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**VIA E-MAIL**

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December 10, 2007

Mr. Scott Thomson  
Vice President, Finance and Regulatory Affairs  
Terasen Gas Inc.  
16705 Fraser Highway  
Surrey, BC V4N 0E8

Dear Mr. Thomson:

Re: Terasen Gas Inc.  
2007 Annual Review,  
2008 Revenue Requirements and Delivery Rates

Pursuant to the November 13, 2007 Annual Review, enclosed is Commission Order No. G-153-07 with Reasons for Decision.

Yours truly,

*Original signed by:*

Erica M. Hamilton

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Enclosure

cc: Registered Intervenors/Interested Parties

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**BRITISH COLUMBIA  
UTILITIES COMMISSION**

**ORDER  
NUMBER** G-153-07

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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 2008 Revenue Requirements and Delivery Rates**

**BEFORE:** L.F. Kelsey, Commissioner  
P.E. Vivian, Commissioner December 10, 2007

**O R D E R**

**WHEREAS:**

- A. Commission Order No. G-51-03 approved for Terasen Gas Inc. ("TGI" or "Company"), the Settlement Agreement for a 2004-2007 Multi-Year Performance-Based Rate Plan ("the Settlement"). Subsequently, Commission Order No. G-33-07 approved the two-year extension of the Settlement for 2008 and 2009; and
- B. The Commission, by Order No. G-112-07 dated September 20, 2007, set out the Regulatory Timetable for the TGI filing of its 2007 Annual Review Material, information requests, responses, the 2007 Annual Review, undertaking responses from TGI, Participant Comments, and TGI Reply Comments; and
- C. On October 5, 2007 TGI filed the Annual Review Advance Materials ("Advance Materials") in accordance with the regulatory timetable established by Order No. G-112-07 ("the Application"); and
- D. On October 15, 2007 TGI filed an errata to Section A-3 and Section A-4 of the October 5, 2007 Advance Materials filing. On November 2, 2007, TGI filed three revisions to the October 5, 2007 Advance Materials filing including updated financial schedules ("Amended Application"). Also, on November 2, 2007, TGI filed its responses to information requests; and
- E. The 2007 Annual Review was held on November 13, 2007. The TGI 2007 Annual Review was held jointly with the Terasen Gas (Vancouver Island) Inc. ("TGVI") 2007 Settlement Update Meeting. Subsequently, TGI provided a response to undertakings ("Undertakings Submission") on November 19, 2007 responding to issues raised in the Annual Review; and
- F. The BC Old Age Pensioners Organization et al. submitted Comments on November 27, 2007 in accordance with the Regulatory Timetable; and

**BRITISH COLUMBIA  
UTILITIES COMMISSION**

**ORDER  
NUMBER** G-153-07

2

- G. On November 30, 2007, TGVI provided its Reply Comments. With its Reply Comments, TGI revised its Amended Application to update the 2008 return on equity ("ROE") for TGI to 8.62 percent in response to the Commission setting the benchmark ROE at 8.62 percent pursuant to Commission Letter No. L-93-07, include a revision to the Wheeling Agreement revenue from TGVI pursuant to Order No. G-139-07, revise the forecast for CPI (BC), and apply for approval of its 2008 Revenue Requirements ("the Revised Application"); and
- H. The Revised Application requests approval effective January 1, 2008, to increase the delivery rates for customers, on an permanent basis, by 1.89 percent; and
- I. On December 6, 2007, the Commission issued its Decision on the TGVI and TGI System Extension and Customer Connection Policies Review ("Review") accompanied by Order No. G-152-07. TGI in its Review proposed changes to the Service Line Installation fees ("SLIF") and Service Line Cost Allowance ("SLCA"). TGI proposes to defer the value of the cost of service associated with the approved changes by crediting a deferral account and amortizing it in the following year; and
- J. The Commission has reviewed the Revised Application and the Comments received.

**NOW THEREFORE** pursuant to Sections 58, 60 and 61 of the Utilities Commission Act, the Commission orders for TGI with Reasons for Decision attached as Appendix A to this Order:

- 1. The Commission approves the increase of applicable charges for customers served under Rate Schedules 1, 1S, 2, 2U, 3, 3U, 4, 5, 6, 7, 22, 22A, 22B, 23, 25, and 27 effective January 1, 2008, as provided in the Revised Application, subject to any amendment in the Reasons attached as Appendix A to this Order.
- 2. The Commission approves the Earnings Sharing Mechanism rider for customers served under Rate Schedules 1, 1S, 2, 2U, 3, 3U, 4, 5, 6, 7, 22, 22A, 22B, 23, 25, and 27 effective January 1, 2008, ranging from (\$0.130)/GJ for customers served under Rate Schedule 1 to (\$0.006)/GJ for those served under Rate Schedule 22B.
- 3. The Commission approves the \$0.05/GJ decrease in the Rate Stabilization Adjustment Mechanism rider from the currently approved level of \$0.145/GJ to \$0.095/GJ, effective January 1, 2008.
- 4. The Commission approves the continuation of the rate base deferral account established for the ongoing Provincial Sales Tax appeal related to the Southern Crossing Pipeline project.
- 5. The Commission approves the establishment of a rate base deferral account to record any differences to be amortized in the following year.

**BRITISH COLUMBIA  
UTILITIES COMMISSION**

**ORDER  
NUMBER** G-153-07

3

6. The Commission approves the establishment of a rate base deferral account to record cost of service reductions related to the timing of the Lochburn land sale.
7. The Commission approves the request for TGI to follow Section 3061.04 of the CICA Handbook revision that will result in a reclassification in TGI's financial statements between inventory and property, plant and equipment for pipe, valves, fittings and other items that would ultimately be used for gas plant in service, whereby these costs will be transferred to Plant Work in Process ("WIP") in the financial statements, effective January 1, 2009, as described in the Advance Materials.
8. The Commission will accept, subject to timely filing, amended Gas Tariff rate schedules and full supporting regulatory financial schedules in accordance with the terms of this Order.
9. TGI is to inform all affected customers of the final rates by way of a bill insert or customer notice, to be submitted to the Commission in draft form prior to its release.
10. TGI will comply with all other directions in the Reasons for Decision attached as Appendix A to this Order.

**DATED** at the City of Vancouver, in the Province of British Columbia, this 10<sup>th</sup> day of December 2007.

BY ORDER

*Original signed by:*

L.F. Kelsey  
Commissioner

Attachment

An Application by Terasen Gas Inc.  
for Approval of 2008 Revenue Requirements and Delivery Rates

**REASONS FOR DECISION**

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**1.0 INTRODUCTION**

**1.1 The Application**

By Commission Order No. G-51-03, the Commission approved the 2004-2007 Multi-Year Performance Based Rate Settlement (“Settlement”) for Terasen Gas Inc. (“TGI” or “Company”). Subsequently, Commission Order No. G-33-07 approved the two-year extension of the Settlement for 2008 and 2009.

Commission Order No. G-112-07 approved the regulatory timetable for TGI to hold the Annual Review on November 13, 2007 and directed TGI to file advance material by October 5, 2007.

On October 5, 2007 TGI filed Annual Review Advance Materials (“Advance Materials”) in accordance with the regulatory timetable established by Order No. G-112-07 (“the Application”). On October 15, 2007 TGI filed an errata to Section A-3 and Section A-4 of the October 5, 2007 Advance Materials filing. On November 2, 2007 TGI filed three revisions to the October 5, 2007 Advance Materials filing (“Amended Application”). Also, on November 2, 2007 TGI filed its responses to information requests.

The 2007 Annual Review was held on November 13, 2007. The TGI 2007 Annual Review was held jointly with the Terasen Gas (Vancouver Island) Inc. (“TGVI”) 2007 Settlement Update Meeting. Subsequently, TGI provided a response to undertakings (“Undertakings Submission”) on November 19, 2007 responding to issues raised in the Annual Review.

The BC Old Age Pensioners Organization et al. (“BCOAPO”) submitted its Comments on November 25, 2007 in accordance with the Regulatory Timetable.

On November 30, 2007, TGI provided its Reply Comments. With its Reply Comments, TGI revised its Amended Application to update the 2008 return on equity (“ROE”) for TGI to 8.62 percent in response to the Commission setting the benchmark ROE at 8.62 percent pursuant to Commission Letter No. L-93-07, include a revision to the Wheeling Agreement revenue from TGVI pursuant to Order No. G-139-07, revise the forecast for the British Columbia Consumer Price Index (“CPI (BC)”), and apply for approval of its 2008 Revenue Requirements (“the Revised Application”). The Revised Application requests Commission approval to increase, effective January 1, 2008, the applicable charges in its rate schedules by 1.89 percent to eliminate the anticipated revenue deficiency of \$9.377 million.

The Undertakings Submission and other issues are addressed in the following section.

## 2.0 ISSUES

### 2.1 Inflation CPI (BC) Adjustment

On October 5, 2007 TGI, as part of its Annual Review Advance Materials, provided in Section A-2, page 2, Note 3 the CPI (BC) forecast for 2008 as calculated from the approved sources per Order No. G-33-07, at an average rate of 2.1 percent. The CPI (BC) forecast of 2.1 percent represented the average of the forecasts below:

Conference Board of Canada	1.9%	(July 2007)
B.C. Ministry of Finance	2.0%	(February 2007)
RBC Financial Group	2.3%	(June 2007)
Toronto-Dominion Bank	2.0%	(May 2007)
Average	2.1%	

At the Annual Review meeting, TGI was asked whether or not it was appropriate to update the CPI (BC) forecasts to reflect the most recent updates provided by RBC Financial Group in October 2007. TGI notes that it has also received an update to the Toronto-Dominion Bank forecast dated October 22, 2007. The combined average of the four CPI (BC) forecasts is 2.0 percent, as shown below:

Conference Board of Canada	1.9%	(July 2007)
B.C. Ministry of Finance	2.0%	(February 2007)
RBC Financial Group	2.1%	(October 2007)
Toronto-Dominion Bank	1.9%	(October 2007)
Average	2.0%	

The relevant term of the Settlement Agreement for a 2004-2007 Multi-Year Performance Based Rate Plan and the two-year extension of the Settlement agreement states that the CPI (BC) will be set prospectively and not modified to reflect actual CPI (BC) and the Annual Review will update the inflation forecast for the upcoming year.

In its Undertaking Submission, TGI states it has reviewed the practice that was followed for the 2003-2006 Annual Reviews. For each of the years 2004-2008 the Company provided the most recent forecasts of CPI (BC) at the time of the Annual Review Advance Material filing. TGI notes that if the practice was followed some year's revisions of CPI (BC) would have increased while other years would have lowered.

TGI states that this is a change from past practice and will negatively impact the Company. TGI is prepared to adjust the CPI (BC) rate to 2.0 percent, which would be reflected in the revised filing on November 30, 2007 so long as this practice is followed consistently. TGI calculates the CPI (BC) change will reduce revenue requirements by approximately \$57,000. On November 30, 2007, TGI filed its Revised Application including the revised CPI (BC) of 2.0 percent.

**The Commission finds that the CPI (BC) forecast used for setting rates should be based on the most up-to-date information. The Commission accepts that the CPI (BC) forecast should be updated to 2.0 percent for 2008. The Commission directs that for setting rates in future years TGI is to update the CPI (BC) for forecasts published up to and including the Annual Review meeting date.**

## 2.2 Expected Reduction in Federal Corporate Income Tax Rate in 2008

TGI forecasts a combined federal/provincial income tax rate in 2008 of 32.5 percent. On October 30, 2007 the Federal Government issued an Economic Statement that included reducing the general federal corporate income tax rate by a further 1 percentage point in 2008 beyond already-scheduled reductions, to bring the rate to 19.5 percent in 2008. Subsequently, on October 31, 2007 the economic statement survived a confidence vote in the House of Commons. At this time the legislation has been read the second time in the House of Commons and referred to the Standing Committee on Finance, which has issued its second report without amendment.

At the Annual Review, TGI was asked whether or not it was appropriate to update the net effective tax rate for 2008 from the filing rate of 32.5 percent to the prospective tax rate of 31.5 percent.

In its Undertakings Submissions TGI believes that it has taken a conservative approach in using the 32.5 percent. TGI cites Canadian Institute of Chartered Accountants Handbook (“CICA Handbook”) Section 3465, relating to the actual accounting for tax liabilities of the CICA Handbook as providing some guidance. The Company is of the view that a minority government may not represent persuasive evidence of its ability to enact the proposed changes and believes it prudent to err on the side of conservatism and wait until the requisite legislation had been enacted so that it can assess the full impact of the tax rate change.

TGI also states regardless of when the Company includes a tax rate change in its material, the benefit of lower tax rates will flow through to customers via the existing deferral mechanism to account for any timing and revenue requirement differences. TGI calculates the proposed 1 percent tax rate reduction when in effect, would result in a revenue requirement decrease for 2008 of approximately \$1.18 million.

The Commission notes that regarding the FortisBC Inc. 2008 Revenue Requirements for setting 2008 rates, the Commission approved the Modified Settlement Agreement (Order No. G-147-07) that included the further 1 percent reduction in the corporate income tax rate, effective January 1, 2008 with deferral account recovery and to flow it into rates in the following year if the tax reduction is not enacted.

The Commission finds that the announced income tax change is probable and that it is reasonable to include the tax change for setting 2008 rates given the current stage of the legislative approval process and status of the minority government. **TGI is directed to use the prospective tax rate of 31.5 percent in setting 2008 rates. In the event that enabling legislation is not passed and the tax rate change is not effective on January 1, 2008, the difference in tax rates is to be recorded in a deferral account and fully amortized in the following year.**

## 2.3 Departure from the Uniform System of Accounts for O&M

TGI requests approval to depart from using a portion of the Uniform System of Accounts for recording its O&M in Accounts 600 to 999 and to prepare reports using the New Code of Accounts, providing both a resource-based view and an activity-view, as included in the Annual Review Material filing in Section A-5 O&M Expense and Attachment A-5. In April 2007 TGI filed its Annual Report to the Commission for the year ended December 31, 2006 using the New Code of Accounts, providing both a resource-based view and an activity view. The proposed reporting allows costs to be easily compared year over year regardless of organization structure and that once approved TGI, Terasen Gas (Whistler) Inc. and TGI will report their O&M in this consistent manner going forward.

On September 20, 2007, the Commission issued a letter detailing the progress and proposed reporting format (included as Attachment A-5 in the Advance Materials) from the working group wherein the Commission requested Intervenor comments on the working group findings and results by September 27, 2007. No comments were received from Intervenors.

**The Commission approves the TGI request to depart from using a portion of the Uniform System of Accounts for recording its O&M in Accounts 600 to 999 and to prepare reports using the New Code of Accounts, providing both a resource-based view and an activity-view. The Commission accepts that the New Code of Accounts is to provide consistent and informative reporting similar to the Commission's Uniform System of Accounts for Gas Utilities. Also, TGI is to request Commission approval for revisions to the New Code of Accounts. A revision may be due to an accounting rules change or operational change that necessitates a change to the New Code of Accounts. Changes to the New Code of Accounts for clarity does not need approval but should be reported to the Commission.**

## **2.4 2008 Return on Equity**

TGI in its Revised Application filed on November 30, 2007 describes the detailed updated application stating the materials included in Tab 1 reflect the 2008 ROE of 8.62 percent as confirmed by Commission Letter L-93-07, and common equity component of 35.01227% in the calculation of the 2008 revenue requirement.

In Appendix A to Order No. G-160-06 the Reasons for Decision on page 5 states:

**“In accordance with Special Direction No. 3, the Commission approves for the amalgamated TGI and TGS the following:**

- **A common equity component of 35.01 percent, effective January 1, 2007.** The Commission considers that an equity component rounded to the nearest two decimal places is sufficient for TGI rate setting.
- **A return on common equity of 8.37 percent, effective January 1, 2007.** The unrounded ROE of 8.37131 percent is rounded to the nearest two decimal places in accordance with Commission Order No. G-109-01.”

**As directed in Commission Order No. G-160-06 TGI is to set the common equity component at 35.01 percent. The Commission approves for TGI in setting 2008 rates an ROE of 8.62 percent and a common equity component of 35.01 percent; both percentage rates are to be rounded to the nearest two decimal places.**

## **2.5 Wheeling Agreement**

The Commission issued Order No. G-139-07 approving the Long Term Service Agreements between TGVI and BC Hydro and Power Authority (“BC Hydro”), the Peaking Agreement between TGVI and BC Hydro, and the Capacity Assignment Agreement between TGVI, BC Hydro and TGI subject to certain conditions being met. One of these conditions requires TGVI and TGI to file by December 15, 2007 for Commission approval an agreement that amends the Wheeling Agreement between the two parties effective January 1, 2008. On

November 23, 2007, TGI and TGVI filed for Commission approval, an Amending Agreement to the Wheeling Agreement in accordance with Order No G-139-07. The Commission by Order No. G-149-07 approved the amended agreements. The Amending Agreement results in a reduction in revenue that TGI receives from TGVI in 2008 by \$900,000. TGI has incorporated the changes in the Revised Application filed on November 30, 2007.

## **2.6 CICA Handbook Changes – Estimate of Rate Impact for Changes in Canadian GAAP Related to Future Income Tax Liability**

In its Undertakings Submission, TGI explains it is not contemplating that the changes to Canadian Generally Accepted Accounting Principles (“GAAP”) that will be effective January 1, 2009 will require recovery of future income taxes in rates. TGI submits it will require, for financial statement purposes, an entry to be made to record a future income tax liability and an offsetting rate regulated asset. TGI notes that when International Reporting Standards comes into effect there is a possibility that, for financial statement purposes, the offsetting rate regulated asset would not qualify for recognition.

The Canadian Accounting Standards Board in August 2007 indicated that it would amend Section 3465 of the CICA Handbook to require the recognition of future income tax liabilities and assets as well as a separate regulatory asset or liability for the amount of future income taxes expected to be included in future rates and recovered from or paid to future customers.

The Commission notes that in order for an offsetting rate regulated asset to be created a Commission directive would be required that would allow for future income taxes to be recovered in future rates. **TGI is to file by June 30, 2008, a report on the accounting change impact to its financial statements presentation for 2009, the CICA Handbook guidance for future income tax recognition in 2009, any guidance from other acceptable sources of GAAP, impact on net-of-tax accounting resulting from the accounting change, and the impact, if any, to the regulated schedules and rates resulting from the CICA Handbook changes for regulated operations, plus any other pertinent details. The report should provide the regulatory options for the utility such as setting rates fully complying with the CICA Handbook, partially complying with the CICA Handbook, and seeking a variance from the CICA Handbook.** If and when setting rates that include deferred income tax, the options may include setting rates using normalized taxes for the current portion of the deferred income tax and amortizing or not amortizing the past accumulated deferred income tax balance into rates.

## **2.7 Inventory and Property, Plant and Equipment**

Commission Information Request No. 1 Question 12.7 asked when was the last time TGI conducted a comprehensive inventory and property, plant and equipment audit to verify the plant assets to the plant sub-ledger. In the information response TGI states that no special purpose audits of the inventory and property, plant and equipment (“PP&E”) records have been performed in the last 10 years. At the Annual Review, TGI committed to an undertaking regarding inventory and PP&E audits. The Submissions Undertaking states that TGI’s annual inventory count and obsolescence provision are reviewed and tested by the external auditors as part of their procedures. TGI submits that the review and test of the Company’s internal controls by its external auditors and the verification of assets and inventory on a test basis provide substantial assurance that assets are being recorded properly and adequately safeguarded. TGI explains in the Undertakings Submission that a comprehensive physical plant validation by the Company’s external auditors would be prohibitively costly.

Commission Information Request No. 1 Question 12.8 asked if the Company has a robust plant inventory system to perform actuarial data analysis for a depreciation study rather than relying on simulated plant records. The response from TGI states the asset sub-ledger has the asset acquisitions and retirements recorded by year, providing the ability to analyze the data and prepare detailed depreciation studies. The Commission is encouraged that TGI has the financial system in place to perform detailed depreciation studies. However, the Commission notes that TGI should have a robust plant inventory system to perform actuarial data analysis that provides meaningful results since the analysis is dependent on the quality of recordkeeping.

BCOAPO in its Comments notes that there has been no comprehensive audit of TGI's inventory and PP&E in the past 10 years.

The Commission acknowledges that an audit by the Company's external auditors for physical plant validation is prohibitively costly. However, the implementation of internal controls to conduct audits of inventory and PP&E can be performed on an ongoing program cycle basis by the asset's custodians or plant accounting department. The Commission in regards to inventory and PP&E would like further information on how TGI's audit framework incorporates risk based and cyclical audits, control assessments, and how the internal audit function independently evaluates the effectiveness of these internal controls including policies and procedures on an ongoing basis. Proper recording of assets is important since rate base composed primarily of plant assets is a significant factor in setting rates.

The Commission notes the importance of a company's internal controls and its effect on substantive procedures for regulatory reporting. The internal controls include the following:

- Controls to ensure that fixed asset additions are properly authorized and recorded.
- Controls to ensure that all fixed asset sold or retired are properly approved and recorded.
- Controls to ensure that fixed assets included in the accounts are still in existence.
- Controls to ensure that depreciation is properly determined and recorded.

**The Commission directs the TGI Internal Auditor to independently evaluate the effectiveness of the Company's inventory and PP&E internal controls, including physical plant validation, and provide a detailed report within four months of the 2007 fiscal year end to be included in the Annual Report to the Commission. Specifically, the report should include the inventory and PP&E external audit, internal audit, and departmental/operation work plans that are in place for the recording, identifying, and safeguarding of assets. Also, the report should explain the policies and procedures in place and assess their effectiveness as controls. The purpose of the report is to assess the adequacy of internal controls for regulatory reporting of assets.**

## **2.8 Extension of Settlement Agreement beyond December 31, 2009**

In its Comments BCOAPO states that its main concern is not with the current filing but rather that the Settlement Agreement not be extended beyond December 31, 2009. BCOAPO submits that rates effective for January 2010 should be set pursuant to a comprehensive cost of service filing for a 2010 test year that would recognize the actual lower O&M costs that TGI expects to incur, review of the allocation of shared services between TGI and TGVI, and suitable updates of cost of service items.

TGI in its Reply Comments states that while TGI has made no application to extend the current extended settlement beyond 2009, a question regarding this possibility was raised by stakeholders at the Customer Advisory Council meeting held on October 16, 2007 and again by stakeholders at the Annual Review. The Company plans to discuss the possibility of an extension of the extended settlement with stakeholders in the first quarter of 2008 and will determine at that time whether there is sufficient stakeholder interest in convening a workshop on this matter.