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February 11, 2009
File No.: 240148.00595/14797

BY ELECTRONIC FILING

British Columbia Utilities Commission
Sixth Floor, 900 Howe Street
Vancouver, BC V6Z 2N3

**Attention: Erica M. Hamilton,
Commission Secretary**

Dear Sirs/Mesdames:

**Re: Terasen Gas Inc.
An Application by Terasen Gas Inc. for a Certificate of Public Convenience
and Necessity for the Fraser River Crossing Upgrade Project**

We enclose the Reply Submissions of Terasen Gas Inc. in respect of the above mentioned matter. Twenty hard copies of same will follow by courier.

Yours truly,

FASKEN MARTINEAU DuMOULIN LLP

[Original signed by Matthew Ghikas]

Matthew Ghikas

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Encl.

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**IN THE MATTER OF
THE UTILITIES COMMISSION ACT, R.S.B.C. 1996, CHAPTER 473**

AND

**AN APPLICATION BY TERASEN GAS INC.
FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND
NECESSITY FOR THE
FRASER RIVER CROSSING UPGRADE PROJECT**

**REPLY SUBMISSIONS OF
TERASEN GAS INC.**

FEBRUARY 11, 2009

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I. INTRODUCTION

1. These are the Reply Submissions of Terasen Gas Inc. ("TGI") in the above noted matter.
2. Only two intervenors filed substantive comments on this Application, the City of Richmond and BCOAPO. The City of Richmond submitted a letter in support of the Application, stating that the Application "addresses both pipelines, therefore assuring reliability of natural gas service to the constituents of various Metro Vancouver municipalities." It further confirmed that "the Terasen pipeline design and construction is completed in a manner such [sic] they will not interfere with the City's ability to adjust the dikes (i.e., raised to meet minimum City requirements, sea level rise associated with global warming, widened, etc.) using standard dike

construction practices."¹ BCOAPO, in its February 4, 2009 Submissions, has similarly endorsed the Project. It states that TGI "has exercised its judgment in evaluating the alternatives and in determining the supplementary criterion [sic] of return period and pipe positioning." BCOAPO adds that they have no basis to dispute that "this project is non-discretionary and the alternative proposed is in the public interest."² Accordingly, these Reply Submissions address only discreet issues and proposals raised in the BCOAPO Submissions.

II. RATEPAYER IMPACT

3. BCOAPO states that its primary concern with the Application is "the significant cost risk that will ultimately be borne by TGI ratepayers."³ BCOAPO's perception that there is "significant cost risk" underlies its proposals for "further discovery" and a "cost collar". However, as discussed below, BCOAPO's starting premise that there is "significant cost risk" on this Project is not supported by the evidence. Moreover, TGI has proposed preferable mechanisms for providing the Commission and intervenors with comfort that TGI is managing the project appropriately. Finally, BCOAPO's proposed "cost collar" is not only unnecessary, but also inappropriate.

A. BCOAPO Has Overstated the Risk Associated With the Project

4. BCOAPO has overstated the risk associated with the Project. The evidence does not support BCOAPO's assertion that there is "significant cost risk".

5. TGI has expressed confidence that the cost estimates provided in the Application are within an acceptable accuracy range. Both the expected cost range for each line item and the overall costs are based on TGI's experience and the best information currently available.⁴ Although there are always some risks of unforeseeable conditions in an HDD project, such as drilling into gravel pockets, cobble fields or boulder type obstructions, TGI has done extensive geotechnical work on this Project to minimize that possibility.⁵ Moreover, as BCOAPO

¹ Exhibit C3-2, City of Richmond Submission (Dec. 18, 2008).

² BCOAPO Submissions, at para. 14.

³ BCOAPO Submissions, at para. 15.

⁴ Exhibit B-4, Response to BCUC IR 1.5.9; 2.12.7.

⁵ Exhibit B-5, Response to BCOAPO IR 2.9.3.

recognizes in its Submissions, TGI has proposed concrete measures to manage costs and minimize rate impact.⁶

6. BCOAPO asserts, without citing any evidence, that it has "begun to see a trend of project costs increasing significantly beyond the high case estimates found in the original application (adjusted for inflation)."⁷ Whatever BCOAPO's perception is, the evidence in this Application demonstrates that actual costs incurred by TGI to complete recent projects have been within or below the initial cost estimate range, with the exception of the Port Mann HDD project (discussed below).⁸

7. In support of its position that there is "significant cost risk" on this Project, BCOAPO cites the increase in the Project cost estimates between the estimated cost of \$9.75 million (excluding AFUDC) in the 2008 Resource Plan and the estimate of \$27.3 million in the Application. As TGI has explained, however, the most significant factor leading to the increase is that the 2008 Resource Plan estimate was developed based on a previous generation of geotechnical engineering knowledge that suggested the replacement of the NPS 20 crossing only.⁹ Once the cost of a second (larger pipe diameter) crossing has been accounted for, the difference between the estimates is in fact quite modest.

B. BCOAPO's Proposal for "Additional Discovery"

8. Although there is no basis in the evidence for BCOAPO's view that there is "significant cost risk" on this Project, BCOAPO argues that "additional discovery should be triggered if the control budget estimate is higher than 10% above the current base case estimate of \$27.3M." BCOAPO suggests that the purpose of such "additional discovery" would be to permit intervenors and Commission staff to "have an opportunity to explore, among other things, the potential of a risk sharing mechanism."¹⁰

⁶ Exhibit B-1, at 26-28; BCOAPO Submissions at paras. 9, 11.

⁷ BCOAPO Submissions, at para. 15.

⁸ Exhibit B-5, Response to BCOAPO IR 2.9.3.

⁹ Exhibit B-2, Response to BCUC IR 1.15.1.

¹⁰ BCOAPO Submission, at para. 18.

9. TGI submits that there is no benefit to be obtained from requiring additional process if the control budget is still within the proposed estimate range. The estimates provided in the Application are within an acceptable accuracy range for the Commission to assess the public interest of the Project and to confirm the appropriateness of the selected Project alternative. TGI has expressed the view, and BCOAPO has accepted, that the Project is non-discretionary. As such, the Project should proceed for system reliability and safety reasons regardless of whether the revised control budget comes in below or above BCOAPO's proposed +10% threshold, or, for that matter, regardless of whether the revised control budget falls below or above TGI's proposed +20% estimate range. Moreover, the "additional discovery" will effectively eliminate any possibility of proceeding with a 2009 construction window. TGI's evidence was that, by having contractors bid based on a 2009 and 2010 construction window, it would increase the prospects of obtaining lower bids.¹¹ BCOAPO has agreed with TGI's approach of trying to preserve its options as to the timing of construction in the hope of being able to reduce construction costs.¹²

10. This Project is not conducive to the employment of a risk-sharing mechanism, as suggested by BCOAPO. The largest project risks (i.e. geotechnical uncertainty) are managed through the contract design, and potential overruns due to such risks are not within the control of TGI.¹³

11. TGI submits that the additional mechanisms proposed by TGI (i.e. submittal of the revised control budget, approval of the revised control budget if it exceeds the current +20% estimate, and quarterly reporting),¹⁴ combined with the potential for a prudency review following the completion of the Project, are more appropriate means of ensuring cost transparency.

¹¹ Exhibit B-1, at 27; Exhibit B-4, Response to BCUC IR 2.12.5, 2.12.6, 2.12.8.

¹² BCOAPO Submissions, at para. 9.

¹³ Exhibit B-2, Response to BCUC IR 1.6.2.

¹⁴ Exhibit B-1, at 36; Exhibit B-4, Response to BCUC IR 2.12.8.

C. BCOAPO's Proposal for a "Hard Cost Collar"

12. BCOAPO advocates the imposition of "a hard cost collar equal to the high end of TGI's current estimates (\$27.3M + 20%)." TGI submits that a cost capping mechanism is inappropriate, regardless of whether some incentive is provided to TGI to reduce costs below the current estimate range. All costs prudently incurred in the construction of this Project should be recoverable in rates.

13. In the Commission's recent *Dockside Green* Reconsideration Decision, the Commission cited efforts on the part of the applicant to mitigate cost risk and removed the previously-imposed cost caps. The Commission stated:

The Commission is persuaded by the argument that the interests of both the ratepayers and the utility will be properly served by removing the Conditions and instead, as DGE suggests, 'reviewing the relevant circumstances at the time the event occurs before making a judgement about how extraordinary incremental costs should be recovered' [reference omitted]. As noted above, DGE states it "is a regulated public utility under the Act. The Commission has comprehensive regulatory powers over DGE to protect customers and the public interest. If DGE incurs extraordinary incremental costs, then the Commission has the authority to review the prudence of those costs before DGE may include them in the rates it will charge its customers."¹⁵

14. TGI has already highlighted in paragraph 5 above the steps TGI has taken, *ex ante*, to manage cost risk on this Project. TGI's customers are afforded the appropriate degree of protection regarding the management of the Project construction costs by means of (i) TGI's proposed structure for the HDD contract; (ii) TGI's proposal¹⁶ that the Commission approve the revised control budget prior to the project proceeding only if the revised control budget exceeds the current -15 to +20% range of estimates provided in the Application; (iii) TGI's quarterly

¹⁵ *Re Application by Dockside Green Energy LLP for Reconsideration of Certain Provisions in Certificate of Public Convenience and Necessity for the District Energy System* (Reasons for Decision, June 30, 2008) at 10 and 11. See also, e.g., *Re FortisBC Inc. Certificate of Public Convenience and Necessity Black Mountain Substation Project* (Decision July 9, 2007), at 25-26 and *Re British Columbia Transmission Corporation Application for a Certificate of Public Convenience and Necessity for the Interior to Lower Mainland Transmission Project*, (Decision August 5, 2008), at 108-109. In the latter case, the Commission reasoned that "The steps taken by BCTC demonstrate, on an *ex ante* basis, significant concern in addressing the costs of the ILM Project."

¹⁶ Exhibit B-4, Response to BCUC IR 2.12.8. The proposal from the Application was clarified and revised in this response.

reports to the Commission, and (iv) an ability of the Commission to require an after-the-fact prudence review if it appears that TGI has not acted prudently in its management of the Project.

15. BCOAPO's proposed "cost collar" would require TGI to minimize exposure to cost overruns by shifting cost risk to the contractors and suppliers including risk that are beyond the reasonable control of those contractors and suppliers. This is not necessarily the most cost effective result for customers. Contractors and suppliers can be expected to charge TGI disproportionately more to cover additional risks they may face that are beyond their control, which translates directly into higher Project costs.

16. In any event, TGI submits that BCOAPO's proposed "cost collar" is contrary to the *Utilities Commission Act*. Under section 60 of the Act, if TGI provides adequate service, it must be provided with a reasonable opportunity to receive a fair and reasonable return for that service. The Commission has stated, for instance: "The Commission's mandate is to ensure that ratepayers receive safe, reliable and non-discriminatory energy services at fair rates from the public utilities it regulates, and that shareholders of those public utilities are afforded a reasonable opportunity to earn a fair return on their invested capital."¹⁷ The capital invested by a public utility in a project, on which it is to be afforded a reasonable opportunity to earn a fair return, is all of the prudently incurred expenditures associated with the project. Cost caps such as BCOAPO's proposed "hard cost collar" deny utility shareholders a reasonable opportunity to earn a fair return on their invested capital if the prudently incurred expenditures on the project ultimately exceed the cost cap.

17. TGI's experience in the Port Mann HDD project illustrates why a "hard cost collar" is inappropriate. As TGI explained in its response to BCOAPO IR 2.9.3, the cost overruns in the Port Mann project resulted from significant geotechnical challenges unanticipated by the HDD drilling contractors. Had BCOAPO's proposed "hard cost collar" been imposed by the Commission on the Port Mann project, TGI would have been prevented from recovering prudently incurred costs on a project that the Commission had previously determined was in the public interest and necessity. On this Fraser River Crossing Upgrade

¹⁷ *Re Terasen Gas Inc. And Terasen Gas (Vancouver Island) Inc. Application To Determine The Appropriate Return On Equity And Capital Structure And To Review And Revise The Automatic Adjustment Mechanism* (Decision, March 2, 2006), at 7.

Project, while TGI has undertaken significant studies to mitigate geotechnical uncertainties, the risk cannot be completely eliminated. Customers should not pay for imprudently incurred expenditures, but are not entitled to the guarantee sought by BCOAPO that no overruns will occur on this Project.

18. TGI respectfully submits that cost caps such as the “hard cost collar” proposed by BCOAPO are inappropriate, and would be counterproductive. TGI will not agree to the proposed "hard cost collar" on this Project.

III. CONCLUSION

19. TGI respectfully submits that the Application should be granted as sought by TGI. The “hard cost collar” proposed by BCOAPO is inappropriate, and would be counterproductive.

All of which is respectfully submitted.

[Original signed by Matthew Ghikas]

Matthew Ghikas

Counsel for Terasen Gas Inc.

All of which is respectfully submitted.

[Original signed by Song Jin Hill]

Song Jin Hill

Counsel for Terasen Gas Inc.

February 11, 2009