CEG Energy Options Inc.

July 6, 2006

Mr. Robert J. Pellatt
Commission Secretary
British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, B.C. V6Z 2N3

Dear Sir:

Re: Terasen Gas CPCN Application for Residential Customer Commodity Unbundling - CEG Energy Options Inc. Written Argument

Please accept this letter as argument on behalf of CEG Energy Options Inc. regarding the outstanding issues in the above-captioned proceeding.

The evidence clearly demonstrates that Terasen Gas' Commercial Customer Commodity Unbundling program has been a success. Commercial customer acceptance of gas marketers' product offerings has been strong. Among the thousands of commercial customers who have opted to switch to a competitive supplier are many residential customers who are represented by groups of condominium owners. Given that condominium boards are comprised of individual condominium owners, it is reasonable to extrapolate that same level of interest to the single-unit homeowner market segment as well. In light of the success of the Commercial Unbundling initiative in B.C. along with residential customer acceptance in other jurisdictions, there is no reason to expect that the single-unit residential market in B.C. will be any less receptive.

Terasen Gas' Essential Services Model has proven to be a cost effective mechanism for enabling customers to have commodity supply options. As we move forward into even more turbulent and challenging times for consumers of energy commodities, it is important that residential gas users not be excluded from the option of having multiple suppliers competing for their business with products and services that will either address customers' needs or be unsaleable in the marketplace.

With the exceptions that are outlined below, CEG supports the Terasen Gas Application as revised by Terasen Gas' letter of June 22, 2006.

Independent Dispute Resolution Fee:

CEG agrees with the Retailer Group's position that it is unreasonable to assess even a nominal fee to a marketer in cases where the marketer is found to be operating within the Code of Conduct and honouring its commitments to customers and the utility. If even a small proportion of customers take advantage of a system where customers have absolutely nothing to lose by lodging a frivolous complaint, the mediator and marketers could end up incurring extra costs and being bogged down by complaints that have no merit.

Performance Bond:

Terasen Gas' current requirement for a $250,000 bond or letter of credit is consistent with other western Canadian jurisdictions and sufficiently onerous to ensure that potential "fly-by-night" operators are unable to enter the market. In any event, the North American natural gas market has matured to a point where it is no longer possible for under-capitalized entities to acquire gas supply. And CEG suggests that there is no level of bonding that could possibly protect customers from an Enron-like failure as was alluded to during the oral hearing. With Terasen Gas in the role of default supplier, customers are not at risk of a physical interruption of gas supply as a result of a marketer failure. Burdening marketers with a requirement to post more significant credit that increases with the number of customers will have the effect of lessening competition and increasing the costs of doing business - both to the detriment of natural gas consumers in B.C.

Electronic/Voice Signature:

CEG does not currently use either electronic or voice signature for either new gas supply contracts or customer renewals. However, we do not agree that voice and electronic signature contracting should be prohibited. With regard to voice signature, there is merit to the argument that if done according to a clearly defined script, a customer can more easily understand a plain language verbal offer and acceptance of a transaction than a written contract. Electronic signature of internet-based contracts has become widely accepted and should be allowed as an acceptable means of contracting in the residential natural gas market as well.

Stable Rate Option:

Terasen Gas' justification for wanting to continue offering the Stable Rate Option ("SRO") after opening the residential market to competition appears to fall into three categories:

1. The SRO is not in direct competition with marketer's product offerings.
2. The SRO will provide a "benchmark" price for customers to compare with marketer offerings.
3. There is educational value associated with the SRO.

CEG respectfully submits that Terasen Gas' assumption that marketers will offer only multi-year contract terms to residential customers is erroneous. As discussed during the workshop, CEG Energy typically offers customers contract terms of 1, 3, or 5 years. During our nearly 20 years in business, we have found that there is a contingent of customers who prefer a one-year term. In some cases customers want to "try" the service before making a long-term commitment. We cannot at this point see any reason why CEG would not offer the same contract term options to residential customers. Certainly we will guage consumer interest in a shorter-term option and base our decision on the results of our assessment at the time. However, if Terasen Gas is allowed to continue offering the SRO, CEG will not participate in the short-term market in light of the considerable competitive advantage that Terasen Gas enjoys in its position as the incumbent and dominant supplier in the B.C. marketplace.

CEG does not agree with Terasen's assertion that the SRO price provides a meaningful "benchmark" for customers. The SRO price is set at one point in time each year while marketers will be providing price offers to customers on an ongoing basis throughout the year.

Given the volatile nature of the gas market, there is a high probability that market prices will either rise or fall significantly soon after the SRO price is set. If for example market prices decline significantly shortly after Terasen Gas establishes its SRO price, a marketer's price may appear to be more attractive relative to the SRO price. Conversely, if prices rise significantly after the SRO price is set, marketers will be unable to offer prices that appear to be competitive with the SRO. So rather than being a meaningful benchmark, the SRO is more likely to provide misleading information to customers regarding the value of marketers' offers.

Another significant consideration is related to the risk to default-supplied customers associated with Terasen Gas' continuation of the SRO once the residential market is open to competition. If we assume that short-term price volatility in the gas market is random, it follows that roughly 50% of the time market prices will fall subsequent to Terasen Gas establishing its SRO price. In those cases, the takeup of the SRO will likely be poor because marketers' offers will be more attractive relative to the SRO. And default-supplied customers will be left "holding the bag" with any out-of-the-money hedges being left in the CCRA. In the other 50% of the time when market prices escalate after Terasen Gas establishes the SRO price, the takeup of the SRO will likely be much higher because marketers' offers will appear to be less attractive relative to the SRO. So there will be no offsetting gain for default-supplied customers through in-the-money hedges being allocated to the CCRA. The bottom line is that a continuation of the SRO in a post-unbundling marketplace would appear to be a "no-win" proposition for default-supplied residential customers.

CEG submits that the continuation of the SRO in a competitive market is not justified based on its educational value. The Commission can rest assured that between Terasen Gas' planned educational campaign and marketers' advertising and sales efforts, customers will be well informed that there are new supply options available to them.

A final point regarding the SRO is related to Terasen Gas' unfair competitive position. If Terasen Gas wants to compete, it should be required to do so through a non-regulated arms length entity that is governed by code of conduct rules. The entity must compete on a level playing field with other marketers and be restricted in terms of access to the billing envelope, use of the Terasen Gas brand, etc. And the entity's shareholder, not default-supplied customers, must bear the risk for potential hedging losses.

In closing, CEG Energy would like to thank the Commission for the opportunity to provide input into this matter. We are confident that with some relatively minor modifications as outlined above, the implementation of the proposed Residential Customer Commodity Unbundling initiative will result in a robust and competitive marketplace that will serve consumers needs during the critical years to come as market prices serve to rationalize the supply and demand for this finite commodity.

Sincerely,

Kirby Morrow

Kirby Morrow
Director, BC & PNW