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August 16, 2018

ELECTRONICALLY FILED

British Columbia Utilities Commission
Suite 410, 900 Howe Street
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Attention: Mr. Patrick Wruck,
Commission Secretary

Dear Mr. Wruck:

Pacific Northern Gas Ltd (PNG) and Triton LNG Limited Partnership (Triton) Letter Agreement (the Letter Agreement) Application - Project No.1598957

Further to the BCUC Order G-116-18, please find enclosed for filing:

1. Western LNG's Responses to Information Requests of BCUC (Exhibit A-10); and
2. Western LNG's Responses to Information Requests of PNG (Exhibit B-10).

Yours very truly,

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Pacific Northern Gas Ltd. (PNG)
Pacific Northern Gas Ltd. and Triton LNG Limited Partnership Letter Agreement Application

BCUC INFORMATION REQUEST NO. 1 TO WESTERN LNG LLC

A. DAVIS THAMES DIRECT EVIDENCE

- 1.0 Reference: Western LNG LLC (WLNG) Proposal
Exhibit C1-5, Direct Evidence of Davis Thames on behalf of WLNG, pp. 5–7, 11–13;
Exhibit B-1, Appendix A**

On page 5 of Davis Thames’ direct evidence, he states: “On January 8, 2018 Western delivered a proposal to PNG for contracting the entire 70 MMcf/d based largely upon the terms and conditions contained in the EDFT TSA.”

On page 7 of Davis Thames’ direct evidence, he states the following:

...Western provided the term sheet proposal to PNG on January 8, 2018. The terms were based substantially on the terms of the previously-approved EDFT TSA, but Western deliberately proposed favourable terms to itself in several areas since this was the first submission of what was expected to be a back and forth negotiation. Western never received a response to the term sheet, save for the response received in April, and this response bore little to no resemblance to the terms proposed by Western in January.

- 1.1 With specific reference to both the EDF Trading Limited (EDFT) Transportation Service Agreement (TSA) and WLNG’s proposed term sheet, please identify the terms proposed by WLNG which were not consistent with the EDFT TSA and explain the reason for the differences.

Response:

Please see Table 1.

- 1.1.1 If one of the differences in terms proposed by WLNG was the unit demand charge, please explain the reason for this difference and how WLNG arrived at its proposed unit demand charge, including the supporting calculations and assumptions.

Response:

WLNG did not propose a different rate than that contained in the EDFT TSA.

- 1.2 Please further explain the statement that PNG’s response “bore little to no resemblance to the terms proposed by Western.” Please compare and contrast PNG’s response to WLNG’s proposed terms.

Response:

WLNG provided a traditional non-binding term sheet to PNG in order to facilitate discussion of an agreement containing the proposed terms. The traditional response to such a proposal would be an exchange of term sheet drafts between the parties, adding to, changing, or deleting proposed terms, until the two parties discussing the transaction come to a meeting of the minds about the principle terms of a transaction, and determine to draft definitive agreements reflecting such terms. The response that PNG ultimately provided to WLNG was a proposed letter agreement that was similar to the Triton letter agreement. This proposed agreement was not a turn of WLNG’s term sheet in the traditional sense outlined above, but (as WLNG subsequently discovered) a rewrite of the PNG-Triton agreement that had been concluded by PNG and Triton earlier. Further the proposed transaction was quite different. Instead of entering into an option to contract for existing transportation capacity, the proposal submitted by PNG consisted of a complicated two-step process to provide 70,000 Mcf/day of capacity to WLNG. The first step would entail the reservation of only 30,000 Mcf/day of existing capacity, which is less than half of the transportation capacity needed by WLNG to construct its proposed project. The second step entailed a process under which WLNG would pay for PNG to conduct engineering studies to expand PNG’s pipeline by 40,000 Mcf/day. PNG would then provide WLNG terms under which it would be willing to provide service to WLNG for the 40,000 Mcf/day of expanded capacity, and WLNG would only have the right to accept or reject these terms, and upon acceptance would pay another option fee. The parties would then negotiate a transportation agreement, and this agreement would contain a right for WLNG to request the commencement of service for the entire 70,000 Mcf/d of capacity or not. A term sheet for the transportation agreement was also provided, but it only provided for delivery of gas at the existing terminus of PNG’s facilities in Kitimat, and did not contemplate terms under which PNG would develop, permit, construct, and operate a lateral to WLNG’s proposed site.

On pages 5–6 of Davis Thames’ direct evidence, he states the following:

It was not until mid-April that PNG notified Western that it had completed the proposal, which would involve Western obtaining an option to contract for 30 MMcf/d of existing capacity, and the right, subject to engineering studies and Western’s acceptance, to contract for an additional 40 MMcf/d of capacity created by constructing an expansion of the pipeline, to deliver the full 70 MMcf/d to a potential Douglas Channel project site.

- 1.3 Please confirm, or explain otherwise, that the statement from page 7 that PNG’s response “bore little to no resemblance to the terms proposed by Western” and the statement on page 5 in the above preamble regarding the proposal provided by PNG in mid-April, are referring to the same “proposal” by PNG.

Response:

Confirmed.

- 1.4 Please compare and contrast PNG’s proposal provided to WLNG in mid-April to the proposed Letter Agreement with Triton, which was provided by PNG as Appendix A to the Application (Exhibit B-1). Please describe in detail both the similarities and differences.

Response:

Please see Table 2.

- 1.5 Please clarify if WLNG rejected the mid-April proposal from PNG.

Response:

No, it was not rejected. WLNG and PNG have held further discussions regarding PNG’s proposal, but the final disposition of the Triton letter agreement is an important factor in how WLNG and PNG will proceed with their negotiations.

- 1.5.1 If yes, please explain why the proposal provided by PNG in mid-April was not considered acceptable by WLNG.

On page 11 of Davis Thames’ direct evidence, he states: “Western’s proposal would benefit the existing shippers to a greater extent than Triton’s proposal.”

On page 12, he further states: “The difference in proposed contracted volume makes a significant difference in terms of potential benefit to existing shippers, since the act of setting rates at PNG is essentially a zero sum game.”

- 1.6 Please clarify who the “existing shippers” are that Davis Thames is referring to in his testimony. If Davis Thames is using the terms “shippers” and “ratepayers” interchangeably, please clarify that Davis Thames is aware that not all of PNG’s ratepayers are shippers and explain if this impacts his statements on pages 11 and 12.

Response:

The Commission is correct that Davis Thames was interchangeably using the terms “shippers” and “ratepayers”, and should have been more precise in differentiating between the two. If the statement on page 11 had been phrased “Western’s proposal would benefit the existing ratepayers to a greater extent than Triton’s proposal”, and the statement on page 12 had been phrased “The difference in proposed contracted volume makes a significant difference in terms of potential benefit to existing ratepayers, since the act of setting rates at PNG is essentially a zero sum game”, the two statements would have been more accurate. Mr. Thames’ comment that “the act of setting rates at PNG is essentially a zero sum game” was meant from the perspective of PNG, since all of PNG’s cost of service is allocated to ratepayers and shippers, and any incremental revenue received from a new shipper goes to reduce the proportion of the cost of service that existing ratepayers are allocated by an equal amount, with PNG having no economic interest in the outcome.

On page 13 of Davis Thames' direct evidence, he states the following:

In Western's view, it would be a reasonable outcome, assuming that no other party desired capacity on PNG at this time, to propose an arrangement whereby (i) Triton and Western proportionally contract for the existing capacity on the system; (ii) Triton and Western proportionally contract for the expansion on the mainline between Summit Lake and Terrace; (iii) Triton contracts for expansion capacity from Terrace to Prince Rupert; and (iv) Western contracts for the expansion lateral from Kitimat to its proposed project site. In the event that either Triton or Western decide not to proceed with their project, then part (ii) would no longer be necessary and the daily quantity in (i) could be adjusted accordingly.

- 1.7 Please provide a detailed explanation, with reference to Davis Thames' testimony on page 5 regarding PNG's proposal provided to WLNG in mid-April, as to the aspects with which the mid-April PNG proposal differs from the outcomes described by Davis Thames on page 13 of his testimony.

Response:

The Triton Letter Agreement provides that Triton will reserve 20,000 Mcf/day of existing transportation capacity from Summit Lake to Prince Rupert, with an option to expand this quantity by 30,000 Mcf/day subject to completion of studies intended to upgrade the throughput of the leg from Terrace to Prince Rupert. If Triton exercises its option to expand the capacity agreement to 50,000 Mcf/day, PNG will have to modify two compressor stations between Terrace and Prince Rupert¹ to accommodate the demand, and 50,000 Mcf/day of existing capacity between Summit Lake and Terrace will be allocated to the Triton agreement. The proposed modification of the two compressor stations would require neither a federal nor provincial environmental assessment prior to construction activities commencing.²

By contrast PNG has proposed that WLNG reserve 30,000 Mcf/day of existing capacity from Summit Lake to Kitimat. Assuming that Triton exercises its option in its letter agreement, PNG would have contracted 50,000 Mcf/day to Triton and 30,000 Mcf/day to WLNG, for a total of 80,000 Mcf/day. This, when combined with the transportation requirements to serve PNG's ratepayers, consumes all of the transportation capacity available in the Summit Lake to Terrace leg of PNG's system.³

The optional 40,000 Mcf/day of transportation capacity to be provided to WLNG would have to come from an expansion of the mainline from Summit Lake to Terrace.⁴ This would be a substantial undertaking involving

¹ Pacific Northern Gas Ltd. and Triton LNG Limited Partnership Letter Agreement Application – Project 1598957, Exhibit B-1 page 4.

² PNG response to WLNG IR No. 1, Exhibit B-9, response to IR 10.2.

³ The amount of daily capacity available on PNG is subject to PNG's obligation to serve its winter peak demand. There is additional annual capacity that would be available, but WLNG (and presumably Triton) requires substantially ratable daily deliveries over the year for its proposed project.

⁴ See PNG's response to WLNG IR No. 1, Exhibit B-9, response to IR 11.2(e). Total capacity indicated in this graph is 140 MMcf per day after expansion to accommodate both Triton's and WLNG's demand, from existing maximum capacity of 115 MMcf per day. WLNG notes that in its response to 11.2(b) Scenario B, a minimum of 42 MMcf per day of capacity is left on the mainline if Triton were to exercise its option to increase its contract quantity to 50 MMcf per day, meaning that less

modifications at four compression stations, two new compressor stations, and ~160 km of pipe.⁵ An expansion of this scope would trigger a federal and provincial environmental assessment.⁶

If the two agreements were structured instead as provided on page 13 of Davis Thames' testimony, and given that 50,000 Mcf/day is approximately 41.7% of the sum of the two capacities requested by Triton and WLNG⁷, then:

- i. If 30,000 Mcf/day of mainline expansion capacity is required to accommodate both Triton and WLNG's demand over and above PNG's existing obligations to its ratepayers and other transportation customers, then Triton would subscribe for 12,500 Mcf/day and WLNG would subscribe for 18,500 Mcf/d of expansion capacity, subject to Commission approval, project development cost reimbursement agreements from both Triton and WLNG, and successful permitting by PNG;
- ii. Of the remaining 80,000 Mcf/day of existing capacity that would be required to serve both Triton and WLNG, Triton would contract for 33,333 Mcf/day and WLNG would contract for 46,667 Mcf/day;
- iii. Triton would subscribe for the expansion capacity needed to deliver 50,000 Mcf/day from Terrace to Triton's proposed project site in Prince Rupert, subject to Commission approval, a development funding agreement, and successful permitting by PNG; and
- iv. WLNG would subscribe for the expansion capacity needed to delivery 70,000 Mcf/day from PNG's existing terminus in Kitmat to WLNG's proposed project site, subject to Commission approval, a development funding agreement, and successful permitting by PNG.

Both companies desire an option, so if either of the companies fails to exercise its option, then the expansion contemplated in part (i) no longer becomes necessary and can be cancelled, and the balance of the capacity in the existing mainline from Summit Lake to Terrace can be increased to the other party's total throughput requirement. In this case the rate agreed for both the expanded and existing capacity would be modified to reflect the rate agreed for the existing capacity alone.

WLNG believes this would be a more equitable outcome because both parties would then have an interest in and share the risk of the outcome of the substantial effort to loop the mainline from Summit Lake to Terrace, instead of only WLNG.

than 30 MMcf per day of additional capacity would have to be constructed to accommodate both parties at maximum demand.

⁵ PNG response to WLNG IR No. 1, Exhibit B-9, response to IR 10.3.

⁶ PNG response to WLNG IR No. 1, Exhibit B-9, response to IR 10.3.

⁷ Triton seeks 50 MMcf per day of capacity and Western seeks 70 MMcf per day of capacity for a combined total of 120 MMcf per day. $50 / 120 = 41.7\%$, and $70 / 120 = 58.3\%$.

- 1.8 Please confirm, or explain otherwise, that under the scenario described in the above preamble (i.e. page 13 of the Davis Thames’ direct testimony), in the event that either Triton or WLNG decide not to proceed with their project, assuming no other parties contracted for capacity, there would be increased unused capacity on PNG’s system as a result of outcome (ii), due to the fact that Triton and WLNG would have proportionally contracted for the expansion of the mainline between Summit Lake and Terrace.

Response:

Not confirmed. As stated above, if one of the two parties elects not to proceed with its project, the expansion of the mainline would no longer be required, and the other party would obtain a sufficient amount of the existing capacity to serve its demand. The benefit to the ratepayers would be commensurate with which project ultimately moved forward. The benefit can be compared under three alternate scenarios:

1. If the Triton project moves forward and WLNG does not exercise its option, then the transportation revenues paid by Triton on 50 MMcf per day would reduce the cost of service that ratepayers were responsible for, resulting in lower rates;
2. If the WLNG project moves forward but Triton fails to exercise its option, then the ratepayers would receive a larger benefit due to WLNG paying transportation revenues on substantially all of the existing unutilized capacity; or
3. If both of the Triton and WLNG projects move forward, then the ratepayers would receive a benefit that was roughly equivalent to scenario #2, because substantially all of the existing unutilized capacity would be contracted between both Triton and WLNG. In this scenario the effect of the revenues earned on new expansion capacity would not affect ratepayers’ rates, since it is assumed that Triton and WLNG would pay a rate derived from PNG’s marginal cost of service for constructing the expansion capacity.

Entering into a contract with both parties, instead of only one contract with a single party, diversifies the risk that that party does not move forward with their project. In the proposed case of two shippers sharing the expansion and existing capacity, redundancy is built in so that one of two projects can fail to exercise their transportation option, but the ratepayers will still obtain lower rates (though the extent of the rate reduction will depend on which of the two projects moves forward).

B. JEFFREY CHURCH DIRECT EVIDENCE

**2.0 Reference: Jeffrey Church Testimony
Exhibit C1-5, Direct Evidence of Jeffrey Church; Exhibit B-9, WLNG IR 9.9**

In response to WLNG IR 9.9, PNG stated the following:

PNG agrees that for each of the NEB regulated Group 1 gas transmission pipelines listed in the preceding questions, the pipeline's tariff provides that it conduct an open season...

...PNG is significantly different from the large NEB regulated Group 1 pipelines (consisting of those pipeline companies with extensive systems and several third-party shippers) that Western LNG has cited:

- PNG is primarily a distribution utility, serving over 42,000 end-use customers with natural gas. The pipelines noted by Western LNG do not have a utility function. On the PNG system the rates payable by certain shippers affect the delivered cost of natural gas to PNG's utility customers.

On page 4 of Jeffrey Church's direct evidence, he describes his experience in considering the policies of natural gas pipelines in Canada.

- 2.1 Please explain whether Jeffrey Church's experience and policy analysis has included companies/pipelines similar to PNG, specifically regarding the fact that PNG is primarily a distribution utility.

Response:

Dr. Church has limited direct experience in a consulting capacity with natural gas distribution utilities. However, his research and teaching have frequently addressed issues associated with gas distribution utilities. Two areas of focus in his research and teaching have been (i) on how to design rates that promote allocative efficiency and ensure revenue adequacy for regulated firms that provide more than one type of service and (ii) how to toll expansions and allocate capacity. The issue of tolling and allocating capacity are clearly applicable in this case. PNG provides service to multiple customer classes that is bundled, i.e., includes gas sales, distribution, and transmission, and transmission of natural gas for others. As discussed further in response to the next question, PNG's specific characteristic (being both a distribution utility and a potential provider of contract natural gas transmission service) does not provide any material distinction between PNG and pipelines providing only transmission service that is relevant to his direct evidence.

- 2.2 Please explain how PNG's specific characteristics of being primarily a distribution utility distinguish it from the National Energy Board (NEB)-regulated Group 1 pipelines and how, if at all, these differences may impact the analysis provided in Jeffrey Church's direct evidence.

Response:

In the context of assessing whether a different process would lead to a better allocation of PNG's available capacity and/or expansion capacity on its main transmission line from Summit Lake to Terrace, the fact that it is primarily a distribution utility is likely immaterial. This is true for the following reasons:

- i. PNG’s rates are unbundled for its bundled service. Its utility consumers receive bundled service consisting of natural gas, distribution, and transmission. Thus in the Church Evidence, utility consumers are sometimes characterized as shippers.⁸ But it charges its utility customers two sets of rates, a delivery charge and a commodity charge. The delivery charges are intended to recover the costs of providing transmission and distribution services, i.e., PNG’s costs as a pipeline. The commodity charge is the cost of natural gas. The commodity charge appears to be a straight pass through: utility consumers are billed PNG’s cost of acquisition without a mark-up. Thus the issue in setting PNG’s delivery rates is similar to that of any pipeline: how to set efficient prices and cost recovery of providing pipeline services.
- ii. As explained in the Direct Evidence of Dr. Church (“Church Evidence”) in response to question 13, rate setting for multiproduct natural monopolies involves a trade-off between allocative efficiency and revenue adequacy. This trade off requires that the different services be tolled such that their rate exceeds their long run marginal cost of service, thereby earning margins that contribute to ensuring the service provider breaks even. This links the rates charged for service A to the rates charged for service B and vice versa. As a regulated monopoly provider of gas distribution and transmission service, this fundamental tolling issue applies to both PNG and Group 1 pipelines regulated by the NEB.
- iii. PNG does not distinguish between distribution and transmission charges. It charges its utility consumers a delivery charge(s) for the delivery by its pipeline system of natural gas.
- iv. The link between the delivery charges for different classes of customers on PNG is recognized by PNG. In response to Western IR 9.9 PNG observes that “[o]n the PNG system the rates payable by certain shippers affect the delivered cost of natural gas to PNG’s utility customers.”
- v. The processes employed on the NEB-regulated Group 1 pipelines are designed to promote the efficient allocation of capacity and investment in new capacity. They do so by revealing and collecting information regarding demand and costs for transmission of natural gas. PNG’s ‘first come, first served’ process does not.
- vi. The information from a more open process would promote both the more efficient allocation of options, as well as the design of efficient tolls (tolls which send the correct price signals to different classes of customers and different types of service), promote investment, and ensure revenue adequacy) efficient allocation of existing excess capacity, and efficient expansion of PNG.
- vii. The advantages of the information created by an open process does not depend on the pipeline being an NEB-regulated Group I pipeline or PNG, which provides both transmission service (of the kind of interest to both Triton and Western LNG) and bundled services (gas sales, transmission, and distribution) to utility customers.
- viii. Far from providing a reason for why the analysis in the Church Evidence is not applicable to PNG, the

⁸ In particular, in the discussion in the Church Evidence (e.g. response to 17 and 19) where a link is drawn between the benefit to existing or other shippers from allocating capacity efficiently because their charges can be lower, those existing or other shippers include and are mostly PNG’s utility customers, i.e., rate payers. It is their delivery charge that can be reduced if more revenue is captured from contract shippers.

existence of utility consumers simply reinforces the need to ensure that the process followed by PNG for granting options and allocating capacity for transmission service promotes efficiency. As explained in the Church Evidence a more open process that is responsive to market conditions and the willingness to pay of potential natural gas shippers is more likely to result in maximizing the economic value of PNG's transmission capacity and minimizing the burden to utility customers of recovering PNG's revenue deficiency. The delivery charges for utility consumers are more likely to be lower.

In response to questions 11 and 12 on pages 7 and 8 of Jeffrey Church's direct evidence, he explains how existing capacity and expansion capacity is allocated on other contract carrier pipelines in Canada.

- 2.3 Please explain if any of the other contract carrier pipelines in Canada considered in the responses to questions 11 and 12 operate as distribution utilities.

Response:

The discussion in the responses to questions 11 and 12 is a general discussion of open seasons on contract carriers. The three pipelines referenced explicitly, TransCanada, Maritimes & Northeast, and Foothills, are not distribution utilities.

- 2.3.1 If yes, please provide examples of these contract carrier pipelines and compare/contrast them to PNG.
- 2.3.2 If no, please explain to what extent, if any, this impacts the applicability of Jeffrey Church's responses to questions 11 and 12 to PNG.

Response:

It does not impact the applicability of the responses to questions 11 and 12 to PNG. The responses provide background on how other contract carrier pipelines allocate existing and expansion capacity and provide some insight into the result of the open season process, i.e., the creation of information that promotes efficiency in decision making. See Response to BCUC Western IR 2.2.

In response to WLNG IR 9.9, PNG stated: “Having an opportunity to reserve uncontracted capacity for a period of time until the project proponent can complete the development phase of its project is viewed to be the best approach to securing additional shippers on the PNG pipeline system...” PNG then provides various reasons to support its approach.

2.4 Please discuss how an open season process (or other process) would address the objectives/concerns outlined by PNG in support of its current approach, including the following:

- Ability to verify creditworthiness and coordinate project development with PNG’s preparation of its system to provide transportation service;
- Obtaining a commitment to backstop engineering studies;
- Ability by PNG to own and conduct engineering studies to retain control of the intellectual property;
- Providing a guaranteed benefit to PNG’s existing utility customers during the development phase of a project; and
- Providing assurance that an agreement is terminated prior to PNG incurring any additional capital investment.

Response:

In response to PNG Western IR 9.9 PNG explains why its approach (first come, first served plus an option) has historically been preferred to an open season. The first of these, that it is a distribution utility, has been addressed in the response to BCUC Western IR 2.2. The second main reason is the risk reduction to shippers of having an option. As discussed in Church Evidence response to question 18, the option approach mitigates two sets of risks: (a) not having capacity available at relatively known tolls and (b) financial liability of committing to demand charges for an extended period of time, e.g. twenty years. Under the option approach, shippers can reserve capacity without a long term financial commitment. The discussion in the Church Evidence in response to question 18 explores whether developments in the world-wide LNG market imply that the risks no longer warrant the costs of an option approach and, if not, whether the option can be maintained, but make it more likely that the option and capacity will be allocated to its most valued shipper.

This IR asks whether the five other benefits of the existing PNG process identified by PNG in its response to PNG Western IR 9.9 can be preserved with a more open process. It is important to recognize that the PNG process is a two-stage contractual process. As discussed in the response to question 14 in the Church Evidence, in the first stage PNG uses a first come first served process to allocate an option. In the second stage if the option is exercised, a firm transportation agreement is implemented. The five benefits identified in this IR from the Commission are not tied to the first come first served characteristic of the existing PNG practice, but instead the option. As explained in the Church Evidence in response to question 18, the option can be preserved, but better outcomes in terms of capacity allocation and lower tolls for utility customers realized if the first stage of the existing PNG process is changed. Rather than using a first come, first served approach to allocate the option, a more open process to allocate the option could be used, as discussed in the response to question 18 in the Church Evidence.

The facts in this case make clear the costs of the first come first served approach to allocate the option. The facts in this case seem consistent with there being at least two shippers:

- of at least equal creditworthiness;
- willing to backstop engineering studies;
- willing to agree that engineering studies remain the property of PNG;

- willing to pay an option; and
- willing to enter into a letter agreement/option that allows for termination prior to capital investment.

PNG argues that it is the commitment to the backstop agreement that separates contracting parties and allocates the option and, subsequently, the capacity. But this is clearly second best, and, as in this case, incapable of breaking what appears to be a tie except for the order assigned by PNG. Instead a more open competition/process for the option where the objective of PNG is to maximize the economic value of its capacity would more likely result in ensuring the option and capacity are allocated efficiently, thereby maximizing the benefit to existing utility customers, unlike the PNG first come first served process.

Moreover, uncontracted capacity may not be allocated only to a single shipper. PNG appears to understand that a first come first served process is not optimal for allocating expansion capacity when there is credible interest from more than one shipper. The same is true for uncontracted capacity.

Many of the objectives/concerns that PNG identifies are not unique to PNG and are not uniquely addressed by its current approach. In particular, the recovery of costs from shippers if the shipper does not enter into a firm transportation agreement and creditworthiness are issues that are more general.

The issue of creditworthiness is an issue that is not unique to PNG or even pipelines. It is an issue for all suppliers who make long lived capital expenditures that are specific to a customer. This means that recovery of that capital depends on the ability of the specific customer to pay. The risk of stranded costs—non-recovery of investment—is mitigated by requiring customers to sign long term contracts with demand charges. Demand charges are based on the sunk costs of a unit of capacity and are paid regardless of whether the capacity is used. The concern with creditworthiness is that even though a shipper signs a long term transportation agreement, it will not be able to honour its commitment to pay the demand charges because of bankruptcy.

Pipelines, including PNG, attempt to mitigate the risk of non-payment by having credit requirements in the long term transportation agreement. The credit requirements typically specify that before the commencement of service, the shipper is required to maintain some minimum investment grade rating for its debt and after the commencement of service if the rating is not maintained, the shipper must post a letter of credit. Failure to maintain the investment grade rating or post the letter of credit allows the pipeline to terminate service.

The concern with demonstrating creditworthiness by other pipelines is illustrated by, Trans Mountain. It required that shippers demonstrate their creditworthiness at the conclusion of its open season, and included provisions regarding creditworthiness in its firm transportation agreement and rules and regulations.

In fact it is not clear how the existence of the option and the option period addresses the issue of creditworthiness anymore or less than during an open season. The demonstration of creditworthiness is typically part of the transportation agreement and ongoing rules and regulation of the pipeline.

The result of an open season is often a Facilities Support Agreement (FSA). A FSA has many of the same provisions as the Letter Agreement used by PNG. In particular it can contain provisions for recovery of costs and expenses if the project is terminated. Costs and expenses incurred by the pipeline in the development of the project, including “pre-development expenses related to the initial development” of the project “incurred prior to and during the Open Season”.⁹

⁹ See Trans Mountain Pipeline Expansion Project Facility Support Agreement (March 27, 2012) Articles 6 and 7.

- 2.5 Please discuss both the benefits and risks to PNG’s existing utility customers of implementing an open season process. Please also compare the benefits and risks of an open season process to PNG’s existing process from the perspective of PNG’s existing utility customers.

Response:

The key issue in this proceeding is whether PNG’s existing method has an appropriate balance between minimizing risk to PNG, minimizing risk to utility consumers, and maximizing the economic value of the excess capacity. The present system would appear to favour minimizing risk, but at the expense of maximizing the economic value of excess capacity in a way that would benefit utility customers.¹⁰ The danger with the current PNG process is that the benefits of the excess capacity—both current capacity and capacity that can be recommissioned and reactivated at relatively low cost—will not be allocated efficiently and its value not captured by utility consumers, but instead captured by the shipper first in line (in this case, Triton).

First, the facts of this application suggest that many of the risks identified by PNG are perhaps not so important as to warrant its existing methodology. As explained in the response to question 18, in the Church Evidence (see also Thames Direct Evidence at pp. 10-11), the market for LNG has improved and hence interest in transport of natural gas has increased. This not only means that the risk to potential shippers from developing projects and committing to capacity has been reduced, but that concerns over stranded costs and the risk that utility consumers will be responsible for recovery of the costs of engineering studies should likely be reduced. PNG capacity is more likely to have a liquid market as conditions in the LNG market improve, making its existing capacity, including that which can be reactivated and recommissioned at relatively little cost, particularly attractive to potential shippers. Hence the risk to utility customers that Triton, going forward, is the only option should not be overemphasized.

Second, many of the objectives/concerns identified by PNG can be addressed or achieved through maintaining the option or can, and are, addressed, through Facility Support Agreements. The key institutional change is not necessarily to abandon the option or aspects of the option that would remain if there is an open season, but to eliminate the first come first served allocation rule of PNG. It is this aspect of PNG’s current practice that is problematic. Replacing it with a more open process that creates a market for PNG’s capacity has many benefits for utility consumers since it is more likely to allocate PNG’s capacity to projects that create the most economic value, value that can be captured by appropriate tolling and used to reduce the rates of utility consumers.

The assessment that PNG’s allocation process does not reflect an optimum balance between risk and reward for utility customers is reflected in this proceeding. The relative risks to utility customers of the Triton and Western projects are not obviously different and yet the revenues to PNG from allocating capacity to Western might be considerably larger.¹¹

¹⁰ Given that PNG is regulated based on its cost of service, it is not clear how much risk is imposed on PNG shareholders. Instead if any adverse outcomes to PNG are borne by its utility consumers, then the issue is the appropriate tradeoff between risks to utility consumers versus the level of their rates. By assuming more risk, their expected rates could easily fall and this change could easily be beneficial if the increase in risk is minimal, but the reduction in rates substantial.

¹¹ See Thames Direct Evidence at pp. 11-12.

**PNG – Triton LNG Letter Agreement
Western Response to BCUC IR No. 1 to WLNG
August 16, 2018**

Table 1 – Response to BCUC IR No. 1 to WLNG: IR 1.1

Provision	EDFT TSA	WLNG proposed Term Sheet	Explanation for differences
Credits for Prior Option Fees Paid by Others	EDFT obtained credit for \$3.25 million in prior option fees paid by others (which exceeded initial \$2 million Option Premiums paid by EDFT).	WLNG did not claim credit for prior option fees paid by others.	WLNG did not believe that it was entitled to the credit.
Option Premium	\$2 million upon acceptance by BCUC of the EDFT TSA plus \$166,667 per month from the earlier of FID or July 1, 2015 until the commencement of service date.	\$1 million, payable upon WLNG entering into the option agreement.	WLNG reasoned that not requesting credits for prior option fees paid by others (which exceeded initial option premiums paid by EDFT) would justify a lower initial option premium payable for the capacity. WLNG also noted that the proposed \$1 million was consistent with option fees paid in the past as set forth in the recitation of prior option fees paid in the EDFT TSA. ¹²
Crediting of Option Premium	The option premium (\$2 million plus the monthly payments through commencement of service) plus \$3.25 million in prior option fees would be creditable against up to 50% of monthly demand charges without interest in any month.	1/24 th of the option premium would be credited against monthly demand charges during each of the first 24 months of the transportation agreement.	WLNG reasoned that extending the credit period for two full years would lessen the immediate cash impact of crediting the premium to the benefit of PNG.

¹² According to Section 1.2 of the EDFT TSA, \$1 million was paid pursuant to the Original Agreement, \$1 million was paid on each of five sequential dates pursuant to the Second Agreement and \$2 million was paid pursuant to the EDFT TSA (but a substantial portion in excess of the option premium was creditable after the commencement of service date).

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Provision	EDFT TSA	WLNG proposed Term Sheet	Explanation for differences
Exercise Date	Agreement was not structured to be “exercised” by EDFT, but provided for various termination rights, some resulting in reimbursement of the option premium, some with no further payments required, and some with an associated termination payment.	WLNG would “exercise” its right to enter into a transportation service agreement and expansion agreement within 18 months. Simultaneously, WLNG would designate a commencement of service date (to occur within 27 months of the exercise date) and designate the location of the proposed project site.	WLNG’s proposed exercise structure was reflective of the fact that WLNG and PNG did not have a fully negotiated service agreement, and would have to negotiate the agreement during the pendency of the option, whereas EDFT and PNG already had a fully negotiated transportation agreement and expansion agreement that could alternatively be terminated by EDFT.
Contract Quantity	79,000 Mcf/day during December, January, and February, and 86,000 Mcf/day during the remaining months of the year, in each case converted to GJ using the prevailing heat contact factor.	70,000 Mcf/day.	WLNG’s proposed contract quantity was lower than EDFT’s due to feedback provided by the PNG market representative that PNG could only sell up to 70,000 Mcf/day of transportation capacity. As described in WLNG’s evidence, WLNG had initially sought substantially more capacity (up to 140,000 Mcf/day), and would have preferred a greater quantity consistent with what was contracted by EDFT, but sought to accommodate PNG on this point.
Term	20 years	10 years	This was the most material deviation between the proposed term sheet and the EDFT TSA, and was viewed by WLNG as an initial position in the expected negotiation between itself and PNG. WLNG later indicated its willingness to PNG to accept a term equal to the 20-year term concluded with EDFT in January 2018.

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Provision	EDFT TSA	WLNG proposed Term Sheet	Explanation for differences
Credit – Existing Capacity	If not determined to be creditworthy, posting of a letter of credit for 12 months of demand charges.	If not determined to be creditworthy, letter of credit or surety bond equal to the total amount of reservation fees payable over the lesser of 70 days or the remaining days in the term (standard NEB credit terms).	WLNG’s proposed credit terms for existing capacity were intended to be the same as the credit requirements for existing capacity on NEB regulated pipelines.
Credit – Expansion Capacity in Lateral	S&P Rating / Months of demand charges A- or better / 0 months BBB+ / 12 months BBB- or below / 24 months	If not determined to be creditworthy, letter of credit or surety bond for the present value of all remaining reservation fees discounted at PNG’s approved cost of equity.	WLNG’s proposed terms for the expansion lateral were intended to leave PNG and the rate base whole for any unrecovered capital in the event of a credit-related termination of the agreement.

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Table 2 – Response to BCUC IR No. 1 to WLNG: IR 1.4

Triton Letter Agreement Section Number	Triton Letter Agreement Provision	Proposed Western Letter Agreement Provision
Section 3: Firm Service	Firm Service Volume of 50 MMcf per day	Firm Service Volume of 70 MMcf per day
Section 4: Transportation Agreement	Date by which PNG and Triton will use commercially reasonable efforts to enter into a definitive transportation service agreement is January 31, 2019.	The date is listed as “[•], 2019”, indicating that the date was to be determined.
Section 5(a): Option Fee	CDN\$500,000	CDN\$750,000
Section 5(d): Dates and events upon which Triton may terminate the option agreement and be reimbursed the entire option fee.	<ul style="list-style-type: none"> • BCUC Approval is not issued by August 31, 2019;¹³ • The Expanded Capacity Notice is not issued on July 31, 2018 other than as a result of delays caused by Triton; or • The BCUC Approval is issued by August 31, 2018¹² but such BCUC Approval includes conditions which are not satisfactory to both Triton and PNG pursuant to Section 5(c) 	Contains the same events but each date is listed as “[•], 2019”, indicating that the date was to be determined.
Section 5(e): Final date by which PNG must deliver the Expanded Capacity Notice to Triton	July 31, 2018	The date is listed as “[•], 2019”, indicating that the date was to be determined.
Section 5(g): Obligations related to the Backstop Agreement	Final paragraph contains a provision that is to be included in the Backstop Agreement requiring PNG to reimburse Triton for a pro rata portion of amounts paid by Triton pursuant to the Backstop Agreement if PNG determines that it used all or any portion of the Preliminary Design Work to contract with a third party to provide firm service in respect of the Expanded Capacity on or before August 31, 2021.	<p>The final paragraph found in the Triton Letter Agreement was not included in the proposed Western Letter Agreement.</p> <p>Instead, the provision included a requirement that WLNG provide a letter of credit to PNG simultaneously with entering into the Backstop Agreement. No amount was specified, and the Triton Letter Agreement does not contain a similar requirement in any other provision.</p>

¹³ PNG and Triton later agreed to amend this date to October 31, 2018. See Exhibit B-1-3.

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Triton Letter Agreement Section Number	Triton Letter Agreement Provision	Proposed Western Letter Agreement Provision
Section 5(i): Option to enter into a Transportation Agreement	If Triton exercises the Transportation Option, Triton is to propose a commencement of service date that is not later than 3 years from the date of the exercise notice.	If WLNG exercises the Transportation Option, WLNG is to propose a commencement of service date that shall not be earlier than [two] years and no later than [three] years from the date proposed in a development agreement (see below) ¹⁴
Section 5(j): extension of option term and refundability of the option fees	<p>The base extension premium is CDN\$250,000.</p> <p>The Initial Option Fee, the Expanded Capacity Option Fee, and any Option Extension Fees paid to PNG will be applied to the contract demand charges. Per Exhibit A, there will be up to a 50% monthly reduction in reservation fees until the option fees are recovered.</p>	<p>The base extension premium is CDN\$375,000.</p> <p>The Initial Option Fee and the Expanded Capacity Option Fees are reimbursable, but it states that only a portion of any Option Extension Fees will be recoverable, without stating the portion. Per Exhibit A, only 50% of Option Extension Fees will be reimbursable pursuant to up to 50% crediting of the monthly reservation fees.</p>

¹⁴ WLNG took the bracketed number of years to mean that PNG sought WLNG’s feedback as to whether those time boundaries were acceptable.

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Triton Letter Agreement Section Number	Triton Letter Agreement Provision	Proposed Western Letter Agreement Provision
New Section 5(k) and 5(l): obligation to enter into a Development Agreement and key terms thereof	Not included	<p>Section 5(k) includes a condition that prohibits extension of the option unless the parties have entered into a Development Agreement.</p> <p>Section 5(l) lists certain key terms of the Development Agreement, which is intended to reimburse PNG for the costs incurred for future phases of engineering, authorizations, and construction work for the Expansion Capacity¹⁵:</p> <ul style="list-style-type: none"> • A backstop by Western of PNG’s development costs for the Expansion Capacity until such time as WLNG has exercised its option for Transportation Service¹⁶; • Bilateral quarterly reporting obligations on both PNG and WLNG related to progress on expansion work and progress on the project, respectively.
Section 5(k): covenant regarding reservation of the Firm Service Volume (Section 5(m) in the proposed Western Letter Agreement)	PNG commits reserve for Triton’s exclusive use the Firm Service Volume and covenants not to enter into any other agreement with respect thereto.	WLNG’s provision is materially similar except for a new final sentence that states “PNG reserves the right to provide service up to 5 MMcf per day of capacity for other customers to have priority over the Transportation Option.”
Section 6(a): Termination Fee if Initial Option Fee has not been paid	CDN\$100,000.	CDN\$150,000.
Section 6(b): Termination Fee if Initial Option Fee has been paid	PNG will refund CDN\$400,000 of the CDN\$500,000 option fee.	Non-refundable.
Section 8: Assignment	Requires the written consent of the other Party, but Triton may assign to an affiliate.	WLNG has no assignment rights without the consent of PNG, which may be withheld if the proposed assignee has lesser creditworthiness

¹⁵ This term was not defined in the proposed Western Letter Agreement, but WLNG takes it to refer the capacity contemplated by an Expanded Capacity Notice.

¹⁶ To wit, entered into a transportation service agreement whereby costs incurred by PNG would be recovered in rates.

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Triton Letter Agreement Section Number	Triton Letter Agreement Provision	Proposed Western Letter Agreement Provision
		<p>than WLNG or its guarantor.</p> <p>PNG may assign without approval provided that the assignee owns the pipeline and assumes the agreement. WLNG may assign all – but not less than all – of its rights and obligations to an Affiliate that meets the minimum Credit Requirements.</p>
Exhibit A: Indicative Terms for Transportation Agreement		
Primary Term:	20 years	30 years
Delivery Point:	Ridley Island	Interconnection with PNG’s existing 10” lateral in the vicinity of Kitimat ¹⁷
Contract Demand:	20 MMcf per day up to approximately 50 MMcf per day subject to Triton’s Expanded Capacity Notice.	70 MMcf per day subject to adjustment in accordance with WLNG’s election regarding the Expanded Capacity
Unit Demand Charge:	[●] per GJ, plus such incremental amounts as may be included in an expanded capacity notice issued by PNG.	
Base Interruptible Charge:	[●] per GJ	TBD
Inflation Factor:	Defined, related to BC CPI.	TBD
Option Fee Credits:	All option fees to be credited up to a maximum of 50% of monthly demand fees.	Same, except that only 50% of extension option fees to be credited.
Minimum Tangible Net Worth:	No provision	Greater of 5 years of firm demand tolls or the remaining book value of the incremental system upgrades used to serve WLNG’s demand.

¹⁷ This description expressly precludes transportation service and construction of the lateral from Kitimat to WLNG’s proposed project site.

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Triton Letter Agreement Section Number	Triton Letter Agreement Provision	Proposed Western Letter Agreement Provision
Credit Requirements:	Triton or its guarantor has an investment grade rating from at least two agencies, or otherwise is determined to be creditworthy by PNG in its reasoned judgment.	Three conditions on WLNG or its guarantor: <ul style="list-style-type: none"> • Minimum investment grade rating from a recognized rating agency (or lower of a split rating); • Meets Minimum Tangible Net Worth test; • Has a head office in Canada or the United States or a country with a Minimum Sovereign Risk Rating of investment grade, and additionally such country is otherwise acceptable to PNG.