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January 5, 2004

British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, B.C.
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Attention: R.J. Pellatt, Commission Secretary

Dear Sirs:

**RE: Terasen Gas Inc.
2004 Revenue Requirement Application for the Fort Nelson Service Area**

This is the final argument of Terasen Gas Inc. ("Terasen Gas" or "the Company") respecting its October 10, 2003 Application to amend its Schedule of Rates for the Fort Nelson Service Area (the "Application").

This final argument is filed pursuant to Commission Order No. G-68-03. Terasen Gas is not aware of any other person having filed a submission in respect of the Application.

Summary of Application

The Application seeks:

1. An increase in rates for the Fort Nelson Service Area for 2004;
2. Establishment of the following deferral accounts effective January 1, 2004:
 - a Rate Stabilization Adjustment Mechanism ("RSAM") account to function in the same manner as the RSAM account in the other service areas of Terasen Gas;
 - deferral accounts the same as in effect for the other Terasen Gas service areas to collect (a) variances between actual and forecast property taxes and (b) variances in utility interest expense;
3. Implementation effective January 1, 2004 in the Fort Nelson Service Area of the same changes to depreciation rates as approved for Terasen Gas by the Commission in its February 4, 2003 Decision (the "Decision"). The depreciation rate changes being sought are:
 - meters, regulators and meter installations increased from 3% to 3.57%;

- miscellaneous (i.e. non-infrastructure) computer software increased from 12.5% to 20%;
 - the amortization of software tax savings (recorded in account 211-contributions in aid of construction) of non-infrastructure software to be increased from 12.5% to 20%, providing a partial offset to the revenue requirement effect of the software depreciation increase; and
4. Confirmation that the Overheads Capitalization rate of 16% of gross operating and maintenance expenses as approved by the Commission in its Decision for the other service areas of Terasen Gas is also applicable to the Fort Nelson Service Area.

Each of these elements of the Application is discussed below.

Rate Increase

By Commission Order G-68-03 the existing Schedule of Rates for the Fort Nelson Service Area was made interim effective January 1, 2004. That Order also provides that any increase in the rates for the period from January 1, 2004 to the effective date of the 2004 permanent rates would be recovered through the use of a rate rider in 2004.

In its October 10, 2003 Application the Company sought to increase its Fort Nelson rates by \$89,000 in annual revenue. That increase was 1.96% of overall revenue or 7.45% of delivery margin.

During the written public hearing process revisions to the increase in annual revenue were identified. The Response to Question 3.1 of the BCUC Staff Information Request identified a correction to the 2003 accumulated depreciation, which had the effect of lowering the 2004 opening accumulated depreciation balance and increasing 2004 rate base. This revision increased annual revenue requirements by \$4,000. The Response to Question 11.2 identified a correction to 2004 UCC additions which increased the CCA income tax deduction and reduced annual revenue requirements by \$1,000. The Response to Question 3.2 identified a need to incorporate the 2003 computer hardware retirement into the rate base calculations which reduced depreciation expense in 2004 and decreased the annual revenue requirement by \$41,000.

Since the Application was filed the Commission has issued its Letter No. L-57-03 which notified Terasen Gas that the Commission had determined that 9.15% is the appropriate return on common equity ("ROE") for Terasen Gas. As noted at page A-4 of the Application, the materials filed in the Application utilized an ROE of 9.0%. An ROE of 9.15% rather than 9% increases the annual revenue requirement for the Fort Nelson Service Area by \$3,000. The Application was filed before the Annual Review materials were filed by Terasen Gas for its three other service areas. Those Annual Review materials made use of a lower forecast of interest rates than did the Application. Adjusting the forecast interest rates for the Fort Nelson Service Area to be consistent with the forecast used for the balance of the Terasen Gas service areas reduces the annual revenue requirement for the Fort Nelson Service Area by \$5,000.

The net effect of the revisions and adjustments noted above is to reduce the revenue requirement of the Fort Nelson Service Area. Terasen Gas now seeks an increase in its Fort Nelson revenue requirement and rates of \$49,000 for 2004. The \$49,000 annual increase is 1.08% of overall revenue or 4.1% as a percentage of delivery margin. Consistent with Commission Order No. G-68-03 Terasen Gas requests that the foregone increase for the period from January 1, 2004 to the effective date of the permanent increase in rates be recovered through the use of a rate rider to be in place during the balance of 2004.

The Company submits that the information provided in the Application, together with its responses to the BCUC Staff Information Request, demonstrate that the increase being sought is required for the Company to be provided with the opportunity to earn its allowed return on equity. The current rates in the Fort Nelson Service Area are insufficient to provide the Company with that opportunity.

The forecast Fort Nelson volumes and revenues for 2004 are based on the expectation of an increase in the use per account for both residential and commercial customers in 2004. The industrial (Rate 25) volumes are forecast to remain at close to 2003 levels. The outlook for customer additions sees small increases in residential and commercial customers in 2004, and no change in the number of Rate 25 customers. Terasen Gas submits these forecasts are reasonable.

The additions to the rate base of the Fort Nelson Service Area in 2003 and 2004 are addressed in Tab 3 of the Application. The most significant 2004 addition is the replacement of an odourizer as part of the Company's hazardous liquids containment program. For 2004 the overhead capitalized increases which, as discussed below, results from bringing the overheads capitalization methodology for the Fort Nelson Service Area into line with the methodology approved for use in the other service areas of the Company.

The operating and maintenance expenses for the Fort Nelson Service Area have been determined on a basis consistent with past practice, except for an adjustment associated with the outsourcing of the customer billing function to CustomerWorks. In its August 1992 Decision respecting Terasen Gas (then BC Gas) the Commission accepted the allocation of corporate costs to the Fort Nelson Service Area on the basis of throughput volumes. The Company has continued that allocation methodology since 1992. Included in the corporate costs so allocated have been the costs of the customer billing function. Under the arrangements with CustomerWorks the cost of that function is \$54.54 per customer, and in the Application that cost has categorized as a direct cost per customer. The effect of treating the customer billing costs as a direct cost is to reduce the net operating and maintenance costs of the Fort Nelson Service Area by \$45,000.

Terasen Gas submits that the revenues and expenses for the Fort Nelson Service Area contained in the Application materials are reasonable forecasts and demonstrate that the rates should be increased by \$49,000 on an annual basis.

Deferral Accounts

Rate Stabilization Adjustment Mechanism

The Company seeks the establishment of an RSAM account to function in a manner similar to the RSAM account approved for the other three service areas of Terasen Gas.

In the other three service areas the RSAM account records delivery margin variances relating to residential and commercial customers. For the Fort Nelson Service Area Terasen Gas seeks to include its two Rate 25 customers in the RSAM. The Fort Nelson Service Area RSAM account would record delivery margin variations that arise from the actual use per customer being higher or lower than forecast, including variances from forecast relating to the Rate 25 customers.

In the Decision the Commission approved the recording of interest on RSAM balance variances from forecast at the Company's short-term interest rate. Terasen Gas seeks Commission approval for the similar recording of interest (at the Company's short-term interest rate) on Fort Nelson Service Area RSAM balance variances from forecast with the interest expense being credited or debited, as appropriate, against the Fort Nelson RSAM account.

The Response to Question 7.1 of the BCUC Staff Information Request provided the historical allowed and achieved ROE for the Fort Nelson Service Area for each of the years from 1995 to 2002. As explained in the Response to Question 7.2, for 1999 and 2000 the margin variations resulting from use per account being different than forecast or industrial energy use being different than forecast were the primary cause of the Company's achieved ROE being less than the allowed ROE. For 2001 and 2002 there were a number of factors which contributed to the achieved ROE being significantly less than the allowed ROE. If an RSAM account had existed for the Fort Nelson Service Area it would have enabled the Company to achieve the allowed return on common equity in two of those four years and in the other two years it would have caused the Company's achieved ROE to be closer to the allowed ROE.

The Company submits that lack of an RSAM account in Fort Nelson Service Area has contributed to the volatility of the Company's earnings, and it would benefit both the customers and the Company over the long-term to have an RSAM account in place. The capital structure and allowed return on equity for Terasen Gas, which are also applicable to the Fort Nelson Service Area, are intended to reflect the risk profile of Terasen Gas and accordingly reflect the existence of the RSAM. Terasen Gas submits that an RSAM for the Fort Nelson Service Area is required to ensure that the risk profile of the service area is consistent with the capital structure and allowed ROE for the service area.

Terasen Gas has applied for the establishment of a single RSAM account for the Fort Nelson Service Area and submits that a single account that includes the Rate 25 customers is appropriate. In Question 7.4 of the BCUC Staff Information Request the Company was asked if it would be appropriate for Rate 25 customers to have a class-specific RSAM and rider. Terasen Gas responded to that question by stating that it is not opposed to a class-specific RSAM and separate rider for Rate 25, but went on to note that the Commission has historically ordered that the revenue deficiency arising from customer use rate changes or industrial revenue changes be shared across all customer classes in

the other service areas of the Company. In its Order No. G-80-03 (relating to 2004 rates for the three other service areas of Terasen Gas) the Commission applied the principle that rate increases arising from reduced average use per account by residential and commercial customers should not be "streamed back" to those customer classes. Consistent with that principle, if there were to be an annual revenue requirement application for the Fort Nelson Service Area then all customers would be affected by changes in the use of gas by all Fort Nelson customers. It is submitted that the establishment of a single RSAM account is consistent with the result that would occur if there were annual revenue requirement applications for the Fort Nelson Service Area.

Other Deferral Accounts

Terasen Gas seeks Commission approval for the establishment of a deferral account that would record the variances between actual and forecast property taxes and a deferral account that would record the variances in utility interest expense due to short-term debt interest rate variances and long-term debt rate, timing and principal variances from those embedded in the rates approved as a result of this Application. The deferral accounts being sought are the same as those already in existence for Terasen Gas in its three other service areas.

These deferral accounts will protect both customers and the Company from unexpected variances from forecast property taxes and interest expense and Terasen Gas submits they should be established.

Depreciation Rates

At page 38 of the Decision the Commission approved changes to the depreciation rates of Terasen Gas for its desktop software and for meters, regulators and meter installations. Terasen Gas seeks approval to implement, effective January 1, 2004, in the Fort Nelson Service Area the same depreciation rates for those items as approved in the Decision. The depreciation rates for meters, regulators and meter installations would become 3.57%, and the depreciation rate for non-infrastructure computer software would become 20%. The amortization of software tax savings of non-infrastructure software would also be set at 20%, providing a partial offset to the increased depreciation of non-infrastructure computer software.

The Fort Nelson Service Area plant accounts are a subset of the Terasen Gas plant accounts. Since the Fort Nelson Service Area shares the same structure as the rest of Terasen Gas, the Company is seeking approval for the same depreciation rates for the measurement and computer software accounts as those approved for use in the three other service areas of Terasen Gas.

Overheads Capitalization

At page 35 of the Decision the Commission concluded that for Terasen Gas the overhead capitalization rate of 16% continued to be a reasonable allocation of overhead costs to plant additions. Terasen Gas had requested a change in its rate of overhead capitalized from 16% to 10%.

For 2003 and earlier years overhead capitalized was allocated to the Fort Nelson Service Area from the Terasen Gas corporate total overhead capitalized. The annual allocation to

the Fort Nelson Service Area was based on Fort Nelson's percentage of total company sales and transportation volumes. Terasen Gas now seeks Commission approval of the 16% overhead capitalization rate used in the other service areas of the Company.

As set out in the response to Question 10.1 of the BCUC Staff Information Request, if the methodology for 2003 and earlier years was used to calculate the 2004 overhead, the amount of overhead capitalized would be \$69,000 rather than the \$115,000 for 2004 shown in the Application. The lesser capitalization of overhead would require that operating and maintenance expenses increase. There would also be a rate base effect from the decreased overheads capitalized. If the previous methodology, rather than the 16% of gross Operating and Maintenance expenses, were used for 2004 then the revenue requirements for the Fort Nelson Service Area would have to increase by approximately \$44,000. That \$44,000 increase in revenue requirements is not reflected in the discussion above relating to the Rate Increase, and the changes to the rates would have to be greater than set out above if the old overhead capitalization methodology were continued.

Terasen Gas submits that the Overheads Capitalization rate of 16% of gross operating and maintenance expenses should be the rate used in the Fort Nelson Service Area.

Conclusion

As set out on page B-3 of the Application, customers' rates in Fort Nelson, both the commodity portion and the delivery margin portion, are among the lowest anywhere in North America. The most recent revenue requirement change affecting the rates for delivery service in the Fort Nelson Service Area was a decrease in 1995.

Terasen Gas submits that the increase in rates it is seeking is supported by the evidence in this proceeding and with the increase the rates in the Fort Nelson Service Area will be just and reasonable.

The Company submits that the deferral accounts it seeks to have established are in the interests of both customers and the Company and should be approved by the Commission. The depreciation rate changes and the overheads capitalization methodology that are sought in the Application will result in consistency between the Fort Nelson Service Area and the three other service areas of Terasen Gas and the Company submits they should be approved by the Commission.

All of which is respectfully submitted.

Yours very truly,

TERASEN GAS INC.

Original signed by Scott Thomson

Scott Thomson