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January 21, 2011

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”)**
**Customer Choice Program – 2010 Program Summary and Recommendations**

**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. 1**

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On November 23, 2010, Terasen Gas filed the Application as referenced above. In accordance with Commission Order No. G-191-10 setting out the Regulatory Timetable for review of the Application, Terasen Gas respectfully submits the attached response to BCOAPO IR No. 1.

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

Yours very truly,

**TERASEN GAS INC.**

***Original signed:***

Diane Roy

Attachment

cc (e-mail only): Erica Hamilton, Commission Secretary
Registered Parties

**1.0 Reference: Exhibit B-1, General**

1.1 Please provide a high level estimate as to the total costs that have been paid thus far by the residential rate class to provide the Customer Choice option. Please provide a high-level breakdown of the costs in current $.

**Response:**

From August 15, 2006 through December 31, 2010, approximately $14.5 million has been paid by residential customers to develop, introduce and maintain the Customer Choice program.

**Table 1: Residential Customer Choice Costs**
**(In current dollars, August 15, 2006 through December 31, 2010)**

| Description | Total |
|---|---|
| Development | $ 5,689,291 |
| Operating | 2,620,757 |
| Recoveries & Adjustments | (2,996,965) |
| Education | 9,231,075 |
| Net Costs | $ 14,544,158 |

1.2 Please provide a high level estimate of the total benefits realized by the residential rate class who choose this option and indicate how these benefits are quantified in current $.

**Response:**

Terasen Gas has not compiled the data necessary to quantify the dollar savings that have accrued to customers that choose fixed rate Consumer Agreements. The task would require additional time to accomplish. There are approximately 290 price groups currently supported within the Customer Choice program. References in other responses and in the November 2010 filing refer to disparities between the average Gas Marketer and TGI variable rates. These references should not be used to interpolate aggregate cost impacts. The references are presented to describe average price differentials. Because the contracted rates each customer pays can change each year, there is no readily available way to compile the necessary historical information by customer account to calculate actual savings in current dollars.

Since marketer rate offerings also fluctuate with prices in the market, at best, the Company can roughly quantify what an average customer might have paid in 2007 versus what they would have paid if they remained on the default Terasen offering. The Weighted Average CCRA Rate from November 1, 2007 to Dec. 31, 2010 was $6.48/GJ and the Weighted Average Marketer Rate for a residential customer over this same time period was $9.69/GJ.

Financial savings have never represented a stated goal of the program and the Company does not believe the requested analysis is an appropriate measure by which to quantify customer benefits. The value for customers stems from their opportunity to choose commodity suppliers, and the peace of mind knowing that they are protected from unanticipated market fluctuations. TGI has been consistent in this position. As per the Commodity Unbundling Project for Residential Customers CPCN Application, filed with the BCUC on April 13, 2006, research undertaken before the program launched suggested that, "…customers perceived the primary benefit of Unbundling as providing price stability with the **possibility** of savings."[1] Similar to fixed rate mortgages, value is not necessarily derived from savings over the life of the fixed rate term, but rather in the comfort taken that one is protected from unforeseen interest rate increases.

1.3 Please provide the annual costs associated with the Customer Choice option allocated to and recovered from the residential class in 2010.

**Response:**

As of December 31, 2010, recoveries for residential Customer Choice operations exceeded program costs for the first time. The associated rider will be adjusted in 2011 to reflect the surplus and effectively reduce the total program costs to customers.

**Table 1: 2010 Residential Customer Choice Costs**

| Description | Total |
| --- | --- |
| Operating | $ 898,300 |
| Recoveries | (1,483,443) |
| Education | 497,454 |
| Net Costs | $ (87,689) |

[1] Commodity Unbundling Project for Residential Customers CPCN Application, filed with the BCUC on April 13, 2006. Page 14.

1.4 Please provide the projected annual costs associated with the Customer Choice option forecast to be recovered from the residential class in 2011.

**Response:**

TGI expects to fully recover program costs from existing Gas Marketer fees in 2011. The Company will review the existing fee structure and recommend changes prior to the next Customer Choice Annual General Meeting. The existing fee structure may need to change to ensure adherence to the principle of cost causality. Gas Marketer fees should be used to recover program costs, but the fee structure was not intended to recover original development costs. Based on forecast costs, including customer education, the existing fee structure is expected to result in a small surplus.

1.5 Please provide actual or estimated costs for 2010 of (i) the number of customers in the residential class and (ii) the breakdown of residential customers between those taking marketer-supplied commodity and those taking utility-supplied commodity (average numbers in 2010).

**Response:**

Terasen Gas understands this question is asking the Company to clarify the cost of the Customer Choice program on a per customer basis, and specifically to compare the impact on unbundled versus bundled customers. Program costs are allocated through a bill rider to all customers in the Lower Mainland, Inland and Columbia service areas, regardless of their commodity supplier. The 2010 net surplus of $87k identified in BCOAPO IR 1.1.3 above results in an estimated $0.12 reduction in the rate established for the 2011 Customer Choice program rider.

1.6 Please confirm that the costs associated with the Customer Choice option allocated to and recovered from the residential class are recovered from all residential customers.

**Response:**

Yes, as noted in BCOAPO IR 1.1.5, the costs associated with the Customer Choice option are allocated to and recovered from all residential customers.

1.7 Please provide estimates for 2011 of (i) the number of customers in the residential class and (ii) the breakdown of residential customers between those taking marketer supplied commodity and those taking utility supplied commodity (average numbers in 2011).

**Response:**

The following table describes the number of residential customers forecasted to be supplied by Gas Marketers and Terasen Gas in 2011. TGI expects Gas Marketer supplied customers to fall from 115,037 in 2010 to 112,507 customers in 2011, representing an approximate 2% reduction. Please see BCOAPO IR 1.1.5 for a description of 2010 participation rates.

**Table 1: Forecast Number of Customers by Commodity Supplier (2011)**

| | Marketer Supplied | TGI Supplied | Total |
| --- | --- | --- | --- |
| **Lower Mainland** | 74,627 | 454,628 | 529,255 |
| **Inland** | 34,413 | 176,827 | 211,240 |
| **Columbia** | 3,467 | 17,141 | 20,608 |
| **Total** | 112,507 | 648,596 | 761,103 |

1.8 In Terasen's view, for customers that are aware of the Customer Choice program but yet choose to stay with the regulated offering, to the extent that costs for a program they will never use are visited upon them, is this an intra-class subsidy from regulated supply customers to marketer supplied customers? Please explain.

**Response:**

TGI is of the opinion that specific costs should be evaluated to answer this question adequately. All customers benefit from the Customer Choice program even if they currently choose to remain with Terasen Gas. Personal financial situations change, life events occur and commodity markets fluctuate. The availability of fixed-rate commodity options is comparable to other utility products like the Equal Payment and Pre-Authorized Payment plans. Costs to administer these plans are borne by all customers even though many customers choose not to participate in either at any particular time. TGI believes that the Customer Choice program set up costs, customer education, and even short to mid-term residual operating costs not recovered through Gas Marketer fees should be recovered through all customers. Terasen Gas does not perceive these potential cost allocations to represent intra-class subsidies because customers may choose to opt in at any time.

Consistent with the Company's original proposal, Terasen Gas believes that program implementation costs should be recovered from all residential customers who are able to participate in the program. This belief is emphasized in the 2006 Unbundling CPCN, which stated that "*Ongoing operating costs would be recovered where possible from Gas Marketers. Further, any residual operating costs would be recovered using a rate rider from residential customers who are eligible to participate in the program. The proposed cost treatment approach follows the methodology adopted for use in the Commercial Unbundling program.*"[2]

In 2010, all program costs were recovered via Gas Marketer fees. In fact, recoveries exceeded program costs and result in an approximate $0.12 reduction in the applicable TGI bill rider. In developing the proposed framework and business rules for Customer Choice, Terasen Gas was mindful to implement a cost effective solution. The Customer Choice program follows a cost-causality principle in which program costs are recovered from the parties that drive program costs, most typically the Gas Marketers. Although Gas Marketer fees currently cover all program costs, including those associated with customer education, TGI stresses that this rate of recovery was not anticipated. TGI is of the opinion that all eligible customers should cover customer education costs because it is important that all customers understand their rights and obligations, before they sign a contract. Terasen Gas expects participation rates to rise and fall, and that participants will change over time. As is the case with communication costs for products like our Equal Payment Plan and Pre-Authorized Payment plan, TGI believes all eligible customers should share in the costs necessary to fund the educational activities associated with Customer Choice. These costs represent investments in consumer protection, protection that safeguards every customer before they sign a Consumer Agreement.

As previously noted, program costs are currently fully covered by Gas Marketer fees. Even if this situation temporarily changes because of decreased customer participation rates, TGI believes that short to mid-term cost transfers to all eligible customers is appropriate. Gas costs fluctuate, and although participation rates have suffered recently, TGI expects program participation to increase when commodity rates increase in the future. Because customers can choose to participate in the program at any time (just like the Company's Equal Payment Plan or Pre-authorized Payment Plan), Terasen Gas believes that education and any other potential residual program costs should be borne by all eligible customers rather than just those currently enrolled in a Consumer Agreement.

[2] Commodity Unbundling Project for Residential Customers CPCN Application, April 13, 2006, Section 1.4, Cost of Service, page 6.

1.9 Does Terasen agree that theoretically, over the long run, due to such circumstances as the marketers' requirements for a return on their gas acquisition activity, lower economies of scale in administration, etc., marketer supplied commodity would be expected to be more expensive than the utility regulated supply offering?

**Response:**

Recent experience in BC suggests that the average marketer supply commodity rate will generally be more expensive than utility regulated supply offering. Since unbundled service was introduced to residential customers in 2007, the average marketer price has exceeded the average TGI variable price in all but one three month period in 2008. Fixed rate contracts represent an insurance plan against rising natural gas prices. Because risk is shifted to the Gas Marketers, customers will typically pay a premium for the assurance that their rate is protected. It is important to note that some customers are willing to pay this premium for the peace of mind that their commodity rate will not change even if market prices increase. A study completed by the Citizens Utility Board ("CUB") in Illinois, a non-profit, nonpartisan organization that represents the interests of residential utility customers of Illinois suggests that customers seldom save with fixed rate products. CUB's analysis suggested that only 8% of customers selecting a fixed rate natural gas commodity contract saved money. Report details are available at www.citizensutilityboard.org/GasMarketMonitor.php.

**2.0 Reference: Exhibit B-1, Section 3.1, page 9**

**Preamble: The evidence states:**

*As of June 30, 2010, approximately 117,000 residential customers and 21,000 commercial customers for a total of 138,000 were enrolled on current and future-dated fixed-price contracts. This represents 16% of the total customer base of more than 830,000 eligible customers. In an important trend however, enrolments have decreased by 7% from the 2009 figures due to a variety of contributing factors, including contract expiries and less Gas Marketer sales activity. As discussed in Section 1.1 of this Application, the significant disparity (an average 69% price premium) between typical five-year Consumer Agreements and the regulated variable rate has likely influenced this trend. Consumers are not renewing fixed-rate offers and many customers are trying to cancel existing contracts.*

2.1 Please provide Terasen's views as to the participation level or participation rate at which utility facilitation of the Customer Choice option becomes economically unfeasible, i.e., given current and or projected participation, at what level of annual costs would the program's costs exceed the program's benefits?

**Response:**

As noted in BCOAPO IR 1.1.8, TGI does not foresee short to mid-term unfavourable variances necessitating the dissolution of the Customer Choice program. The current fee structure recovered all program costs, including the $500,000 for 2010 customer education[3]. A significant shift in participation may occur in late 2012. This represents the expiration of original 5-year residential Consumer Agreements. Significantly reduced levels of customer participation (i.e. 20-30%), will require TGI to adjust Gas Marketer fees and/or pass some program costs onto all eligible customers. As noted in BCOAPO IR 1.1.8, TGI is of the opinion that the Customer Choice program infrastructure should be maintained during periods of lower participation rates. The Company expects participation to fluctuate based on market conditions. Price spikes in commodity pricing or a general increase in natural gas prices will likely attract a percentage of customers back to a fixed rate product. Terasen Gas will evaluate current fee structures and recommend changes to Customer Choice stakeholders prior to the 2011 AGM.

[3] TGI will review existing fee structures and recommend changes prior to the next Annual General Meeting. TGI recommends that Gas Marketer fees should cover most program costs, with the exception of Customer Education related expenses that benefit all eligible customers.

2.2 In Terasen's view, is the 69% premium of marketer offering cost due to a market failure such as (i) market power on the part of marketers, (ii) asymmetric information with the Choice customer having less information than the marketer, or (iii) other? Please explain.

**Response:**

Terasen Gas does not agree that the existing premium reflects a market failure, market power on part of the marketers or asymmetric information. Most Consumer Agreements were signed in 2007 when spot gas prices, and natural gas futures were higher and generally trending up. Commodity prices have unexpectedly fallen since mid 2008, believed to be largely driven by the contracting economy in North America as well as the introduction of shale gas across the continent. The variance between average Gas Marketer rates signed in 2007 and the current TGI regulated variable rate have resulted in the significant disparity. Importantly, a number of gas marketers now offer rates competitive with the Terasen Gas variable-rate.

2.3 Does Terasen have any estimate of the real value added provided by marketers in supplying commodity to residential customers?

**Response:**

Terasen Gas has no estimation of the financial savings garnered by individual customers within the program. As per BCOAPO IR 1.1.2 above, Terasen Gas is of the opinion that the real value customers realize through fixed-rate contracts is in the knowledge that they are protected from significant commodity price spikes, and the opportunity that they **may** realize savings over the life of the contract. With an approximate 17% adoption of fixed rate products in BC, TGI is confident that a significant number of customers value the product.