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January 18, 2010

British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, BC
V6Z 2N3

Attention: Ms. Erica M. Hamilton, Commission Secretary

Dear Ms. Hamilton:

Re: Terasen Gas Inc. ("Terasen Gas")

Application for a Certificate of Public Convenience and Necessity ("CPCN") for the Tilbury Property Purchase (the "Application")

Response to the British Columbia Utilities Commission ("BCUC" or the "Commission") Information Request ("IR") No. 2

On October 28, 2009, Terasen Gas filed the Application as referenced above. In accordance with Commission Letter No. L-2-10 setting out a Revised Regulatory Timetable, Terasen Gas respectfully submits the attached response to BCUC IR No. 2.

If you have any questions or require further information related to this Application, please do not hesitate to the undersigned.

Yours very truly,

TERASEN GAS INC.

Original signed:

Tom A. Loski

Attachments

cc: Registered Parties

12.0 References:

a) "…TGI requests that the capital costs of the Tilbury Property purchase remain in a non-rate base deferral account and attract AFUDC." (Exhibit B-1, p. 4)

b) "TGI proposes to capture all its capital costs related to the purchase of the Property in a non-rate base deferral account attracting AFUDC and to enter these costs into rate base in January 1, 2012." (Exhibit B-1 p. 29)

c) "6.2 Satisfaction of Purchaser's Conditions Precedent (PSA, p. 18)

The Purchaser shall make commercially reasonable efforts to obtain the approval of the British Columbia Utilities Commission ("BCUC", or "Commission") for the inclusion of the Purchase Price in the rate base of the Purchaser on or before the BCUC Condition Date." (PSA, p. 18)

12.1 Please confirm that the "capital costs" in references a) and b) above is equivalent to the estimate shown in Appendix 9, page 1.

Response:

Confirmed. The total estimated capital costs and estimated AFUDC (based on the assumed dates of payments made for the transaction) are found in the table in Appendix 9, Page 1. Please also refer to the response to BCUC Confidential IR 2.5.1, Attachment 5.1 which includes a revised Appendix 9 to capture changes resulting from the Commission's Decision and Order No. G-158-09 dated December 16, 2009 on the Terasen Utilities Return on Equity and Capital Structure Application.

12.2 Please confirm that the BCUC Condition Date referred to in the PSA Definitions is equivalent to 5 business days after BCUC approval of this Application.

Response:

Not confirmed. The BCUC Condition Date is the earlier of March 11, 2009 and the date that is five (5) business days after the BCUC approves this Application dated October 23, 2009 for approval to include the Purchase Price in the rate base on terms satisfactory to TGI (PSA, Section 1(d) as amended by Amendment dated December 21, 2009 and Section 4.1(b)).

12.3 Please clearly explain whether TGI's proposal is to include the capital costs in rate base as of January 1, 2012 (as referenced in (b) above) or as of the BCUC Condition Date (as referenced in (c) above).

Response:

This response is being filed confidentially under separate cover as it references the contents of the PSA which TGI is obligated to keep confidential pursuant to section 9 of the PSA.

12.4 Please provide all the journal entries that TGI has recognized or expects to recognize at the date of the Initial Deposit, the Second Deposit, and as at the PSA Closing Date.

Response:

This response is being filed confidentially under separate cover as it references sensitive information that was filed confidentially in Confidential Appendix 9 of the Application. Please also refer to the response to BCUC Confidential IR 2.5.1, Attachment 5.1 which includes a revised Appendix 9 to capture changes resulting from the Commission's Decision and Order No. G-158-09 dated December 16, 2009 on the Terasen Utilities Return on Equity and Capital Structure Application.

12.5 What type of financing is required by TGI in order to advance the Deposits and balance on Closing Date of this Property purchase? How will this impact TGI's capital structure?

Response:

The appropriate way in which to view the financing of the costs of the Property is with the 60% debt and 40% equity as permitted in TGI's approved capital structure. While the immediate source of financing at the time that cash outlays occur may be short term debt TGI does not believe that the cost of short term debt appropriately reflects the cost of financing the acquisition of the Property (or TGI's other capital expenditures, for that matter). The issuance of new equity or long term debt is done in conjunction with overall cash management within the organization.

New issues of equity or debt are typically done in tranches that are large enough to manage issue costs and keep the overall costs of financing as low as possible. If incremental capital costs are incurred, such as the acquisition costs for the Property, the timing and / or amounts of long term debt issues or equity infusions will need to be advanced or adjusted accordingly. Thus any impact of cash outlays from the Property acquisition on TGI's capital structure will be temporary and within the normal tolerances of cash flow management within the Company.

13.0 Reference: Exhibit B-1, Application, p. 26

"The milestone for receipt of the CoC assumes receipt after 6 months; however the PSA allows up to 2 years…" (Exhibit B-1, p.26)

13.1 Please explain why a 2 year window is required to obtain a CoC? Is this amount of time allowance reasonable in obtaining a CoC for this type of property?

Response:

This response is being filed confidentially under separate cover as it references sensitive information that was filed confidentially under Appendix 2 of the Application.

13.2 Has the vendor provided the Company with a schedule of on-going site remediation activities, which would support the allotment of the 2 year window? If not, why not. If so, please provide a copy to the Commission.

Response:

This response is being filed confidentially under separate cover as it references sensitive information that was filed confidentially under Appendix 2 of the Application.

13.3 Please confirm that the vendor's remediation schedule has been accepted or acknowledged by the Ministry of the Environment.

Response:

This response is being filed confidentially under separate cover as it references sensitive information that was filed confidentially under Appendix 2 of the Application.

13.4 Has TGI obtained an independent review to confirm whether or not this remediation schedule appears reasonable? If not, why not?

Response:

This response is being filed confidentially under separate cover as it references sensitive information that was filed confidentially under Appendix 2 of the Application.

14.0 Reference: Exhibit B-2, BCUC IR 1.3.1 and BCUC IR 1.9.4

"...TGI has determined that the smaller piece of the Property to the south of Tilbury Road is not needed for compliance with CSA Z276 and TGI will be investigating subdividing and selling this piece." (BCUC IR 1.9.4)

14.1 Please explain in detail the reasons supporting this determination, making specific reference to CSA Z276 criteria.

Response:

TGI relies on Clause 4.2, the Retroactivity clause, to demonstrate compliance with Z276.

Per Clause 5.2.3.2 and Table 1 of Z276 (shown in Appendix 4 of the CPCN Application), TGI uses the thermal radiation exclusion zones as guidance when making risk based evaluations related to the existing Tilbury LNG Facility. With reference to the map appended to the response to BCUC IR 1.1.4, the small piece of the Property south of Tilbury Road is outside the thermal radiation exclusion zones as defined by the 5 kW/m^2 contour relative to the existing tank. Also, given the location, the size and shape of this small piece of the Property, TGI considers it very unlikely that the development of this small property could jeopardize the ability of the existing LNG Facility to remain in compliance with CSA Z276 through the Retroactivity Clause.

14.2 What is the expected time frame for the sale of the portion of land (Property South of Tilbury Road) that is deemed not required for the purposes of maintaining compliance with CSA Z276)?

Response:

Upon completion of this transaction and once the appropriate regulatory and permitting requirements are met, TGI will engage the City of Delta to confirm subdivision requirements and costing and our real estate broker to verify any changes in the market. Upon cost review and satisfaction, TGI plans to market the site for sale and begin the subdivision process. The amount of time required to subdivide and sell the portion of the Property is not known at this time.

"TGI must undertake a series of activities and incur an estimated $0.5 million to subdivide the 5.13 acre section south of Tilbury Rd and make it ready for sale." (BCUC IR 1.9.4)

14.3 Please provide a breakdown of the estimated $0.5m cost required to subdivide this surplus land.

Response:

The estimated $0.5 million cost breakdown to subdivide the surplus land is:

- Civil Engineering $32,000
- Service Improvement Costs $226,000
- Fees from City $57,000
- Real Estate & Legal Fees $180,000

14.4 Has TGI obtained a market assessment on the 5.13 acre section south of Tilbury Road? Please explain.

Response:

This response is being filed confidentially under separate cover as it includes the market valuation of a portion of the Property contained in the Opinion of Value prepared by CBRE Richard Ellis that was filed confidentially under Appendix 8 of the Application.

14.5 If the total cost to subdivide and sell any surplus land is more than what TGI could potentially sell it for, is TGI proposing that ratepayers be held responsible for this loss?

Response:

TGI does not believe that the situation described in the question is a likely outcome since for it to occur would require a very large decrease in land values from current levels. Nevertheless in the process of investigating and assessing the opportunity to subdivide and sell the 5.13 acre portion south of Tilbury Rd, TGI will be conducting a thorough analysis of the possible benefits, costs and risks of completing the subdividing and sale process. If the unlikely situation posed in the question were to occur and it became apparent that subdivision/sale costs were likely to be higher or the selling price lower to the degree that there was concern about selling the 5.13 acre portion of the property for less than subdivision / sale costs, TGI would make an assessment of the best approach to take before proceeding with any of the significant costs of subdividing. It should also be noted that the 5.13 acre portion of the Property will have ongoing O&M costs and property taxes associated with ownership and selling this piece of the Property will shed these costs going forward. A business case for subdividing and selling would have to consider the benefit of avoiding these costs as well. TGI would only sell the portion of the Property south of Tilbury Road if it were cost-effective for customers.

As stated in the response to CEC IR 1.17.2, TGI believes, based on information presently available, that subdividing and selling the 5.13 acre portion south of Tilbury Road represents a better approach to cost mitigation than retaining this piece of the Property and seeking third party revenue generation opportunities. Unless there was some unforeseen impediment to completing the subdivision and sale process or there was a clear financial benefit for customers to retaining this portion of the Property, TGI's preference would be to subdivide and sell this portion of the Property.

14.6 Would TGI's shareholders consider an alternate approach of accepting the property price risk (net gain/loss) associated with the sale of any surplus land? If not, why not?

Response:

No, as stated in the response to BCUC IR 1.8.2, TGI's shareholders would not consider an alternate approach of accepting the property price risk associated with the sale of any surplus land.

As has been described in the Application and in various IR responses, the principal reason TGI is seeking to acquire the Property is to facilitate continued compliance with the mandatory safety requirements of CSA Z276. TGI believes the acquisition of the Property is in the interests of customers, regardless of the success in cost mitigation efforts. As stated in the response to BCUC IR 1.9.4, the vendor of the Property is seeking to dispose of the entire property and does not wish to undertake the cost and effort to subdivide and sell the Property in portions. In these circumstances TGI believes that acquiring the piece of land that is being offered for sale and then undertaking the necessary activities to sell the portion of the property it does not need for

CSA Z276 compliance is the most cost effective means of acquiring the portion of the land that is needed.

Further, TGI does not at this time have a way to forecast the degree of success it will have in cost mitigation or the time it will take to achieve such success. Although TGI has obtained broker opinions of value and of the opportunities for leasing the property (as per confidential Appendices 8 and 10) the amount of time required to subdivide and sell the portion of the Property or to find interested parties and lease portions of the retained land are not known at this time. As indicated on page 29 of the Application, the cost-mitigation opportunities can only be pursued once the purchase of property is completed and the appropriate regulatory and permitting requirements are met.

15.0 Reference: Exhibit B-2, BCUC IR 1.9.6

15.1 In the event of shut down and removal of the Tilbury LNG facility at some future date, how would the removal and reclamation costs be recovered and from whom? What is the extent to which any increase in the value of this Property or other land associated with the Tilbury LNG facility would be used to offset said removal and reclamation costs.

Response:

The treatment of future site removal and reclamation costs that are incurred at some future date would depend in large part on the treatment of those costs over the service life of the assets. As stated in TGI's Negotiated Settlement Agreement as approved by Commission Order No. G-141-09 dated November 26, 2009, Page 12:

"23. Negative Salvage Values

On an annual basis, TGI includes a provision for estimated net negative salvage value (removal costs less proceeds) in its depreciation rates. This treatment recognizes that net negative salvage value is a cost of providing service using the asset and should be recovered from customers over the useful life of the asset. An alternative treatment is to recover the net negative salvage values at the time they are incurred resulting in future customers paying for the removal costs, which TGI views as inappropriate. The inclusion of a provision for estimated net negative salvage value in depreciation rates is a practice that has been followed by TGI historically, and with this RRA TGI had proposed continuation of this treatment. This treatment is consistent with the BCUC Uniform System of Accounts and is generally followed by other investor-owned utilities in British Columbia and across Canada.

The Parties agree that for the purposes of the two year period covered by this Agreement, the provision for net negative salvage (net removal costs) will be removed from the depreciation estimates. Instead, an estimate of the amount of net removal costs to be incurred in each of the years 2010 and 2011 ($8.038 million and $11.29 million) will be included in the cost of service and recovered from customers in each of those years. Any variances between the actual amount of net removal costs realized and the estimated amounts included in cost of service will be recorded in a new deferral account created for this purpose that will be called the "Removal Cost Deferral Account". The amount accumulated in the Removal Cost Deferral Account over the two year period of this Agreement will be recovered from (or returned to) customers in 2012.

TGI continues to be of the position that removal costs should be recovered over the service life of the asset and not at the time the removal costs are actually incurred. TGI will work with Commission staff and a depreciation rate specialist in determining both the methodology and estimates for the removal costs and include the documentation to *support the rates in its next depreciation study filed as part of its next Revenue Requirement Application."*

If, as was proposed in TGI's 2010 and 2011 Revenue Requirements Application, TGI collects removal costs from customers over the service life of the Tilbury LNG Facility, then at the time of removal, any costs incurred would already be fully provided for. This is consistent with the concept of an Asset Retirement Obligation as defined under International Financial Reporting Standards.

If TGI does not collect removal costs from customers over the service life of the Tilbury LNG Facility, then under the regulatory treatment that has been allowed for the years 2010 and 2011, the costs would be included in cost of service in the year incurred, and any variation from the estimated amounts would be included in a deferral account for future recovery from ratepayers.

Under both of these alternatives, the costs are recovered from ratepayers.

The treatment of any potential losses or gains on ultimate disposal of the Property or other land associated with the Tilbury LNG facility is discussed in the response to BCUC IR 1.9.6.

16.0 Reference: Exhibit B-2, BCUC IR 1.7.1

TGI explains that non-capital costs (property taxes and O&M expenses) associated with the purchase of the Property that will be amortized over three years.

16.1 Please explain why TGI is not treating all costs incurred on the Property (including property taxes and O&M expenses) as part of the Property's capital cost.

Response:

Under International Accounting Standard 16 - Property, Plant and Equipment, the cost of an acquired asset is comprised of:

(a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

In the case of the Tilbury land purchase, only the initial purchase costs that have been included in the capital cost estimate qualify for recognition as a capital asset. Any property taxes and O&M costs incurred subsequent to purchase do not qualify as a capital asset, and in the normal course would be expensed and included in TGI's cost of service. Since TGI has already set its cost of service and rates for 2010 and 2011, TGI is proposing to include these amounts in a non-rate base deferral account (or in the existing Property Tax deferral account for property taxes) until January 1, 2012, at which time they would be amortized into cost of service over a three-year period.

16.2 Has TGI considered recognizing the Property in Account 105 Utility Plant Held For Future Use and accumulate interest (based on the short term interest rate) until such time of the Closing Date of the PSA where the Property would then enter into rate base? Please discuss.

Response:

As described in the response to BCUC IR 2.16.1, TGI cannot include the property in rate base until January 1, 2012 since the revenue requirements and rates for 2010 and 2011 have already been determined and do not include any allowance for the cost of service of the Property. However, the Property will be employed in utility service immediately after the transaction is completed on the Closing Date. The use of a non-rate base account attracting AFUDC is a bridging measure that allows the Property to earn a fair return until it can be added to rate base and its cost of service recovered in TGI's revenue requirements. The return afforded by recording AFUDC in a non-rate base deferral is the same return that TGI would earn on the Property if an allowance had been made in TGI's 2010 and 2011 revenue requirements to include the cost of service of the Property. For further discussion on the appropriateness of recording AFUDC on the non-rate base deferral account rather than short term interest please see the response to BCUC IR 2.12.5

TGI does not believe it is appropriate to record the Property initially in Account 102 (rather than Account 105) Gas Plant Held for Future Use because the Property will be employed in utility service as soon as the transaction is completed and TGI has ownership of the Property. The responses to BCUC IRs 1.9.2 and 1.9.4 provide additional support for this position.