



**LETTER NO. L-21-04**

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**VIA E-MAIL**

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March 30, 2004

Mr. Scott Thomson  
Vice President, Finance and Regulatory Affairs  
Terasen Gas Inc.  
16705 Fraser Highway  
Surrey, B.C. V3S 2X7

Dear Mr. Thomson:

Re: Terasen Gas (Vancouver Island) Inc. ("TGVI")  
Gas Supply Strategy for Thermal Generation on Vancouver Island  
Deferral Account Approved by Order No. G-69-03

This letter is in response to your March 10, 2004 letter, which provided an Update Report on the preliminary investigation of a gas supply strategy for thermal generation on Vancouver Island as required by Order No. G-69-03 and which requested authorization of an increase in deferral account funds to a total of \$2,860,000.

Commission Order No. G-69-03 approved a deferral account to record up to \$945,000 of preliminary investigation expenditures through January 2004, with the prudence of the expenditures and the disposition of the amount in the deferral account to be determined at a later date. The January 2004 date was subsequently extended by letter dated February 19, 2004 to March 31, 2004. The cover letter to the Order anticipated that the expenditures that were the subject of Letter No. L-27-03 would also be recorded in the deferral account. The next Update Report should outline such earlier expenditures.

The Negotiated Settlement of TGVI's 2003-05 Revenue Requirements requires TGVI to obtain a commitment from a customer for reimbursement of costs where detailed project costs and engineering designs are required, and the project does not proceed. As there is no customer requesting service, the Commission indicated in the cover letter to Order No. G-69-03 that it expected that TGVI would minimize the amount of detailed design work on the gas supply strategy while remaining consistent with its desire to advance the development of the strategy.

The March 10, 2004 Update Report outlines progress to date, including identification of a site for liquefied natural gas ("LNG") storage, and indicates actual expenditures of \$575,000 to February 29, 2004. Expenditures in March through June 2004 are estimated at \$1,570,000 and those in July through September 2004 are estimated at \$715,000, for a total of \$2,860,000.

The Resource Plan that TGVI intends to file in May 2004 should provide insight into the value of LNG storage. BC Hydro recently revised the schedule of its Call for Tenders ("CFT") for generation on Vancouver Island and expects to announce the preferred option on October 8, 2004. This is close to the end of the period that is covered by the work program and expenditures that TGVI proposed in its March 10<sup>th</sup> letter. TGVI indicates that the work proposed for 2004 is necessary in order to be able to award the Engineer/Procure/Construct contract for the LNG project in January 2005 and to, if approved, complete the facilities by November 2007.

The estimated expenditures for the period through September 2004 cover three main areas. External costs related to a LNG storage facility total \$1,949,000. External costs related to increasing and upgrading compression on the TGVI system total \$425,000. Costs that are internal to the Terasen Inc. group of companies are forecast at \$486,000. Although the prudence and disposition of amounts recorded in the deferral account will be reviewed at a future date, the Commission has concerns about some of the expenditures that TGVI proposes to record. The Commission is of the view that approved Operating, Maintenance and Administrative expenses generally should cover system planning activities to handle ongoing load growth on the utility system. Moreover, the Commission considers that deferral account treatment is not appropriate for development costs that are internal to the group of affiliated companies, particularly considering the steps that are currently underway to consolidate the operations of TGVI and Terasen Gas Inc.

For the foregoing reasons, the Commission directs that the expenditures to be recorded in the subject deferral account will be limited to external expenditures that relate to a proposed LNG storage facility on Vancouver Island. Consistent with this view, the Commission approves an increase to \$1,949,000 (plus expenditures related to Letter No. L-27-03 if not included in the \$575,000 figure) as the amount of preliminary investigation expenditures to be recorded in the deferral account approved by Order No. G-69-03.

In order that the Commission can monitor progress on the preliminary investigation, TGVI is requested to file progress reports at two month intervals that provide updates on the work program and cost estimates and identify expenditures to date. Progress reports should be filed at the end of May, July and September 2004.

In the event TGVI becomes aware that it likely will not be transporting significant volumes of gas to Vancouver Island for new gas-fired generation (e.g. when BC Hydro announces the pre-qualified bidders for the CFT on April 30, 2004), TGVI will be expected to immediately re-evaluate whether it should curtail work on the investigation and to provide a report on the situation to the Commission.

Yours truly,

*Original signed by:*

Robert J. Pellatt

JBW/cms