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September 11, 2009

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British Columbia Public Interest Advocacy Centre  
Suite 209 – 1090 West Pender Street  
Vancouver, BC  
V6E 2N7

Attention: Mr. James L. Quail, Executive Director

Dear Mr. Quail:

**Re: Terasen Gas Inc. (“Terasen Gas”)  
2010 and 2011 Revenue Requirements and Delivery Rates Application**

**Response to the British Columbia Public Interest Advocacy Centre on behalf of  
the British Columbia Old Age Pensioners Organization et al (“BCOAPO”)  
Information Request (“IR”) No. 2**

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On June 15, 2009, Terasen Gas filed the Application as referenced above. In accordance with Commission Order No. G-89-09 setting out the Regulatory Timetable for the Application, Terasen Gas respectfully submits the attached response to BCOAPO IR No. 2.

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

Yours very truly,

**TERASEN GAS INC.**

***Original signed:***

Tom A. Loski

Attachment

cc (e-mail only): BCUC and Registered Parties



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**1.0 Reference: BCOAPO IR No. 1.1.1**

- 1.1 Please provide a table that breaks out, by revenue requirement category (O&M, depreciation, taxes, and return), the amounts and increases indicated for 2010 and 2011 both with and without the proposed changes in ROE and capital structure.

**Response:**

The changes in ROE and capital structure affect only the income tax and earned return components of the revenue requirement. The components of the revenue requirement increase for the RRA as filed, and the RRA including the Terasen Utilities ROE and Capital Structure Application, are set out in the following tables.

As noted in TGI's response to BCUC IR 2.31.1, the Commission has an obligation in setting rates to provide utility equity investors with an opportunity to earn a fair return on equity. This obligation must be considered independently of the rate impacts. It should also be recognized that the outcome of the ROE proceeding affects the financial integrity of the Terasen Utilities and it is in customer's interests to have a financially healthy utility.



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### Total Revenue Requirement

(in \$ Millions)

Line No.	Particulars	2010		2011	
		As filed	With ROE & Capital Structure	As filed	With ROE & Capital Structure
(1)	(2)	(3)	(4)	(5)	(6)
1	Gross O&M Expense	\$ 209.6	\$ 209.6	\$ 219.1	\$ 219.1
2	Operating Leases	-	-	-	-
3	Capitalized Overhead	(16.8)	(16.8)	(17.5)	(17.5)
4	Net O&M Expense	192.8	192.8	201.6	201.6
5	Property & Other Tax Expense	49.2	49.2	50.2	50.2
6	Depreciation Expense	106.2	106.2	109.0	109.0
7	Amortization Expense	(2.4)	(2.4)	1.5	1.5
8	Other Revenue	(22.4)	(22.4)	(24.4)	(24.4)
9	Income Tax Expense	31.6	46.1	31.7	45.2
10	Return on Equity	75.2	111.6	77.7	115.3
11	Utility Interest Expense	110.1	104.0	115.4	107.7
12					
13	Revenue Requirement	<u>540.3</u>	<u>585.1</u>	<u>562.8</u>	<u>606.3</u>
14					
15	Revenue at Existing Rates	512.4	512.4	512.9	512.9
16					
17	Revenue Deficiency/(Surplus)	<b>27.9</b>	<b>72.7</b>	<b>49.8</b>	<b>93.4</b>



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### Incremental Revenue Requirement

(in \$ Millions)

Line No.	Particulars	2010		2011	
		As filed (3)	With ROE & Capital Structure (4)	As filed (5)	With ROE & Capital Structure (6)
1	Gross O&M Expense	\$ 16.3	\$ 16.3	\$ 9.6	\$ 9.6
2	Operating Leases	(1.8)	(1.8)	-	-
3	Capitalized Overhead	11.3	11.3	(0.8)	(0.8)
4	Net O&M Expense	25.9	25.9	8.8	8.8
5	Property & Other Tax Expense	1.6	1.6	1.0	1.0
6	Depreciation Expense	26.4	26.4	2.9	2.9
7	Amortization Expense	(2.3)	(2.3)	3.8	3.8
8	Other Revenue	(1.5)	(1.5)	(1.9)	(1.9)
9	Income Tax Expense	8.6	23.1	0.0	(0.9)
10	Return on Equity	(23.1)	13.3	2.5	3.7
11	Utility Interest Expense	1.8	(4.2)	5.4	3.7
12					
13	Revenue Requirement	37.4	82.2	22.5	21.1
14	Use Rates	(9.5)	(9.5)	(0.5)	(0.5)
15					
16	Revenue Deficiency/(Surplus)	<b>27.9</b>	<b>72.7</b>	<b>22.0</b>	<b>20.6</b>

In preparation of this response, a transposition error in the table attached to BCOAPO IR 1.32.1 was identified. Rows 10 & 11 of the table in BCOAPO IR 1.32.1 were transposed; please refer below for the corrected table.

(in \$ Millions)

Line No.	Particulars	2009 Projected (3)	2010 Forecast (4)	2011 Forecast (5)	Reference (6)
1	Gross O&M Expense	\$ 193.3	\$ 209.6	\$ 219.1	- Tab C-13, Schedule 28, (Line 19 + Line 21)/1000
2	Operating Leases	1.8	-	-	- Tab C-13, Schedule 72, 4 & 5, Column 5, Line 24/1000
3	Capitalized Overhead	(28.1)	(16.8)	(17.5)	- Tab C-13, Schedule 28, Line 22/1000
4	Net O&M Expense	167.0	192.8	201.6	
5	Property & Other Tax Expense	47.6	49.2	50.2	- Tab C-13, Schedule 72, 4 & 5, Column 5, Line 25/1000
6	Depreciation Expense	79.8	106.2	109.0	- Tab C-13, Schedule 33 & 34, Columns 2 & 3, Line 6/1000
7	Amortization Expense	(0.1)	(2.4)	1.5	- Tab C-13, Schedule 33 & 34, Columns 2 & 3, Line 11/1000
8	Other Revenue	(20.9)	(22.4)	(24.4)	- Tab C-13, Schedule 26 & 27, Columns 2 & 3, Line 24/1000
9	Income Tax Expense	23.0	31.6	31.7	- Tab C-13, Schedule 72, 4 & 5, Column 5, Line 31/1000
10	Return on Equity	98.3	75.2	77.7	- Tab C-13, Schedule 75, 62 & 63, Column 6, Line 12/1000
11	Utility Interest Expense	108.2	110.1	115.4	- Tab C-13, Schedule 75, 62 & 63, Column 6, (Line10 + Line 11)/1000
12					
13	Required Gross Margin	<b>502.9</b>	<b>540.3</b>	<b>562.8</b>	
14					
15	Gross Margin at Existing Rates		512.4	512.9	- Tab C-13, Schedule 4 & 5, Column 2, Line 21/1000
16					
17	Revenue Deficiency/(Surplus)		<b>27.9</b>	<b>49.8</b>	= Line 13 - Line 15



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**2.0 Reference: BCOAPO IR No. 1.2.1**

2.1 Regarding TGI's exercise to estimate the income elasticity of demand for natural gas, please provide the equation used, the coefficient estimates, the t-values for each coefficient, the unadjusted R2, the adjusted R2, and the data used.

**Response:**

The equation used to estimate the income elasticity of demand for natural gas was:

$$\text{Natural Log(Normalized Use Per Customer)} = \beta_0 + \beta_1 \text{ Natural Log(Income)}$$

The above model was applied to Lower Mainland and Inland Residential customers, and the following table illustrates the coefficient estimates, t-statistics for each coefficient, p-values for each coefficient, R-square and also adjusted R-square statistics.

<b><u>Lower Mainland Region:</u></b>					
	<i>Coefficients</i>	<i>t Stat</i>	<i>P-value</i>	<i>R-Square</i>	<i>Adjusted R-Square</i>
Intercept	11.17	10.45	0.00	80%	78%
Income	<b>-0.62</b>	-6.02	0.00		
<b><u>Inland Region:</u></b>					
	<i>Coefficients</i>	<i>t Stat</i>	<i>P-value</i>	<i>R-Square</i>	<i>Adjusted R-Square</i>
Intercept	11.81	11.10	0.00	84%	82%
Income	<b>-0.71</b>	-6.84	0.00		

The data used to model the income elasticity of demand for natural gas is illustrated in the following table.

Year	Normalized UPC (GJ/Year)		Natural Log(Nml UPC)		Annual Income		Natural Log(Ann. Income)	
	LML Rate 1	INL Rate 1	LML Rate 1	INL Rate 1	LML	INL	LML	INL
1996	122.8	103.7	4.81	4.64	29,002	25,995	10.28	10.17
1997	123.0	103.2	4.81	4.64	29,429	26,491	10.29	10.18
1998	122.8	102.1	4.81	4.63	29,664	26,901	10.30	10.20
1999	121.9	103.8	4.80	4.64	30,830	27,836	10.34	10.23
2000	116.9	98.8	4.76	4.59	32,770	29,064	10.40	10.28
2001	105.2	87.5	4.66	4.47	32,691	29,461	10.39	10.29
2002	113.0	88.0	4.73	4.48	32,544	30,447	10.39	10.32
2003	111.6	88.7	4.71	4.49	33,526	31,313	10.42	10.35
2004	109.8	85.7	4.70	4.45	35,181	33,245	10.47	10.41
2005	103.6	81.9	4.64	4.41	37,094	35,702	10.52	10.48
2006	103.2	81.6	4.64	4.40	40,252	38,706	10.60	10.56



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Income data was sourced from the BC Stats website, assuming the Greater Vancouver Regional District is representative of the Lower Mainland Region and the Central Okanagan Regional District is representative of the Inland Region.



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### 3.0 Reference: BCOAPO IR No. 1.2.2

3.1 Please provide TGI's current commodity cost of gas and forecast cost of gas for 2010 and 2011.

#### Response:

The attached table provides the projected commodity cost of gas for 2009 and the forecast commodity cost of gas for 2010-2011 based on the recorded results to July 31, 2009 and the forward prices at August 24, 2009.

	<b>Terasen Gas Inc.</b>		
	<b>Forecast Commodity Cost of Gas (\$000s)</b>		
	<b>2009</b>	<b>2010</b>	<b>2011</b>
	<b>(Projected)</b>	<b>(Forecast)</b>	<b>(Forecast)</b>
<b>Commodity Cost of Gas</b>	<b>\$ 528,997</b>	<b>\$ 556,234</b>	<b>\$ 567,588</b>

TGI's current Commodity Cost Recovery Rate of \$5.962/GJ was approved, effective April 1, 2009, via Commission Order No. G-23-09.

On June 8, 2009, TGI filed its 2009 Second Quarter Gas Cost Report proposing no change to the Commodity Cost Recovery Rate, effective July 1, 2009, which was accepted under Commission Letter No. L-43-09.

On September 3, 2009, TGI filed its 2009 Third Quarter Gas Cost Report ("Third Quarter Report") proposing a \$1.009/GJ decrease in the Commodity Cost Recovery Rate, to \$4.953/GJ effective October 1, 2009. The Commodity Cost Recovery Rate decrease proposed within the Third Quarter Report relates primarily to the projected surplus balance within the Commodity Cost Reconciliation Account ("CCRA") at September 30, 2009 as the forecast commodity average unit cost of gas for the following 12-month period, of October 1, 2009 to September 30, 2010, is approximately \$6.02/GJ. A Commission decision regarding the rate decrease proposed within the Third Quarter Report is expected shortly.



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#### 4.0 Reference: BCOAPO IR No. 1.4.2

- 4.1 Is a reasonable interpretation of the referenced response that TGI would likely not have pursued some of the productivity initiatives it undertook under PBR had TGI been under traditional cost of service regulation over the PBR period? Please elaborate and specify any particular PBR initiatives to which this would apply, if applicable.

##### Response:

No, that is not a reasonable interpretation of the referenced response. The response was intended to convey that TGI does not see any value in the exercise of comparing the results of the PBR to a hypothetical scenario involving an assumed traditional ratemaking model for the same period.

The PBR Agreement was a comprehensive document, which included many items and set out the framework that the Company operated in during the PBR Period. The incentive mechanisms, which were but one set of items contained within the PBR Agreement, were designed to encourage the Company to achieve efficiencies that benefit the customers in the long term, without sacrificing service quality standards in the short term. The PBR Agreement has performed as designed to the benefit of both TGI customers and TGI itself. Over the six years of the PBR Period, TGI has undertaken O&M cost saving measures, which were shared 50:50 between customers and the Company. In TGI's view, it is highly speculative to guess what productivity measures would have been undertaken if TGI had been under traditional cost of service regulation over the PBR Period. The speculation required would not only relate to previous management decisions, but would also relate to the actual form and nature of the revenue requirements, rates and other parameters in place under traditional cost of service each and every year over the period. Therefore, the Company see no value in carrying out this hypothetical exercise.

- 4.2 Is the last sentence in the referenced response intended to imply that no ex post evaluation of the PBR's actual results should be undertaken? Please explain.

##### Response:

No. TGI believes that an ex post evaluation of the results of the PBR is appropriate. However, the success or failure of the PBR Arrangement should be evaluated based on whether it achieved its objectives. The primary objectives were to encourage savings to be shared by customers and the shareholder relative to the Commission-approved base O&M and capital amounts, while still preserving customer service. The question posed, by contrast, had invited





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speculation about what the level of productivity initiatives would have been undertaken had a traditional regulatory model been in place instead of the negotiated PBR. TGI does not believe that this is the correct point of reference.

The following statements from the 2003 Negotiated Settlement approved by Commission Order No. G-51-03 express the dual objectives of encouraging TGI to control capital and O&M spending while preserving acceptable service quality, and identify the point of reference for assessing the Company's progress in accomplishing those objectives:

*"The parties have agreed to a continuation of the 50/50 sharing mechanism of earnings above or below the allowed return on equity, net of incentives. The sharing mechanism creates an alignment between the Company and ratepayers." (p.3)*

*"Maintaining acceptable levels of service quality is an important aspect of incentive regulation. In this settlement agreement the parties have agreed to an expanded group of ten SQIs, seven of which have specific benchmarks to be achieved and three which (sic) will be compared with previous year's results." (p.3)*

The parties to the negotiated settlement, which included the Company, BCOAPO and a number of other Intervenor, agreed to the terms and the package was approved by the Commission.

There are five key areas as outlined in the Application (on pages 4 to 8), that demonstrate the benefits achieved over the PBR Period, which are the parameters that should be considered when evaluating the success of the PBR's actual results. These key areas include:

1. Company's Corporate Governance Structure and Management Processes and Controls;
2. Delivery of Customer Service and Delivery Rates paid by our Customers;
3. Operational Performance;
4. Employee Impacts; and
5. Financial Results, for the benefit of customers and our shareholder.

Over the PBR Period, TGI was committed to continuous improvement and Operational Excellence for the benefit of its customers and shareholder. The Company also achieved high levels of customer satisfaction and generally met or exceeded the levels set out in the SQIs while maintained relatively steady delivery rates. Company's savings were achieved in both O&M and capital expenditures, resulting in depreciation savings and rate base reductions. On the whole, TGI was able to provide high level of service and savings to its customers during the PBR Period.



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**5.0 Reference: BCOAPO IR No. 1.4.3**

- 5.1 Please provide the dollar impacts on net income associated with the Tax Rate Changes, Depreciation Rate Changes, and CCA Changes that are listed in TGI's response.

**Response:**

The tax and depreciation rate changes, as noted in the response to BCOAPO IR 1.4.3, were forecast as a part of the applicable Annual Reviews and correspondingly, included in annual rate setting. Therefore, any benefits associated with these changes were flowed through to customers and did not impact TGI's net income. In the case where the tax rate was changed subsequent to the delivery rate setting for the year, the difference was included in a deferral account and returned to customers, and also did not impact TGI's net income.

In the case of changes to CCA rates, and as discussed in BCOAPO IR 1.4.3, CCA rate changes were included in the Company's Annual Reviews if promulgated before the determination of rates for that year. Any variances between the CCA rates used in determining customers' rates and CCA rates included in the determination of the Company's achieved ROE were included in the calculation of the Earnings Sharing. Other than the CCA rate changes discussed on page 416 of the Application and in response to BCUC IRs 2.123.1 through 2.124.5, the net income impact of these changes was immaterial, estimated at less than \$70,000.



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**6.0 Reference: BCOAPO IR No. 1.6.1**

- 6.1 Does TGI have any further quantitative information pertaining to TGI's accuracy with respect to forecasting costs and revenues (and their drivers) two years into the future, other than what is contained in this application and evidence? If so, please provide.

**Response:**

TGI has nothing further to add other than what is contained in the Application and evidence. TGI has gone through an extensive and rigorous forecasting process. TGI continues to believe that this process is reasonable and effective, and continues to believe that the forecasts as presented are reasonable and appropriate

- 6.2 Please provide a high level commentary on how ratepayers are protected under the current cost-of-service application in the event that TGI materially misforecasts its (i) O&M costs and/or (ii) its capital expenditures.

**Response:**

Under the proposed TGI RRA for 2010 and 2011, any variances in O&M expenses that are not subject to deferral account treatment, and any variances in regular capital expenditures, will not affect ratepayers in the forecast period, but will affect the earnings of TGI.



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**7.0 Reference: BCOAPO IR No. 1.7.2**

- 7.1 Please indicate whether the time required for preparation of pre-filed evidence is related to the proposed multi-year PBR term. Please explain your response.

**Response:**

TGI has not proposed a multi-year PBR with this RRA. The original question, BCOAPO IR 1.7.2, for which the Company responded to was a hypothetical question about a potential future application. Although TGI failed to see the relevance of that question as the Company has not proposed a Multi-year PBR with this Application, in the spirit of being responsive, TGI provided its response to the speculative question. It was within that speculative context that Company crafted its response to that particular question. In the response to BCOAPO IR 1.7.2, TGI indicated that we anticipate that the time required for preparation of an application for a multi-year PBR depends on the **term** and **scope** of the agreement. Within this context, term refers to the length of the agreement going forward while scope refers to all other variables contained within the agreement.

- 7.2 Please indicate whether the time required for preparation of pre-filed evidence is related to possible extension requests by TGI, once the initially proposed term expires.

**Response:**

TGI has not proposed a multi-year PBR with this RRA . Please see TGI's response to BCOAPO IR 2.7.1.



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**8.0 Reference: BCOAPO IR No. 1.10.1**

8.1 Other things equal, does TGI expect its net income to be favourably impacted, relative to its peers in Alberta and Ontario, should the economic outlooks for the provinces of B.C., Alberta, and Ontario be actually realized?

**Response:**

As TGI's "net income" is driven primarily by its established ROE, please refer to TGI's response to BCOAPO IR 1.10.1.



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**9.0 Reference: BCOAPO IR No. 1.13.1**

9.1 Please provide comparable targets for the RRA period, if available.

**Response:**

TGI has not yet established targets for RRA Period and won't be in a position to do so until we have received the Commission's Decision regarding this Application.



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**10.0 Reference: BCOAPO IR No. 1.15.2**

10.1 Please indicate whether TGI intends to compile and share SQI Performance data over the RRA period. If not, please explain why.

**Response:**

TGI intends to continue to use SQI performance data internally in order to evaluate the Company's service quality and performance to customers. TGI is a strong believer in performance measures to help the Company and employees focus on what's important and to improve performance. The ongoing provision of SQI performance data was a negotiated commitment related to the PBR Agreement and a benefit of that settlement and regulatory construct. Under the traditional revenue requirement framework, we would expect to make those results available at the time of the next revenue requirement application.



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## 11.0 Reference: BCOAPO IR No. 1.30.1

11.1 Do TGI's beliefs regarding deferral of capital expenditures in a PBR period also apply under the RRA? Please explain and, if applicable, show how this is reflected in TGI's current RRA application.

### Response:

Yes, TGI continues to believe that deferring capital expenditures without jeopardizing the safety and reliability of the system is prudent and appropriate. The capital expenditures that TGI has forecast in 2010 and 2011 are those expenditures that the Company believes are required to maintain the safety and reliability of its distribution and transmission system.

This policy is reflected in TGI's current RRA application in a number of areas, some examples of which are provided below:

- Under IT capital expenditures, the identified projects for 2010 and 2011 have a combined cost of approximately \$45 million, but TGI has forecast \$18 million in each of the two years in accordance with business priorities and available resources;
- Under Transmission capital expenditures:
  - A number of mainline valves on the Interior Transmission System are being replaced due to equipment obsolescence, age related deterioration, and nuisance gas leaks and odorant calls. A replacement program started in 2009 is in place and is expected to continue into 2012 and beyond, with a replacement of 3-5 valves per year. The replacement of these valves has been staged into future years based on risk and to minimize impact to customers while maintaining safe and reliable operation of the transmission system.
  - A similar approach is used to manage the remedial capital work associated with natural hazards from geotechnical and hydrotechnical sources. Through active monitoring and regular assessment of risks, natural hazards for our pipelines are systematically remediated.
  - In the In Line Inspection program, the minimum inspection frequency of a pipeline is at a 5-year interval. However, conditions of a pipeline through corrosion growth modeling and other analyses of the inspection results are used to establish subsequent re-inspection time intervals. In many instances, where the pipelines are assessed to be in good conditions with low corrosion growth potential, the next inspection interval is extended up to a maximum of 10 years which would result in reduced inspection, repair, and capital replacement costs.