Scott A. Thomson
VP, Finance & Regulatory Affairs and
Chief Financial Officer

16705 Fraser Highway
Surrey, B.C. V4N 0E8
Tel: (604) 592-7784
Fax: (604) 576-7074
Email: scott.thomson@terasengas.com
www.terasengas.com

Regulatory Affairs Correspondence
Email: regulatory.affairs@terasengas.com

January 19, 2007

British Columbia Utilities Commission
Sixth Floor
900 Howe Street
Vancouver, B.C. V6Z 2N3

Attention: Mr. Robert J. Pellatt, Commission Secretary

Dear Sir:

**Re: Terasen Gas Inc.**
**Application for Approval of Extension of Settlement Agreement for the 2004-2007 Performance-Based Rate Plan for 2008-2009**

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On April 20, 2003, Terasen Gas Inc. ("Terasen Gas", "TGI" or the "Company") filed its multi-year Performance-Based Rate ("PBR") Application. The British Columbia Utilities Commission ("BCUC" or the "Commission") in its Orders No. G-29-03 and G-38-03 set out the timetable for a Negotiated Settlement process which included a Workshop and Pre-Hearing Conference followed by the submission of Information Requests by interested parties and responses by the Company. Negotiations commenced June 9, 2003, and a proposed Settlement Agreement for a 2004-2007 PBR Plan was reached by Terasen Gas, Intervenors and Commission Staff. Commission Order No. G-51-03 approved the Multi-Year PBR Plan and rates for 2004-2007 with Appendix A of that Order providing the details of the Settlement Agreement (the "Current TGI Settlement").

As part of the Current TGI Settlement, a more extensive annual review process was agreed to, along with a Mid-Term Assessment Review to be held prior to the end of 2006 to ensure that no unintended outcomes or deterioration in service quality had occurred. On November 15, 2006, the Company held its Annual Review and Mid-Term Assessment Review Workshop (the "Workshop"). In attendance were representatives of Interested Parties, stakeholders and Intervenors as well as Commission Staff. During the Workshop, in addition to a review of 2004 through 2006 results and the 2007 rate proposals, TGI discussed its longer term regulatory strategy, including the possibility of an extension of the Current TGI Settlement, as well as a potential future amalgamation with Terasen Gas (Vancouver Island) Inc. ("TGVI"). A rate settlement extension application for the period 2008-2009 is also being made by TGVI to help to facilitate an amalgamation option.

The Company noted at the Workshop that it had in all material respects met all of the Service Quality Indicator benchmarks. Two of the measures were only nominally off benchmark targets but showing an improvement trend over the settlement period to date. TGI noted that, in addition to the Company meeting the Service Quality Indicators, customers had shared an estimated pre-tax Incentive totalling $19.9 million through the Earnings Sharing Mechanism from 2004 to 2006. The Company expressed the view that an extension of the current PBR model and settlement period will contribute to continued alignment between the interests of

Terasen Gas and its customers, with the benefits realized through further capital and operational efficiencies being shared.

To facilitate the extension of the Current TGI Settlement, the Company has met with interested parties since the Workshop to discuss the merits of its proposed settlement extension terms. The consensus of all groups with whom TGI has met was that an extension would be preferable to a full rate hearing, which would have to commence with an application late in the second quarter of 2007 to begin the process of setting rates for 2008. While it is the view of the Company that a three-year extension of the Current TGI Settlement would align well with the timing of a possible amalgamation of TGVI and TGI, the consensus of the other stakeholders favours a two-year extension.

Appendix B is the listing of parties to the Current TGI Settlement, as noted in Commission Order No. G-51-03, Appendix A, Pages 31-33.

During December 2006 and January 2007, TGI consulted with counsel and/or representatives from the following stakeholder groups, all of whom were registered intervenors in the Company's multi-year Performance-Based Rate ("PBR") Application:

- British Columbia Hydro and Power Authority ("BC Hydro");
- Ministry of Energy, Mines and Petroleum Resources ("MEMPR");
- Inland Industrial Group;
- British Columbia Public Interest Advocacy Centre on behalf of the British Columbia Old Age Pensioners Organization *et al* ("BCOAPO");
- Avista Energy Canada Ltd. ("Avista");
- Elk Valley Coal Corporation ("Elk Valley");
- BC Health Services;
- Commercial Energy Consumers Association of British Columbia ("CEC");
- Lower Mainland Large Gas Users Association ("LMLGUA"); and
- IGI Resources Inc., a BP Energy Company ("IGI Resources").

BCOAPO, Elk Valley, BC Health Services, BC Hydro, MEMPR, CEC, and Avista, have indicated that they support or have no concerns with a two-year settlement extension on the terms outlined in Appendix A ("Two-year TGI Settlement Extension"). It should be noted that Avista, who dissented from the Current TGI Settlement when negotiated in 2003, supports the proposed two-year settlement extension.

During the 2003 NSP process for the Current TGI Settlement, a group of interested parties including the aforementioned LMLGUA and Avista, as well as the Heating Ventilating Cooling Industry Association of B.C., the B.C. Greenhouse Growers Association, and the United Flower Growers Co-operative Association ("LMLGUA et al") were represented by shared Counsel. LMLGUA et al had dissented from the current settlement. TGI approached LMLGUA et al's former representative in an attempt to consult on the current proposal. TGI was advised that LMLGUA et al's former counsel has not received instructions to act on the group's behalf related to the Company's current proposal. As stated above, TGI consulted with the LMLGUA and Avista and the Company would note that the balance of this group has not participated actively during the current settlement period in the annual review workshops and rate applications.

At the time of filing, although the Company had discussions with the following stakeholders, TGI had not received comments from the Inland Industrials, LMLGUA and IGI Resources.

As discussed during the consultation sessions held with stakeholders, and as further evidence that an extension is warranted, it should be noted that the current settlement terms have provided competitive and stable delivery rates, over the settlement period to date. It is the Company's view that the current settlement terms are an efficient regulatory construct providing incentives to Terasen Gas to continually look for ways to make its operating and capital expenditures as efficient as possible with due consideration to safety and other service quality indicators. A continuation of the settlement terms within the bounds of the current rate design will contribute to rate stability by providing added predictability around operating and maintenance ("O&M") expenses and capital cost inputs to the revenue requirement.

Before approaching stakeholders with the possibility of a settlement extension, a proposed term sheet was drafted in order to facilitate discussion and to clearly identify that the majority of terms from the Current TGI Settlement would not be changed. Key terms proposed, that would continue to use the same formula and mechanisms, were:

- the calculation of O&M expense,
- the Overhead Capitalization rate, and
- the Capital Additions formula.

The simple extension of most terms of the current settlement along with the continuation of the Service Quality Indicators, Trigger Mechanism, and Annual Review process terms as safeguards, provides comfort to stakeholders which the Company believes led to the support that they have expressed.

While the majority of terms being proposed have exactly the same mechanisms, calculations and wordings as the Current TGI Settlement, the length of term for the proposed extension was one item respecting which interested parties differed in their views. Although some stakeholders were of the view that an extension period of up to four years was warranted, all stakeholders expressed views that an extension period of two years is appropriate, with which TGI agrees.

The proposed terms for the Two-Year TGI Settlement Extension, as set out in Appendix A, are the same as those reviewed with stakeholders, with one exception being the extension period has been agreed to as two years, 2008 and 2009, whereas the extension period was left blank in the draft proposed terms reviewed with stakeholders.

Stakeholders may note as well, changes in formatting of the proposed settlement terms. Appendix A includes a column that shows the wording from the Current TGI Settlement along with the proposed extension terms to facilitate a direct comparison.

With due consideration to the regulatory efficiencies that this extension will afford all parties, and the continued view that the settlement terms provide an effective regulatory mechanism for TGI to make it's operations more efficient, Terasen Gas submits that a two-year extension of the Company's performance-based rate settlement, on the terms set out in Appendix A, is warranted and is in the best interests of both customers and shareholders. In support of this Application, please find attached a letter from the MEMPR and the proposed settlement terms for the extension period.

In extending the term of the existing settlement and as discussed with stakeholders, TGI is forgoing seeking changes to both depreciation and overheads capitalization rates which would increase cost of service and revenue requirements significantly beyond the levels anticipated under an extension. Accordingly, and considering the support of stakeholders and parties to the existing settlement, TGI submits that the public interest is best served by the Commission accepting the extension as requested

**REQUEST FOR APPROVAL**

Terasen Gas requests Commission approval of a two-year extension of the 2004-2007 Performance Based Rate Plan and Negotiated Settlement Agreement terms as outlined and expanded in Appendix A.

TGI proposes an expedited Commission review and approval process for this Application as the Company has completed significant consultation with key stakeholder groups with no opposition stated. TGI respectfully proposes the following Regulatory Agenda and Timetable:

- Friday, January 19, 2007 - TGI Submits 2008-2009 Extension Application
- Friday, February 2, 2007 – Stakeholder Comments
- Wednesday, February 7, 2007 – TGI Reply Comments
- Friday, February 16, 2007 – Commission Decision

In accordance with Commission Letter No. L-78-06, Terasen Gas has attached a draft procedural Order and draft Order for Commission review.

All of which is respectfully submitted.

If you have any questions related to this Application please contact Tom Loski at (604) 592-7464.

Yours very truly,

**TERASEN GAS INC.**

***Original signed***

Scott A. Thomson

Attachments
Appendix A – TGI Proposed Term Sheet for Settlement Extension
Appendix B – TGI 2004-2007 PBR NSP Participants
Letter of Support
Draft Orders (BCUC only)

cc: 2004 – 2007 PBR NSP Participants

## Two-Year TGI Extension

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement (“Current TGI Settlement”) | 2008-2009 Extension Period |
|---|---|---|
| **Term**<br><br>Terasen Gas proposes a five year term for the PBR Plan | A four year term from 2004 to 2007 was accepted. | A two-year period commencing January 1, 2008 and ending in December 31, 2009. |
| **Productivity**<br><br>Page C-25 proposes a results-based adjustment factor of 0.75% each year from 2004-2008 for O&M and Net Gas Plant in Service. | The adjustment factor will be 50% of CPI for 2004 and 2005, and 66% of CPI for 2006 and 2007. See O&M and Capital Additions Forecast sections below. | Continue use of mechanism without change from Current TGI Settlement. The productivity factor of 66% of CPI will be used for both 2008 and 2009, consistent with factor used in 2006 and 2007. |
| **Inflation**<br><br>CPI (BC) will be used to adjust the controllable expenses as described on page C-10. Rates will be set prospectively, and as in the 1998 plan, the rates will not be modified to reflect actual CPI (BC). CPI (BC) is forecast as 1.8% for 2004 and 2% for 2005-2008 in Section H, Tab 3, page 2.2. The Annual Review will update the inflation forecast for the upcoming year as described in Section H, Tab 9, p. 1 and BCUC IR10.1, but there will be no true up to actual CPI(BC). Alternative inflation indices were discussed in BCUC IR 10.2 and Elk Valley Coal Corporation IR#2, Questions 2-4. | CPI (BC) accepted as filed. | Continue use of mechanism without change from Current TGI Settlement. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| **Customer Growth**<br>The Annual Review will update the customer count for the actual number of customers at the start of the year and forecast customer growth for the upcoming year as described in page F1 and BCUC IR 9.1. | Accepted as filed-same as 1998-2001 PBR. | Continue use of methodologies without change from Current TGI Settlement. |
| **Revenues**<br>Revenue categories identified on pages C-13 to C-14 include amounts received from sale and delivery of gas, transportation service, revenues received under tariff supplements, $85 from application for service and revenues from account transfers. Revenues will be forecast each year and the company is at risk within the year for variances in industrial revenues, customer additions, applications for service and account transfers. Throughput variances for residential and commercial customers in rates 1, 2 and 3/23 will be subject to RSAM. Variances in Burrard Thermal and SCP revenues will be deferred and amortized.<br>Pages F-1 to F-8 state that the forecast process has a customer additions forecast, an average use per account forecast and an industrial forecast. A 2003 industrial survey will be presented at the 2003 Annual Review. The residential use per account of 108 GJ was used for 2003 and in the Application for 2004. The use per account for rates 1, 2, 3 and 23 will be reforecast at the 2003 and subsequent Annual Reviews.<br>Other revenues of Centra Gas (PCEC) Wheeling Agreement and SCP third party revenues will be forecast each year at the Annual Review. Late payment revenue will be adjusted to the same formula as O&M expenses.<br>Page C-14 indicates that load-building programs will be brought forward either at or before Annual Reviews. These are separate from DSM programs as confirmed in BCUC IR 7.2 | Forecast process is acceptable. Earnings variances relating to at risk revenue items will be included in the Earnings Sharing Mechanism. | Continue use of methodologies without change from Current TGI Settlement.<br>At-risk items unchanged.<br>RSAM continues unchanged. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement (“Current TGI Settlement”) | 2008-2009 Extension Period |
|---|---|---|
| **Gas Cost**<br><br>Section H, Tab 8, p. 1 states that the cost of gas used under the PBR will be based on the approved unit gas costs prevailing at the time the volume and revenue forecast is made. Page C-19 proposes the continuation of GCRA and GSMIP. | Accepted as Filed | Continue use of methodologies without change from Current TGI Settlement.<br><br>Continuation of CCRA and MCRA Accounts (which replaced the GCRA) without change from Current TGI Settlement. |
| **O&M**<br><br>Section H, Tab 9, p. 1 proposes that O&M expense for 2004-2008 be determined by a formula-based approach that starts from a base of the 2003 Decision O&M escalated by growth in customers and inflation less an adjustment factor of 0.75%.<br><br>The O&M formula on Section H, Tab 9, p. 1 is:<br><br>[Base Cost x(1+Growth) x (1+Inflation-0.75% adjustment factor)]<br><br>Page C-13 proposes that pension and insurance costs will be forecast each year with variances deferred for flowthrough amortization over one year.<br><br>Vehicle and Coastal Facilities Lease are added (not part of O&M formula)<br><br>Pipeline Integrity Costs-if a planned capital expenditure is to be funded through O&M then page C-19 proposes that the allowed O&M be increased. | Accepted for 2004 – 2007 with adjustment factors of 50% CPI in 2004 and 2005, and 66% CPI in 2006 and 2007.<br><br>Beginning in 2004, ongoing pipeline integrity costs are to be expensed as O&M and a levelized adjustment will be made to the base O&M in the formula for years 2004-2007. Facilities retrofits will continue to be treated as CPCNs throughout the term.<br><br>See also Capital Additions Forecast. | Continue use of mechanism/formula without change from Current TGI Settlement. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement (“Current TGI Settlement”) | 2008-2009 Extension Period |
|---|---|---|
| **Overhead**<br><br>Page G-5 proposes a 16% overhead per year from 2004-2008, calculated consistent with the response to BCUC IR 11.1 and Section H Tab 9 Page 2 of the Application. | Accepted as Filed except that the amount of gross O&M not subject to Overheads Capitalized will be escalated by the O&M formula. The amount not subject to overhead capitalization is the sum of $19,373,000 (Section H, Tab 9, Page 2) and the levelized incremental pipeline integrity O&M expenses of $5,505,000. | Continue to use a 16% overheads capitalization rate without change from Current TGI Settlement. |
| **Net Gas Plant in Service Formula**<br><br>Section H, Tab 3, p. 2 proposes that Mid-year NGPiS for 2004-2008 be determined by a formula-based approach that starts from a base of the 2003 Mid-year NGPiS escalated by growth in customers and inflation less an adjustment factor of 0.75%.<br><br>The NGPiS formula on Section H, Tab 3, p. 2 is:<br><br>Current Mid-year NGPiS=(Prior Mid-year NGPiS/customer) x (Forecast Average Number of Customers in Current Year) x (1+Inflation-0.75% adjustment factor)<br><br>2003 Mid-year NGPiS is based on actual 2003 opening NGPiS and the projected 2003 year end NGPiS from the fall 2003 Annual Review.<br><br>Formula-based values of NGPiS, accumulated depreciation, CIAOC, net plant additions are not rebased during the five year PBR. | The Net Gas Plant in Service formula approach was not accepted.<br><br>See Capital Additions Forecast. | The Net Gas Plant in Service Formula was not accepted as part of the Current TGI Settlement. |
| **Capital Additions Forecast**<br><br>Section H, Tab 3, pp. 2.2 to 2.4 and BCUC IR 2.2 show gross plant additions are back-calculated in several steps from the formula-based mid-year NGPiS and forecast retirements. Forecast retirements are the same as the amounts in last year’s PBR | <u>Base Capital Expenditures.</u><br><br>As per BCUC IR 4.6, use formulas based on customer additions and average number of customers. Using | <u>Base Capital Expenditures</u><br><br>Continue use of formula without change from |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| proposal. | (1+CPI (BC)-Adjustment Factor).<br><br>Base capital expenditure amounts will not be rebased to actual amounts during the term. For rate setting in subsequent years the formula base capital expenditures from the prior years will be adjusted for projected customer counts and trued up for actual customer counts as this information becomes known.<br><br>The cumulative difference over the four-year term between the trued-up formula based capital expenditures and actual base capital expenditures will be subject to a phase-out of the benefits of 2/3 in the year after the term and 1/3 in the second year after. An example of the capital true-up process and capital benefits end-of-term phase-out is attached as Appendix 3.<br><br><u>Capitalized Overhead</u><br><br>16% of gross O&M calculated by formula, consistent with the response to BCUC IR 11.1 and Section H Tab 9 Page 2 of the Application. The levelized O&M increase for ongoing pipeline integrity program expenditures will not be subject to overheads capitalized.<br><br><u>CPCN Additions</u><br><br>CPCN expenditures are excluded from the capital formula. Except in very unusual circumstances, CPCNs will not be filed for projects below $5 million.<br><br>Transmission Pipeline Integrity CPCNs will be limited to retrofits, which BCUC IR 23.2.1 (2003 Revenue Requirement Application) showed as $2.8 million in 2004 and $3.0 million in 2005. CPCN expenditures to be included for rate setting purposes will be only for those projects which have been approved by the | Current TGI Settlement.<br><br><u>Phase-Out</u><br><br>Continuation without change from the Current TGI Settlement. Phase-Out to commence with expiration of settlement extension term.<br><br><u>Capitalized Overhead</u><br><br>Continue to use a 16% overheads capitalization rate without change from Current TGI Settlement<br><br><u>CPCN Additions</u><br><br>Continue use of $5 million threshold for CPCN's without change from Current TGI Settlement. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| | Commission and are projected to be in service prior to the year for which rates are being set. The revenue requirement effect of variances between projected and actual CPCN expenditures for those projects being added to rate base will be taken into account in the Earnings Sharing Mechanism. | |
| **15% Plant Additions Benefit Factor**<br><br>Appendix C-A-2. p. 2 proposes that the current year plant additions savings (actual versus NGPiS formula) be multiplied by a factor of 15% to represent the average avoided annual revenue requirement. An example is provided in BCUC IR 1.9.2 showing a levelized saving of 13.21%. The 15% factor provides for the possibility of plant accounts with higher depreciation rates or higher cost of capital in the future. | Accepted for application only to base capital additions for the end-of-term capital benefits phase-out except that the factor should be 14%. | Continuation without change from the Current TGI Settlement. Phase-Out to commence with expiration of settlement extension term. |
| **Depreciation Rates**<br><br>Section H, Tab 4 deals with the calculation of depreciation expense for 2004 to 2008. Depreciation rates for Meters, Meter Installations and Regulators and Computer will be adjusted effective January 1, 2004. Under the PBR proposal, the accumulated depreciation used in setting rates each year in the Annual review process will arise from the NGPiS calculation, as described in BCUC IR 2.1. Retirements to be used in the accumulated depreciation calculation will be forecast each year for the Annual Review. | Accepted as Filed. | Continue to use current depreciation rates without change from Current TGI Settlement. |
| **Restructuring Deferral Account**<br><br>Pages C-15 and C-16 propose that after the PBR Plan is approved, investments in restructuring will be deferred and recovery will commence in 2004 from actual savings before any sharing. If there is a debit balance in the deferral account in 2008 then it is applied against the full term efficiency incentive. In LMLGUA IR 13, the | All restructuring costs incurred during the Term are to be treated as normal expenditures. Specific restructuring initiatives requiring longer term recovery or providing longer term benefits beyond the end of the Term can be brought forward by the Company for | Continue use of deferral account without change from Current TGI Settlement. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| Company confirmed that if it incurs restructuring costs and efficiencies do not materialize then the restructuring costs are borne by the Company.<br><br>In BCUC IR 1.11.5 the Company proposes a non-rate base deferral account. In BCOAPO IR 4.1 the Company proposes that the revenue requirements would not be increased by the amount of the deferral account.<br><br>In LMLGUA IR 4.1 the Company anticipates that a definition of what is to be included in restructuring costs would be included in the negotiated settlement document. The Company proposed items to be included are in BCUC IR 1.11.1.<br><br>On page C-15 and in BCUC IR1.11.2 and BCOAPO IR 4.1 and 4.2 the Company states that positive variances from the allowed ROE will first be used to offset the costs included in the restructuring deferral account prior to sharing. | consideration at any Annual Review.<br><br>Net restructuring costs incurred by the Company between July 1, 2003 and December 31, 2003 will be captured in a deferral account, to be recovered as a 2004 expense. Net restructuring costs refers to the netting off of savings the Company realizes in 2003 from restructuring activities. The deferral account will be non-interest bearing non-rate base. | |
| **Full Term Efficiency Incentive**<br><br>Page C-16 and Appendix C-A-2, pp. 1-4 describe FTEI as motivating new efficiencies and provides for retaining savings for five years after the investment is made to repay the cost of the initial investment before savings are shared with customers. | The FTEI is not accepted. However, there will be a capital benefits phase-out at the end of term as described in the Capital Additions Forecast section above. | The FTEI was not accepted as part of the Current TGI Settlement.<br><br>The capital benefits phase-out will continue with the phase-out to commence with expiration of the settlement extension term. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement (“Current TGI Settlement”) | 2008-2009 Extension Period |
|---|---|---|
| **Sharing Mechanism**<br>Appendix C-A-2, pp. 1-4 describes and provides an example of the sharing mechanism for savings in net O&M, the gross plant additions benefit and industrial revenue variances. The allocation of savings to the Restructuring Deferral Account and the FTEI is also described.<br>Pages C-15 and C-16 propose that sharing commence on January 1, 2004 with 50/50 sharing of earnings above or below the allowed ROE, net of GSMIP, the DSM Achievement Incentive and other incentives. The customers’ portion of the sharing will be projected at Annual Reviews and provided to customers by a rider in the following year. The customers’ actual portion of sharing shall be determined after year end and variances from projections provided to customers by a rider in the following year. Sustained (two-year average) return that is 200 basis points above or below the allowed ROE triggers an Off-Ramp review. | The 50/50 sharing mechanism is accepted based on the difference between the allowed and actual ROE (net of GSMIP, DSM Incentive, load building and incentives for partially controllable items) using the common equity component of the actual rate base.<br>See Trigger Mechanism. | Continue use of mechanism without change from Current TGI Settlement. |
| **Deferred Charges and Amortization**<br>Pages G-6 to G-7 seeks continuation for 2004 to 2008 of:<br>• Deferred interest account to collect interest expense variances from forecast short-term debt rates and from forecast long term debt rates, principle, timing of issues and long term debt issue costs.<br>• DSM incentive grants for deferral of grants of up to $1.5 million per year. BCUC IR 7.2 explained that the deferral account would only be used to collect incentive payments and rebates to customers. Costs associated with advertising (including awareness programs), program promotion, program design, administration, research and evaluation would be O&M expenses. | Proposed deferral accounts and amortization periods are acceptable.<br>A DSM assessment report should be provided at the Annual Review of proposed programs for the upcoming year and an analysis of existing programs. | Continue use of deferral accounts without change from Current TGI Settlement. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| Additional requests:<br>• Amortize over 5 years commencing in 2005, the deferred 3rd party revenues arising from the cancellation of PG&E contract net of any mitigation revenues received.<br>• Deferral of variances in pension expense and insurance expense from forecast.<br>• Deferral of the costs of the PBR Application and amortize over 5 years.<br><br>Section H, Tab 3, pp. 6.1 to 6.6 requests the following treatment:<br>• Deferred interest is amortized over three years.<br>• Market Rebate Incentive-Water Heater Grants are continued until final year of amortization in 2004.<br>• NGV Conversion Grants with continued additions as approved by Orders G-98-99 and G-7-03 and five year amortization.<br>• 2003 Revenue Requirement with five year amortization.<br>• 2004-2008 Revenue Requirements with accumulation of costs and five year amortization.<br>• DSM program to continue with expenditures of $1.5 million per year for 2004-2008 and three year amortization.<br>• DSM-DRIA to continue with three year amortization.<br>• Property Tax Deferral with continued accumulation of variances between forecast and actual with three year amortization.<br>• GCRA and GCRA Interest with continued recording of interest on GCRA variances from forecast. Amortization in accordance with Orders No. G-124-00, G-134-01 and G19-03. | | |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| • RSAM will continue to accumulate differences between forecast and actual use rate of RSAM customers per year from 2004-2008. Any RSAM additions are amortized over three years. Variances between forecast and actual balances will accumulate short-term finance costs.<br>• BC Hydro Services Agreement Costs with continuation of two year amortization by 2003 Decision and Order G-7-03.<br>• Coastal Facilities with continuation of five year amortization by Order C-14-98. With deferral of costs approved by Order C-14-98 and two year amortization by 2003 Decision and Order G-7-03.<br>• ABC-T Project Requirements Phase with two year continued amortization commencing in 2003 by Order G-24-02.<br>• Burner Tip Service with continued one year amortization by 2003 Decision and Order G-7-03.<br>• Earnings Sharing Mechanism as an amortization of the January to February 2003 refund over the remaining March to December 2003 period by 2003 Decision and Order G-7-03.<br>• Salmon Arm Reinforcement with continued amortization by Order G-26-00. Final year of amortization in 2003.<br>• NGV Compression Equipment Recovery with continued 10 year amortization by Order G-143-99.<br>• 2001 Rate Design with continued amortization over three years starting in 2002 by Order G-116-01.<br>• Overheads Change-Income Tax Refund and CIAOC Software Tax Savings/OH Change with continued amortization over five years by 2003 Decision and Order G-7-03.<br>• Other Post Employment Benefits with continued regulatory | | |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| accounting treatment by Order G-7-03.<br>• Deferred 2000 SCP Cost of Service with amortization over five years by Orders G-135-99 and G-7-03 and 2003 Decision.<br>• SCP Net Mitigation Revenue and SCP West to East Transmission with continued five year amortization by Orders G-124-00, G-123-01, G-7-03 and 2003 Decision.<br>• SCP PG&E Contract Cancellation with forecast lost revenue per Letter L-48-02 and requested amortization over five years commencing in 2005.<br>• CCT Deferral with continuation of five year amortization starting in 2003 by 2003 Decision and Order G-7-03 of deferred credit recorded by Orders G-85-97 and G-48-00.<br>• CCT Assessment with amortization period of three years by 2003 Decision and Order G-7-03. | | |
| **Working Capital**<br>Section H, Tab 5, p. 1 proposes that Gas in Storage and Transmission Linepack and All Other Working Capital will have a revised forecast at the Annual Review. Cash Working Capital will use lead/lag methodology from the 1992 Decision with changes from the 2003 approved lead or lag days currently in rates brought forward each year as necessary.<br>In BCUC IR 11.2 the Company discusses using a formula to calculate cash working capital based on the mid-year NGPiS. | Accepted as filed. | Continue determinations of working capital without change from Current TGI Settlement. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement (“Current TGI Settlement”) | 2008-2009 Extension Period |
|---|---|---|
| **Finance, Accounting and Tax Issues**<br>Pages G-1 to G-6 propose:<br>• New long term debt issues of \$850 million for 2004-2008 with an expected rate of 7%. A 2003 long-term debt issue of \$150 million for 2003. Debt expense to be reforecast at each Annual Review as described on page C-12.<br>• Short term debt rates of 4% for 2004 and 5% for 2005-2008. Debt expense to be reforecast at each Annual Review.<br>• Any changes in GAAP would be treated as flowthrough items.<br>• A report will be filed on the separation of BC Gas Inc. pensions, salaries and expenses from BCGUL. The Corporate Centre is expected to have 40-45 employees. Forecast O&M is consistent with the 2003 Decision and the amounts charged by the corporate Centre to BCGUL will be consistent with the 2003 Decision. | Accepted, but any changes in regulatory treatment resulting from changes in GAAP will require Commission approval. | Continue without change from Current TGI Settlement.<br>Any changes in regulatory treatment resulting from changes in GAAP will require Commission approval. |
| **Regulatory Accounting Methodologies**<br>Page C-19 proposes the continuation of GCRA/RSAM accounts, taxes payable method for income taxes, regulatory treatment for CPCNs from the 1998-2001 PBR Plan, accounting for certain assets and rate stabilization accounts on a net of tax basis, accounting for property, plant and equipment to include overhead and AFUDC. Approved depreciation rates are used. The current accounting treatment of property, plant and equipment retirements will continue. | Accepted as Filed. | Continue without change from Current TGI Settlement. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| **Taxes**<br><br>Page C-13 proposes a deferral account to record variances in property taxes, income tax rates, LCT rates, and any new government tax expenses, charges and levies. Amortization over three years as a flowthrough item. At the Annual Review a forecast of income tax and LCT rates and other tax expenses for the following year will be provided and customers' rates for that following year will be determined on the basis of that forecast. | Accepted as Filed. | Continue without change from Current TGI Settlement. |
| **Exogenous Factors**<br><br>Exogenous Factors are described on page C-16 as items beyond the Company's control that will be adjusted in rates (flowthrough). These factors include judicial, legislative or administrative changes, orders or directions, catastrophic events, bypass or similar events, major seismic incident, acts of war, terrorism or violence, changes in generally accepted accounting principles, standards and policies, changes in revenue requirements due to Commission directions.<br><br>In BCUC IR 1.5, the Company lists the flow through items and exogenous factors and discusses the merits of fixing an expense and allowing the item to be "at risk". The Company believes that partially controllable items should be evaluated on an item by item basis and considered in the context of the overall PBR. | Accept the arguments of Terasen Gas and accept same practice as 1998-2001 PBR. | Continue use of mechanism without change from Current TGI Settlement.<br><br>Exogenous factors that have been approved by the Commission throughout the term of the Current TGI Settlement will continue for the extension period. |
| **Service Quality Indicators**<br><br>Appendix C-A-1, pp. 7-14 discusses benchmarks for proposed SQIs. Appendix C-A-1, p. 5 proposes a benchmark based, where possible, on a three year history at the beginning of the PBR that is | Refer to the SQI section in the Annual Review document (Appendix 2) | Continue use of Service Quality Indicators without change from Current TGI |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| maintained throughout the PBR period.<br><br><u>Proposed SQIs</u> — <u>Benchmark</u><br>Response Time to Site for Emergency Calls — 21.1 minutes<br>% of Responses within 30 Seconds -Emergency — 95%<br>% of Responses within 30 Seconds-Non-Emerg — 75%<br>Trans System Annual Reportable Incidents — 2 Reportable/yr<br>% of Customer Bills Meeting Performance Criteria — Score 5.0 or less<br>Meter Exchange Appointment Activity — 92.2% met<br><u>Directional Indicators</u> — <u>Three Year Average</u><br>Number of Third Party Damages — 1,219<br>Leaks per Kilometre of Distribution Mains — 0.0041<br><br>BCUC IR 1.10.7 states whether or not the achievement level for SQIs should be used to qualify the Company for an incentive should be dealt with similar to the 1998-2001 PBR. Page 13 of that PBR stated that SQIs will be reviewed at Annual Reviews and participants can make submissions to the Commission that a deviation from a benchmark is significant enough that it should limit incentive payments to the Utility. | | Settlement. |
| **Trigger Mechanism**<br><br>Page C-18 proposes that a full regulatory review is triggered if the two-year average achieved ROE after sharing exceeds or drops below the allowed ROE by 200 basis points or if there is a serious degradation of Service Quality Indicators. LMLGU IR 21 clarified that the two-year average refers to two consecutive years and in IR 32 the Company expressed the belief that "serious degradation" cannot be defined in a manner that would foresee all circumstances. | A Commission review of the PBR Plan can be requested by any party if the achieved ROE after earnings sharing varies from the allowed ROE by 150 basis points in any year of the term. | Continue use of mechanism without change from Current TGI Settlement. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement (“Current TGI Settlement”) | 2008-2009 Extension Period |
|---|---|---|
| **Annual Review**<br><br>The process for the Annual Review and rate setting for the following year is described in BCUC IR14.1 as being similar to the 1998-2001 PBR as adjusted for 2004-2008 PBR Plan formulas, SQIs, plant additions. | Expanded 1998-2001 PBR Annual Review process is acceptable. See attached. | Continue use of Annual Review without change from Current TGI Settlement. |
| **No Surprises** | Terasen Gas is to advise all parties of any major changes planned for the Utility and nothing in this settlement provides Terasen Gas with any approval to change its business practices to the detriment of customers. For example, the spin off of significant operations, such as those outsourced to CustomerWorks would require disclosure prior to undertaking. | Continue adherence to “No Surprises” clause/spirit without change from Current TGI Settlement. |
| **Mid-Term Assessment Review**<br><br>Page C-18 proposes that a review be held prior to the end of the third year (2006). If there are unintended outcomes or deterioration in service quality, the parties can jointly address a cure. LMLGUA IR 12.1 describes the Mid-Term Assessment Review as an expanded Annual Review. | The proposal is acceptable. | The Mid-Term Assessment review was held in the third year of the Current TGI Settlement (2006).<br><br>Not necessary for extension term. |
| **Customer Advisory Council (CAC)**<br><br>(This item was not addressed in the Application) | A customer advisory council will be established which meets twice yearly to deal with any customer issues that have arisen during the year. The purpose of the CAC will be to provide a non-binding forum for customer groups and the Company to communicate and deal with customers' concerns constructively and proactively. One of the meetings will be held in | Continue the Customer Advisory Council without change from Current TGI Settlement. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| | advance of the Annual Review to provide an opportunity for customers to raise issues again at the Annual Review which have not been satisfactorily resolved in the CAC process. The Company's representatives on the CAC will comprise of the President, Vice President of Marketing and Vice President of Regulatory Affairs. A record of the meetings will be kept and made available upon request. | |
| **Equity Thickness**<br>Page G-1 confirms that the Company finances its assets with a mix of debt and equity following the Commission's approved capital structure of 33% common equity and 67% debt. | The equity component is consistent with the 2003 Decision and is acceptable. This does not preclude the Company from making an application to the Commission for a variation of its equity thickness if appropriate. | Continue with same terms as in Current TGI Settlement, i.e. the terms of this settlement extension "does not preclude the Company from making an application to the Commission for a variation in its equity thickness if appropriate." Also consistent with Current TGI Settlement the terms of this settlement extension does not preclude the Company from making an application to the Commission for a variation in the generic ROE mechanism and the Company's allowed ROE. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| **Load Building**<br><br>Company proposed incentives around load building initiatives. | Concept of incentives for load building initiatives accepted, subject to DSM-like assessment (including net present value of expected revenues and costs) of each initiative. | Company may develop load building initiatives during the Term consistent with the Current TGI Settlement. |
| Company proposed framework of specific load building program based on increased penetration for gas cooking, clothes drying and water heating appliances. See attachment. Company may develop other initiatives during the Term. | A DSM-like assessment (including net present value of expected revenues and costs) should be provided at or before Annual Review before initiative starts. | |
| | | |
| **<u>Other Items</u>** | | |
| **<u>Partially Controllables</u>**<br><br>Stakeholders expressed interest in exploring positive incentives around partially controllable expenses. The Company was also interested. | Company to have a positive incentive around provincial and municipal government taxes, fees and expenses. Details of an incentive respecting property taxes were agreed. See Appendix 5.<br><br>Company or interested parties (intervenors/Commission staff) to bring forward any new ideas around positive incentives for partially controllable expenses to Annual Reviews. | Continue without change the property tax incentive as set out in the Current TGI Settlement.<br><br>Consistent with the terms of the Current TGI Settlement, Company or interested parties (intervenors/Commission staff) to bring forward any new ideas around positive incentives for partially controllable expenses to Annual Reviews. |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement (“Current TGI Settlement”) | 2008-2009 Extension Period |
|---|---|---|
| | | |
| ***Additional Items for Extension Period*** | | |
| **Comprehensive review of customer connection policies and system extension policies** | | TGI committed, as part of its 2006 Annual Review and Mid-Term Assessment review, to undertake in 2007 a comprehensive review of its customer connection policies and system extension policies, including its MX test. An application will be made to the Commission for review and approval in 2007 taking into consideration the 2007 Energy Plan and the results of the 2007 BC Hydro Rate Design proceeding, with implementation in 2008. |
| **Review of DSM funding and economic tests** | | TGI committed, as part of its 2006 Annual Review and Mid-Term Assessment Review, to undertake in 2007 a review of the economic tests used to evaluate its DSM and efficiency related programs. This review will also assess |

| Settlement Items | 2004-2007 PBR Negotiated Settlement Agreement ("Current TGI Settlement") | 2008-2009 Extension Period |
|---|---|---|
| | | the 2006 CPR study and the potential need for increased DSM funding and will take into consideration the anticipated Provincial 2007 Energy Plan. An application will be made to the Commission for review and approval in 2007, with implementation in 2008. |

**COUNT 21 1-Terasen Gas Inc.-Performance-Based Rate Plan 2004-2008-Registered Intervenor**

Mr Ray Aldeguer
Senior Vice-President
Corporate Resources & General Counsel
**British Columbia Hydro and Power Authority**
18th Floor, 333 Dunsmuir Street
Vancouver C V6B 5R3
**Tel:** 9,604,623-4513 **Fax:** 9,604,623-4407
**Email:** alice.ferreira@bchydro.com
**Representing**:

r tirling M Bates
enior Regulatory Advisor
il & Gas Section
**inistry of Energy & Mines**
**olicy & Legislation Division**
th Floor, 1810 Blanchard Street
O Box 9318 Stn Prov Govt
ictoria C V8W 9N3
**Tel:** 8,1,250,952-0185 **Fax:** 8,1,250,952-0271
**Email:** Stirling.Bates@gems6.gov.bc.ca
**Representing**:

Mr David Bursey
**Bull Housser & Tupper**
**Barristers & Solicitors**
1055 West Georgia Street
PO Box 11130, 3000 Royal Centre
Vancouver C V6E 3R3
**Tel:** 9,604,641-4969 **Fax:** 9,604,646-2563
**Email:** dwb@bht.com
**Representing**:
**TGI-PBR04/08**-Inland Industrials

r ames Campbell
484 Shoreacres Road
idney BC 8L 2E2
**Tel:** 8,1,250,655-0820 **Fax:** N/A
**Email:**
**Representing**:

Mr Rick Dowling
Business Manager and Financial Secretary
**International Brotherhood of Electrical Workers, (IBEW)**
4220 Norland Avenue
Burnaby BC 5G 3X2
**Tel:** 9,604,571-6500 **Fax:** 9,604,294-1538
**Email:** local213@shaw.ca
**Representing**:

r ruce Farmer
irector
**ffice & Professional Employees' International Union Local 378**
nd Floor, 4595 Canada Way
urnaby BC V5G 4L9
**Tel:** 9,604,299-0378 **Fax:** 9,604,299-8211
**Email:** bfarmer@opeiu.ca
**Representing**:

Mr Gordon A Fulton
Gordon A. Fulton Law Corporation
**Boughton Peterson Yang Anderson, Law Corporation, Barristers & Solicitors**
Suite 1000 Three Bentall Centre
595 Burrard Street PO Box 49290
Vancouver C V7X 1S8
**Tel:** 9,604,647-4104 **Fax:** 9,604,683-5317
**Email:** gfulton@boughton.ca
**Representing**:
BCUC Counsel

r ichard Gathercole
xecutive Director
**C Public Interest Advocacy Centre**
15 - 815 West Hastings Street
ancouver BC 6C 1B4
**Tel:** 9,604,687-3063 **Fax:** 9,604,682-7896
**Email:** Rjg@bcpiac.com
**Representing**:
**VIGP03** - BC OldAgePensionersOrg.etal. **Heritage** - BCOAPO
**TGI-Pent/SalArm** - BCOAPO

Ms ary-Margaret Gaye M.Sc., P.Ag.
Executive Director
**BC Greenhouse Growers' Association**
5355 - 152nd Street
Surrey BC V3S 5A5
**Tel:** 9,604,576-5484 **Fax:** 9,604,576-5481
**Email:** Mary-Margaret@bcgreenhouse.ca
**Representing**:

r avid Humber
anager, Technical Development
**est Fraser Mills Ltd**
**estPine MDF**
00 Carradice Road
uesnel BC V2J 5Z7
**Tel:** 8,1,250,991-7107 **Fax:** 8,1,250,991-7115
**Email:** dave.humber@westfraser.com
**Representing**:

Mr George Isherwood
Regulatory Affairs Executive
**Aquila Networks Canada (British Columbia) Ltd.**
1290 Esplanade
PO Box 130
Trail BC V1R 4L4
**Tel:** 8,1,250,368-0313 **Fax:** 8,1,250,364-1270
**Email:** george.isherwood@aquila.com, lavern.humphrey@aquila.com
**Representing**:

Mr Jim F Langley
Manager, Marketing Services
**IGI Resources Inc.**
568 Alpine Court
North Vancouver BC V7R 2L6
**Tel:** 9,604,982-0204 **Fax:** 9,604,982-0206
**Email:** langlej3@bp.com
**Representing**:

Ms Nelle Maxey
Manager
**Heating Ventilating & Cooling Industry (HVCI) Association of BC**
6004 Lois Street
Powell River BC V8A 4T7
**Tel:** 8,1,888,774-8484 **Fax:** 8,1,888,774-8484
**Email:** hvci@shaw.ca
**Representing**:

Ms Mary McCordic
Director, Energy Marketing
**Avista Energy Canada, Ltd**
1006 - 1166 Alberni Street
Vancouver BC V6E 3Z3
**Tel:** 9,604,254-7173 **Fax:** 9,604,682-6447
**Email:** mary.mccordic@avistaenergy.com
**Representing**:

Mr Gary Newcombe
**Direct Energy Marketing Limited**
1000, 111 - 5th Avenue S.W.
Calgary AB T2P 3Y6
**Tel:** 8,1,403,290-7745 **Fax:** 8,1,403,266-6684
**Email:** gary.newcombe@directenergy.com
**Representing**:

Mr J David V Newlands
**Elk Valley Coal Corporation**
**c/o Pacific Western Energy Inc**
6209 Angus Drive
Vancouver BC V6M 3P2
**Tel:** 9,604,264-9147 **Fax:** 9,604,261-1964
**Email:** dnewlands@telus.net
**Representing**:
**TGI-PBR04/08, TGI-Pent/SalArm -** Elk Valley Coal Corporation

Mr Richard T O'Callaghan PEng
**RT O'Callaghan & Associates Inc**
PO Box 3483
Vancouver BC V6B 3Y4
**Tel:** 9,604,683-8353 **Fax:** 9,604,488-0665
**Email:** rto@rtocallaghan.com
**Representing**:
BC Health Services Ltd.

Mr Lyle J Oliver
Manager Commodity Services
**Direct Energy Business Services**
810 Cliveden Avenue
Annacis Business Park
Delta BC V3M 5R5
**Tel:** 9,604,523-3022 **Fax:** 9,604,523-3092
**Email:** lyle.oliver@na.centrica.com
**Representing**:

Ms Dominique Ramirez
**Willis Energy Services Ltd**
500 - 885 Dunsmuir Street
Vancouver BC V6C 1N5
**Tel:** 9,604,685-2206 **Fax:** 9,604,685-1713
**Email:**
**Representing**:

Mr Greg Staple
Strategic Account Manager
Downstream Marketing
**BC Pipeline and Field Services Division**
1333 West Georgia Street
Vancouver BC V6E 3K9
**Tel:** 9,604,691-5721 **Fax:** 9,604,691-5997
**Email:** staple@duke-energy.com
**Representing**:

Mr Chris Weafer
**Owen • Bird**
**Barristers & Solicitors**
2900 - 595 Burrard Street
PO Box 49130 Three Bentall Centre
Vancouver BC V7X 1J5
**Tel:** 9,604,691-7557 **Fax:** 9,604,632-4482
**Email:** cweafer@owenbird.com
**Representing**:
**BCH-Heritage**-BC Greenhouse Growers' Association, Commercial Class Energy Customers of BC Hydro, United Flower Growers Co-operative Association **TGI-Pent/SalArm**- Interior Municipalities Group
**TGI-04/08PBR**-Lower Mainland Large Gas Users Assocation; Heating Ventilating Cooling Industry Assoc. of BC; BC Greenhouse Growers Association; United Flower Growers Association; Avista Energy

BRITISH
COLUMBIA

December 21, 2006

Via E-Mail
regulatory.affairs@terasengas.com

Mr. Scott A. Thomson
Vice President, Finance and Regulatory Affairs
and Chief Financial Officer
Terasen Gas Inc.
16705 Fraser Highway
Surrey, BC  V4N 0E8

Dear Mr. Thomson:

The Ministry of Energy, Mines and Petroleum Resources (the Ministry) wishes to provide its comments with respect to Terasen Gas Inc. (Terasen) and Terasen Gas Vancouver Island (TGVI)'s requests for extension to their respective Settlement Agreements (the Settlements).

The Ministry is encouraged by the financial and service quality performance of Terasen over the Settlement period. Terasen has remained within the approved band of Return on Equity (RoE), customers have shared in earning surpluses via the Earnings Sharing mechanism and Service Quality Indicators have shown improvement over the period.

The Ministry remains concerned about the current level of Demand Side Management (DSM) activities. These concerns were outlined in the Ministry's Information Request and Comments submitted to the British Columbia Utilities Commission (the Commission) as part of Terasen's 2006 Annual Review and Mid-Term Assessment Review.

With respect to TGVI, the Ministry is encouraged by the company's reduction of its Revenue Deficiency Deferral Account (RDDA) over the Settlement period. The current Settlement supports an aggressive timetable for the retirement of the RDDA by 2011. However, given the uncertainty surrounding the status of the Island Co-generation Project, retirement of the RDDA by the end of 2011 is not guaranteed.

In addition, the Ministry is concerned that any extension would transform what was originally intended to be a two-year agreement into a six or possibly seven-year agreement. The Ministry suggests that any further extension to the Settlements, and to TGVI's Settlement in particular, be considered within the context of the British Columbia Government's new Energy Plan.

The Ministry understands that this request for extension is related to future amalgamation of the two utilities. While the Ministry expresses its concerns about DSM and TGVI's commitment to eliminate the RDDA, it would support a two-year extension period to both the Terasen and TGVI Settlements.

Sincerely,

*Original signed by*

Ines Piccinino
Director, Oil and Gas Policy

**Ministry of Energy, Mines and Petroleum Resources**

Oil and Gas Policy Branch
Oil and Gas Division

5th Floor, 1810 Blanshard Street
PO Box 9318 Stn Prov Govt
Victoria, BC V8W 9N3