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August 13, 2009

Bull, Houser & Tupper LLP
3000 Royal Centre, P.O. Box 11130
1055 W. Georgia Street
Vancouver, BC
V6E 3R3

Attention: Mr. Brian Wallace

Dear Mr. Wallace:

Re: Terasen Gas Inc. ("TGI", the "Company"), Terasen Gas (Vancouver Island) Inc. ("TGVI") and Terasen Gas (Whistler) Inc. ("TGW")
Collectively the "Terasen Utilities"
Return on Equity and Capital Structure Application (the "Application")

Response to the Joint Industry Electricity Steering Committee ("JIESC"), the British Columbia Public Interest Advocacy Centre on behalf of the British Columbia Old Age Pensioners Organization *et al* ("BCOAPO"), and the Commercial Energy Consumers Association of British Columbia ("CEC") Joint Information Request ("IR") No. 2

On May 15, 2009, the Terasen Utilities filed the Application as referenced above. In accordance with the British Columbia Utilities Commission Order No. G-70-09 setting out the Regulatory Timetable for the Application, the Terasen Utilities respectfully submit the attached response to the joint JIESC/BCOAPO/CEC IR No. 2, in advance of the August 14, 2009 deadline.

If there are any questions regarding the attached, please contact the undersigned.

Sincerely,

TERASEN GAS INC.
TERASEN GAS (VANCOUVER ISLAND) INC. and
TERASEN GAS (WHISTLER) INC.

Original signed by:

Scott A. Thomson
Vice President, Regulatory Affairs & CFO

Attachments

cc (email only): BCUC and Registered Parties

JIESC/BCOAPO/CEC-TGI-63.

REFERENCE: JIESC/BCOAPO/CEC-TGI-4

REQUEST:

(a) In part b) the answer is that equity investors require a higher return than debt investors and in part d) TGI acknowledge that there have been times when the allowed ROE was less than the government bond rate. Would TGI accept that the allowed ROE can at times be less than the utility's bond yield because of rare market conditions?

Response:

The time in question when the allowed ROE was less than the government bond yield was towards the end of a series of energy price shocks in the 1970s due to the formation of cartels and oil embargos resulting in high levels of inflation and in Canada a prolonged period of wage and price controls. Interest and mortgage rates increased to over 20% with the government using monetary policy to attempt to get inflation under control. This may or may not be considered rare market conditions, they have happened before in other countries but since the Government of Canada has set inflation targets and brought its debt as a percentage of GDP under control, inflation fears have been calmed and a long track record of low inflation has ensued.

The circumstances which led to bond rates being higher than allowed ROEs do not exist at the present time, nor are they likely to in the foreseeable future.

(b) Further would Terasen Utilities accept that market conditions of the last nine months have been rare in that spreads on A rated long term bonds were at one point approximately twice their normal recessionary levels? Or does TGI reject the idea that market conditions over the last nine months have been "rare"?

Response:

Terasen does accept that market conditions over the last nine months have been rare, primarily due to the fact that the speed and magnitude with which corporate credit markets deteriorated and the significant widening of credit spreads in a short period of time. The volatility of the last nine months has not been rare to the extent that market turmoil is not an uncommon occurrence.

JIESC/BCOAPO/CEC-TGI-64.

REFERENCE: JIESC/BCOAPO/CEC-TGI-5

REQUEST:

(a) TGI defines being allowed an unfair ROE as a business risk, would this normally be described as a regulatory risk and not a business risk since it is not organic to TGI's operations?

Response:

Considering TGI operates a regulated business and the regulator plays the role of proxy for the competitive market, regulation is a part of our business. Since the regulator sets our allowed return, the prospect of the return being set at level that does not produce a comparable and fair return introduces risk for the business. However if Dr. Booth would prefer to think of it as regulatory risk that the company bears, then Terasen has no objection.

(b) TGI describes assets being excluded from rate base even though they are used and useful as a business risk, again is this not more commonly defined to be a regulatory and not a business risk?

Response:

See response to JIESC/BCOAPO/CEC IR 2.64 (a) above.

(c) In terms of 2) please provide a table of the actual rate base and all rate base exclusions that TGI would define as used and useful that the BCUC has disallowed since 1990 and the reasons for their exclusion.

Response:

In 1996 the Commission ordered that TGI write-off approximately $1.3 million in costs related to the Theseus project for a new customer information system platform. In 2005, TGVI was ordered to write-off approximately $78 thousand in capital costs related to the Sooke main extension. Although it pre-dated the period requested in the question, the acquisition of the

Lower Mainland Gas Division assets from BC Hydro in 1988 resulted in a significant disallowance of approximately $177 million of costs that could not be included in rate base. These costs continue to be amortized over the life of the assets resulting in a material reduction in earnings.

(d) In answer to e) TGI was unable to provide comparable allowed versus actual ROE data for other utilities. In order to remove any challenges to the accuracy of the data can TGI or Ms McShane confirm that the following was provided by Ms. McShane in answer to information request CA-NP-28 on July 15, 2009 and explain why such could not simply have been provided in answer to this information request.

Requests for Information

CA-NP-28
Attachment B
NP 2010 GRA

Selected Utilities
Actual vs. Approved Return on Equity

	Enbridge Gas Distribution			Union Gas			Gaz Metro	
	Allowed	Actual Weather	Normal Weather	Allowed	Actual Weather	Normal Weather	Allowed	Actual
1990	13.25	13.57	13.60	13.75	10.70	13.40	14.25	14.25
1991	13.12	9.40	13.29	13.50	11.50	12.50	14.25	14.25
1992	13.12	13.29	13.40	13.50	14.00	13.70	14.00	14.00
1993	12.30	15.26	14.43	13.00	15.30	14.30	12.50	12.50
1994	11.60	14.69	12.49	12.50	10.95	12.14	12.00	12.04
1995	11.65	10.71	12.66	11.75	12.17	12.12	12.00	11.78
1996	11.88	15.00	13.14	11.75	13.47	12.52	12.00	12.04
1997	11.50	13.17	13.00	11.00	12.19	12.26	11.50	11.90
1998	10.30	8.31	11.97	10.44	8.03	11.14	10.75	11.09
1999	9.51	7.94	10.77	9.61	8.76	10.10	9.64	10.22
2000	9.73	8.23	10.83	9.95	10.62	10.11	9.72	10.06
2001	9.54	10.80	10.03	9.95	9.30	11.45	10.38	10.38
2002	9.66	8.98	11.81	9.95	10.67	12.36	9.69	10.67
2003	9.69	13.14	9.74	9.95	11.98	12.08	10.34	10.82
2004	9.69	12.17	10.66	9.62	11.36	11.51	10.96	11.47
2005	9.57	9.46	9.46	9.62	10.79	10.99	11.64	10.51
2006	8.74	5.71	8.86	8.89	8.48	10.26	9.33	9.66
2007	8.39	10.70	9.78	8.54	NA	NA	9.57	9.91

	Terasen Gas		ATCO Gas			ATCO Electric			
	Allowed	Actual	Allowed	Actual	Normalized	Allowed	Actual Tx	Actual Dx	Actual Integrated
1990	13.50					13.50			12.55
1991	13.50					13.50			14.29
1992	12.25	9.06				13.25			13.56
1993	N/A	11.91				11.88			12.58
1994	10.65	9.73				11.88			12.60
1995	12.00	12.03				11.88			12.67
1996	11.00	11.80				11.25			11.38
1997	10.25	11.27							11.73
1998	10.00	9.70					10.11	8.32	
1999	9.25	9.97					9.10	9.52	
2000	9.50	10.12					11.32	10.90	
2001	9.25	9.31	9.75	8.65	9.58		10.25	10.49	
2002	9.13	10.03	9.75	11.24	9.77		10.30	12.15	
2003	9.42	10.23	9.50	11.55	10.68	9.40	8.46	12.12	
2004	9.15	9.31	9.50	9.48	10.42	9.60	9.36	11.53	
2005	9.03	10.09	9.50	5.81	8.00	9.50	9.61	9.10	
2006	8.80	9.82	8.93	8.26	9.74	8.93	9.28	9.38	
2007	8.37	9.55	8.51	10.83	11.02	8.51	8.50	10.26	

Response:

It is confirmed that the referenced data were provided by Ms. McShane in response to CA-NP-28 in a Newfoundland Power proceeding on July 15, 2009. The question confirms TGI's initial response to JIESC et al TGI-5 with the proviso that the word "**if**" was inadvertently omitted before the words "it is relevant" (the correction follows), "On the basis of discussions with the other utilities TGI understands that Dr. Booth has asked similar questions of them in other proceedings in which he has appeared as a witness and for which he prepared information requests. Given that, TGI expects that Dr. Booth has most of this information already and **if** it is relevant and of consequence to this proceeding he has adequate time and resources to present it in his evidence…"

JIESC/BCOAPO/CEC-TGI-65.

REFERENCE: JIESC/BCOAPO/CEC-TGI-18

REQUEST:

> In answer to d) Mr. Carmichael states that investors "prefer to invest in foreign utility – like infrastructure assets to reduce the volatility of their portfolio valuation by diversifying away from public market securities and investing in long term infrastructure assets whose value is more stable than that of the public market." Please explain why this does not mean a reduction in risk and why he has not answered the question of what a reduction in risk means for the cost of capital.

Response:

As Benjamin Graham, a professor of finance at Columbia University from 1928 to 1957 commented "Most of the time, common stocks are subject to irrational and excessive price fluctuations in both directions as the consequence of the ingrained tendency of most people to speculate or gamble … to give way to hope, fear and greed." These human emotions have influenced the pricing of assets and securities significantly during periods of the financial and credit markets disruption (see response to BCUC IR 2.90.1). The diversification of market investment portfolios by investors has not averted double digit portfolio valuation losses. This apparently increasing financial market risk and volatility is not associated with the asset being financed (utility-like infrastructure) or with the purchaser of the asset, usually an investor, such as a pension fund, having a long term investment horizon. The reduction of market risk for the institutional investor by way of the institution's ability to privately finance the asset being acquired may or may not lead to a reduction in the asset's assumed cost of capital.

A sustainable, verifiable, long term reduction in risk usually results in a marginally lower cost of capital, everything else remaining constant.