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**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER** G-98-05

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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 Transactions Related to the
Southern Crossing Pipeline and Inland Pacific Connector**

BEFORE: L.F. Kelsey, Commissioner October 5, 2005
L.A. Boychuk, Commissioner

O R D E R

WHEREAS:

- A. The Commission, by Order No. C-11-99, approved a Certificate of Public Convenience and Necessity for BC Gas Utility Ltd. ["BC Gas", now Terasen Gas Inc. ("Terasen Gas")] for the Southern Crossing Pipeline ("SCP") project. The Order also approved a Firm Tendered Transportation Service Agreement ("TSA") for approximately 52.5 MMcf/d of SCP capacity from Yahk or Kingsvale to Huntingdon with each of British Columbia Hydro and Power Authority ("BC Hydro") and PG&E Energy Trading, Canada Corporation ("PG&E"). The Order also accepted for filing a Peaking Gas Purchase Agreement ("Peaking Agreement") with each of BC Hydro and PG&E. The Order also approved the provision that allowed BC Hydro to assign its TSA and Peaking Agreement to Terasen Inc. ("Put Option") for the remaining period in the primary term upon 13.5 months notice; and
- B. By an application dated December 5, 2002, BC Gas advised the Commission that PG&E was encountering financial difficulties and requested Commission approval for a set of transactions that were designed to preserve the value of the SCP capacity contracted to PG&E for BC Gas and its customers. By Letter No. L-48-02 dated December 5, 2002, the Commission stated it was prepared to approve certain transactions related to SCP capacity held by PG&E, including the termination of the PG&E TSA and Peaking Agreement; and
- C. Letter No. L-48-02 also addressed certain other requests made by BC Gas including the disposition of Inland Pacific Connector ("IPC") project costs in the event the project is deferred substantially and the acceptance by BC Gas of the BC Hydro SCP capacity should BC Hydro exercise its Put Option; and
- D. By Order No. G-9-03, the Commission approved the cancellation of the TSA with PG&E and approved a TSA for SCP capacity with Northwest Natural Gas Company ("NWN"). Commission Order No. G-53-05 subsequently approved the Amendment and Restatement of Firm Transportation Service Agreement with NWN; and

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- E. On June 1, 2005, Terasen Gas applied for Commission approval of several transactions that are related to matters that were addressed in BC Gas' December 5, 2002 application and Commission Letter No. L-48-02 (the "Application"). These matters include the treatment of payments and revenue related to the PG&E TSA and its termination, the exercising by BC Hydro of its Put Option effective November 1, 2005 and the recovery of IPC development costs; and
- F. Commission Order No. G-55-05 established a written hearing process to review the Application and set down a Regulatory Agenda that included a Workshop on June 29, 2005; and
- G. Terasen Gas filed a copy of its December 5, 2002 application on a non-confidential basis, and on August 5, 2005 responded to Information Requests; and
- H. The Commission received written comments from Duke Energy Gas Transmission on behalf of Westcoast Energy Inc., the Lower Mainland Large Gas Users Association, B.C. Old Age Pensioners' Organization et al., and the Inland Industrials consisting of Weyerhaeuser Company Ltd., Teck Cominco Metals Ltd., Zellstoff Celgar Limited and Canadian Forest Products Ltd.; and
- I. Terasen Gas filed written reply comments on September 2, 2005; and
- J. The Commission has considered the Application and the evidence and written comments received in the written hearing, and has made determinations on the approvals that Terasen Gas requested in the Application. The Commission's Reasons for Decision are attached as Appendix A to this Order.

NOW THEREFORE the Commission orders as follows for Terasen Gas:

- 1. The Commission approves the recording in the SCP Deferral Account of the PG&E contract termination payments for the period November 2004 through December 2005, of \$962,500 offset by tax saving estimated at \$332,063.
- 2. The Commission approves the recovery in the delivery margin of the amortization of the balance in the SCP Deferral Account at the end of 2005 that is related to the PG&E termination payments, over the four years from 2006 to 2009 at approximately \$157,609 per year.
- 3. The Commission approves the recovery of PG&E termination payments of \$825,000 per year from January 2006 to October 2009 and \$145,000 per year from November 2009 to October 2019 as an offset to the corresponding NW Natural delivery margin revenue for 2006 forward.
- 4. The Commission approves the continued use of the 6 MMcfd of residual SCP capacity as part of the Terasen Gas Midstream portfolio.
- 5. The Commission approves the termination of the BC Hydro/Terasen Inc. TSA and Peaking Agreement effective November 1, 2005 without payments from Terasen Inc. to Terasen Gas.

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6. The Commission approves the debiting of an annual charge of \$3.6 million (based on monthly installments) against the Midstream Cost Reconciliation Account, with an equal and offsetting amount to be credited to the delivery margin revenue account, for a limited period as a unique and unusual transaction in the circumstances of the SCP and the termination of the BC Hydro TSA. The debiting and crediting will commence on either November 1, 2005 or January 1, 2006, as consistent with the amount of BC Hydro/Terasen Inc. TSA revenue that Terasen Gas forecast in its Annual Review submission for 2005, and will end on the earlier of November 1, 2010 or such other date as the Commission may determine.
7. The Commission approves the inclusion of the 52.2 MMcfd of BC Hydro SCP capacity as part of the Terasen Gas Midstream portfolio effective November 1, 2005, and adjustments to other peaking and transportation capacity resources in a manner that optimizes the portfolio.
8. The Commission denies the application for the recovery of IPC development costs.

DATED at the City of Vancouver, in the Province of British Columbia, this 6th day of October 2005.

BY ORDER

Original signed by:

L.F. Kelsey
Commissioner

Attachment

**TERASEN GAS INC.
TRANSACTIONS REGARDING SOUTHERN CROSSING PIPELINE
AND INLAND PACIFIC CONNECTOR**

REASONS FOR DECISION

1.0 INTRODUCTION

1.1 Southern Crossing Pipeline

In May 1997 BC Gas Utility Ltd. (“BC Gas”, now Terasen Gas Inc., “Terasen Gas,” the “Company”) applied to the British Columbia Utilities Commission (the “Commission”) for a Certificate of Public Convenience and Necessity (“CPCN”) for the construction of the Southern Crossing Pipeline (“SCP”) from Yahk to Oliver, B.C. The Commission’s April 3, 1998 Decision concluded that the SCP was not the preferred resource option at that time, and denied the CPCN application (Exhibit C5-2, pp. 1, 2).

Terasen Gas reapplied to the Commission for a CPCN for the construction of the SCP in December 1998. The Commission in its May 21, 1999 Decision, concluded that the SCP offered the highest potential benefit to ratepayers over the long term and stated that it was prepared to issue a CPCN for SCP provided that several conditions were met. In part, the Commission’s determination was based on third party Firm Tendered Transportation Service Agreements (“TSA”) and Peaking Gas Purchase Agreements to help offset the cost of service impacts of the new pipeline. Commission Order No. C-11-99 approved the CPCN for the project, and the SCP was put into service in December 2000 (Exhibit B-1, p. 1).

Order No. C-11-99 also approved TSAs with British Columbia Hydro and Power Authority (“BC Hydro”) and PG&E Energy Trading, Canada Corporation (“PG&E”) for 52.5 MMcf/d of firm transportation capacity from Yahk to Huntingdon, B.C. In addition, the Order accepted for filing a Peaking Gas Purchase Agreement (“Peaking Agreement”) with each of BC Hydro and PG&E that provided Terasen Gas with equivalent volumes of peaking gas supply at Huntingdon for up to 15 days each year. The arrangements with BC Hydro permitted BC Hydro to assign its TSA and Peaking Agreement to BC Gas Inc. (now Terasen Inc.), by giving 13.5 months notice (the “BC Hydro Put Option”) (Exhibit B-1, p. 1).

1.2 Inland Pacific Connector

In response to natural gas market activity in winter 2000/01, Terasen Inc. (the parent of Terasen Gas) began developing the Inland Pacific Connector (“IPC”) project (Exhibit B-1, p. 2; Exhibit B-6, BCUC IR 8.1.1). The IPC project would have added compression to the SCP and constructed a new pipeline from Yahk to Huntingdon, B.C. (or alternatively to an interconnection with the Westcoast Energy Inc. system at Hope, B.C.). In May 2001, Terasen Inc. held an Open Season for IPC transportation capacity (Exhibit B-1, p. 2; Exhibit B-6, BCUC IR 9.1). Terasen Gas, Northwest Natural Gas Company (“NWN”) and others responded to the Open Season. However, because Terasen Gas recognized that the market conditions supporting new pipeline capacity in the region changed significantly, IPC development activities were largely suspended by mid 2003 and Terasen Gas now considers the project to be “indefinitely deferred” (Exhibit B-6, BCUC IR 9.2, 10.8.3, 15.1). The IPC development cost of \$5.4 million is carried in a Terasen Gas Preliminary Survey and Investigation Charges account that does not attract interest and is not included in utility rate base (Exhibit B-6, BCUC IR 8.2).

1.3 Re-contracting of PG&E SCP Transportation Capacity

On December 5, 2002 Terasen Gas applied to the Commission for approval of a set of transactions that were designed to preserve the volume of the SCP capacity contracted to PG&E, in reaction to Terasen Gas’ concerns relating to financial difficulties that PG&E was experiencing at that time. The transactions were summarized as follows:

- PG&E and Terasen Gas would terminate the 52.5 MMcfd TSA and Peaking Agreement effective January 1, 2003. PG&E also agreed to assign an equivalent amount of upstream TransCanada PipeLines Ltd. Nova/ANG (“TCPL”) capacity to Terasen Gas effective January 1, 2003. Terasen Gas agreed to make certain payments to PG&E over the period through October 2019 and PG&E had an option to convert the payment stream to a net present value payment.
- Terasen Gas would enter into a firm service contract with NWN for 46.5 MMcfd of SCP capacity for the period November 2004 through October 2020. Effective November 1, 2004, Terasen Gas would also assign an equivalent amount of TCPL service to NWN.

By Letter No. L-48-02 the Commission confirmed that it was prepared to approve the set of transactions. Commission Order No. G-9-03 subsequently approved the NWN TSA and the cancellation of the PG&E TSA. Letter No. L-48-02 also approved the use of SCP and TCPL capacity as core assets until November 2004, and the recording of variances from the forecast amount of revenue from the PG&E SCP capacity and related mitigation revenue in a separate SCP third party mitigation revenue account. Letter No. L-48-02 also responded

to Terasen Gas' requests regarding the BC Hydro Put Option, recovery of IPC project development costs, and other matters related to the set of SCP transactions.

1.4 Current Application for Transactions Regarding SCP and IPC

On June 1, 2005, Terasen Gas requested Commission approval of a number of additional transactions and other matters related to SCP and IPC (the "Application"). Commission Order No. G-55-05 established a Regulatory Agenda for a written hearing process for the review of the Application, including a Workshop on June 29, 2004.

On June 24, 2005 Terasen Gas filed a copy of its December 5, 2002 application regarding transactions related to the SCP (Exhibit B-2). Although Terasen Gas had requested confidentiality when it filed the application in 2002, it subsequently stated that no part of the material now needed to be held confidential (Exhibit B-2). Terasen Gas also responded to Information Requests on the Application and stated that it does not consider any of the material, including information that relates to the Midstream Annual Gas Contracting Plan, to be confidential (Exhibits B-5, B-6, B-7). That is, all of the record in this proceeding has been fully disclosed to participants.

Written comments were received from Duke Energy Gas Transmission on behalf of Westcoast Energy Inc. ("Westcoast"), the Lower Mainland Large Gas Users Association (the "Association"), the BC Old Age Pensioners' Organization et al. ("BCOAPO"), and the "Inland Industrials" made up of Weyerhaeuser Company Ltd., Teck Cominco Metals Ltd., Zellstoff Celgar Limited and Canadian Forest Products Ltd.

On September 2, 2005 Terasen Gas submitted its written reply to the comments from Intervenors.

2.0 APPLICATION

2.1 Approvals Requested

Terasen Gas, in this Application, is seeking approval from the Commission of several transactions:

- Approval of the recovery mechanism for the PG&E termination payments and recovery of the SCP deferral account related to the Interim Period, effective January 1, 2006.
- Approval to continue to use the 6 MMcfd residual SCP capacity as part of its Midstream Portfolio of resources.

- Approval for Terasen Gas and Terasen Inc. to terminate the transportation service and peaking gas agreements currently held by BC Hydro on the effective date (November 1, 2005) of the assignment by BC Hydro to Terasen Inc.
- Approval for the Company to include the 52.5 MMcfd SCP capacity (currently held by BC Hydro) in its Midstream resource portfolio, effective November 1, 2005, and make adjustments to its other peaking and transmission capacity resources in a manner that optimizes the portfolio.
- Approval of an annual allocation of \$3.6 million (based on monthly installments) to be debited against the Midstream Cost Reconciliation Account (“MCRA”), with an equal and offsetting allocation to be credited to the delivery margin revenue account for the remainder of the primary term (i.e. ending November 1, 2010), to be effective November 1, 2005.
- Recovery of IPC development costs, including a provision for Allowance for Funds Used During Construction (“AFUDC”), which are currently included in a non-utility deferral account, effective January 1, 2006.

Several of the requested approvals were clarified through Information Requests, and are discussed in detail in the following sections of these Reasons for Decision.

2.2 Treatment of the Transactions and Related Requests for Approval as a Package

In the Application, Terasen Gas presents all transactions as elements of a “package” and attempts to identify or construct “cause/effect” linkages and interdependencies between them.

Terasen Gas “submits that these transactions should be considered, to the extent possible as a whole, in consideration of the linkages and interdependencies of each.” (Exhibit B-1, p. 3).

The Inland Industrials refer to the transactions in linked form, as:

“The proposed bargain embedded in this package of transaction[s] is that Terasen Inc. will forgo its opportunity for profit from the released SCP capacity by assigning it to Terasen [Gas] who are better positioned to take advantage of the value of the SCP capacity. In exchange, Terasen Inc. asks ratepayers to absorb the costs accumulated in various deferral accounts related to IPC and the PG&E/NWN transactions for which Terasen [Gas] is currently at risk (Exhibit 6-3, pp. 3, 4).”

The Commission considers that the Application addresses three distinct and separate groups of issues.

The groups of issues are:

- 1. Transactions related to the termination of the PG&E TSA for SCP capacity and Peaking Agreement, and the re-contracting of most of the SCP capacity with NWN;**

- 2. Transactions related to the termination of the BC Hydro/Terasen Inc. TSA for SCP capacity and Peaking Agreement; and**
- 3. Recovery from ratepayers of IPC development costs.**

While linkages and interdependencies may be found within the groups of issues, and may be perceived or, in retrospect, constructed between and among the issues, the Commission is of the view that the three independent groups of issues can and should be considered separately.

3.0 PG&E AND NWN TRANSACTIONS

The transactions related to the termination of the PG&E TSA and Peaking Agreement, the re-contracting of most of the related SCP capacity to NWN and the deferral account treatment for variances from the forecast amount of revenue from PG&E were approved by Letter No. L-48-02 and Order No. G-9-03. Commission Orders No. G-80-03 and G-112-04 approved the amortization of the before-tax \$2,622,704 debit balance in the SCP Deferral Account at the end of 2004, as a charge against margin revenue over the five year period of 2005 to 2009 (Exhibit B-1, Attachment 2; Exhibit B-6, BCUC IR 2.2, 3.2). The Commission Panel has not been asked to and has not revisited the foregoing approvals.

In the Application, Terasen Gas requested the following additional approvals related to the PG&E and NWN set of transactions:

- Approval to record in the SCP Deferral Account, the PG&E contract termination payments for the period November 2004 through December 2005 of \$962,500 offset by tax savings estimated at \$332,063.
- Approval to recover in the delivery margin the amortization of the balance in the SCP Deferral Account at the end of 2005 that is related to the PG&E termination payments over the four years from 2006 to 2009 at approximately \$157,609 per year.
- Approval to recover the PG&E termination payment of \$825,000 per year from January 2006 to October 2009 and \$145,000 per year from November 2009 to October 2019, as an offset to the NWN delivery margin revenue for 2006 forward. (This indicates that termination payments charged to the delivery margin will not exceed the corresponding NWN TSA revenue.)
- Approval to continue to use the 6 MMcf/d of residual SCP capacity (the difference between the amounts of SCP capacity contracted to PG&E and to NWN) as part of the Terasen Gas Midstream portfolio.

(Exhibit B-1, p. 3; Exhibit B-6, BCUC IR 3.1, 3.2, Appendix A)

Terasen Gas provided information about the impact on ratepayers of the PG&E and NWN set of transactions, estimating the net benefit to ratepayers at \$3.3 million in 2006 and \$5.2 million in 2012 (Exhibit B-6, BCUC IR 1.1, Appendix A). The Net Present Value (“NPV”) at 6.02 percent was projected to be \$17.1 million over the period to October 2010, and \$44.0 million to October 2020.

3.1 Views of Participants

None of the Intervenor's opposed the Terasen Gas requests regarding the recovery mechanism for the PG&E termination payment, recovery of the SCP Deferral Account, or the use of the 6 MMcf/d residual SCP capacity as part of the Midstream portfolio of resources.

Westcoast noted that in the proceeding related to the second SCP CPCN application, Terasen Gas had claimed that the PG&E Peaking Agreement was highly beneficial to the Core Market, in contrast to the savings now claimed from the use of replacement peaking resources that are described in the Application (Exhibit C5-2, p. 3). The Association and BCOAPO also indicated concerns about the forecasting of benefits in the Application (Exhibit C8-2, p. 2; Exhibit C4-2, p. 2). Terasen Gas responded that regional market conditions have evolved differently than were predicted at the time the SCP was approved, that it has estimated the benefits based on current market conditions and acknowledged that it is not able to predict how future market conditions may change (Exhibit B-9, p. 2).

3.2 Commission Determination

The most significant component of the estimated benefits from the PG&E and NWN set of transactions are the higher demand charges under the NWN TSA, which are set out in that contract. Terasen Gas attributes a further \$1.318 million of benefit through the replacement of the PG&E Peaking Agreement with downstream storage (Exhibit B-6; BCUC IR 1.4). The Terasen Gas estimate of future peaking gas cost is heavily dependent on the assumptions used in the calculation. For example, Terasen Gas assumes that peaking gas in both a normal year and a design year will cost 2.5 times the average winter Kingsgate price, based on the last five years' winter maximum daily price volatility. No evidence or discussion was provided to support the appropriateness of this assumption other than a representation that the estimate was conservative. The Commission Panel notes that if one assumed that the average cost of peaking gas in a normal year would be 1.5 times the average winter Kingsgate price, the estimated cost of PG&E peaking would be approximately equal to downstream storage and no savings would result.

The cost and benefit projections in the Application also depend on assumptions made by Terasen Gas and there is a large amount of uncertainty in some of the calculated benefits. Nevertheless, this uncertainty is unlikely to overshadow the increased delivery margin revenue that results from re-contracting the PG&E SCP capacity to NWN under a long-term TSA. **The Commission concludes that the set of transactions related to PG&E and NWN are likely to have net benefits for Terasen Gas ratepayers.**

The Commission considers that the approvals requested in the Application that are related to this set of transactions are consistent with earlier approvals in Letter No. L-48-02, and are reasonable. **The Commission approves the Terasen Gas requests as identified earlier in this section of the Reasons for Decision.**

4.0 BC HYDRO/TERASEN INC. TSA AND PEAKING AGREEMENT

Letter No. L-48-02 addressed a Terasen Gas request related to the BC Hydro Put Option as follows:

“The (December 5, 2002) Application also requests that in the event British Columbia Hydro and Power Authority (“B.C. Hydro”) exercises its Put Option to assign its SCP capacity to BC Gas Inc., BC Gas will accept return of the capacity. BC Gas may have greater flexibility than BC Gas Inc. to mitigate losses resulting from the return of this capacity. The Commission is prepared to approve the return of the B.C. Hydro SCP capacity provided BC Gas is reimbursed for any net costs or losses that result.”

BC Hydro exercised the BC Hydro Put Option to assign its TSA and Peaking Agreement to Terasen Inc. effective November 1, 2005.

In the Application, Terasen Gas requested the following approvals related to the BC Hydro/Terasen Inc. TSA and Peaking Agreement:

- Approval to terminate the BC Hydro/Terasen Inc. TSA and Peaking Agreement effective November 1, 2005 without any payments from Terasen Inc. to Terasen Gas.
- Approval to debit an annual charge of \$3.6 million (based on monthly installments) against the Midstream Cost Reconciliation Account (“MCRA”), with an equal and offsetting amount to be credited to the delivery margin revenue account for the period commencing November 1, 2005 and ending November 1, 2010.
- Approval to include the 52.5 MMcfd of BC Hydro SCP capacity as part of the Terasen Gas Midstream portfolio, effective November 1, 2005 and to make adjustments to its other peaking and transmission capacity resources in a manner that optimizes the portfolio.

(Exhibit B-1, p. 4; Exhibit B-6, BCUC IR 7.1)

Terasen Gas provided information regarding the financial impact on ratepayers of the set of transactions related to the early termination of the BC Hydro contracts (Exhibit B-6, BCUC IR 4.1, Appendix A). (The primary term of the BC Hydro/Terasen Inc. TSA and Peaking Agreement would have expired on November 1, 2010, and there is little basis for projecting that the agreements and related payments would have continued beyond that date.) Terasen Gas projects that termination of the agreements will have a net benefit to ratepayers of \$2.3 million in 2006, and a NPV of \$9.4 million at 6.02 percent over the period to 2010. Terasen Gas considers that the loss of \$3.6 million of demand charge revenue and the cost of contracting additional peaking supply and downstream supply are more than offset by the savings that result from Terasen Gas decontracting 54.0 TJ/d (approximately 51.7 MMcfd) of Westcoast Transportation-south service from Station 2 to Huntingdon ("T-south").

4.1 Views of Participants

Westcoast observed that the NPV analysis in the Application is based on numerous assumptions and input variables controlled and selected by Terasen Gas. Westcoast submitted that the release of Terasen Inc. from its obligations under the BC Hydro TSA and Peaking Agreement would seriously undermine the Commission's SCP Decision and deprive Terasen Gas' core market customers of a known and fixed revenue source of \$3.6 million per year to help offset some of the SCP annual cost of service (Exhibit C5-2, p. 4). Terasen Gas responded that Westcoast has not substantiated how the SCP Decision would be undermined and suggested that the benefits of incorporating the SCP capacity into the Midstream portfolio have been conservatively estimated and clearly outweigh the loss of revenue from the BC Hydro/Terasen Inc. TSA (Exhibit B-9).

The Association supported the Westcoast submission and stated that any financial benefits resulting from the SCP should be solely for the account of the customer on the basis that they are responsible for the significant costs of the SCP (Exhibit C8-2, p. 2). Terasen Gas responded that, although market conditions have evolved differently than were predicted at the time of the SCP Decision, Terasen Gas takes very seriously its responsibility to mitigate SCP costs and maximize benefits to its customers. However, it suggested that this should not be at the expense of shareholders.

The Inland Industrials did not oppose any of the Terasen Gas proposals related to the BC Hydro/Terasen Inc. TSA and Peaking Agreement and noted that the rate impact on transportation customers of the proposed transactions would be the same as if Terasen Inc. continued to hold the BC Hydro SCP capacity. The Inland Industrials opposed a suggestion by Terasen Gas that transportation customers be allocated a pro-rata share of

the BC Hydro SCP capacity in return for not debiting an annual \$3.6 million charge to the MCRA, on the basis that it would represent a substantial loss of value for transportation customers.

The BCOAPO accepted Terasen Gas' proposals related to the BC Hydro/Terasen Inc. TSA and Peaking Agreement, but requested that the Commission direct Terasen Gas "to provide an update of the actual realized and forecast savings 12 months after the Commission issues its Decision in this Proceeding." BCOAPO submitted that this would provide a reasonable safeguard that ratepayers will have a remedy should any net costs or losses become apparent in the future. Terasen Gas accepted the suggestion to provide an after-the-fact report, but expressed concern about the implied treatment of variances from its estimate of benefits from the proposal. Terasen Gas submitted that if Terasen Inc. were to have an obligation to keep it whole on an after-the-fact basis, this risk would need to be offset by a share in any savings that it realized.

4.2 Commission Determination

Terasen Gas estimated that the cost of the Westcoast capacity that it decontracted would have been \$6.9 million per year at a Westcoast toll of \$0.35/GJ (Exhibit B-3, revised Attachment 3a). When asked about the reallocation to remaining customers of a portion of the demand charge revenue that Westcoast would lose due to the decontracting, Terasen Gas provided a calculation indicating \$8.1 million of savings based on the assumption that Westcoast's Interruptible Transmission Service ("IT") revenue would increase by almost as much as the demand charge revenue that Westcoast would lose by the decontracting (Exhibit B-6; BCUC IR 4.6). Presumably a customer other than Terasen Gas is using the additional Westcoast IT, as otherwise the reduction in Terasen Gas' Westcoast toll charges would be minimal. Moreover, since Terasen Gas is shown as holding 572 MMcfd (or 45 percent) of a total Westcoast contracted capacity of 1280 MMcfd, it is apparent that an assumption of no additional IT revenue for Westcoast would indicate a considerably lower net savings due to decontracting.

The Commission Panel notes that BCOAPO did not take issue with the request to terminate the BC Hydro/Terasen Inc. agreements, and is persuaded that the critical considerations are that 54.0 TJ/d of Westcoast T-south capacity has been terminated effective November 1, 2005, and that this will result in material reductions in Westcoast toll charges. **The Commission concludes that the termination of BC Hydro/Terasen Inc. agreements is likely to result in net savings to ratepayers, and so the termination of the agreements without any payment by Terasen Inc. should be approved.**

With the uncertainty in the estimation of many of the projected costs and benefits related to the transactions, the Commission Panel understands why BCOAPO would request a report in 12 months on the actual results. The Commission Panel notes Terasen Gas' concern about the treatment of variances from its estimate of benefits, but does not agree that the risk associated with an after-the-fact assessment of costs and benefits would justify a share of the savings, providing the benefits have been forecast appropriately. However, an after-the-fact assessment of net benefits would need to compare actual costs to a projection of what costs would have been under an alternative scenario. Moreover, costs and benefits over the next 12 months may or may not be representative of the situation over the remaining primary term of the agreements to November 2010. **In order to provide certainty and reduce the future regulatory burden, the Commission will not require Terasen Gas to report on the actual results of these transactions.**

The request to debit the MCRA with an amount equivalent to the \$3.6 million per year of revenue from BC Hydro is a proposal by Terasen Gas to keep whole all delivery margin customers (both sales and transportation), since all of the savings in Westcoast toll charges will flow into the MCRA and hence will not benefit transportation customers (Exhibit B-6; BCUC IR 7.4.3). Terasen Gas confirmed that the net effect from a tax perspective of the debiting and crediting will be zero (Exhibit B-6; BCUC IR 7.4.7).

No such treatment was proposed for the residual 6 MMcf/d of SCP capacity from the PG&E TSA, and Terasen Gas acknowledged that there are not a large number of precedents for the proposed treatment. Terasen Gas states that the proposed treatment for the lost BC Hydro revenue is consistent with the SCP Deferral Account treatment of the lost PG&E revenue for the period January 2003 through October 2004, since in both cases the delivery margin revenue account is credited for the lost revenue (Exhibit B-6, BCUC IR 7.4.4). However, since the debit balance in the SCP Deferral Account is being amortized to delivery margin revenue rather than the MCRA, the Commission is not persuaded that the treatment would be consistent.

The Settlement Agreement regarding the Cost Allocation for the SCP Project that was approved by Order No. G-74-04 stated:

“The Parties agree that SCP costs are to be allocated to firm sales and transportation customers in proportion to the benefits received. In its Application, BC Gas proposed that all costs associated with SCP cost of service would be recovered through the delivery margin. The Parties recognize that the costs of all other BC Gas-owned transmission and peaking facilities are currently recovered in the delivery charge. There is no agreement as to whether this should continue following the full rate design for BC Gas that the Commission has directed to occur in 2001. However, until otherwise ordered by the Commission the Parties accept the recovery of the SCP cost of service through the BC Gas delivery margin.”

Terasen Gas confirmed that there has been no determination that the SCP cost of service should be recovered in some way other than through the Terasen Gas charge (Exhibit B-1, Exhibit B-6; BCUC IR 7.12). The Commission notes that BCOAPO did not oppose the proposed debit to the MCRA, while the Inland Industrials expressed concern about the need for balanced treatment of sales and delivery margin customers. In the unique circumstances related to the SCP and the termination of the BC Hydro TSA, the Commission considers that it should approve the proposed debit to the MCRA and credit to the delivery margin revenue account, providing that it will continue in effect only until the earlier of November 1, 2010 or the Commission orders otherwise. The Commission may wish to revisit this matter in a future Terasen Gas rate design proceeding.

Based on the response to BCUC IR 6.6 in Exhibit B-1, it is uncertain when the debit to the MCRA and credit to the delivery margin revenue account should commence. BC Hydro will pay \$3.0 million of demand charges in 2005 and, if the Annual Review revenue forecast for 2005 assumed this amount from the BC Hydro/Terasen Inc. service, there is no need for a credit from the MCRA account until January 2006. If \$3.6 million of revenue was assumed for 2005, then the credit from the MCRA account should commence for November 2005. Terasen Gas will be expected to provide clarification on the matter in its 2005 Annual Review filing.

Terasen Gas confirmed that the recommended Midstream portfolio for 2005/06 in its 2005/06 Midstream Annual Gas Contracting Plan included the 52.5 MMcf/d of BC Hydro/Terasen Inc. SCP capacity (Exhibit B-6, BCUC IR 7.3). Commission Letter No. L-56-05 accepted the recommended Midstream portfolio for 2005/06, subject to a Commission determination on the Application.

The Commission approves the Terasen Gas requests as set out earlier in this section of the Reasons for Decision, except that the debiting of \$3.6 million per year to the MCRA and the crediting of an equal and offsetting amount to the delivery margin revenue account is approved for a limited period as a unique and unusual transaction in the circumstance of the SCP and the termination of the BC Hydro/Terasen Inc. TSA. The debiting and crediting will commence on either November 1, 2005 or January 1, 2006, as consistent with the amount of BC Hydro/Terasen Inc. TSA revenue that Terasen Gas forecast in its Annual Review submission for 2005, and will end on the earlier of November 1, 2010 or such other date as the Commission may determine.

5.0 IPC COSTS

5.1 Terasen Gas proposal

Terasen Gas seeks recovery, effective January 1, 2006, of IPC development costs, including a provision for AFUDC, which are reported to be included in a Terasen Gas non-utility deferral account. Further, the Company proposes that the IPC development costs be included as part of the SCP rate base and that AFUDC, commencing November 1, 2004 and calculated on a monthly basis thereafter, be added to rate base.

“Terasen Gas submits that it is reasonable and fair to customers to recover the IPC development costs, including AFUDC, by placing the costs into the SCP rate base and recovering the costs through the delivery charge, and requests approval of these transactions as described, effective January 1, 2006 (Exhibit B-1, p. 12).”

5.2 Background

Terasen Gas describes the background to the IPC project at page 10 of the Application:

“During the winter of 2000/01, as the North American energy markets went through significant volatility, the capacity constrained Sumas/Huntingdon market experienced unprecedented price increases. As a solution to the unparalleled increase in demand and value for regional pipeline capacity, Terasen Gas began developing the IPC project as a solution to the constrained market place at Sumas/Huntingdon. By connecting back to the Alberta AECO supply hub, IPC also presented benefits to Terasen Gas and other regional participants by providing diversity and security of supply.

The IPC proposal involves the expansion of SCP through construction of additional compressor stations, and a 246 kilometre 24-inch pipeline connecting SCP near Oliver to the Huntingdon hub. The project was expected to cost \$495 million and would add 300-350 MMcfd of additional pipe capacity to the region. A less costly alternative to connect to the Westcoast system at Hope was also assessed, which would allow the project economics to support a smaller 200 MMcfd expansion based on a \$300 million project.

In May of 2001 the Company conducted an Open Season for capacity on the IPC. NWN had been an active supporter of IPC, and made a binding commitment to contract for IPC capacity during the IPC Open Season.

An Application to the Environmental Assessment Office (“EAO”) for a Project Approval Certificate was filed on February 19, 2002, and an extensive consultation process followed over the next 12-13 months. At this time, Terasen Gas is in receipt of a Section 11 Order, and the Supplemental Information Specifications from the EAO office that successfully completes the first phase of the Environmental Review and sets out the process for obtaining the final approvals for IPC.”

“In the first quarter of 2003, development activities on IPC were largely suspended due to the changing market conditions causing in the deferral and /or cancellation of many planned power generation projects and reduction in industrial load in the region.”

In 2002, Terasen Gas (then BC Gas Utility Ltd.) requested Commission approval of several matters related to the SCP. At the same time, Terasen Gas requested approval of activities initiated and managed by Terasen Inc. (then BC Gas Inc.). Specifically, Terasen Gas indicated that by April 2003, \$5.6 million would have been spent on the IPC project, and Terasen Gas requested approval to recover these development and marketing expenditures from Terasen Gas customers in the event the IPC project did not proceed. At that time, by Letter No. L-48-02, the Commission advised that “If the IPC project is deferred substantially, the Commission is prepared to receive and review an application for approval to recover some or all IPC expenditures from Terasen Gas customers based on the value that IPC expenditures have had for customers, including the contribution to the present arrangement with NWN (Exhibit B-1, p. 3).”

In the Application, Terasen Gas states that it recognizes current market conditions are not expected to support new regional capacity in the near term and that it has indefinitely deferred further development of the IPC project.

5.3 The IPC Project

The Application is somewhat confusing with respect to which “Terasen” corporate entity initiated the IPC project and was responsible for the risk associated with its development. The Application intimates that the responsible entity was Terasen Gas. Throughout the IPC section of the Application reference is made to “Terasen Gas”. In this Application, Terasen Gas is defined as Terasen Gas Inc. However, through the Information Request (“IR”) process, it became clear that the project was initiated by Terasen Inc., the un-regulated parent of Terasen Gas Inc., which holds both regulated and non-regulated business interests. Necessary funding for the IPC project was approved by the Executive Committee and the Board of Directors of Terasen Inc. (IR 8.1.4). The open season for capacity on the proposed IPC was conducted by Terasen Inc. (IR 9.1) and environmental approval was applied for by Terasen Inc. (IR 13.1). Terasen Gas indicates nevertheless, that the final ownership structure of the IPC asset had not been made at the time the development activities were taking place (Exhibit B-6; IR 8.1.1).

In response to a Commission IR, Terasen Gas elaborated on the ownership structure:

“While SCP was based mainly on meeting Terasen Gas requirements, IPC is intended mainly to serve regional market demands including those of Terasen Gas. A determination as to the ownership structure that will provide the most competitive tolls for IPC while maintaining or enhancing the value of SCP to existing customers had not been completed. At the time of the IPC application the expectation was that an EAO approval issued in the name of BC Gas Inc. would provide the most flexibility to ensure a competitive ownership structure whether the project became part of the utility or was owned by a separate BC Gas entity (Exhibit B-6, BCUC IR 13.3).”

Westcoast summarized its view of the ownership situation in its comments of August 19, 2005:

“Westcoast would point out that the IPC was not a Terasen Gas project. Rather, the IPC was developed and promoted by Terasen Inc. The project was designed primarily to serve power generators and other customers in the export market (like Northwest Natural) and therefore there was little reason for Terasen Gas to be promoting the project. The environmental approvals for the project were sought by Terasen Inc. (Terasen Gas response to Commission I.R. No. 13) (unlike the SCP environmental approvals that were sought and obtained by Terasen Gas), the open season for the project was conducted by Terasen Inc. (Terasen Gas response to Commission I.R. No. 9.1 and Appendix D) (unlike the SCP open season that was conducted by Terasen Gas), and the contracts for project capacity were in the name of Terasen Inc. (see Schedules to the Terasen Inc. open season documents in Appendix D) (unlike the SCP contracts that were with Terasen Gas). Terasen Gas was, in fact, a prospective contract shipper on the IPC, and therefore could not have been both a shipper and the project proponent” (Exhibit C5-2).

Terasen Gas does not refute these statements. In response to Commission IR 8.1.1 Terasen Gas indicates that “...it was the shareholders of Terasen Inc. that were exposed to the development costs if the project did not proceed and it could not be demonstrated that IPC development activities delivered value to Terasen Gas customers that would not otherwise have been realized.”

Commission Determination

The Commission concurs with this view expressed by Terasen Gas and finds that the development costs for the project, other than those for which Terasen Gas can demonstrate delivered value that otherwise would not have been realized by its customers, must be to the Account of Terasen Inc.

5.4 Value derived through the IPC

Terasen Gas believes that its customers have realized long term direct and indirect benefits as a result of the marketing and development efforts carried out during and related to the IPC project. Specifically, Terasen Gas believes that the development of a legitimate pipeline alternative to serve the region has better positioned Terasen Gas in its dealings with Westcoast, citing the successful negotiation of the Kingsvale South tolls in

2002. Terasen Gas also believes that the agreement with NWN would not likely have been realized if the IPC project had not been under development (Exhibit B-1, pp. 10-11).

The requests that Terasen Gas made to the Commission in 2002 which are referred to in Section 5.2, included a request for approval for the recovery of the IPC Marketing and Development expenses in the event the IPC project did not proceed by 2006. In its response, the Commission indicated that it “is prepared to receive and review an application for approval to recover some or all IPC expenditures from BC Gas customers based on the value that IPC expenditures have had for customers, including the contribution to the present arrangement with NWN” (Letter No. L-48-02, p. 2). It is important to note that Letter No. L-48-02 was issued based on the information provided in the Terasen Gas application at the time and was not the result of a public review or any stakeholder input. It was also issued after almost all of the expenditures on IPC had been made (Exhibit B-6; BCUC IR 10.8.3).

With respect to transportation arrangements with Westcoast, Terasen Gas suggests that the development of IPC prompted Westcoast to respond with its own expansion project, which in turn led to the successful negotiation of the Kingsvale South tolls with Westcoast:

“Terasen Gas submits that these realized savings, to the benefit of all Terasen Gas customers, as well as savings to other Westcoast shippers from the reduction in the Westcoast tolls, would have been more difficult to attain without the development efforts of the IPC project (Exhibit B-1, p. 11).”

In response, Westcoast suggests that there is no linkage or “cause effect” between the IPC project and Westcoast’s expansion project and revision of tolls:

“The open season conducted by Westcoast for T-South capacity in 2001 preceded the IPC open season conducted by Terasen Inc. The development of the Westcoast expansion project, including discussions with expansion shippers, was underway well before the Westcoast T-South open season. The Westcoast open season resulted in contracts for about 200 MMcf/d of expansion capacity with an unprecedented volume weighted average contract term of approximately 27 years.

In short, contrary to Terasen Gas’ assertions, the Westcoast expansion project would have proceeded with or without the IPC proposal and there is no link between the IPC and the agreement that Westcoast negotiated with Terasen Gas for 105 MMcf/d of capacity from Kingsvale to Huntingdon (Exhibit C5-2, p. 5).”

Terasen Gas does not take the position that the IPC project was pivotal or conditional to the negotiation of terms more favorable to Terasen Gas. Rather, it is of the view that terms would have been more difficult to attain without the development efforts of the IPC project.

Letter No. L-48-02 makes specific reference to the “arrangement with NWN.” Terasen Gas’ explanation of this arrangement is as follows:

“Terasen Gas submitted its 2002 Application to the Commission for approval to enter into a set of transactions that effectively allowed the utility to terminate the transportation and peaking service agreements with PG&E and to use the released SCP capacity to provide long term firm transportation to NWN. These arrangements came about as a result of the following events and activities:

- The Company was developing the IPC project as a solution to the constrained market place at Sumas/Huntingdon market area that had resulted in significant price increases and volatility during the winter 2000/01.
- NWN was seeking firm transportation service from Alberta to Huntingdon and had made a firm commitment to contract for transport capacity on the proposed IPC project.
- The parent company of PG&E was in grave financial difficulty (PG&E Corp subsequently entered into bankruptcy protection) and Terasen Gas was seeking to protect the SCP revenue it received from PG&E.”

(Exhibit B-1, p. 5)

Intervenors are not, for the most part, supportive of the recovery of IPC costs as proposed by Terasen Gas. Westcoast did not comment on the specific issue of recovery. However, Westcoast argued that the project was a Terasen Inc. project, not a Terasen Gas project. The Inland Industrials would support cost recovery as long as Midstream customers rather than delivery margin customers bear the cost. Otherwise, the Inland Industrials are opposed to the recovery of IPC costs from ratepayers. The Association takes the position that as Terasen Gas “did not make an application and as it incurred costs without prior approval of the Commission customers should not be burdened with those costs. The regulatory relationship between the customer, the utility and the Commission should not be reduced to a poker game whereby the company gambles with its money without playing by the rules and then expects the customer to fund the losses when things do not go their way” (Exhibit C8-2, p. 2). On the other hand BCOAPO, in these circumstances, accepts the principle of the recovery of IPC expenditures in rates although, as a general principle, it believes the risk associated with such expenditures are properly to the shareholders account.

Terasen Gas believes that the agreement with NWN, along with the resulting significant revenues would not likely have been realized if the IPC project had not been under development. Although this is a possibility, Letter No. L-48-02 states that Terasen Gas had a longstanding business relationship with NWN. The Commission is not persuaded that, as circumstances evolved, an agreement with NWN to utilize SCP capacity on some reasonable timeline and commercial terms was unlikely. As with the Westcoast arrangements, it is

difficult to look back and say with any certainty that contracting arrangements would have been different had the IPC not been a factor at play at the time. Terasen Gas is a sophisticated regulated utility and has demonstrated, in the original contracting of SCP service and the negotiations with Westcoast, astute planning, negotiating and relationship building skills. To attribute today's reality with respect to the arrangement with NWN entirely to the IPC does not give due credit to those organizational strengths.

The record shows that there was considerable market activity leading up to and including the time period when these discussions, negotiations and events between Westcoast and Terasen Gas took place and the **Commission is not persuaded that there is any certainty that without the prospect of the IPC the eventual results would have been different.**

5.5 Commission Determination

The Commission finds that there is little merit to the Terasen Gas submission that IPC contributed to favourable outcomes regarding Westcoast service and tolls.

The Commission is not persuaded that the value in the NWN arrangements results definitively from the IPC project and could not have been negotiated on reasonable commercial terms in some other manner. Therefore it does not accept the argument that all expenses associated with ICP should be recovered from rate payers. No evidence has been advanced to attribute to IPC a defensible portion of any perceived value. Therefore, even if the Panel were to find that some value could be attributable to IPC, the allocation would be entirely arbitrary and without evidentiary support.

For the foregoing reasons, the Commission does not approve Terasen Gas' Application for recovery of IPC development costs.

In the light of this decision, the Commission has not addressed the requests related to of the treatment of AFUDC and the accounting treatment of the recovery of IPC costs.