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**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER** G-98-04

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**IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473**

and

**An Application by Terasen Gas Inc.
for Approval of a Gas Supply Mitigation Incentive Program for the 2004/05 Gas Contract Year**

BEFORE: L.F. Kelsey, Commissioner November 3, 2004
K.L. Hall, Commissioner

O R D E R

WHEREAS:

- A. The Commission, by Order No. G-92-95, approved for Terasen Gas Inc. ("Terasen Gas") (formerly known as BC Gas Utility Ltd.) the Off-System Incentive Program ("OSIP") for a two-year period commencing January 1, 1996; and
- B. As part of its May 5, 1997 Revenue Requirements Application for 1998 to 2002, Terasen Gas filed a revised incentive plan. During the Alternative Dispute Resolution process, it was agreed by all parties to deal with the form of gas cost incentive plan(s) that would succeed OSIP in a series of separate meetings. The following Commission Orders approved a Gas Supply Mitigation Incentive Program ("GSMIP") for each subsequent gas contract year: Order No. G-125-97 for 1997/98, Order No. G-92-98 for 1998/99, Order No. G-82-99 for 1999/2000, Order No. G-106-00 for 2000/01, Order No. G-124-01 for 2001/02 and Order No. G-79-02 for 2002/03, which included the GSMIP settlement document attached as Appendix A; and
- C. Order No. G-67-03 approved the continuance of the 2002/03 GSMIP for the 2003/04 gas contract year without any revisions to the formula or the Service Quality Indicators; and
- D. By letter dated September 24, 2004, Terasen Gas proposed that the 2003/04 GSMIP should continue for a further year; and

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- E. By letter dated October 26, 2004, the British Columbia Public Interest Advocacy Centre advised that it agreed that the 2003/04 GSMIP formula and Service Quality Indicators should continue for the 2004/05 GSMIP; and
- F. The Commission has reviewed the filing and is satisfied that the GSMIP Settlement document, attached as Appendix A, should be approved for the 2004/05 gas contract year.

NOW THEREFORE the Commission approves for Terasen Gas the 2004/05 Gas Supply Mitigation Incentive Program that is attached as Appendix A for the gas contract year from November 1, 2004 through October 31, 2005.

DATED at the City of Vancouver, in the Province of British Columbia, this 9th day of November 2004.

BY ORDER

Original signed by:

L.F. Kelsey
Commissioner

Attachment



APPENDIX A
to Order No. G-98-04

Scott A. Thomson
Vice President,
Finance & Regulatory Affairs

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November 2, 2004

British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, B.C.
V6Z 2N3

Attention: Mr. R.J. Pellatt, Commission Secretary

Dear Sir:

**RE: Terasen Gas Inc. ("Terasen Gas")
Gas Supply Mitigation Incentive Program ("GSMIP") 2004/2005**

The above-referenced document was submitted to the British Columbia Utilities Commission ("Commission") for approval on October 27, 2004. Subsequently, following discussions with Commission Staff, Terasen Gas made further revisions to the October 27, 2004 submission. The revised document is attached herewith for Commission review and approval.

We trust the enclosed is satisfactory. Should the Commission require further information, please contact Mike Hopkins at (604) 592-7842.

Yours very truly,

TERASEN GAS INC.

Original signed by Tom Loski

For: Scott A. Thomson

c: Dick Gathercole

TERASEN GAS INC.

GAS SUPPLY MITIGATION INCENTIVE PROGRAM ("GSMIP") FOR THE 2004/2005 CONTRACT YEAR

The parties, consisting of Counsel representing the British Columbia Public Interest Advocacy Centre, Terasen Gas Inc. ("Terasen Gas") and the British Columbia Utilities Commission ("BCUC"), have met on October 15, 2004 to review the existing incentive arrangement. The parties agree to continue with the existing GSMIP plan with the intention of rolling the plan over for the 2004/05 contract year. The GSMIP 04/05 plan will generate sharing revenue based on mitigation recovery but will allow the BCUC to disapprove of any Incentive payment if Terasen Gas overall Gas Supply service is deemed not acceptable for the Contract year. To provide the BCUC the information to assess performance a number of Service Quality Indicators ("SQL's") will be reported. A requirement to provide certain market information to assist the BCUC in its analysis is also included. BCUC Staff will review performance under the SQL's and will have the right to disapprove of mitigation revenue sharing if it deems Terasen Gas performance under the SQL's is not acceptable. The sharing mechanism will continue to limit Terasen Gas revenue sharing in excess of \$1 million. It should be noted that all GSMIP mitigation activity falls within the Midstream account under the Essential Services Model for Commodity Unbundling, with GSMIP revenues affecting only rates determined through the Midstream Cost Reconciliation Account. Terasen Gas will continue to provide information regarding the Service Quality Indicators ("SQL's") so that the BCUC can assess the performance of Gas Supply service. The following objectives have not changed and should continue to serve as the guiding principles in determining the structure of GSMIP.

GSMIP Objectives and Guiding Principles

1. Supply Security

The plan should discourage any activity that might adversely affect the security of supply or total net gas costs.

2. Alignment of Interests

The plan should ensure that Terasen Gas maximizes net revenues from its off-system business activities.

3. Fair and Reasonable Incentives

The plan should be structured to avoid paying incentives for activities and results already achieved, but reward new, substantial exertions by the Company.

4. Simplicity

The plan should be structured in such a way that it minimizes administrative effort.

5. Fair and Reasonable Performance Targets

The plan should ensure that performance targets and expected productivity improvements are just and reasonable and that the level of incentive sharing corresponds to the level of excellence demonstrated by Terasen Gas' gas procurement and mitigation activities.

This document sets out the terms of GSMIP 2004/05 which remain unchanged from GSMIP 2003/04.

Key Components of Gas Supply

The Key components of Gas Supply are sequential as follows:

1. Development of an Annual Contracting Plan to acquire an optimum mix of transport, storage and supply contracts including implementation of the Annual Contracting Plan.
2. Planning and implementing the Price Risk Management Plan.
3. Managing counterparty risk and credit exposures.
4. Ensuring 100% Firm customer commodity supply reliability.

Providing acceptable performance in these four key components should indicate that Terasen Gas has met the criteria of acceptable service quality for Firm Customers.

GSMIP Structure

1. Term

The terms of GSMIP 2004/05 will commence on November 1, 2004 and will expire on October 31, 2005. In order to determine the incentive to be received by Terasen Gas in 2005, the Company's performance during the gas contract year ending October 31, 2005 will be examined. If appropriate, and upon approval by the BCUC, Terasen Gas will then withdraw from the Midstream Cost Reconciliation Account any incentive amounts earned.

2. Expiration & Incentive Review

GSMIP 2004/05 is recognized as short-term in nature, applying to the November 1, 2004 - October 31, 2005 contract period only. At the end of the period it will be reviewed and its continuation will be subject to BCUC approval.

3. Service Quality Indicators

The Service Quality Indicators ("SQI's") are being continued in the GSMIP plan to provide information for the BCUC to assess the overall performance of the Gas Supply Function. Each of the SQI's will have identifiable targets that establish acceptable performance. At the year-end Terasen Gas is required to file a report on performance relative to the SQI's. The Commission will then determine if the results of the SQI's show that Terasen Gas has provided an acceptable level of overall Gas Supply Service in the year. The SQI's are as follows:

3.1 Annual Contract Plan (ACP) - Portfolio Optimization

As part of the ACP submission, Terasen Gas shall compare the expected overall costs of the proposed portfolio vs. the current portfolio. Commodity and asset pricing used to determine overall costs for both portfolios will be based on forward market expectations at the time of submission. For example, if current asset costs are forecast to increase in cost for the coming contract year that will be the new baseline used in the comparator analysis.

Performance Target: The ACP plan must be submitted to the BCUC by March 31 of each year. The approved ACP, including any revisions throughout the year must be successfully implemented over the contracting period recognizing those market conditions that may arise.

3.2 Price Risk Management Plan (PRMP) Implementation

Terasen Gas submits the PRMP to the Commission each spring to seek approval for hedging limits for the following contract periods. Once the BCUC approves the PRMP, Terasen Gas begins implementation within the approved guidelines. Terasen Gas then provides to the BCUC all trade data including submission of quarterly updates on the mark-to-market activities. From time to time the BCUC may also request information on status of the plan and Terasen Gas strategy position. PRMP activities are an important part of the Gas Supply Function with the financial positions often having a significant impact on overall gas costs.

Performance Target: Terasen Gas is to continue to provide the PRMP in a timely fashion meeting the expectations of the BCUC for approval. Terasen Gas is to implement the PRMP including any approved revisions within the guidelines presented in the plan including any provisions or understanding about transaction volumes within stated timelines.

3.3 Counterparty Risk and Credit Exposure Management

Implementation of financial and physical transactions necessary to optimize Gas Supply management for Firm customers creates significant credit exposure. Terasen Gas has a conservative and well defined credit policy that is actively managed and has avoided non-recoveries over the last few years of volatile markets. This has been a significant benefit to Firm customers. Terasen Gas is to provide a report that summarizes credit management activities over the year, outlining mitigation strategies put in place to manage marketplace dynamics and identifying any defaults.

Performance Target: Terasen Gas is to show that it has effectively managed credit exposure for Firm customers prudently avoiding potential non-recoveries if deemed reasonably preventable.

3.4 Commodity Supply Reliability

Terasen Gas must balance cost minimization with supply reliability. Ensuring that Firm customers have 100% of Firm requirements is an over-riding objective of Gas Supply. Terasen Gas shall identify any curtailments of Firm customers over the year. Terasen will also identify curtailments of Interruptible customers. Supply reliability also includes reliability of assets contracted by Terasen Gas to meet customer needs. Contract default and Interruptible curtailments are subject to market conditions so targets are not being established for them. Terasen Gas will also summarize reliability measures put in place for the contracting year and a summary of any supply failures of commodity, pipeline and storage assets.

Performance Target: 100% delivery of Firm customer demand.

4. Gas Cost and Market Pricing Information

This information is to be provided to the BCUC to provide relevant market information.

4.1 Regional Local Distribution Companies Rate Indicators

Terasen Gas is to provide monthly Gas Costs as available for other regional LDC's such as Cascade, Puget, Avista, and Northwest Natural over the contract year. Terasen Gas will also provide a summary of the portfolios utilized by each of these other LDC's and illustrate differences from the Terasen Gas portfolio. Determination of the regional LDC portfolios will be through review of public information and discussion

with each of their respective Gas Supply departments and will therefore be an estimate only. Regulator approved and implemented financial price fixing activity and deferral treatment vary significantly between the LDC's and drive rates to a large extent so individual LDC rates could vary significantly at a given time.

4.2 Terasen Gas Actual Gas Costs and Market Index prices

Terasen Gas shall provide actual incurred monthly Gas Costs excluding fixed costs and hedging. Terasen Gas shall also provide data on actual Daily and Monthly Index prices at Sumas, Nymex, AECO and Station #2. This Data will be used to calculate Gas Cost proxy's for purchasing 100% of daily Firm demand at both the Sumas and AECO Daily midpoint Index for reference. Because the Sumas Daily price does not meet intra-day balancing needs and there is insufficient market liquidity to ever consider this kind of purchase strategy the comparison is only a proxy and does not define any true measure other than to show how the portfolio approach protects customers from much of the market volatility even before hedging activity.

4.3 Commodity Costs compared to Market

Terasen Gas develops a portfolio of pipeline, storage and commodity contracts that provide supply reliability and price diversity for Firm customers. The majority of Firm demand is in the Lower Mainland and is tied to the Sumas Hub. The Sumas market is subject to considerable volatility.

Terasen Gas must be a significant contributor to managing demand variability at this location. The portfolio of assets is accepted as necessary to manage Firm customer load variability and access less volatile supply sources upstream. Value recovery realized on transport and storage assets is subject to the volatile nature of market conditions and will vary considerably from year to year. Therefore, performance on contracted assets should be based on portfolio development and recovery of available mitigation value as proposed in this plan.

The portfolio assets provide commodity purchasing options to Terasen Gas. Terasen Gas commodity buying should be reasonably competitive with market price availability. Terasen Gas will provide monthly data on actual Gas commodity purchase costs before hedging compared to Sumas, Station#2 and AECO Monthly and Daily Index priced gas.

5. Sharing Mechanism

Objectives

- Continue with separate commodity and transport/storage revenue mechanisms combining the two revenues into one overall sharing allocation.
- Continue with the sharing hurdle referencing total monthly gas purchase cost instead of just the fixed component. The total gas purchase cost shall be the monthly Sumas Index. The existing commodity mechanism concept of sharing on the last \$1/GJ of hurdle rate revenue will continue in concept, but the hurdle for 2004/05 will be based on total gas purchase cost as identified by the Sumas Monthly Index.
- The sharing mechanism will continue to include a linear adjustment to the \$1/GJ hurdle rate revenue sharing proportion to maintain the potential for \$1 million sharing with a high level of recovery on actual Firm volumes resold. Transport and storage revenue assumptions are factored into this mechanism to recognize this revenue contributes to

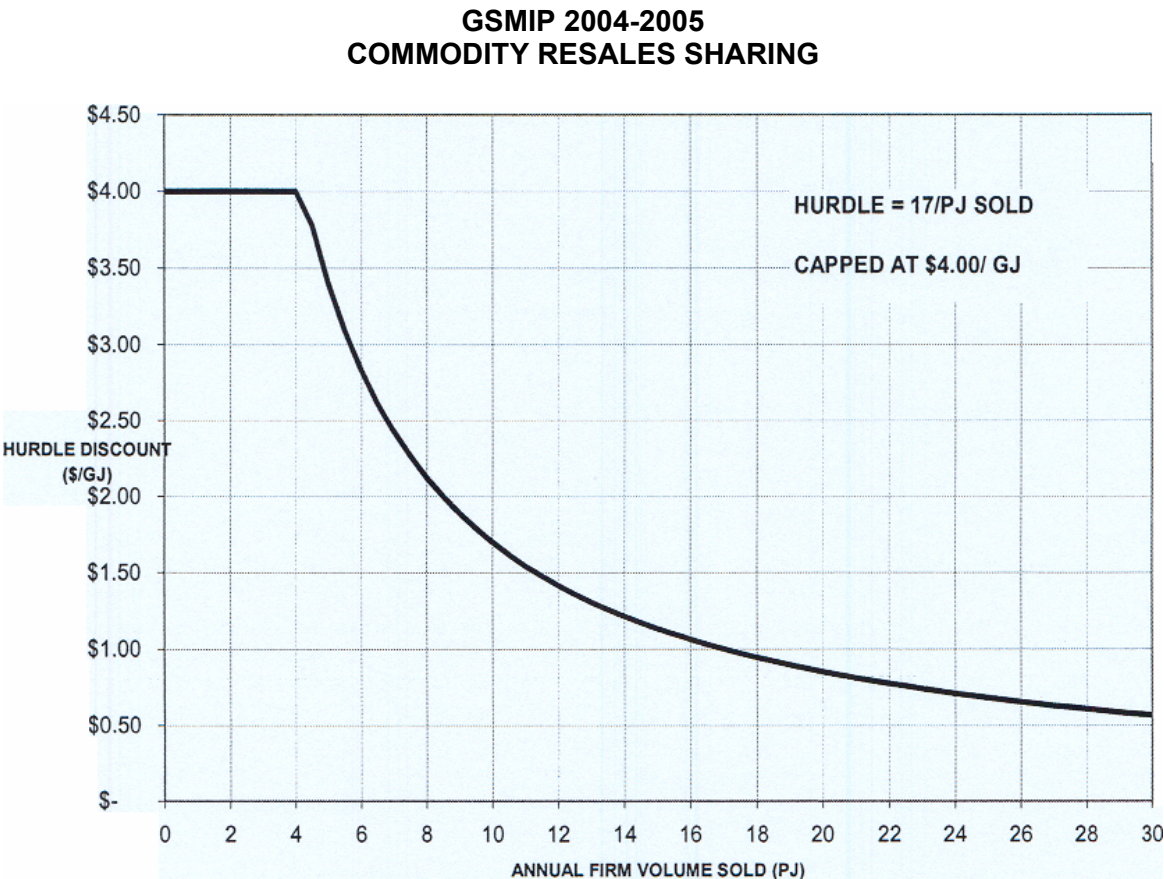
the overall sharing capability to \$ 1 million. Continue to cap total sharing at 1.25% after \$1 million sharing is earned.

Incentive Structure Summary

Terasen Gas recovers mitigation revenue from recovery of revenue from surplus term gas purchased for Firm customers and third party recovery of value from unutilized Firm customer pipeline capacity and storage assets. Each of these activities are distinctly separate transactions. Eligible commodity sharing and transport and storage margin will be combined to calculate the basis for Terasen Gas final incentive sharing.

a) Eligible Commodity Resale

Terasen Gas commodity sharing reward is dependent primarily on how close it can come to achieving full recovery of purchase costs for core customers regardless of commodity pricing and volume available for resale. Terasen Gas revenue sharing on each gas unit resold will be dependant on total surplus Firm volumes sold in the contract year. The lower the Firm volume available the higher the Terasen Gas sharing on total revenue recovered. The amount of resale revenue Terasen Gas shares is based on a discount from the Monthly Sumas Index. This discount from the Index varies based on the formula $17 / (\text{Annual PJ sold})$.



b) Transport and Storage

The existing transportation and storage mechanism works well and shall be continued. This activity will include the net revenue from spot gas purchases and sales transacted to recover revenue from core transportation and storage assets.

Terasen Gas Sharing Incentive

The parties agree to combine the transport and storage revenue with the eligible commodity revenue to create one sharing mechanism. Terasen Gas incentive share will be 5% of the Total Eligible Margin up to the first \$1 million sharing earned. When Terasen Gas achieves \$1 million sharing, the Terasen Gas share will reduce to 1.25% on all remaining Total Eligible Margin.

The proposed mechanism meets the objective of limiting Terasen Gas sharing in the case of extreme mitigation revenue opportunity available but still provides reasonable sharing when minimal or more historic opportunity, such as is forecast next year, is available to be recovered by Terasen Gas.

6. Employee Incentives

Within the context of other incentive plans and market competitive compensation levels for employees, Terasen Gas will continue to recognize those Gas Supply employees deemed to have directly or indirectly contributed toward the generation of net revenues achieved under GSMIP 2004/05. Such incentive compensation will be based upon and related to the incentive earnings of Terasen Gas.

7. Regulatory & Management Reporting

In order for the BCUC to adequately monitor and evaluate the company's performance, the already well-developed record keeping and reporting procedures will be continued. In the interest of simplicity, it has been agreed that the year-end reporting will be reduced to include the high-level summary reports but exclude the detailed reports and graphs showing margins and volumes by day, location and customer. Terasen Gas will also continue with its current practice of regular quarterly filings with the BCUC consisting of a summary report that details all off-system and non-core on-system activity and associated financial impacts. This report will be submitted to the BCUC within two months of the quarter-end. Terasen Gas will also provide an update on the status of the SQI's and Gas Cost and Market Pricing twice per year, once after the winter and once after the summer at year-end, within two months of the season-end.

Terasen Gas will also continue to keep distinct and separate records, for audit purposes, of a daily "Load Forecast Sheet", which details all on-system supply requirements, and a "Deal Sheet" for each and every transaction that will feature all information as it relates to the economics of each transaction.

Terasen Gas will confer with BCUC staff to ensure that these reports provide an appropriate level of disclosure and audit capability with a minimum of administrative burden. The BCUC will examine the calculation of any incentive payments received under the GSMIP 2004/05 plan and will make any appropriate adjustments. For the benefit of interested parties, an overview report will be issued by the BCUC at the end of the term. Such report shall provide an analysis of the effectiveness of GSMIP 2004/05.

Definitions:

Commodity-sharing Mechanism

Core Commodity Volume	All gas volumes under purchase contract as approved by the BCUC to meet Firm customers as approved in the ACP.
Commodity Resale Volumes	All Commodity Volume purchases in the ACP, including daily-priced and monthly-priced gas, in excess of actual Firm customer needs.
Hurdle Discount	<p>The unit commodity resale margin hurdle discount (CDN\$/GJ) from the Weighted average Sumas Monthly Index price converted to CDN\$/GJ. The Discount Hurdle shall be determined at the end of the contract year once total annual resale volumes are known. The Hurdle Discount is calculated by multiplying by the factor of 17/ (PJ annually resold). This equation is capped at \$4/GJ.</p> <p>For example, if total annual volume sold is 20 PJ the Hurdle would be $17/20 = \\$0.85/\text{GJ}$.</p>
Annual Average Sumas Index Price	Volumes sold each month will be compared to the Sumas Index for that month. The Annual Average Sumas Index Price shall be the weighted average of the actual monthly resale volumes times the monthly Sumas Index for each of the months divided by the total annual volumes resold.
Eligible Commodity Resale Hurdle	This is the Hurdle rate before Terasen Gas shares in resale revenue. It is the Annual Average Sumas Index Price less the Hurdle. For Example, if the annual average weighted Sumas Index price was \$6.125/GJ and Terasen Gas sold 20 PJ annually, the Hurdle Discount would be \$0.85/GJ and the Eligible Commodity Resale Hurdle would be \$5.275/GJ. Terasen Gas would share on all revenue recovery above this \$5.275/GJ hurdle.
Eligible Resale Sharing	All revenue generated above the Eligible Commodity Resale Hurdle. For example, if Terasen Gas averaged annually \$6.20/GJ recovery on 20 PJ the Eligible Resale Sharing would be $20 \text{ PJ} \times (\$6.20/\text{GJ} - \$5.275/\text{GJ}) = \$18.5 \text{ million}$.
Eligible Transportation and Storage Margin	The revenue received by Terasen Gas from third parties via assignment of Core transportation and Storage including the net revenue received by Terasen Gas via back-to-back Transport and Storage buy/sell mitigation activity.
Total Eligible Margin	Eligible Commodity Resale Sharing plus Eligible Transportation and Storage Margin.