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**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER** G-138-10

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

and

Terasen Gas (Whistler) Inc.
2010-2011 Revenue Requirements and Rates Application

BEFORE: A.W.K. Anderson, Commissioner
A.J. Pullman, Commissioner September 1, 2010
P.E. Vivian, Commissioner

O R D E R

WHEREAS:

- A. On November 9, 2009 Terasen Gas (Whistler) Inc. (TGW) applied to the British Columbia Utilities Commission (Commission) for approval of its 2010-2011 Revenue Requirements and Rates Application (the Application) to amend its rates, effective January 1, 2010, pursuant to sections 58, 60, 61 and 89 of the *Utilities Commission Act* (the Act);
- B. By Order G-136-09 dated November 19, 2009, as amended by Order G-136-09A dated December 15, 2009, the Commission approved interim refundable rates for TGW effective January 1, 2010;
- C. On December 16, 2009, the Commission issued Order G-158-09 fixing the return on equity (ROE) of Terasen Gas Inc. (TGI) at 9.5 percent effective July 1, 2009 and TGW's ROE at 50 basis points above that of TGI;
- D. On December 23, 2009 TGW filed certain amendments to the Application which included amendments to the approvals sought in the Application (the amendments together with the Application, now collectively the Application). In the Application, TGW proposes to unbundle the 2010-2011 tariff rate for General Service Rate (SGS) into the following components:
 - i. A Basic Charge per Month of \$7.50 effective January 1, 2010;
 - ii. A Delivery Charge per gigajoule of \$11.610 commencing January 1, 2010 and \$10.735 commencing January 1, 2011;
 - iii. A Gas Cost Recovery Charge per gigajoule of \$6.691 (to be reset quarterly after Commission review of the Quarterly Gas Cost Reports) and a Rate Rider "A" of \$1.817 per gigajoule, subject to quarterly review and resetting, as appropriate both effective January 1, 2010; and
 - iv. A Minimum Monthly Charge of \$7.50.

The proposed unbundled tariff rates represent an approximate 13.5 percent decrease in total tariff in 2010 as compared to 2009. A further 2.9 percent decrease is proposed for 2011. These decreases are before considering the total tariff impact resulting from any Commission-approved quarterly adjustments to the Gas Cost Recovery Charge and ROE adjustments required under Commission Order G-158-09;

- E. TGW further proposes to establish a gas cost deferral account and gas cost recovery rate setting methodology on a basis consistent with the TGI commodity and midstream cost recovery mechanisms, effective January 1, 2010, and proposes that the December 31, 2009 closing balance in the TGW Gas Cost Reconciliation Account be amortized over the two year test period;
- F. TGW further proposes to change the cost sharing formula as it relates to costs associated with the Aerial Crossings for the natural gas pipeline lateral by reducing the Base Incentives amounts and increasing the amount of the costs to be recovered through a deferral account to be amortized over 50 years;
- G. Pursuant to the terms of Order G-53-06 dated May 19, 2006, as amended by Order G-76-06 dated June 26, 2006, TGW agreed, as a condition to receiving a Certificate of Public Convenience and Necessity for its Whistler Natural Gas Conversion Project (Conversion Project), to a cost cap for that project of \$6.01 million and now seeks to include actual project costs of \$11.87 million in rate base and to a cost sharing formula establishing a cost cap for the Intermediate Pressure Pipeline Project (IP Pipeline Project or Pipeline);
- H. By Order G-32-10 dated February 26, 2010, the Commission established a process for the review of the Application which provided in part for a written hearing and in part, for an oral public hearing limited to the issues concerning the Conversion Project and proposed changes to the cost sharing formula with Aerial Crossings for the natural gas pipeline lateral and proposals to reduce the Base Incentives amounts and recalculate the amount of the Capital Contribution;
- I. The oral public hearing took place in Vancouver on March 24-25, 2010;
- J. Following receipt of written arguments and reply, by letter dated May 20, 2010, the Commission established an Oral Phase of Argument to address issues with respect to the Commission's jurisdiction to impose and enforce the cost cap mechanisms;
- K. The Oral Phase of Argument took place in Vancouver on June 8, 2010; and
- L. The Commission has reviewed and considered the Application, the evidence and the submissions and has determined that, with some modifications including a reduction in the Conversion Project costs, the Application should be approved.

NOW THEREFORE pursuant to sections 58, 60, 61 and 89 of the Act, the Commission Orders, with Reasons for Decision to follow, that:

- 1. The Application, including the unbundled rate decrease of approximately 13.5 percent in 2010 and a further 2.9 percent in 2011, adjusted to reflect any Commission-approved quarterly adjustments to the Gas Cost Recovery Charge and ROE adjustments required under Commission Order G-158-09, is approved, subject to the directions which follow:
 - (a) TGW shall adopt International Financial Reporting Standards for regulatory purposes at the same time as such standards have been adopted for financial accounting purposes;
 - (b) TGW shall establish separate sub-accounts to specifically track Harmonized Sales Tax adjustments related to Operations and Maintenance and capital items;
 - (c) TGW shall apply an overhead capitalization rate of 14 percent in 2010 and 2011;

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- (d) TGW shall not include a provision for negative salvage in computing depreciation charges for 2010 or 2011 and, in place of that provision, shall record an estimate of actual removal costs incurred in each of those years; and
- (e) The costs related to the Conversion Project to be included in rate base for recovery from customers shall be limited to \$11.03 million.
2. The order sought with respect of the Pipeline component to change the sharing formula as it pertains to costs associated with the Aerial Crossings for the natural gas pipeline lateral, as described in Tab 13 of the Application is approved. TGW is to advise the Commission within 10 working days when the costs for the Pipeline component are finalized and the impact on rates are determined.
 3. TGW is to calculate revised interim rates and to submit, in a compliance filing, amended financial schedules including the spreadsheet model in accordance with the directives in this Order, on or before October 15, 2010. These amended financial schedules should reflect the Commission's Decision on the 2010 and 2011 revenue requirement.
 4. The revised interim rates for TGW will remain in effect until all Pipeline component costs are finalized or until addressed by further order of the Commission.
 5. If there are any differences between the 2010 interim and permanent delivery rates that are determined by the application of this Order or by the Commission following final disposition of the outstanding Pipeline costs or upon the issuance of a further order making rates permanent, those amounts are subject to refund/recovery, with interest at the average prime rate of TGW's principal bank, as soon as practicable, in the manner as set out by a Commission Order that establishes permanent rates.
 6. TGW will comply with all other directives in the Reasons for Decision.

DATED at the City of Vancouver, in the Province of British Columbia, this *First* day of September 2010.

BY ORDER

Original signed by:

A.W.K. Anderson
Panel Chair/Commissioner



IN THE MATTER OF

TERASEN GAS (WHISTLER) INC.

2010 - 2011 REVENUE REQUIREMENTS

**REASONS FOR DECISION
FOR ORDER G-138-10**

October 25, 2010

BEFORE:

A.W.K. Anderson, Panel Chair / Commissioner
A.J. Pullman, Commissioner
P.E. Vivian, Commissioner

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Commission Order G-138-10 is attached for the reader's convenience.

1.0 INTRODUCTION

On September 1, 2010, the British Columbia Utilities Commission (Commission) issued Order G-138-10 with respect to an application by Terasen Gas (Whistler) Inc. (TGW), with Reasons to follow. These are the Reasons, excepting those that relate to the Whistler Natural Gas Intermediate Pressure Pipeline Project (Pipeline project). Those Reasons are set out in the Confidential Reasons for Decision for Order G-138-10 Paragraph 2 issued concurrently with these Reasons. Section 5.2 of these Reasons explains why the Commission Panel is issuing Confidential Reasons on the relief sought in relation to the Pipeline project.

1.1 Overview of Application

On November 9, 2009, TGW applied to the Commission for approval of its 2010-2011 Revenue Requirements and Rates Application (the Application) to amend its rates, effective January 1, 2010, pursuant to sections 58, 60, 61 and 89 of the *Utilities Commission Act* (the Act). On December 23, 2009, TGW filed amendments, including changes to the approvals sought in the Application (the amendments, together with the Application, now collectively the Application).

TGW proposes to unbundle the 2010-2011 tariff rate for General Service Rate (SGS) into the following components:

- i) A Basic Charge per Month of \$7.50 effective January 1, 2010 for 2010 and 2011;
- ii) A Delivery Charge per gigajoule of \$11.610 commencing January 1, 2010 and \$10.735 commencing January 1, 2011;
- iii) A Gas Cost Recovery Charge per gigajoule of \$6.691 (to be reset quarterly after Commission review of the Quarterly Gas Cost Reports) and a Rate Rider "A" of \$1.817 per gigajoule, subject to quarterly review and resetting as appropriate, both effective January 1, 2010; and
- iv) A Minimum Monthly Charge of \$7.50.

The proposed unbundled tariff rates result in a decrease of approximately 13.5 percent of total tariff revenue in 2010 as compared to 2009. A further 2.9 percent decrease is proposed for 2011. These decreases are before considering the impact resulting from any Commission-approved quarterly adjustments to the Gas Cost Recovery Charge and Return on Equity (ROE) adjustments required under Commission Order G-158-09.

The Application also seeks, among other things, approval for:

- i) inclusion in TGW's rate base of the costs of converting the Whistler propane distribution system to natural gas (Conversion costs) in the amount of \$11.87 million, \$5.86 million in excess of the maximum Conversion costs approved by the Commission in Orders C-03-06 and G-53-06 (Exhibit B-1, p. 55);
- ii) amendments relating to certain Pipeline project costs (Application, Confidential Tab 13); and
- iii) changes to certain accounting treatments and to harmonize the General Terms and Conditions

of TGW's Tariff and Special Rates Schedule with those of its sister companies, Terasen Gas Inc. (TGI) and Terasen Gas (Vancouver Island) Inc. (TGVI).

1.2 Background of Conversion and Pipeline Project Approval

By Order C-3-06 dated June 27, 2006, the Commission approved a Certificate of Public Convenience and Necessity (CPCN) for TGW's application to convert its Whistler propane system to natural gas (Conversion project) and for the Pipeline project. Under the Commission approval granted, TGVI would construct and ultimately own the Pipeline, and TGW would contribute funding for the Pipeline project. The approvals were subject to conditions described in Commission Order G-53-06 and the accompanying Reasons for Decision, as amended by Commission Order G-76-06 (Orders). The Orders limited the costs eligible for inclusion in rate base and recovery from ratepayers to \$6.01 million for the Conversion project and to an amount determined by formulae for the Pipeline project (cost caps). Expenditures in excess of the cost caps were to be shared equally by TGW's shareholders and ratepayers.

2.0 ELEMENTS OF PROPOSED RATES

TGW seeks approval for a number of elements used to forecast of 2010 and 2011 customer rates. Key elements are discussed below.

2.1 Gas Sales and Transportation Demand

TGW forecasts energy demand for 2010 and 2011 to be 759 and 764 terajoules (TJ), respectively (Exhibit B-1-2, p. 2) based on forecast customer additions and average use per customer. (Exhibit B-1, p. 13)

2.1.1 Forecast Customer Additions

TGW's amended forecast for net customer additions in 2010 and 2011 is 36 and 39, respectively. TGW states that this represents a decrease from 2009 additions due to the end of the influence of the 2010 Winter Olympics. (Exhibit B-1, p. 16 as amended by Exhibit B-1-2, p. 2)

Neither British Columbia Old Age Pensioner's Organization (BCOAPO) nor the Commercial Energy Consumer's Association of British Columbia (CEC) disagreed with TGW's forecast of customer additions. The Regional Municipality of Whistler (RMOW) did not comment on this matter.

The Commission Panel accepts TGW's forecast of customer additions as reasonable.

2.1.2 Forecast Average Use Per Customer

TGW's forecast of average use per customer for the test period is based on the average use per customer in the three years ended on December 31, 2008. (Exhibit B-1, p. 17) TGW submits that it is not aware of factors that would dramatically alter the most recent three year averages. (TGW Argument, p. 5) TGW has also requested approval for the creation of a Revenue Stabilization Adjustment Mechanism (RSAM) to

replace the existing Sales Margin Differential account similar to the mechanisms used by TGW's sister company, TGI. (TGW Argument, p. 13)

TGW states that the RSAM account would allow TGW to either return to, or recover from customers all variances between actual and forecast use per customer by way of a delivery rate rider over a three year period commencing in 2012. (Exhibit B-1, p. 43)

Intervener Arguments

CEC does not take issue with TGW's evidence and position on Gas Sales and Transport Demand. (CEC Argument, p. 2)

BCOAPO expresses concern over TGW's approach to forecast average use per customer load using data for 2006-2008, as 2006 appears to be an outlier year. BCOAPO submits that normalized actual results for 2007-2009, inclusive, should be used to forecast the average use per customer class during the test period. Alternatively, BCOAPO would accept forecasting based on actual normalized results for 2007 and 2008 and projected 2009 results as originally filed in Exhibit B-1, Table 3-3. (BCOAPO Argument, p. 23)

TGW submits that there is insufficient data to conclude that 2006 is an outlier year that should be excluded from the calculation. TGW submits that the proposed RSAM account insulates customers from the effects of variances, and accordingly departing from TGW's forecasted methodology is not warranted. (TGW Reply, p. 1)

The Commission Panel finds TGW's average use per customer forecast to be reasonable and agrees that modification is not warranted. No evidence was presented to suggest that 2006 was an outlier year, or to demonstrate that applying average use per customer results from 2007-2009 will provide more accurate forecasting results. The Commission Panel notes that the proposed RSAM account will adjust for variances between actual and forecast usage.

The Commission Panel agrees that aligning TGW's methodology with that of TGI is beneficial. The creation of the RSAM account to replace the Sales Margin Differential Account is approved. The commencement of amortization of the RSAM account over three years commencing in 2012 is also approved. The Commission Panel directs TGW to provide details of any balance accumulated in the RSAM deferral account during 2010 and 2011 in its next revenue requirements application, and to propose a method for recovery from, or refund to, customers at that time.

2.1.3 Demand Side Management

Demand side management (DSM) programs have not been included in the Application and have not been offered to TGW customers. RMOW submits that this lack of comparable DSM programs contributes to the flat average gas use per customer during the test period. The RMOW indicates its dissatisfaction with TGW's position on DSM in Whistler and encourages the use of regulatory tools to accelerate customer-level conservation within TGW's service area. The RMOW also refers to its commitment to improved conservation and sustainability as well as a desire to see fossil fuel conservation play a key role in a lower carbon economy. (RMOW Argument, p. 1)

TGW submits that it plans to expand energy efficiency and conservation initiatives to Whistler beginning in 2012. (TGW Reply, p. 2)

The Commission Panel shares RMOW's concern about the lack of DSM initiatives in TGW's Application, and directs TGW to develop plans for DSM programs, consistent with British Columbia's energy objectives, in its next revenue requirements application.

2.2 Cost of Gas

TGW is seeking approval for Cost of Gas elements to more closely align TGW's methodology with those of TGI. Specifically, TGW requests approval for the following elements relating to Cost of Gas:

- i) Setting Gas Cost Recovery Charge at \$6.691 per gigajoule and a credit Rate Rider "A" of \$1.817 per gigajoule, effective January 1, 2010 and subject to quarterly review and resetting as appropriate;
- ii) Setting the Delivery Charge at \$11.610 per gigajoule as at January 1, 2010 and \$10.735 per gigajoule for January 1, 2011;
- iii) Unbundling of the variable delivery and gas cost components of rates, but deferring implementation of unbundled variable rate components on customer bills until the new Customer Information System is put into service in order to avoid short-term conversion costs;
- iv) Implementing the gas cost deferral account and gas cost recovery rate setting methodology, on a basis consistent with the Terasen Gas commodity and midstream cost recovery mechanism effective January 1, 2010; and
- v) Establishing the methodology for amortization of the December 31, 2009 balance in the TGW Gas Cost Reconciliation Account to customers over the 24 month term of the Application.

(Exhibit B-1-2, amended p. 176; TGW Argument, p. 7)

CEC indicates that it does not take issue with TGW's Cost of Gas evidence or position. (CEC Argument, p. 2) Neither BCOAPO nor RMOW address these matters in their submissions.

The Commission Panel agrees that aligning TGW's methodology for Cost of Gas elements with that of TGI is beneficial. TGW's proposals for the treatment of various components of Cost of Gas described above are approved.

2.3 Operating and Maintenance Expenses, Other Revenue and Terasen Gas (Vancouver Island) Inc. Transport Charge

2.3.1 Operating and Maintenance Expenses

TGW forecasts Operating & Maintenance Expenses in nominal dollars of \$849 thousand in 2010 and \$868 thousand in 2011. TGW attributes cost increases to inflation as well as an increase in the number of customers, accounting changes and shared and corporate service cost allocations. (Exhibit B-1, p. 26) Increases in the number of customers and accounting changes are discussed elsewhere in this document.

TGW's combined shared and corporate service costs were \$244,800 for 2009 and are forecast to be \$349,800 for 2010 and \$363,500 for 2011. (Exhibit B-5, BCUC 1.8.1, p. 16)

TGW submits that the projected increase in shared and corporate service allocations results from changes in cost allocation methodology newly adopted by TGI and TGVI. These changes will discontinue the existing agreement with TGVI and replace it with new agreements with TGI and Terasen Inc. TGW submits that the new methodology more accurately reflects the actual costs of providing such services. (TGW Argument, p. 9). TGW states that revised methodology to allocate both shared and corporate service costs was independently reviewed by KPMG. (Exhibit B-1, Appendix G)

BCOAPO notes that the change between 2009 and 2010 represents a 43 percent increase and a further 3.9 percent increase in 2011. (BCOAPO Argument, p. 25) BCOAPO expresses concern that the methodology used in 2004-2005 for shared and corporate service charges may not be inappropriate to the extent asserted by TGW for 2010 and 2011. BCOAPO further submits that the escalation approved for 2010 be limited to 20 percent at most with only a further escalation by Consumer Price Index for 2011. (BCOAPO Argument, p. 25). BCOAPO neither provides nor refers to any evidence in support of its 20 percent limitation proposal.

TGW submits that, unlike past years, shared and corporate cost allocation forecasts for 2010 and 2011 have been based on a study, which yields a much more accurate allocation of shared and corporate costs than the formula methodology used in past years. It is TGW's position that the revised methodology represents the best information available to allocate the value of services received by TGW. TGW also submits that the new methodology for allocating shared and corporate service costs was accepted in the TGI and TGVI 2010-2011 Negotiated Settlement Agreements. (TGW Reply, p. 2)

The CEC did not take issue with the TGW evidence and positions with respect to operating and maintenance expenses. (CEC Argument, p. 3)

The Commission Panel finds BCOAPO's proposal to limit the escalation of shared services and allocated costs to 20 percent to be unsupported by any evidence, and is accordingly denied.

The Commission Panel accepts TGW's evidence that the proposed cost sharing and allocation methodologies for both Shared and Corporate Service costs are based on current and relevant studies to quantify costing activities between the various Terasen entities, and notes that these methodologies were accepted in the TGI and TGVI 2010-2011 Negotiated Settlement Agreements. The Commission Panel finds that the proposed sharing/allocation methodologies provide a reasonable quantification of the cost of services attributable to TGW.

TGW's proposed discontinuance of the Shared Services Agreement between TGVl and TGW, the adoption of the Shared Services Agreement between TGI and TGW, and the Corporate Services Agreement between Terasen Inc. and TGW for the years 2010 and 2011 are approved as requested in the Application.

2.3.2 Other Revenue and Transport Charges

TGW forecasts Other Revenues of \$56.0 thousand in 2010 and \$56.4 thousand in 2011. (Exhibit B-1-2, Schedule 2.1) The projected increase in Other Revenues results from expected growth in late payment charges. (TGW Argument, p. 9)

The completion of the Pipeline and Conversion projects results in TGW being required to pay for natural gas transportation services provided by TGVl's pipeline. TGW forecasts Transportation Charges of \$0.958 per gigajoule in 2010 and 2011 in accordance with Commission Order G-141-09 approving the Negotiated Settlement Agreement reached with TGVl for the 2010 and 2011 period. (TGW Argument, pp. 9-10)

None of the Interveners commented on other revenue and transport charge matters.

The Commission Panel accepts and approves TGW's forecast for other revenues and transportation charges for the 2010 and 2011 forecast years as reasonable.

2.4 Taxes

TGW's Application seeks approval to use a Tax Variance Deferral Account for variances in income, property, commodity and other tax liabilities. (Exhibit B-1, p. 34) TGW also proposes to account for the impact of Harmonized Sales Tax (HST) within the Tax Variance deferral account. (TGW Argument, p. 10)

BCOAPO supports TGW's proposal to track subsequent variances resulting from the change in HST in both operating & maintenance (O&M) and on capital expenditures so that these amounts may be charged or credited to ratepayers. BCOAPO requests separate HST sub-accounts be established to separately track O&M from capital variances. (BCOAPO Argument, p. 26) CEC does not take issue with TGW's position or evidence on taxes. (CEC Argument, p. 3)

The Commission Panel considers that the proposal to use a Tax Variance Deferral Account is an appropriate mechanism for the regulatory treatment of taxes. The Commission Panel agrees with the comments of BCOAPO concerning separation of operating and capital adjustments, and for those reasons directs TGW to establish separate sub-accounts to specifically track HST adjustments related to O&M and capital items and to provide this information with future revenue requirements applications. TGW is also directed to provide details of any balance accumulated in the Tax Variance Deferral Account during 2010 and 2011 and to propose a method for recovery from or refund to customers in its next revenue requirements application.

2.5 Rate Base

TGW forecasts its rate base for 2010 and 2011 at \$42.9 million and \$42.7 million respectively (TGW Argument, p. 11) and seeks a number of approvals related to the accounts comprising the rate base.

2.5.1 Net Plant-in-Service

TGW seeks to implement a change in accounting methodology for Net Plant-In-Service due to the adoption of International Financial Reporting Standards (IFRS), which is scheduled to occur during the test period. TGW forecasts midyear Net Plant-In-Service to be approximately \$12.4 million for both 2010 and 2011. (TGW Argument, p. 11)

TGW states that under proposed IFRS accounting standards for rate regulated utilities, it will no longer be able to include unrecognized accumulated gains or losses from asset disposals within accumulated depreciation. TGW plans to transfer total unrecognized gains of \$42.7 thousand from accumulated depreciation into a proposed IFRS transitional deferral account, and proposes to capture future gains and losses on the retirement or disposal of assets in a deferral account. TGW believes that the result of such an additional deferral account will preserve the effect of current regulatory treatment. (TGW Argument, p. 12)

The Commission Panel considers that the use of deferrals accounts is an appropriate mechanism for regulatory purposes to account for the transitional and ongoing impacts of the conversion of financial accounting standards to IFRS as described by TGW. TGW is directed to provide a report containing the details, with descriptions and explanations, of the amounts transferred to the new deferral accounts. The report is to be provided to the Commission within 60 days of the effective date of TGW's adoption of IFRS. TGW is further directed to provide details of any balance accumulated in the deferral accounts during 2010 and 2011 and to propose a method for recovery from or refund to customers where appropriate.

2.5.2 Deferral Accounts

TGW seeks approval to continue with previously approved deferral accounts or to dispose of certain existing accounts and to establish new Regulatory Application Deferral Accounts, as discussed elsewhere in these Reasons. TGW also requests approval for the creation of new deferral accounts to defer and amortize the costs related to this Application over two years, and the recent Return on Equity and Customer Care Enhancement applications over 5 years. (TGW Argument, p. 15)

The Commission Panel considers amortizing regulatory costs over time periods greater than one year to be appropriate in the case of TGW's regulatory applications in order to match costs with revenues and to assist in stabilizing revenue requirements, and accordingly approves the creation and amortisation of the requested Regulatory Application Deferral accounts.

2.5.3 Working Capital

TGW seeks to adopt the recent Cash Working Capital Lead/Lag Days resulting from a 2009 study for TGV for the purpose of determining TGW's working capital. TGW submits that the resulting impact of adopting the methodology of this study is a working capital decrease in 2010 and 2011 of \$16 thousand and \$5 thousand respectively. TGW also proposes to treat customer security deposits as part of unfunded debt instead of as a component of working capital. TGW submits that these proposals would align TGW with the treatment applied by TGV as accepted in the 2010-2011 Negotiated Settlement Agreement approved by Commission Order G-140-09. (TGW Argument, pp. 15-16)

The Commission Panel agrees that aligning TGW's methodology with respect to Cash Working Capital Lead/Lag Days with that of TGV is beneficial as it reflects the results of a recent study. The Commission Panel accepts TGW's proposals to adopt the Cash Working Capital Lead/Lag Days resulting from the 2009 study of TGV and to include customer security deposits as part of unfunded debt, rather than as a component of working capital.

The Commission Panel has reviewed TGW's rate base forecasts for 2010 and 2011 and approves them, subject to the adjustment determined in Section 3 of these Reasons. The submissions of BCOAPO and CEC concerning matters impacting the determination of rate base are also addressed in Section 3.

2.6 Financing and Capital Structure

Commission Order G-158-09 sets TGW's rate of return on equity (ROE) at 50 basis points above the Benchmark ROE determined in that Order, resulting in a ROE for TGW, effective July 1, 2009, of 10 percent. By application of G-158-09, TGW's capital structure remains unchanged at 40 percent equity and 60 percent debt. In determining TGW's interest rate for unfunded debt, TGW submits that it considered historical lending rates, which have been on average 1.08 percent below the bank prime lending rate. (Exhibit B-5, BCUC IR 1.21.1) TGW indicates that this rate is obtainable on short-term financing as this debt is secured through its parent, Terasen Inc., at a rate equal to the Banker's Acceptance rate plus a spread of 80 basis points. As Bankers' Acceptances are typically lower than the prime lending rates, TGW does not feel that proposed interest rate for unfunded debt is unusual. (TGW Argument, p. 17)

CEC does not take issue with TGW's position or evidence on Financing and Capital structure. (CEC Argument, p. 3) BCOAPO and RMOW make no submissions on this matter.

The Commission Panel accepts TGW's submissions on Financing and Capital Structure as described in the Application and finds these submissions are consistent with Order G-158-09. The Commission Panel has reviewed TGW's calculation of the interest rate for unfunded debt and accepts it as reasonable.

2.7 Accounting and Other Policies

TGW proposes to change a number of accounting policies, primarily as a result of the adoption of IFRS. TGW also seeks to align its accounting policies with those of TGI and TGV where possible. (TGW Argument, p. 18) The proposed changes relate to training costs, overhead capitalization, and depreciation and IFRS adoption. (Exhibit B-1, p. 82)

2.7.1 Training Costs

TGW proposes that O&M training costs, previously capitalized will be charged as operating expenses as a result of changes to Canadian Generally Accepted Accounting Principles (Canadian GAAP). (TGW Argument, p. 19)

The Commission Panel finds TGW's proposal to expense training costs to be consistent with the requirements of Canadian GAAP, and accordingly approves the proposed change.

2.7.2 Overhead Capitalized

TGW has applied for an overhead capitalization rate of 5 percent of Gross O&M, inclusive of shared and corporate service costs. TGW submits the change results from capitalization restrictions under IFRS as well as due to TGW's participation in a common, central management and support structure for Terasen Utilities. TGW states that costs for capital project support and general administration have decreased under this new structure, due to a more efficient process of providing such services through a common entity. TGW indicates that as a result of this new cost structure, most of TGW's O&M costs are for direct operating and maintenance activities and the percentage relating to capital projects has declined. (Exhibit B-1, p. 93) (TGW Argument, p. 21)

TGW notes that as part of the 2010 and 2011 Negotiated Settlement Agreements for both TGI and TGV, a 14 percent overhead capitalization rate was established. TGW states that it would be willing to accept similar treatment in order to be consistent with its sister utilities. (TGW Argument, p. 22)

The Commission Panel agrees that aligning TGW's overhead capitalization rate with that of TGI and TGV is appropriate in order to achieve consistent accounting treatment amongst the related utilities. The Commission Panel directs TGW to apply an overhead capitalization rate of 14 percent in 2010 and 2011 in order to remain consistent with TGW's sister companies, TGI and TGV. TGW is further directed to file a report with the Commission discussing overhead capitalization rates when the proposed accounting standards have been clarified and approved.

2.7.3 Depreciation Expense

TGW commissioned a depreciation study as at December 31, 2007 (Depreciation Study) in preparation for adopting IFRS. The Application reflects an average composite depreciation rate for TGW, based on the Depreciation Study, of 2.8 percent, a 0.4 percent increase from TGW's previous average composite depreciation rate of 2.4 percent. (Exhibit B-1, Appendix F) TGW states that the depreciation rate change results in an increased revenue requirements of approximately \$80,200 in 2010. (TGW Argument, p. 20)

Based on the Depreciation Study, TGW proposes a number of changes to the methods used to calculating depreciation, commencing in 2010 including:

1. depreciation to be recorded commencing at the time the asset is available for use, consistent with IFRS (TGW Argument, p. 12); and
2. recognition of the accounting impact of the disposal of individual assets (TGW Argument, p. 20).

The rates recommended in the Depreciation Study include provisions for estimated negative salvage value, consistent with methodology in prior depreciation studies. TGW states that 0.4 percent of the 2.8 percent average annual composite depreciation rate is attributable to negative salvage value. (Exhibit B-1, p. 91) TGW notes that in the Negotiated Settlement Agreements reached with TGI and TGV for 2010 and 2011, negative salvage provisions have been removed from the depreciation charge and replaced by an estimate of the annual amount of net removal costs incurred. TGW submits that negative salvage costs should be included in depreciation rates, but states that it is willing to accept the same accounting treatment for the purpose of being consistent with TGI and TGV. (TGW Argument, pp. 20-21)

BCOAPO supports adopting the same treatment of negative salvage value for TGW as was adopted for TGI and TGV. (BCOAPO Argument, p. 26) CEC and RMOW make no submission on this matter.

The Commission Panel takes note of the depreciation methods and policies adopted for TGI and TGV as part of their respective Negotiated Settlement Agreements for 2010 and 2011. As noted in previous sections above, the Commission Panel generally agrees that it is beneficial to align TGW's policies and methodologies with those of TGI and TGV where appropriate. Accordingly, the Commission Panel approves the depreciation policies and practices requested by TGW, for the forecast years 2010 and 2011, subject to the removal of the negative salvage provision from the composite depreciation rate as discussed above.

Notwithstanding the foregoing approval, the Commission Panel is not convinced that the elimination of the negative salvage provision in the determination of the composite depreciation rate is appropriate on an ongoing basis. TGW is directed to include evidence with respect to negative salvage in future revenue requirement applications. The Commission Panel also suggests that consistent with the above comments concerning the alignment of TGW's policies and methodologies with those of TGI and TGV, those utilities also include evidence with respect to negative salvage in their future revenue requirement applications.

2.7.4 International Financial Reporting Standards

TGW proposes to adopt IFRS for regulatory purposes in 2010 but intends to report under Canadian GAAP for financial reporting purposes for that same period. TGW intends to adopt IFRS for financial reporting purposes in 2011. Accordingly, the comparative 2010 financial statements must be restated under IFRS. TGW submits that upon the adoption of IFRS, a reconciling item will be created for the 2010 results and TGW would prefer to avoid this treatment for regulatory purposes. TGW believes it is appropriate to record, for regulatory purposes, any reconciling items created upon adoption of IFRS to the 2010 year should it relate to that year. (TGW Argument, p. 19)

TGW acknowledges that the IFRS standards it proposes to adopt in 2010 reflect both approved and in force and draft proposed, but not approved, standards as at January 1, 2010, including an Exposure Draft on Rate Regulated Activities. TGW proposes to capture any differences between accounting standards proposed in the Application and final standards in place upon adoption of IFRS on January 1, 2011 in an IFRS Transitional Deferral Account. (TGW Argument, p. 18) TGW submits that final results of IFRS standards will not and cannot be determined until after rates have been determined for 2010 and 2011. (TGW Argument, p. 14)

TGW proposes to apply, effective from January 1, 2010, draft accounting standards proposed for rate-regulated enterprises. The Commission Panel accepts that TGW will likely incur reconciliation adjustments upon adopting IFRS and accordingly approves the creation of an IFRS Transition Adjustment deferral account to capture any differences. However, the Commission Panel finds that there is much uncertainty as to what the nature and quantum of any adjustments will be and to which historic years they relate. The Commission Panel considers that much of the uncertainty results because IFRS for rate-regulated enterprises are currently in draft form, and subject to change. The Commission Panel is concerned about the uncertainty surrounding applicable accounting standards, and accordingly directs TGW to apply the same accounting standards for regulatory and financial reporting purposes in 2010. As

TGW has stated its intent to report its 2010 financial statements under Canadian GAAP, those standards should also be applied for regulatory purposes in 2010.

The Commission Panel further directs TGW to adopt IFRS for regulatory purposes as at the same date it adopts IFRS for financial accounting purposes. In order to mitigate uncertainty surrounding accounting standards, TGW is directed, for regulatory purposes, to adopt only those accounting standards that have received final approval and are in force. TGW is directed to record any IFRS reconciliation adjustments in the IFRS Transitional Deferral Account. The Commission Panel directs TGW to provide, in its next revenue requirements application, details of any balances accumulated in the IFRS Transitional Deferral Account and to propose a method to recover from, or refund to, customers such balances at that time.

2.8 Tariff Changes

TGW proposes to harmonize its General Terms and Conditions and Special Rate Schedules with that of TGI and TGVI in the test period. (TGW Argument, p. 23)

Changes sought include:

- a) Tariff changes and new terms and conditions as set out in Tab 11 and Appendix I of the Application including changes to Terms and Conditions; and
- b) Revised fee structure as set out in Tab 11 and Appendix I of the Application, including:
 - a. Revised new customer application fee from \$85 to \$25;
 - b. Revised dishonored cheque charge from \$10 to \$20;
 - c. Removed special meter reading charge;
 - d. Removed move meter from inside to outside of premises at consumer's request charge;
 - e. Removed resetting of meter and regulator charge; and
 - f. Removed where services are performed at cost charge.

(Exhibit B-1, pp. 99-113 and 178)

CEC indicates that it does not take issue with TGW's position or evidence on Tariff changes. (CEC Argument, p. 4) BCOAPO and RMOW made no submissions concerning tariff changes.

The Commission Panel considers that the proposed changes result in beneficial alignment amongst TGW, TGI and TGVI, and accordingly approves TGW's proposed Tariff changes to harmonize its General Terms and Conditions and Special Rate Schedules with those of TGI and TGVI.

3.0 WHISTLER CONVERSION COSTS

3.1 Introduction

TGW's Application includes a request for approval to include the full \$11.87 million cost of the Conversion project in its rate base. The original Conversion project cost estimates were reviewed as part of a CPCN application in 2005. The 2005 application was approved by Order C-3-06 which included a condition, agreed to by TGW and TGV, that the costs for the Conversion project were to have a maximum cost of \$6.01 million (cost cap), some \$5.86 million less than the actual expenditures incurred. (Exhibit B-1, p. 55)

3.2 Summary of Issues and Findings

In considering TGW's Application to include the full cost of the Conversion project in its rate base for recovery through customer rates, two primary issues arise:

1. Whether the Commission has jurisdiction to impose a limit or cost cap on the quantum of costs which can be included in rate base, and whether the Commission can relieve against any such cost cap in future applications.
2. Whether TGW has proven that the Conversion costs were prudently incurred, including those in excess of the cost cap limitation prescribed in Order C-3-06.

In summary, the Commission Panel finds as follows:

1. The Commission does have jurisdiction to impose a cost cap, can relieve against a cap, and must relieve against a cap in applicable cases where unanticipated costs which are in the public interest are prudently incurred and the utility would otherwise be precluded from earning a fair and reasonable return.
2. The Commission Panel finds that TGW has not proven that all of the excess expenditures to complete the Conversion project were prudently incurred. The Commission Panel accordingly finds that the amount to be added to TGW's rate base for costs associated with the Conversion project is \$11.03 million.

The balance of this Section discusses the above issues and findings.

3.3 Does the Commission have jurisdiction to impose a cost cap?

Notwithstanding its agreement at the time of the CPCN application to accept the cost cap, TGW now takes the position that "... the Commission lacks the jurisdiction to impose a cost cap on a CPCN order." TGW submits that there have been two cases decided since the Commission Order imposing the cost cap on the Whistler Gas Project, *Enbridge*¹, and *ATCO*², which confirm that cost caps are problematic both in intent and in effect. (T3:359)

¹ *Enbridge Gas Distribution Inc. v. Ontario Energy Board*, [2006] O.J. No. 1355, 41 Admin. L.R. (4th) 69 (C.A.) ("*Enbridge*")

² *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, [2006] 1 S.C.R. 140, 2006 SCC 4 ("*ATCO*")

TGW addresses the legal test with respect to prudence, and just and reasonable rates in its written Argument, pp. 30-35, and quotes following description of the prudency test from *Enbridge*, at paragraph 11:

The “prudence” inquiry described by the Board has two stages. At the first stage, the decision of Enbridge is presumed to have been made prudently unless those challenging the decision demonstrate reasonable grounds to question the prudence of that decision. At the second stage of the inquiry, reached only if the presumption of prudence is overcome, Enbridge must show that its business decision was reasonable under the circumstances that were known to, or ought to have been known to, Enbridge at the time it made the decision.

(TGW Argument, p. 30)

TGW submits that “[t]he test articulated in the Enbridge case ... precludes disallowing costs based simply on the fact that a project has cost more than anticipated” (T3:360), and states that it “... accepts that it bears the burden of discharging the [*Enbridge*] Stage 2 analysis. (T3:365)

TGW submits that “... the issue to be determined is: were the additional costs above the dead-band prudently incurred in light of the circumstances that were known by TGW, or ought to have been known, at the execution stage?” and “[u]nder the second stage of the prudence test, the Commission must assess whether any of the costs over and above the dead-band [cost cap] were the result of objectively unreasonable actions taken by TGW in the course of executing the Conversion work based on the facts known, or ought to have been known, to TGW at the time TGW took the particular steps in question.” (TGW Argument, pp.31-32)

TGW addresses the balancing of the relative risks as between the shareholder and ratepayer as follows:

The Supreme Court of Canada stated in *ATCO* that ratepayers have an interest in obtaining safe and efficient utility service and bear the risk of “... paying an amount for the regulated service that equals the cost of the service and the necessary resources,” which inherently includes the risk of a change in the cost of service. The shareholder, on the other hand, bears the risk of having its investment decisions reviewed and regulated. In the context of determining fair and reasonable rates for Whistler customers, the customers bear the risk that prudently incurred Project costs have varied from the CPCN estimate, and the shareholder bears the risk of conversion costs that were imprudently incurred. TGW submits that this is, at law, the correct balance.

(TGW Argument, pp. 34, 35)

TGW submits that the test articulated in *Enbridge* precludes disallowing costs based simply on the fact that a project has cost more than anticipated, and that *ATCO* confirms that the Commission must exercise its discretion in the context of a broadly-worded power to impose conditions. In the case of this Application, TGW submits that the power to impose conditions under section 46(3) of the Act must be exercised in a manner consistent with the fundamental obligations in rate setting: to allow the utility to recover, in rates, its prudently-incurred investment in a project.

In its written Argument BCOAPO submits that section 45(9)(b)(ii) of the Act confers authority on the Commission to impose conditions concerning the recoverable cost of construction of a plant or extension, and that in addition, the provision authorizes conditions concerning the extent of impact on rates of an approved project. (BCOAPO Argument, p. 2)

In its oral Argument addressing the cost cap jurisdiction issue, BCOAPO submits that the Commission can relieve against the cost cap in setting rates and has unfettered discretion to ensure a proper outcome. (T3:432, 433) BCOAPO also submits that, if there were compelling reasons to do so, it would be quite proper for the Commission to relieve in whole or part against the cost cap and that there is no jurisdictional problem that arises from that.

BCOAPO's written Argument deals at some length with its alternative submission that TGW is estopped from denying that the Conversion project approval Order G-53-06, as amended by Order G-76-06, is subject to the conditions set out in that Order. TGW addressed BCOAPO's estoppel in its Reply.

The Commission Panel finds, for the reasons that follow, that the Commission does have jurisdiction to impose a cost cap, can relieve against a cost cap, and must, in some circumstances, relieve against a cost cap. The Commission Panel is relieving against the cost cap in this Application, to the extent discussed elsewhere in Section 3, and therefore considers that the estoppel question need not be further addressed in these Reasons for Decision.

The CEC submits that TGW "... was imprudent in incurring costs which ought too (sic) have been allocated directly to customers who caused the costs. It is contrary to any reasonable interpretation of the term 'prudent' to have customers who maintain proper permitted and functioning, convertible appliances to bear cost increased beyond the budgeted, and capped, CPCN costs." (CEC Argument, p. 2)

In its oral argument addressing the cost cap jurisdiction issue CEC submits that the Commission does have the jurisdiction to impose a cost cap, under both section 45(9) (b) and section 46(3) of the Act. The CEC also supports the submissions of BCOAPO with respect to the cost cap issue.

RMOW made no submission with respect to the cost cap issue.

The Commission Panel disagrees with TGW's argument that "... the Commission lacks the jurisdiction to impose a cost cap on a CPCN order" (T3:359) and finds that the Commission does have jurisdiction to impose a cost cap. Sections 45(9)(b) and 46(3) specifically enable the Commission to impose conditions about rates or service or attach terms as public convenience or necessity may require. TGW's argument does not speak to the imposition of a cost cap, *per se*, and certainly not in the context of the Act, but rather to *Enbridge* effectively over-riding any such cost cap in cases where costs have been prudently incurred. TGW has also stepped beyond *Enbridge* by suggesting that the test relates to circumstances which were known or ought to have been known "at the time of execution" and "at the time TGW took the particular steps in question", rather than "... at the time it made the decision" as articulated in paragraph 11 of *Enbridge*, quoted above.

The Commission Panel finds that TGW's CPCN application and subsequent acceptance of the cost cap mechanism were made based on data concerning the Conversion project (the circumstances), which it knew or should have known to be inadequate at the time the decision to make the CPCN application was made.

The Commission Panel also finds that, as described in BCOAPO's submission, it would be quite proper for the Commission Panel to relieve in whole or part against the cost cap and that there is no jurisdictional problem that arises from the Commission Panel so doing. As the Commission Panel finds that it has the ability to both impose and relieve against a cost cap, the Commission Panel concludes that it is left with this issue: to what extent has TGW proven that the Conversion costs in excess of the cost cap amount have been prudently incurred? To the extent that the excess costs have been prudently incurred, following the principle enunciated in *Enbridge*, those costs will be approved for addition to the TGW rate base. Conversion project costs in excess of those prudently incurred will be for the account of TGW's shareholder.

To the extent that the Commission Panel finds that Conversion project costs have been prudently incurred and therefore are to be included in TGW's rate base, the resulting rates will be neither unjust nor unreasonable.

The Commission Panel considers that the imposition of a cost cap condition in this case is directly related to rates, as the costs of the Conversion project which are allowed to be included in TGW's rate base will have a direct impact on rates. The practical effect of the cost cap in this case has been to remove the presumption of prudence from the assessment of the costs incurred in excess of the cap amount. TGW has agreed that it "... bears the burden of proving that the costs it has incurred above [the cost cap] amounts were prudently incurred." (T1:8)

3.4 Has the prudence of excess Conversion costs been proven?

3.4.1 Causes of over expenditures

TGW provides a summary of the costs and variances from budget for the Conversion project at Exhibit B-1, p. 61, and states that the four main reasons for the additional conversion costs were:

1. The number of appliances requiring conversion was some 3,300 in excess of the number permitted or included in the CPCN estimate;
2. There were greater numbers of complex conversions, poorly conditioned appliances and customer piping deficiencies than expected;
3. A permit fee of \$550 thousand required by the British Columbia Safety Authority to carry out oversight of the appliance conversion work was not included in the CPCN estimate of costs; and
4. The intermediate pressure/distribution pressure station required for natural gas service to the Whistler area had to be located further from the pipeline than planned in the original estimate. (T1:19)

TGW cites a number of factors at play in arriving at the decision to proceed with the Conversion project, including:

- the existing propane distribution system was at or near its capacity to serve the Whistler area fuel requirements;
- RMOW was not going to support expansion of the propane system and had significant concerns

about the safety and reliability of the existing system;

- security of supply for the propane system was an issue, arising from the degradation of the CN rail service to Whistler;
- there was an opportunity to co-ordinate the construction of a gas pipeline with the upgrading of the highway to Whistler.

(T2:337)

3.4.2 Scoping and planning for the Conversion Project

TGW developed its costs estimates for the Conversion project utilizing appliance numbers derived from the permit information in its customers' files. No additional in-house or customer premise visit survey attempts were undertaken to assist in estimating the number and nature of conversions required. TGW has stated that "... going out and doing some individual surveys ... to see if in fact the records were correct ... may have provided some value", and "... in hindsight, we probably should have done some surveys other than the survey that we did in 1999 where we went into some of the hotels and confirmed the appliances and conversions that were in there." (T1:37-41, 154)

TGW acknowledges that it did not approach appliance manufacturers to assess conversion costs, and did not know what appliance models were in use in Whistler when the CPCN estimates were prepared. (T1:111) TGW states that it did not believe that approaching manufacturers was the best way to get the best cost estimates for the project. (T1:113) TGW also states that the project "... was much bigger than we understood that it would be," that they "... didn't appreciate the significance of the challenges ...", and "... you can interpret that [the project] wasn't fully scoped..." (T2:332)

In the event, there were some 3,300 more conversions required than estimated in the 2005 CPCN application. (T1:18) TGW has agreed that there was an assessment made not to expend funds to pursue additional data for cost estimates even though "... additional information would have been helpful." (T1:149)

TGW also states that if another conversion were to be undertaken, in Revelstoke for example, an effort would be made to gather as much information as it could. (T1:154) That additional effort to gather information clearly did not take place in the case of the Whistler CPCN cost estimating process, as TGW chose to rely on historic customer records and earlier conversion experience. (T1:37-41) rather than undertaking a Whistler-specific customer survey. (T2:272-274)

TGW indicates that the Conversion project was planned using information from its last similar conversion that was completed in Squamish during 1991. That project took place in a residential community that TGW has acknowledged is quite different than the Resort Municipality of Whistler. (T1: 93-94) TGW's original cost estimate for the Conversion project was prepared in 1999 by performing a limited customer survey audit at that time and that estimate was updated in 2005, six years later, through review of customer records, assessing labour rates and consultation with the contractor who had performed the Victoria conversion project along with estimates of man-hours, materials and per diem expenses. No formal customer appliance audit was planned until immediately before conversion. (T1:82) Further TGW acknowledged that the number of hours of conversion of past projects in Victoria, Nanaimo and Squamish

were not available as individual appliance conversion times were not tracked (Exhibit B-13, BCUC 2.20.1; T1: 92) and that TGW did not have any information to compare Squamish or Victoria's forecasted results with actual results related to appliance or conversion costs. (T1:91)

The Commission Panel concludes that TGW's CPCN application costs estimates for the Conversion project were the result of inadequate data collection and planning. The Commission Panel finds that TGW did not take prudent and necessary steps when planning and budgeting the Conversion project in 2005. At the initially planning phase, TGW did not conduct an updated survey of customer appliances, even on a sample basis, to establish the nature, magnitude and characteristics of appliances subject to conversion within Whistler. Rather, TGW prepared cost estimates for the Conversion project by updating a 1999 cost estimate for the Whistler Conversion and assessing that amount against gross cost amounts resulting from prior conversions, the last of which took place almost 15 years prior in an admittedly dissimilar community. The Commission Panel finds that this information was not an acceptable substitute for collecting current and relevant external data on customer appliances by, for example, contacting appliance manufacturers or conducting a customer survey.

The Commission Panel finds that TGW failed to seek out the details necessary to make reasonable estimates of either the types and number of appliances that currently existed in a unique high end resort community and did not document previously experienced hourly conversion rates for the individual appliances. The significant passage of time since the previous Whistler customer survey, the lack of documented experience and the uniqueness of the Whistler community lead the Commission Panel to the finding that TGW should have taken additional steps to support its CPCN Application cost estimates and to establish its initial plan for the Conversion project. The Commission Panel considers that the failure to accurately estimate the Conversion project costs reflects errors in judgment in scoping and planning for the Conversion project component of the CPCN application.

3.4.3 Execution of the Conversion Project

TGW's failure to accurately estimate Conversion project costs raises the question as to whether the project could have been prudently executed without significantly more complete and accurate scoping and planning. TGW's evidence (see Section 3.4.2) indicates that the full scope and requirements for the Conversion project were not properly understood at least until the audit/survey had been completed after the CPCN approval.

TGW has agreed that it "... bears the burden of proving that the costs it has incurred above [the cost cap] amounts were prudently incurred" (T1:8), and asserts that in carrying out the Conversion project it undertook appropriate planning, coordination and customer communication. TGW also asserts that, the work was performed by carefully supervised trained crews; the conversion team took cost-control measures; and the project was managed and executed cost-effectively. (T1:19, 20)

The Commission Panel considers that prudent, cost effective and efficient execution of the Conversion project could only have been achieved by starting with a process of rigorous scoping and planning. Relevant data must be gathered, issues and risks need to be anticipated, analyzed and resolved in the planning stage to the greatest extent possible, using the best current information available. Such was not the case in the development of the Conversion project.

TGW acknowledges that doing some individual surveys may have provided some value and that additional

information would have been valuable. The Commission Panel concludes in Section 3.4.2 that the appropriate information was not sought out, and that proper planning could not have taken place, and in turn, appropriate project management and execution could not result. This in turn leads the Commission Panel to the conclusion that there is a high probability that some of the project costs must have been incurred to compensate for the lack of due diligence and careful management in the planning process. The sheer magnitude of the cost overrun, nearly 100 per cent, underlines the deficiencies in the planning process.

TGW has acknowledged that it carries the burden of establishing the prudence of the Conversion project costs in excess of the cost cap established in Order C-3-06:

... Terasen is not relying on a presumption of prudence with respect to the costs in excess of the cap set by the conditions of the CPCN order ... Terasen Gas is agreeing that it bears the burden of proving that the costs it has incurred above those amounts were prudently incurred.

...

The ultimate issue ... is whether Terasen has demonstrated that the costs in excess of the amounts allowable pursuant to the CPCN conditions were prudently incurred, and thus recoverable in rates.

(T1:8-9)

The Commission Panel finds that TGW has not established that all of the excess Conversion project costs were prudently incurred. TGW asserts that the additional work that was required to complete the project was appropriately planned, coordinated, supervised, performed by trained crews and efficiently executed. None of the interveners took issue with TGW's assertions with respect to the execution of the work as the scope and challenges of the project were ultimately determined. However, the Commission Panel considers that at least a portion of the effort required could have been avoided or at least reduced had the project been adequately scoped and planned from the outset.

TGW has failed to establish that a number of the costs incurred were unavoidable had the project been adequately scoped and planned from the outset.

Examples of the types of costs, or portions thereof, which the Commission Panel considers have not been established as having been prudently incurred include:

- the time and effort to review the \$12 million cost estimates which arose from the completion of the appliance audit following the award of the CPCN;
- a portion of the costs incurred during the execution of the project to develop Equivalent Standard Agreement approvals, and develop and source appliance conversion kits which were not available from suppliers/manufacturers;
- additional management and field operating costs incurred, to arrange for and deploy additional TGW and contract resources to complete the project on schedule when unanticipated problems were discovered;

- incremental cost of overtime labour rates to compensate for an inadequate supply of field staff as unanticipated problems occurred; and
- inevitable inefficiencies arising from the necessity to react spontaneously to unanticipated problems rather than having identified and anticipated them in advance through a thorough scoping and planning process.

The Commission Panel notes that TGW's estimate of planning costs in its capped, inflation adjusted CPCN budget was \$0.406 million, some 7 percent, of total budgeted costs for the Conversion project of \$6.011 million. Actual planning costs amounted to \$1.649 million, or some 14 percent of the project actual costs, \$1.243 million, or four times more than the adjusted CPCN estimate. (Exhibit B-1, Table 8.3, p. 61) The Commission Panel considers that a significant portion of the additional Planning and Project Management costs could most likely have been avoided had the project been adequately scoped and planned for the CPCN application.

The Commission Panel also considers that, based on the magnitude of the planning cost overruns, it is conceivable that direct labour inefficiencies could have been at least in the order of some 10 to 15 percent of the time required to execute the required conversions.

The challenge is to quantify or value the extent of such excess costs. As it is not possible to now create a prudent Conversion Plan under circumstances that existed at the time of the CPCN, there is no direct comparative evidence to quantify what the total costs of the Conversion project may have been if prudent planning had occurred. TGW has not provided any adequate evidence to quantify what Project Expenditures would have been if the Project Plan was more complete at the time of the CPCN.

3.4.4 Cost to Convert Sub-standard Appliances and Installations

In its communication program to its Whistler customers, TGW stated that it would cover the costs of converting appliances to natural gas. Stated exceptions to that undertaking included cases where parts were not available or the appliances were in poor and/or unsafe condition as determined by the BC Safety Authority. In such cases, customers were advised that they would be responsible for conversion costs. (Exhibit B-5, p. 107) The communications also stated "When appliances can't be converted to natural gas, it is the responsibility of the home/business owner to install appropriate replacement appliances." (Exhibit B - 5, Att. 37.10)

TGW subsequently made modifications to the conversion policy, including:

- absorbing (including in the project costs) the cost of developing and installing substitute conversion kits if they were not available from the manufacturer; and
- absorbing the costs of remedial work in cases where there were requirements to upgrade piping and related installations which did not even meet the standards for propane installations.

Notwithstanding its original policy communications, TGW absorbed all costs relating to the Conversion project other than those cases, some 400, where the appliances were 'red tagged' as they were unsafe and required replacement.

In its opening remarks, TGW states: "The project, which was approved in 2006 and was completed in 2009, has delivered the anticipated benefits to customers. Specifically, customers now pay less to meet their energy requirements previously served by propane based on the delivery charge proposed in this application and the favourable forecast cost differential between natural gas and propane. The project has reduced greenhouse gas emissions and has contributed to improved air quality in the Whistler region. It has also provided greater security of supply. TGW acknowledges the interest and concern of customers and the Commission about the divergence between the estimate for the appliance conversion and the final appliance conversion costs." (T1:16)

Intervener Arguments

BCOAPO submits that "... the Commission should not absolve the utility of the natural consequences of its astonishing lack of diligence in preparing the financial justification when it applied for approval of the project in 2005" and that "TGW is disentitled to include the capital costs of the Whistler conversion work in excess of the cost cap or collar as set out in the Order and Decision of 2006." (BCOAPO Argument, pp. 9, 23) BCOAPO also submitted that "... this Panel can relieve against the cap in setting rates" and "... if there were compelling reasons to do so, it would be quite proper for the Commission to relieve in whole or part against the cost cap. So there's no jurisdictional problem that arises from that ..." (T3:432-433)

BCOAPO did not address the issue of whether, or the extent to which, TGW's expenditures on the Conversion project, in excess of the cost cap, were prudently incurred.

The CEC takes issue with the inclusion of all conversion costs in rate base, and submits that "... the Company acted in an imprudent manner in its management of the costs of the program by failing to allocate the costs incurred to those customers who caused the costs.", and that "[TGW] elected to perform the work, not track the cause of the costs such that the customers could be billed the excess, and instead in this application turn to ratepayers to bear the financial burden of the excess costs by including it in rate base." (CEC Argument, p. 4)

RMOW's Argument was limited to expressing 'primary concern' with respect to the cost overruns of the Conversion project.

In response to BCOAPO's Argument, TGW submits that "... what the Commission cannot do is impose cost-caps that purport to predetermine the maximum allowable recovery of costs in rates without regard to whether the costs ultimately incurred were prudently incurred to deliver a project determined to be in the public interest." (TGW Argument, p. 4)

TGW raised three points in reply to the CEC submission:

- that TGW enforced customer responsibilities in a way that that was most beneficial and cost-effective for the Project as a whole' and that '... for every appliance or piping issue, a decision was made by managers and supervisors who were experienced gas-fitters as to whether it would be cheaper to fix the issue or write-up a Red Tag.';
- that not converting appliances which were unpermitted or had customer related deficiencies would leave the Project incomplete, leaving 31 percent of the appliances in Whistler being unable to take natural gas service; and
- that the issues with respect to the appliances and piping were widespread across all customer classes and all customers benefited from the conversion generally.

(TGW Reply, pp. 21, 22)

The Commission Panel acknowledges the CEC's concern that the Conversion project costs should be charged directly to customers in cases where they caused the costs. However, the Commission Panel accepts TGW's view that purpose of the project was to accomplish the conversion of propane based appliances to natural gas, and considers that TGW's change in policy to absorb the costs related to all installations which were not issued a red tag was a reasonable and pragmatic decision. The Commission Panel accepts TGW's submission that the issues were widespread across customer classes, and that the policy change mitigated potential risk of load loss to TGW, which in turn would negatively impact rates to remaining customers.

The Commission Panel finds that the costs of converting sub-standard appliances and installations are appropriate for consideration as being prudently incurred, subject to the Commission Panel's findings with respect to TGW's failure to establish and allow for the extent to which costs could have been avoided had the project been adequately scoped and planned from the outset.

3.4.5 Quantum of Costs not Prudently Incurred

Section 3.4.3 above lists a number of factors which have been considered in finding that not all the costs incurred to complete the Conversion project were established to have been prudently incurred, and notes the challenge in quantifying the extent of costs incurred in excess of those prudently incurred.

The Commission Panel considers that most of the excess costs relate to labour inefficiencies resulting from inadequate scoping and planning. Quantifying excess costs is challenging based on the evidence available to estimate what the outcome of an adequately scoped and planned project would have been. However, the Commission Panel still needs to apply its judgment in arriving at an estimate of the impact of the inadequate scoping and planning as described in Section 3.4.3. TGW has not persuaded the Commission Panel that all of the additional costs incurred as a result of the inadequate scoping and planning were reasonably unavoidable even if an adequate initial budget been prepared.

In conclusion, taking into account the factors previously noted, the Commission Panel exercises its considered judgment and finds that \$0.84 million of the costs of the Conversion project were not prudently incurred, and that amount will therefore be deducted from the amount for which TGW has sought approval to include in its rate base and recover from rates charged to customers.

4.0 QUARTERLY REPORTING: CONVERSION PROJECT

Order G-53-06 required TGW to make quarterly reports to the Commission on the Pipeline and Conversion projects. TGW acknowledges that, while it made these regular reports to the Commission, it did not provide the revised May 2008 internal cost estimate for the Conversion project (Revised May 2008 Estimate) to the Commission until after the Conversion project was completed. TGW submits that its reporting was reasonable and that written warnings of increased costs were provided to the Commission. TGW submits that, due to various uncertainties, it was not comfortable providing a specific revised estimate to the Commission until additional information was available and could be assessed by the Company. (TGW Argument, p. 77) TGW notes that a revised estimate was provided to the Commission as part of the Application, dated November 9, 2009, after Conversion work was completed. (TGW Argument, p. 79)

Notwithstanding whatever uncertainties TGW might have had with respect to the Revised May 2008 Estimate, the Commission Panel considers that TGW should have, at a minimum, disclosed the Revised May 2008 Estimate with the quarterly reports as it represented TGW's most current estimate of the final costs of the Conversion project.

The Commission Panel directs TGW to provide, in all future project update reports to the Commission, updated internal cost estimates available as of the report date, including explanations for significant changes from previous estimates.

5.0 TERASEN GAS (VANCOUVER ISLAND) INC. IP PIPELINE PROJECT AND TERASEN GAS (WHISTLER) INC. CAPITAL CONTRIBUTION

5.1 TGW Request for Confidentiality

TGW sought confidentiality for the information contained in Tab 13 - "CPCN Capital Contribution" of the Application and the related information requests and responses due to ongoing negotiations between TGVI and the pipeline contractor for the Pipeline project. In TGW's view "the public release of the proposal will jeopardize TGVI's ability to effectively negotiate additional costs related to claims of extra work, which could affect the amount of the capital contribution TGW will have to pay TGVI and correspondingly affect TGW's ratepayers through rates to recover the incremental cost of service." (Exhibit B-1-1, TGW covering letter November 9, 2009)

The Commission's Practice Directive on "Confidential Filings" dated September 12, 2007 addresses requests for confidentiality. No intervenor filed an objection to TGW's request for confidentiality on matters related to Tab 13 of the Application or the information requests and responses related thereto. Accordingly, the hearing of the Application proceeded on the basis that those matters remained confidential.

In addition to reviewing Tab 13 and the confidential information requests and responses, together with a confidential Opening Statement from TGW, the Commission Panel also held a brief *in camera* session during the Oral Hearing which addressed the Pipeline project. No cross-examination took place on Pipeline issues. TGW also filed Confidential Argument on the Pipeline project.

5.2 Commission Determination on Pipeline Project Costs

The Commission Panel recognizes the commercial sensitivity with respect to ongoing negotiations to resolve the final costs of the Pipeline project, the potential risk of disclosure to TGW's negotiation strategy for the resolution of the claims for extra work, the potential effect on the amount of the capital contribution TGW will have to pay TGI and the corresponding effect on ratepayers through rates to recover the incremental cost of service. These concerns appear to be temporary in nature and will no longer exist once the claims for extra work have been resolved.

Accordingly, the Commission Panel is issuing separate Confidential Reasons for Decision (Confidential Reasons) concurrently with these Reasons on TGW's request, more particularly described in Tab 13 of the Application, to change the sharing formula as it pertains to costs associated with the Aerial Crossings for the natural gas pipeline lateral. In the Confidential Reasons, the Commission Panel approves the order sought with respect to the change in the sharing formula as it pertains to costs associated with the Aerial Crossings.

The Confidential Reasons will be released to TGW concurrently with these Reasons. The Commission will also release a copy of the Confidential Reasons to any intervenor who signed an Undertaking to maintain confidentiality over any confidential information received relating to the Application, upon the Commission receiving written confirmation from TGW as to the identity of the intervenors who signed Undertakings and absent any objection from TGW. If, despite an Undertaking, TGW objects to an intervenor receiving the Confidential Reasons, TGW is to file its objection within five working days of the release of the Confidential Reasons to TGW. The intervenors who signed Undertakings will have five working days to respond to any objections to release of the Confidential Reasons and TGW will have 3 working days to reply.

TGW is to advise the Commission within 10 working days when the costs for the Pipeline component are finalized and the impact on rates are determined.

The Confidential Reasons will be made available to the public through posting on the Commission's website within five working days of TGW advising the Commission that the costs for the Pipeline component are finalized and the impact on rates are determined.

5.3 Revised Interim Rates

TGW was ordered to calculate revised interim rates and to submit, in a compliance filing, amended financial schedules including the spreadsheet model in accordance with the directives in Order G-138-10, on or before October 15, 2010. These amended financial schedules should reflect the Commission's Decision on the 2010 and 2011 revenue requirement.

The revised interim rates for TGW will remain in effect until all Pipeline component costs are finalized or until addressed by further order of the Commission.

If there are any differences between the 2010 interim and permanent delivery rates that are determined by the application of Order G-138-10 or by the Commission following final disposition of the outstanding Pipeline costs or upon the issuance of a further order making rates permanent, those amounts are subject to refund/recovery, with interest at the average prime rate of TGW's principal bank, as soon as practicable, in the manner as set out by a Commission Order that establishes permanent rates.

DATED at the City of Vancouver, in the Province of British Columbia, this 25th day of October 2010.

Original signed by: _____

A.W. (KEITH) ANDERSON
PANEL CHAIR/COMMISSIONER

Original signed by: _____

A.J. (TONY) PULLMAN
COMMISSIONER

Original signed by: _____

P.E. (PETER) VIVIAN
COMMISSIONER