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LETTER NO. L-10-06

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March 10, 2006

Mr. Scott A. Thomson
VP, Finance & Regulatory &
Chief Financial Officer
Terasen Gas (Squamish) Inc.
16705 Fraser Highway
Surrey, BC V3S 2X7

Dear Mr. Thomson:

Re: Terasen Gas (Squamish) Inc.
Garibaldi/Brackendale Main Extension Review

Role of the Commission/Background

Pursuant to section 3 of the 1992 Squamish Rate Stabilization Agreement ("RSA"), the Commission reviews and reports on the Terasen Gas (Squamish) Inc. ("TG Squamish or "Company") calculation at the end of each fiscal year of the Company's Actual Volume, Cost of Service, Gate Station Toll, and Company's Revenue based on results for the utility as a whole. In most cases, proposals for mains extensions by TG Squamish are reviewed by the Commission with a report issued to the Province which either recommends approval or denial by the Province of the proposal.

By letter dated February 28, 1994, the Commission requested that TG Squamish provide a yearly accounting of the status of the Company's approved mains extensions. Subsequently, the Commission by Letter No. L-46-94 established reporting requirements for TG Squamish mains extensions to compare actual results of construction costs and customer consumption to forecast for each approved extension. Letter No. L-46-94 also recognized that for under-performing extensions a settlement of the draw variance should be made at the end of five years.

On November 17, 1997, TG Squamish applied for approval of the Garibaldi/Brackendale Main Extension ("Application"). In the Application, the Company agreed to take responsibility for increased RSF funding that results from capital costs that are higher than forecast and customer consumption and attachments less than forecast. The Province's approval of the GBMX Application on July 15, 1998 was conditional on a rate floor of \$8.80/GJ and noted that the two factors of construction cost and volume estimate accepted by TG Squamish would be evaluated on a combined basis relative to the Application case. On July 16, 1998, the Commission issued Letter No. L-42-98 with respect to the Province's approval.

TG Squamish filed its Mains Extension Review including GBMX for the years 1999-2002, 2003, and 2004 based on the methodology used for previously approved mains extensions. After the Mains Extension Reviews were filed by TG Squamish, the Commission issued Letter No. L-45-04 for 1999-2002, Letter No. L-46-04 for 2003, and Letter No. L-105-05 for 2004 which confirmed the reported actual RSF impacts of the approved mains extensions.

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Letter No. L-105-05 found that the Garibaldi/Brackendale Main Extension ("GBMX") had significantly underperformed from forecast accumulating a Rate Stabilization Facility ("RSF") draw of $2,003,529 at the end of 2004, instead of the forecast RSF repayment of $93,292. Letter No. L-105-05, in reference to Letter No. L-46-94, noted that if the variance on an RSF payment for an extension exceeds 15 percent, the difference between the actual and forecast RSF payment will be deducted from the RSF draw for the utility. Since GBMX had under-performed, no draw should be allowed for this main extension in the calculation of the actual RSF.

January 25, 2006 Filing

On January 25, 2006, TG Squamish filed a submission requesting that the Commission review its opinion in Letter No. L-105-05 and re-evaluate its assessment of the liability of TG Squamish with respect to the GBMX and provide its confirmation of the Company's current assessment of its cumulative RSF funding obligations to the Province with respect to the GBMX of $655,831 through the end of 2005 ("January 25, 2006 Filing" or "Filing").

In its Filing, the Company referred to three agreements relevant to the Company. Firstly, the Transportation Service Agreement dated April 1, 1990 between TGVI and TG Squamish calculates the transportation toll for the Company. Secondly, the Rate Stabilization Agreement ("RSA") dated July 9, 1992 between the Province and TG Squamish provides that rates paid by customers are set by formula. The Province under the RSA directs the Commission to set the rates to customers of TG Squamish at the Retail Price, which in most cases will be 67 percent of the BC Hydro trailing block for residential service. The RSA provides for a calculation of the Company's cost of service including cost of gas. Terasen Gas (Vancouver Island) Inc. ("TGVI") pays the Company the amount of any deficiencies which arise when the Company's revenue at the Retail Price is less than the cost of service and TGVI collects from the Company any revenue in excess of cost of service on behalf of the Province. Thirdly, the Rate Stabilization Facility Continuation Agreement ("RSFCA") dated December 14, 1995 between the Province and TGVI recognized the necessity of continuing a rate stabilization for TG Squamish after the termination of the previous Binding Agreement. Included in the RSFCA is a Monthly Toll Revenue of $1.05/GJ. The $1.05/GJ Monthly Toll is the responsibility of the Province for payment to TGVI for shipping gas on the TGVI pipeline to TG Squamish.

Company Position

TG Squamish advises that following the Commission's Letter No. L-105-05 issued on December 2, 2005, TG Squamish sought legal advice upon which it has now determined that its previous interpretations, reflected in its Mains Extensions Review filings and annual reports, had been incorrect. The Company acknowledges that it had not previously calculated its obligations in the manner set out in the January 25, 2006 filing but suggests that this is because it had believed that it had to report on mains extensions based upon Commission Letter No. L.46-94. TG Squamish now submits that the provisions of Commission Letter No. L-46-94 are not applicable to the determination of its obligations under the arrangements respecting the GBMX. TG Squamish states that RSF funding occurs under the RSFCA and now suggests that the terms of the RSFCA must be considered to evaluate the extent to which RSF funding has increased.

TG Squamish calculates that the increase in RSF funding as a result of GBMX not achieving forecast customer attachments and volume and increased capital costs, and therefore its liability, is $553,157 at the end of 2004 and estimates a liability of $655,831 at the end of 2005 (Filing, p. 2). In the January 25, 2006 Filing TG Squamish does not believe its obligation is the sum of the $2,003,529 and the $93,292 found in Letter No. L-105-05. Rather the Company suggests that its commitment for increased RSF funding due to higher than forecast construction costs and lower than forecast customer consumption is established in the RSFCA.

TG Squamish explains that because it had applied Letter No. L-46-94, when the variance exceeded 15 percent, it considered that it was obliged to reduce the draw from the Province by the amount of the underperformance of the main extension, as provided in the reporting procedure (Filing, p. 4). TG Squamish now believes the Company's obligation for increased funding should recognize the actual RSF draw that occurs in the RSFCA. TG Squamish submits that the increased RSF funding should be made based on the actual RSF draw in the RSFCA with actual construction costs and volumes compared to the forecast construction costs and volumes. The difference between the two draws results in a GBMX liability of $553,157 at the end of 2004 and an estimated liability of $655,831 at the end of 2005. The TG Squamish calculation includes the $1.05/GJ Monthly Toll transportation charge which is a component in the RSFCA, but explicitly excluded in the RSA under the definition of "Cost of Gas".

The Company explains that the Province funds the shortfalls of actual revenues and approved costs of TG Squamish. Under the RSA, since the actual GBMX attachments and volumes were less than forecast, the Company believes the Province would not have realized the incremental actual margin from the forecast variance of the consumption volumes. In the Company's view, the Province is responsible for revenue shortfalls that are not related to the at-risk components that TG Squamish has accepted when it sought and received approval for GBMX.

Commission View

The Commission must consider whether the GBMX obligation is to be determined on the basis of: 1) the GBMX actual results for the two at-risk factors which are then compared to the GBMX Application only as represented by the $2,003,529 at the end of 2004; 2) the GBMX actual results for the two at-risk factors and its difference from forecast which are compared from the RSA actual results for the utility as represented by the $1,059,462 at the end of 2004; or 3) the GBMX actual results for the two at-risk factors and its difference from forecast which are compared from the RSFCA actual results as represented by the $553,157 at the end of 2004. Method 1 is the calculation methodology as reported in the 2004 Main Extension Review. Methods 2 and 3 were described in detail on pages 6 to 10 of the Filing.

The issue revolves largely around the wording "increased RSF funding" which was not defined in the 1997 Application or approvals and the relevance of Commission Letter No. L-46-94 to the calculation of the GBMX liability.

The Commission considers the TG Squamish calculation of $1,059,462 million liability at the end of 2004 which excludes the $1.05 Monthly Toll is relevant because "increased RSF funding" was not defined. However, the Commission is not persuaded that in regard to the $1.05 Monthly Toll, TG Squamish' obligation is found under the RSFCA but considers that the obligation is found in the RSA. The Commission notes that the RSFCA is a separate agreement between the Province and TGVI.

Further, the Commission notes that TG Squamish has changed its view over the years since the GBMX was first proposed as a project to the view advanced by the Company in its January 25, 2006 Filing. Specifically, the contingent liability disclosure in the 2003 and 2004 TG Squamish Audited Financial Statements refers to a calculation of the utility's GBMX obligation to the Province that is different from its current view. The disclosure estimated by management and approved by the Company's external auditor indicated that GBMX resulted in excess draws of $1,574,102 to the end of 2004. In its 2003 Financial Statements, Note 7, TG Squamish states that under the terms of the RSA, the RSFCA, the GBMX approval Letter No. L-42-98 and "Letter L-46-94 outlining the reporting requirements for the main extensions, the Company is contingently liable for variances in performance on the main extensions where there is variance from forecast performance greater than 15%" (I.R. 1.4.2).

The Commission has conducted its examination by reviewing the January 25, 2006 Filing and requesting information responses from the utility. The Commission does not agree with TG Squamish that its liability was intended to be limited as currently proposed. The Commission does not accept that because Commission Letter No. L-46-94 predates the 1997 Application and approvals and the RSFCA between TGVI and the Province, that it was no longer intended by the parties to apply to this particular main extension. Further, the Commission notes that the calculation methodology of increased RSF draw used by the Company in the Mains Extension Reviews appeared reasonable when compared relative to each approved application case. If the intent were that L-46-94 would no longer apply in this way, this was certainly not made clear in the 1997 Application or approvals, nor the subsequent filings. Nor was it the basis upon which the parties have operated until TG Squamish's January 25, 2006 Filing. The Commission understands TG Squamish's position and suggests that both the previous and current interpretation of the undefined term "increased RSF funding" could have merit. The Commission considers however that the previous interpretation is most supportable in the circumstances.

The Mains Extension Review method calculated a result of approximately $2.0 million at the end of 2004. However, the method using actual RSA cash flows calculated a result of approximately $1.1 million at the end of 2004. Since the phrase "increased RSF funding" is not adequately defined, TG Squamish and the Province should negotiate an amount between these two methods, at the end of 2004 a ceiling of $2.0 million and a floor of $1.1 million. However, the Commission considers that the method for calculating the ceiling figure of $2.0 million to be consistent with the mains extensions review reports filed by the Company over the years and also consistent with the GBMX approval that was sought and given. The new view explained in the January 25, 2006 Filing is not consistent with the Company's previous GBMX reports which did not question the calculation of the GBMX actual excess RSF draws.

Yours truly,

Original signed by:

Constance M. Smith
for: Robert J. Pellatt

cc: Mr. Stirling Bates, Director Regulatory Section
Ministry of Energy, Mines and Petroleum Resources
Mr. Paul Wieringa, A/ Executive Director
Oil and Gas Policy Branch
Ministry of Energy, Mines and Petroleum Resources