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LETTER NO. L-38-07

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VIA E-MAIL
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May 18, 2007

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

Dear Mr. Thomson:

Re: Terasen Gas Inc. ("Terasen Gas")
2007 Price Risk Management Plan (November 2007 – October 2010)

On April 26, 2007, Terasen Gas Inc. ("Terasen Gas") filed its Price Risk Management Plan ("2007 PRMP") Application for the period November 2007 to October 2010. The Commission has reviewed the Application and response to an information request dated May 14, 2007. As a result of that assessment, Terasen Gas is directed to implement the components as identified in the confidential Appendix A (attached).

Yours truly,

Original signed by:

Robert J. Pellatt

RB/dlf
Attachment

Executive Summary

Terasen Gas Inc. (“Terasen Gas”) strives to provide safe, reliable and cost-effective service and value to energy customers within the province. The Price Risk Management Plan (the “PRMP”) is one of the tools that Terasen Gas uses to support this. The primary objectives of the 2007-2010 Price Risk Management Plan (the “Plan”) are to improve the likelihood that natural gas remains competitive with electricity over the term of the Plan, moderate the volatility of market gas prices and resultant rates for customers, and reduce the risk of regional price disconnects. These objectives are unchanged from the 2006-2009 Price Risk Management Plan (the “2006-2009 Plan”). The Plan is designed within the context of the highly volatile natural gas market and includes contingencies for both high and low pricing scenarios. Hedging under the Plan will extend into the period when commodity unbundling for residential customers (“Customer Choice”) commences, effective November 1, 2007, and the Plan has been put together with that in mind. The Plan covers hedging for both the Commodity Cost Reconciliation Account (“CCRA” or “Commodity”) and Midstream Cost Reconciliation Account (“MCRA” or “Midstream”) annual deliveries for Terasen Gas.

Request for Commission Approval

Terasen Gas is seeking approval from the British Columbia Utilities Commission (the “Commission”) to maintain the same objectives as outlined in the 2006-2009 Plan and to continue with a 36 month rolling term. However, with the widening gap between gas and electric prices since the filing of the 2006-2009 Plan, Terasen Gas is recommending minor changes to the Plan in order to satisfy these objectives. With the increase in residential electricity rates effective February 2007, thereby increasing the electric equivalent, Terasen Gas seeks to reduce the amount of hedging for both the winter and summer periods. This also provides some flexibility in the hedging program in future years given the uncertainty around residential customer migration volumes under the commodity unbundling program. Consistent with the 2006-2009 Plan, a balance of fixed price swaps and options within the hedging portfolio is recommended as each instrument performs better under different pricing environments. Terasen Gas is seeking approval to maintain the strategy approved within the 2006-2009 Plan of reducing the amount of hedging and using options exclusively, subject to a maximum limit, in the event gas prices move above the electric equivalent price. In a high priced environment, options play an important role, providing upside price protection while still maintaining downside price participation if prices fall. Should prices fall significantly, Terasen Gas proposes to immediately hedge preset amounts with fixed price swaps in order to take advantage of a potentially short-term low-priced situation. This would require a slight departure from the predefined implementation schedule but provides Terasen Gas with some flexibility to capture pricing opportunities which meet the objectives of the PRMP. This accelerated hedging was introduced in the 2006-2009 Plan and was successful in lowering Terasen Gas' weighted average hedging costs.

Approval for the definition of a hedging term to be expanded to include a period consisting of combined consecutive winter and summer seasons (i.e. one year) is also requested for the purposes of comparison to annual electricity rates when prices are near the electric equivalent; the implementation schedule has been designed to accommodate this.

Terasen Gas recommends that all of the winter Sumas price exposure continue to be hedged with a combination of fixed price and basis swaps. It has become increasingly important to manage this Sumas price exposure given the reduction in market players and deliveries at Sumas in recent years, creating greater potential for price spikes.

As in previous PRMPs, hedges will be implemented according to a predefined implementation schedule, consistent with a dollar cost averaging approach, to manage volatility, credit availability and implementation risk. This schedule extends out 36 months to take advantage of lower prices further out in time and in the interests of price smoothing. The implementation schedule has been reduced to remain consistent with the reduction in the winter and summer hedging targets.

Under commodity unbundling for residential and commercial customers, Terasen Gas will continue to offer customers a supply option and, as such, the rate stabilization and quarterly gas cost flow-through mechanisms will continue as well as the primary objectives of the PRMP. These mechanisms and objectives are key in protecting existing customers and positioning natural gas as a competitive energy source in the future. While the Plan has been designed to reduce the probability of the occurrence of stranded costs or benefits, Terasen Gas supports transferring any stranded costs or benefits from the CCRA to the MCRA, which will then be recovered from all sales customers. This is consistent with the Commission's decision regarding the Commodity Unbundling Project for Residential Customers Certificate of Public Convenience and Necessity Application.

The volumes available for hedging, net of forecasted unbundling migration, are 281 TJ per day for November 2007 to March 2008 and 271 TJ per day for April 2008 to October 2008. The Plan has been designed around these hedgeable volumes and includes contingencies should they differ significantly from the forecast.