- Applying the 5.7 percent to the current rate base results in a calculated value of \$209 million, FEI states that:

...“based on growth in rate base only...would seem relatively proportional to the 2001 highest deferral balance of \$126 million with the following caveats.

1. The GCRA was split into the CCRA and MCRA in 2004, so the CCRA (\$50 million) only represents one of the gas cost deferrals (sometimes the CCRA and MCRA balances can have an offsetting effect on overall customer rates, but sometimes they have a cumulative effect).
  2. The actual impact to customer rates is based on the deferral balances being grossed up to pre-tax amounts and the tax rates in 2001 were higher than current.
  3. There is a change in customer count since 2001, along with a change in average use rate.”<sup>81</sup>
- Deferral accounts can represent a form of implied financing for utilities from a financial perspective and looked upon similarly as a conventional form of financing obligation. The financial markets' perception of this and any impact on FEI's cost of capital would depend on the size of deferral account balance as compared to the size of the entity and the mechanism for recovery. FEI would not expect a balance of up to \$200 million to appreciably impact the cost of capital of FEI absent of other factors. However, if this were allowed to accumulate in combination with the expected growth of the other FEI financial obligation there may be an impact to FEI's marginal cost of capital, the extent of which would be dependent on the capital markets view of FEI's financial risk.<sup>82</sup>

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<sup>78</sup> Exhibit B-3, BCUC IR 3.3.

<sup>79</sup> Ibid., BCUC IR 4.3.

<sup>80</sup> Ibid., BCUC IR 4.4.1.

<sup>81</sup> Ibid., BCUC IR 4.4.2.

<sup>82</sup> Ibid., BCUC IR 5.2.

FEI does not believe the deferral account balance should be allowed to grow proportionately with the size of rate base. The average annual bill of a residential customer is lower today relative to what it was in 2001; therefore the impact of the recovery of a \$50 million deferral balance on a customer's bill is greater today than it was in 2001.<sup>83</sup>

FEI's position is the balance of the CCRA should be maintained within a reasonable range and note that "some information requests suggest a potential consideration of growing the CCRA as a means to smooth out commodity rates." FEI submits this approach is not appropriate for the following reasons:

1. There is a continuing need for FEI to maintain the balance of CCRA within a reasonable range. This provides greater certainty that FEI will be able to recover its costs from, or refund surpluses to, customers in a timely fashion.
2. Using a deferral account as a price risk management tool is less effective than the medium term hedging strategies as deferral accounts may help smooth out gas costs... but can only partially mitigate the effects of short-term price volatility, because they do not impact the underlying market prices.
3. The effectiveness of growing the CCRA deferral account during volatile periods as a means to smooth out commodity rates is hard to ascertain as it depends on many factors such as the nature of the market circumstances, duration of the market event, and the level of the CCRA account before the event.<sup>84</sup>

### **Intervener's arguments**

The interveners did not comment directly upon the possibility of increasing the CCRA deferral account range.

### **FEI reply argument**

FEI notes both BCOAPO and CEC recognize and place emphasis on the importance of maintaining a range of +/- \$50-\$60 million CCRA balance as a condition of implementing the proposed enhancements. Further, FEI confirms one of the conditions to implement the proposed rate setting mechanism enhancements is its ability to maintain the CCRA balance within this range.<sup>85</sup>

### **Commission discussion**

As outlined in Section 5.2, the Panel has approved FEI's proposal to keep the CCRA deferral account range at +/- \$60 million after tax in keeping with FEI's recommendations. However, the Panel is not persuaded that raising the maximum range of the CCRA deferral account should be rejected outright. The Panel considers there to be potential benefit to examining the option of increasing the maximum amount of the CCRA deferral account as a practical solution to control volatility over the longer term. However, the Panel considers the evidence to be inadequate to support moving forward with a change of this magnitude at this time. Therefore, before considering this approach, a more thorough examination of this option and its implications would need to be undertaken. This is addressed further in Section 7.3.

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<sup>83</sup> Exhibit B-3, BCUC IR 4.4.2.

<sup>84</sup> FEI Final Argument, pp. 6-7.

<sup>85</sup> FEI Reply Argument, p. 2.

## 7.2 Applicability of decision to other gas utilities

The Commission's Guidelines for setting gas recovery rates and managing the gas cost reconciliation balance as set out in Commission Letters L-5-01 and L-40-11, were determined through a public process and apply to other natural gas and propane utilities. The question arises as to whether the revisions to the Guidelines as approved in this Decision should apply only to FEI or whether other utilities, and FEI in the case of its other service areas, should also consider the application of these revised Guidelines to the extent practicable when filing their quarterly gas cost reports and commodity rate change applications.

In L-5-01, the Commission states that although the Guidelines were developed with specific reference to BC Gas (i.e. FEI), the Commission believes the Guidelines will also be appropriate for other provincial gas utilities.<sup>86</sup> In L-40-11, the Commission states the Guidelines will generally apply for other natural gas and propane utilities.<sup>87</sup>

In section 3.2.3 of the Application FEI states "it is important to note that each utility has its own unique rate structures and so applying all of the guidelines components and attributes to other utilities may not make sense." FEI notes that Pacific Northern Gas Ltd. has a commodity charge that includes more third party costs than just gas commodity costs. FEI also observes that propane utilities typically have higher and more volatile underlying commodity costs than natural gas utilities, which means that the same rate change thresholds and caps may not be appropriate for propane utilities.<sup>88</sup>

In the Application, FEI drafted a Commission "L" letter to adopt the proposed revisions to the Guidelines as applicable to FEI only. FEI's proposed wording in the draft letter states: "The Commission anticipates that the Guidelines, as revised by this Letter, will apply to FEI's quarterly natural gas cost reports from the date of this letter, but that these revisions may not be applicable to other natural gas and propane utilities."<sup>89</sup>

FEI confirms it applies the 12-month amortization and +/- 0.95 to 1.0 cost/recovery ratio dead band as set out in the rate setting guidelines in Commission Letters L -5-01 and L-40-11 in the quarterly rate setting for FEI's Revelstoke propane customers. With regard to whether the rate setting guidelines proposed by FEI in its Application should also apply to Revelstoke or other propane utilities, FEI responds that it would have to do further assessment regarding rate setting and the appropriate level of deferral account balances before determining if they are applicable.<sup>90</sup>

In argument neither intervener provides a position or comment in regard to the applicability of the proposed changes to the Guidelines to other natural gas or propane utilities. In addition, although FEI distributed the Application to the other utilities as directed in Order G-10-16, none of these utilities participated in the review of this Application.

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<sup>86</sup> Commission Letter L-5-01.

<sup>87</sup> Commission Letter L-40-11, p. 2.

<sup>88</sup> Exhibit B-1, Section 3.2.3, p. 23.

<sup>89</sup> Exhibit B-1, Appendix E, Draft Letter, p. 2.

<sup>90</sup> Exhibit B-3, BCUC IRs 7.4 and 7.5.

## Commission discussion

The Panel accepts FEI's proposed revisions to the Guidelines may not be applicable for other natural gas and propane utilities. FEI has noted it will need to do further assessment to determine the applicability of the proposed revisions to FEI's Revelstoke propane commodity rate setting. In addition, the Panel observes that FEI has been silent with regard to the application of the proposed revisions to quarterly gas cost rate setting and management of the Gas Cost Reconciliation Account for FEI's Fort Nelson Service Area. Given these circumstances, the Panel concurs with FEI and only addresses the use of the proposed changes to the Guidelines as outlined in this Decision to apply to the CCRA and the CCRC for FEI's Mainland, Vancouver Island and Whistler Service Areas only.

FEI may come forward at a later date with a proposal to also apply some or all of the elements of the revised Guidelines to their propane operations in Revelstoke and natural gas operations in Fort Nelson.

Other gas utilities may also apply for application of these revised Guidelines to the extent practicable when filing their gas cost reports and commodity rate change applications.

### 7.3 Review process

FEI suggests the proposed price risk management strategies be reviewed annually through an update report discussing how the strategies have worked to date and if any refinements need to be made. This report is to include a summary of any hedging gains or costs realized, the reduction in rate volatility achieved with and without hedging, and the commodity rates achieved relative to historical averages.<sup>91</sup> FEI submits that this report will provide a regular opportunity for the Commission to review the effectiveness of the Proposed Strategies.<sup>92</sup> FEI made no submissions as to how the review process will work or whether interveners would be involved.

Within the IR process the potential for current market conditions to change was raised and FEI asked specifically if it would interrupt its strategy or seek approval to alter either the threshold market prices or maximum portfolio percentages. FEI points out that it has proposed an annual update report for the review of its strategies and confirms that if current market conditions were to change significantly, it would consider interrupting its strategy. In addition, FEI states it expects that it would file a hedging plan on an annual basis that includes a rolling three-year hedging horizon and appropriate hedging volumes and price targets given prevailing market conditions. If, in between the annual filings, there are substantial market changes, FEI states it could submit a revision on a one-off basis. FEI expects this would likely be to address changing market price targets as opposed to the maximum hedging volume percentage.<sup>93</sup>

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<sup>91</sup> Exhibit B-1, p. 4; Exhibit B-7, BCOAPO IR 1.1.

<sup>92</sup> FEI Final Argument, p. 8.

<sup>93</sup> ExhibitB-9, CEC Scope B IR 1.4.3; Exhibit B-4 BCUC IR 6.2.



### Intervener arguments

BCOAPO submits that price risk management costs should be reported and should include all costs incurred, both internally and externally, in executing the price risk management strategy. BCOAPO submits the benefits of the price risk management program should periodically be measured against:

- i) the prices sales customers would have paid in the absence of the price risk management strategy (i.e., what the price would be under the status quo); and
- ii) the reduction in volatility realized under price risk management versus status quo.

BCOAPO explains the purpose of this reporting is not intended to judge with perfect hindsight the effectiveness of the particular hedging strategy used, but to provide ongoing feedback to the utility and its customers regarding whether hedging strategies are generally achieving their objectives.<sup>94</sup>

CEC is supportive of conducting a review process and recommends the Commission make its approval of the hedging program conditional on having such reviews. CEC considers the review of strategies conducted on an annual basis as suggested by FEI to be useful, and submits it is important there is ongoing measurement of the results that are achieved with the hedging strategy, versus what would have occurred without it.<sup>95</sup>

### FEI reply arguments

FEI submits it continues to agree to the filing of an annual report. FEI explains that the Proposed Strategies are new and having an annual review will allow the Commission the opportunity to review their effectiveness. FEI submits the review will also allow it to evaluate whether to seek to extend the hedging horizon beyond the currently applied for period on a three year rolling basis and “with appropriate hedging price targets.” In addition, the proposed reporting balances the need to provide the Commission with useful information to assess the Proposed Strategies with the potential for undue administrative burden of reporting.<sup>96</sup>

### Commission determination

The Panel agrees with the parties that there is a need for regular reporting on the price risk management strategies as approved in this Decision. **Accordingly, the Panel directs FEI to file a Price Risk Management Annual Report (Annual Report) providing an update on approved hedging strategies as well as providing relevant commentary on the effectiveness of enhancements to the commodity rate setting mechanism in accordance with the provisions as laid out in this determination.**

The Panel considers there to be a need to understand and evaluate the effectiveness of the hedging strategy but accepts it must be done in a manner that does not unnecessarily complicate or create undue administrative burden. Therefore, process and administrative requirements are limited to those that are needed to adequately assess the effectiveness of these changes. **In keeping with this, the Panel directs the following be included in each Annual Report:**

- **A financial summary of any gains or costs which have resulted from hedging activities.**

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<sup>94</sup> BCOAPO Final Argument, p. 4.

<sup>95</sup> CEC Final Argument, p. 13.

<sup>96</sup> FEI Reply Argument, p. 3.

- **A description of the impact on rate volatility of any hedging activity as compared to what would have occurred had hedging not been undertaken.**
- **The commodity rates achieved relative to historical averages.**
- **An overall assessment of the effectiveness of any hedging activities undertaken and comments on potential improvements or changes.**
- **A description of the impact on rate volatility related to the implementation of the enhancements made to the commodity rate setting mechanism and comments on any issues arising.**

FEI did not propose a timeframe for filing its Annual Report. However, given the content of the Annual Report and the fact that it relates to a broader portfolio of price risk management strategies, the Panel believes it most appropriate to file the Annual Report concurrently with the FEI's annual contracting plan which is typically filed at the beginning of May each year. A copy of the Annual Report is also to be provided to all participants of this proceeding, redacted if necessary. Once the Annual Report has been filed, the need for further process will be assessed by the Commission and if required, a formal process determined.

The Panel observes that it is FEI's intent to file a hedging plan on an annual basis that includes a rolling three-year hedging horizon and appropriate hedging volumes and price targets given prevailing market conditions. This matter was addressed by the Panel in Section 6.0, where FEI's stated intent to extend the program beyond the three-year time horizon ending in March 2019, was denied. As noted in Section 6.0, if FEI wishes to extend or change the provisions of this program it must do so by formal application. In the event a formal application is filed, the Panel expects FEI to include in its application a review of the effectiveness of the strategies approved in this Decision as compared to the other price risk management tools which may be available to FEI. **In particular, FEI is directed to include an evaluation of the option of increasing the acceptable CCRA deferral account balance to \$200 million to manage CCRA during periods of extreme volatility.**

**DATED** at the City of Vancouver, in the Province of British Columbia, this 17<sup>th</sup> day of June 2016.

*Original signed by:*

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D. A. COTE  
PANEL CHAIR / COMMISSIONER

*Original signed by:*

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B. A. MAGNAN  
COMMISSIONER

*Original signed by:*

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R. D. REVEL  
COMMISSIONER



**ORDER NUMBER**

**E-10-16**

IN THE MATTER OF

the *Utilities Commission Act*, RSBC 1996, Chapter 473

and

FortisBC Energy Inc.

2015 Price Risk Management Application

**BEFORE:**

D. A. Cote, Panel Chair/Commissioner

B. A. Magnan, Commissioner

R. D. Revel, Commissioner

on June 17, 2016

**ORDER**

**WHEREAS:**

- A. On October 20, 2014, FortisBC Energy Inc. (FEI) filed with the British Columbia Utilities Commission (Commission) the Price Risk Management Review Report, which included recommendations by FEI for price risk management strategies that help meet the primary objectives in the interests of core sales customers that purchase their commodity supply directly from FEI. The report also included a proposal of a workshop consultation process led by FEI for the purpose of discussing issues and concerns with the goal of acquiring input and feedback regarding proposed price risk management strategies and plans;
- B. On October 27, 2015, FEI filed with the Commission the Price Risk Management Workshop Summary Report, which included background information and a summary of the discussions in the workshop consultation process which took place during the first half of 2015;
- C. On December 23, 2015, FEI filed with the Commission a confidential version and a non-confidential redacted version of its 2015 Price Risk Management Application (Application), which includes the request for approval for the implementation of a medium-term hedging strategy based on pre-defined market price targets and maximum volume limits;

- D. On January 27, 2016 the Commission divided the review of the Application into Scope A and Scope B. Scope A of the Application is FEI's proposed revisions to the quarterly gas cost reporting and commodity rate setting guidelines as currently set out in Commission Letters L-5-01 and L-40-11 and is addressed in Commission Letter L-15-16 dated June 17, 2015. Scope B is FEI's medium-term hedging strategy and is addressed in this order;
- E. FEI requests that the confidential version of the Application be held confidential as it contains details of FEI's hedging strategy and this market sensitive information should be protected and not publicly disclosed in order to preserve and not impair FEI's ability to negotiate and obtain favourable commercial terms for any future natural gas hedging;
- F. The argument phase of the proceeding concluded on April 22, 2016 with FEI's Reply Argument; and
- G. The Commission reviewed the Application and determines that the proposed hedging strategy should be approved for the three year period from April 1, 2016 through March 31, 2019.

**NOW THEREFORE** pursuant to section 71 of the *Utilities Commission Act* the Commission orders as follows:

1. FEI's proposed medium term hedging strategy is approved with the pre-defined price targets and maximum hedging percentages as defined within Section 2 of the Application. Specifically the Commission approves a three year medium-term fixed-price hedging strategy, which includes the following components:
  - a. Execute hedges only when forward AECO/NIT market prices are at or below the proposed target price for up to the proposed percentage of the FEI commodity supply portfolio;
  - b. Execute hedges only when forward AECO/NIT market prices are at or below the second proposed target price for up to the second proposed percentage of the FEI commodity supply portfolio;
  - c. Maximum hedging for any term is 50 percent of the FEI commodity supply portfolio;
  - d. Hedges are limited to fixed price financial swaps or physical fixed price purchases;
  - e. Price targets apply to each winter or summer term or one-year term within the three-year horizon of April 2016 to March 2019, and
2. Extension of the hedging program beyond the three-year time horizon ending March 31, 2019 is denied.
3. The Commission will hold confidential the hedging price targets, volumes and other details as requested by FEI on the basis that disclosure could reasonably be expected to result in harm or prejudice to FEI's competitive or negotiating position.
4. FEI is to comply with all directives in the Decision issued concurrently with this Order.

**DATED** at the City of Vancouver, In the Province of British Columbia, this 17<sup>th</sup> day of June, 2016.

BY ORDER

*Original signed by:*

D. A. Cote  
Commissioner



**VIA EFILE**

June 17, 2016

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

Dear Ms. Roy:

Re: FortisBC Energy Inc.  
2015 Price Risk Management Application

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In 2001 and 2011, the British Columbia Utilities Commission (Commission) established guidelines for reviewing the quarterly gas cost reporting for FortisBC Energy Inc.'s (FEI) Commodity Cost Reconciliation Account (CCRA) and Midstream Cost Reconciliation Account (MCRA) and for setting the respective gas cost rates. These guidelines were established through public processes and are as set out in Commission Letter L-5-01 and Letter L-40-11, together referred to as the Guidelines. The Guidelines were anticipated to generally apply for other natural gas and propane utilities.

On October 20, 2014, FEI filed with the Commission the Price Risk Management Review Report. This report included recommendations by FEI for price risk management strategies to meet the primary objectives in the interests of core sales customers that purchase their commodity supply directly from FEI and a proposal of a stakeholder consultation workshop process led by FEI for the purpose of discussing issues and concerns with the goal of acquiring input and feedback regarding proposed price risk management strategies and plans. On October 27, 2015, FEI filed with the Commission the Price Risk Management Workshop Summary Report, which included background information and a summary of the discussions in the stakeholder consultation workshop process that took place during the first half of 2015.

On December 23, 2015, FEI filed with the Commission the 2015 Price Risk Management Application (Application), which includes requests for approval to implement enhancements to the Guidelines regarding FEI's CCRA deferral account and the Commodity Cost Recovery Charge (CCRC) for FEI's Mainland, Vancouver Island and Whistler Service Areas. These requested approvals are referred to as the Scope A portion of the

Application. Specifically, FEI requests approval to implement a revision to the FEI commodity rate setting mechanism to add a maximum commodity rate change limit of \$1.00 per GJ (increase or decrease), and to incorporate criteria to assist in determining when consideration is to be given to the appropriateness of commodity rate proposals for a 24-month outlook.

The Commission has considered the proposed changes to the Guidelines and agrees that the changes will improve the quarterly reporting process for the FEI CCRA deferral account and the CCRC for FEI's Mainland, Vancouver Island and Whistler Service Areas for the reasons presented by FEI. Therefore, the Commission approves the following revisions to the Guidelines set out in Letters L-5-01 and in L-40-11 as they apply to FEI's CCRA and CCRC.

#### Commodity rate change cap

The Commission approves FEI's proposal to implement a commodity rate change cap of +/- \$1.00 as an enhancement to the Commission's Guidelines with the following two provisions that will apply with respect to the FEI CCRA rate and the CCRA deferral account:

- The \$1.00/GJ cap is restricted for use in two consecutive quarterly review periods where the rate change has been in the same direction. The cap cannot be applied for the third quarter once it has been applied for the preceding two quarters.
- A requirement for use of the \$1.00/GJ cap is that the CCRA deferral account does not exceed the plus or minus maximum of \$60 million after tax.

#### Criteria for clarification of when consideration is to be given to commodity rate proposals beyond standard 12 Month outlook

The Commission approves FEI's proposed three criteria to assist the Commission when considering commodity rate change proposals using timeframes of 24 months rather than the standard 12-month prospective period with the proviso that all of the criteria are met. The approved criteria are as follows:

- When a commodity rate change is indicated using a standard 12-month prospective period;
- When there is a difference of \$0.75/GJ or more between the average CCRA weighted average cost of gas (WACOG) for year one versus year two of the 24-month prospective period; and
- When the direction of the commodity rate change indicated using a standard 12-month prospective period is opposite to the direction of the CCRA WACOG for year two compared to the CCRA WACOG for year one.

The Commission accepts that the purpose of adding these criteria is to provide clarity as to those circumstances where it may be appropriate for the Commission to consider rate changes utilizing a 24-month outlook. These criteria are being added for greater regulatory efficiency and in no way are intended to bind future Commission panels by fettering their discretion.

Applicability to other FEI service areas and other natural gas and propane utilities

The Guidelines, as revised by this Letter, will apply specifically for FEI's quarterly natural gas cost reports for the CCRA and the CCRC for FEI's Mainland, Vancouver Island and Whistler service areas from the date of this letter. The Commission accepts that these revisions may not be applicable for FEI's propane operations in Revelstoke and natural gas operations in the Fort Nelson service area and other natural gas and propane utilities.

FEI may come forward at a later date with a proposal to also apply some or all of the elements of the revised Guidelines to Revelstoke and Fort Nelson. Other gas and propane utilities may also apply for application of these Guideline revisions to the extent practicable when filing their gas cost reports and commodity rate change applications.

Yours truly,

*Original signed by  
Laura Sharpe on behalf of:*

Laurel Ross

CM/yl

cc: Registered Interveners

IN THE MATTER OF  
the *Utilities Commission Act*, RSBC 1996, Chapter 473

and

FortisBC Energy Inc.  
2015 Price Risk Management Application

**EXHIBIT LIST**

**Exhibit No.**

**Description**

*COMMISSION DOCUMENTS*

- |       |  |
|-------|--|
| A-1   | Letter dated January 15, 2016 – BCUC Rules of Practice and Procedure to parties  |
| A-2   | Letter dated January 26, 2016 – Appointment of Commission Panel  |
| A-3   | Letter dated January 27, 2016 – Commission Order G-10-16 establishing the Regulatory Timetable,                              |
| A-4   | Letter dated February 12, 2016 – Scope A Commission Information Request No. 1 to FEI   |
| A-5   | Letter dated February 12, 2016 – Scope B Commission Information Request No. 1 to FEI   |
| A-5-1 | Letter dated February 18, 2016 – Replacement of Scope B Commission Information Request No. 1 to FEI                          |
| A-6   | <b>CONFIDENTIAL</b> Letter dated February 12, 2016 – <b>CONFIDENTIAL</b> Scope B Commission Information Request No. 1 to FEI |
| A-7   | Letter dated March 2, 2016 – Request for Comments regarding FEI Extension Request  |



Exhibit No.	Description
A-8	Letter dated March 3, 2016 – Amended Regulatory Timetable
A-9	Letter dated March 21, 2016 – Commission Order G-38-16 with Regulatory Timetable
A2-1	Letter dated February 11, 2016 – Commission staff submitting Commodity Cost Reconciliation Account and Midstream Cost Reconciliation Account Deferral Accounts and Rate Setting Mechanisms Report
A2-2	Letter dated February 11, 2016 – Commission staff submitting FEI 2014 Price Risk Management Review Report
A2-3	Letter dated February 11, 2016 – Commission staff submitting FEI Price Risk Management Workshop Summary Report.

*APPLICANT DOCUMENTS*

B-1	<b>FORTISBC ENERGY INC. (FEI)</b> Letter Dated December 23, 2015 - 2015 Price Risk Management Application
B-1-1	<b>CONFIDENTIAL</b> Letter Dated December 23, 2015 – Confidential 2015 Price Risk Management Application
B-2	Letter dated March 1, 2016 – FEI Submitting Request for Extension Responses to IR No. 1
B-3	Letter dated March 8, 2016 – FEI Submitting Response to BCUC Scope A IR No. 1
B-4	Letter dated March 8, 2016 –FEI Submitting Response to BCUC Scope B IR No. 1
B-4-1	<b>CONFIDENTIAL</b> Letter dated March 8, 2016 –FEI Submitting Response to BCUC Scope B IR No. 1 <b>CONFIDENTIAL</b> Attachment 9.3
B-5	<b>CONFIDENTIAL</b> Letter dated March 8, 2016 –FEI Submitting Response to <b>CONFIDENTIAL</b> BCUC Scope B IR No. 1
B-5-1	Letter dated March 8, 2016 – FEI Submitting Response to BCUC Scope B Confidential IR No. 1 Filed Non-Confidentially

Exhibit No.	Description
B-6	Letter dated March 8, 2016 – FEI Submitting Response to BCOAPO Scope A IR No. 1
B-7	Letter dated March 8, 2016 – FEI Submitting Response to BCOAPO Scope B IR No. 1
B-8	Letter dated March 8, 2016 – FEI Submitting Response to CEC Scope A IR No. 1
B-9	Letter dated March 8, 2016 – FEI Submitting Response to CEC Scope B IR No. 1
B-10	Letter dated March 16, 2016 – FEI Reply Submission on Further Process

*INTERVENER DOCUMENTS*

C1-1	<b>BRITISH COLUMBIA OLD AGE PENSIONERS' ORGANIZATION, ET AL. (BCOAPO ET AL.)</b> - Letter dated February 4, 2016 - Request to Intervene by Tannis Brathwaite
C1-2	Letter dated February 17, 2016 – BCOAPO Submitting IR No. 1 Scope A
C1-3	Letter dated February 17, 2016 – BCOAPO Submitting IR No. 1 Scope B
C1-4	Letter dated March 3, 2016 – BCOAPO Submitting Comments regarding FEI Extension Request
C1-5	Letter dated March 14, 2016 – BCOAPO Submissions on Further Process
C2-1	<b>COMMERCIAL ENERGY CONSUMERS ASSOCIATION OF BRITISH COLUMBIA. (CEC)</b> - Letter dated February 4, 2016 - Request to Intervene by David Craig
C2-2	Letter dated February 17, 2016 – CEC Submitting IR No. 1 Scope A
C2-3	Letter dated February 17, 2016 – CEC Submitting IR No. 1 Scope B
C2-4	Letter dated March 2, 2016 – CEC Submitting Comments regarding FEI Extension Request
C2-5	Letter dated March 14, 2016 – CEC Submissions on Further Process