September 2, 2005

British Columbia Utilities Commission
Sixth Floor - 900 Howe Street
Vancouver, BC
V6Z 2N3

Attention: Mr. Robert J. Pellatt, Commission Secretary

Dear Sir:

Re: Terasen Gas Inc. (“Terasen Gas” or the “Company”) Application for Approval of Transactions with respect to Southern Crossing Pipeline (“SCP”) and Inland Pacific Connector (“IPC”)

Terasen Gas submitted to the British Columbia Utilities Commission (the “Commission” or “BCUC”), its application for approval of certain transactions with respect to SCP and IPC on June 1, 2005 and a supplement to its application filing was made on June 24. On June 10, 2005 the Commission established a written public hearing and set out the regulatory agenda in its Order No. G-55-05. The regulatory agenda included the opportunity for Intervenors to file Written Comments on August 19, 2005 to be followed by Terasen Gas’ Written Reply to be filed on August 30. On August 30, 2005 Terasen Gas submitted a request to the Commission to defer the submission of its Written Reply to September 2, 2005. This request was approved by the Commission on August 31 (Log No. 11361). This submission represents the Terasen Gas Written Reply.

On August 19, 2005 Terasen Gas received comments from four Intervenors: Westcoast Energy Inc. (“Westcoast”), the Lower Mainland Large Gas Users Association (“LMLGUA”), the Inland Industrials and the British Columbia Old Age Pensioners Organization et al (“BCOAPO”). Terasen Gas will address the comments of each Intervenor separately in this submission.

In its Application Terasen Gas requested approval of several items, which are summarized as:

- the recovery mechanism for the PG&E termination payments,
- recovery of the SCP deferral account,
- the use of the 6MMcfd residual SCP capacity as part of its Midstream Portfolio of resources,
- termination of the transportation and peaking agreements effective November 1, 2005, currently held by BC Hydro
- inclusion of the 52.5 MMcfd SCP capacity (currently held by BC Hydro) in the Company’s Midstream resource portfolio,
- annual allocation of $3.6 million to be debited against the Midstream Cost Reconciliation Account (“MCRA”) with an equal and offsetting allocation to be credited to the delivery margin revenue account effective November 1, 2005,
- recovery of IPC development costs, including AFUDC, by including the costs in rate base.

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Westcoast

In its comments Westcoast focused on describing its version of the facts related to the SCP project. Additionally, Westcoast provided its perspective on the IPC development. Terasen Gas notes that Westcoast in its submission did not make any comment on the Company’s proposal regarding the recovery mechanism for the PG&E termination payments, recovery of the SCP deferral account, or the use of the 6MMcfd residual SCP capacity as part of its Midstream Portfolio of resources.

With respect to SCP, on Page 2, Westcoast makes the argument that the Yahk to Huntingdon transportation service agreements for 105 MMcfd use the entirety of available capacity, but the demand charges don’t recover the total cost of service. Although this is merely an attempt to re-examine issues that were already decided, the submission ignores the additional capacity of approximately 150 MMcfd made available to the Interior from Yahk. Further, it was never assumed or contemplated that the third party agreements would fully recover the entire SCP cost of service. The third party agreements provided some assurance that Terasen Gas was not alone in its expectations for market growth, as others were willing to make commitments based on similar market projections at that time, and provided a significant contribution to the cost of service.

Westcoast’s speculations on Page 3 about what would or would not have been approved if everyone had perfect foresight are not relevant to the issues at hand. The proper basis for decision in the Application that Terasen Gas has put forth involves a determination of who benefits from the mitigation strategies and contractual restructuring that took place after SCP was constructed, and who benefited from Terasen Gas’ ability to meet the competitive market and supply challenges as a result of SCP. All serious players in the industry know that market dynamics are not wholly predictable, and that the challenge is to respond to those changing dynamics in a way that maximizes the current and future value to the market place given the assets available at any given time. The Company submits that attempts to rewrite history are not very helpful and ultimately counter productive.

On Page 3 Westcoast also states that if the SCP capacity is included in the Midstream portfolio as the Company proposes it will result in a situation that includes four specific outcomes. The first of these four outcomes was: “There will be no BC Hydro thermal power generation peak shaving synergies...” The Company reminds Westcoast that BC Hydro has exercised its option included in the agreement that was approved by the Commission. The lack of the synergies listed is not caused by Terasen Inc. being “relieved of its obligations”.

The second point Westcoast makes regarding the approval of the Company’s SCP related proposals will mean “Terasen Gas’ core market customers will forego $3.6 million in annual demand charges payable by Terasen Inc...” Terasen Gas agrees, however, reminds Westcoast that this loss will be more than offset by additional benefits as described by the Company in this proceeding.

A third item raised by Westcoast is “The only third party shipper making any financial contribution to the SCP costs will be Northwest Natural.” Terasen Gas agrees with this observation, however the Company reminds Westcoast that the total revenue stream expected from Northwest Natural as set out in its Application and IR responses exceeds the revenues that would have been received from BC Hydro and PG&E under the original agreements, even after taking into consideration the PG&E termination payments. Terasen Gas also points out that the annual revenue from Northwest Natural will increase while the PG&E termination payment will decrease, as described in the Application.
The last item raised several issues related to peaking resources. Westcoast appears to assert that the peaking agreements that the Company is proposing are not likely to come to fruition. Terasen Gas submits that such is not the case and in fact the Company has entered into some arrangements at costs that are not greater than contemplated in the Application.

On Page 4, Westcoast asserts that the only certainty in the NPV analysis is the loss of $3.6 million in revenues as a result of BC Hydro decisions. It should be emphasized that all of the benefits associated with the optimization of available capacity between Westcoast and SCP are real and have been conservatively estimated. That means that the benefits of incorporating the capacity into Terasen Gas’ portfolio clearly outweigh the loss that Terasen Gas is responding to. The more significant costs that Terasen Gas customers need to mitigate and defray are those associated with the rapidly increasing tolls on the Westcoast T-South system.

In summary respecting the BC Hydro capacity Westcoast stated “the release of Terasen Inc. from its obligations under the BC Hydro TSA and Peaking Agreement would seriously undermine the Commission’s 1999 Decision and deprive Terasen Gas’ core market customers of a known and fixed revenue source to help defray at least some of the SCP annual cost of service.” Westcoast has not substantiated in any way how the Commission’s decision is undermined. The second part of the submission, as described above, simply does not consider the entire benefits that have been identified.

With respect to the debate about IPC’s impact on Westcoast's expansion plans (Page 4-5) the Company is not surprised by Westcoast's assertions, which are contrary to those of Terasen Gas. Given that Westcoast viewed and continues to view SCP and IPC as a competitive threat to its transmission monopoly, it would be rather surprising for Westcoast to acknowledge the impact IPC had on its market response, timing, or the negotiated settlement in the expansion. However, those at Terasen Gas involved in the negotiations at the time remain convinced that it was an important factor. Terasen Gas notes that Westcoast does not make any specific comment either opposing or supporting the Company’s proposal for the recovery of the IPC costs, other than its statement of facts.

LMLGUA

The LMLGUA stated that it supported the submission of Westcoast and made further comment regarding IPC costs and SCP costs. As described above, Terasen Gas takes issue with certain aspects of Westcoast’s version of the facts. LMLGUA made no comment with respect to the Company’s requests relating to the recovery mechanism for the PG&E termination payments, recovery of the SCP deferral account, and use of the 6MMcfd residual SCP capacity as part of its Midstream Portfolio of resources.

In paragraph 2 of its submission, LMLGUA simply argues that IPC development activities took place without any prior Commission approval for the recovery of the costs and as such Terasen Gas should not expect to recover the costs now that the project has been deferred indefinitely. This argument ignores the significant benefits that the IPC development activities have contributed to Terasen Gas customers. It also takes the issue of the recovery of the IPC costs out of the context of the total package of transactions that were and are proposed in both the Application and the December 2002 submission.

LMLGUA states that it did not support SCP during the approval process and since that time SCP has not delivered any benefits to customers. Terasen Gas notes that SCP was approved by the Commission in May 1999 after an exhaustive regulatory review process.
The review process concluded the project was the best solution to meeting customers’ requirements based on the best information available at the time. Since it was put in-service SCP has provided significant benefits to customers:

- Increased security of supply and supply diversity
- Provides supply diversity by providing access to AECO trading hub
- Moderates price volatility at Sumas, provides better price transparency
- Provides access to more peaking gas options
- Reduces requirements for reinforcement of Interior Transmission System
- Contributes to increased operational flexibility
- Improves Gas Control’s ability to reconfigure flows based on maintenance, commitments to firm shippers, Interior demand and line pack
- Increased third party and SCP mitigating revenue

Since SCP was approved, regional market conditions have evolved differently than were predicted at the time, however the natural gas demand in the PNW region continues to grow and the region will be increasingly capacity constrained during periods of high demand. LMLGUA’s assertion ignores the fact that SCP is a long term resource and will provide benefits to Terasen Gas’ customers for decades to come.

In addition, LMLGUA’s primary basis for its claim that SCP has not delivered benefits appears to be on its erroneous understanding of the level of actual throughput since the pipeline was put in service in November 2000. In fact the SCP load factor has been much higher than 5%, both during the winter months and during the summer months. The current gas contract year will average close to 20% for the Yahk to Oliver section and approximately 35% for the capacity on the line between Oliver and Kingsvale.

LMLGUA argues that Terasen Gas has the responsibility to mitigate SCP costs and to maximize benefits to its customers and should not be provided additional incentive to do so. Terasen Gas accepts this mandate and takes this responsibility very seriously. This is evidenced in the Company’s efforts to mitigate the impact of the PG&E financial situation through the Northwest Natural arrangements, its dogged pursuit of the reduced Kingsvale South tolls in the face of Westcoast reticence and the current day to day transactions to maximize the value of SCP capacity in response to market conditions. In addition, by taking the SCP capacity currently held by BC Hydro into its Midstream portfolio, Terasen Gas will realize even greater benefits than had been anticipated. Although Terasen Gas accepts its mandate to minimize costs and maximize benefits to its customers, this should not be at the expense of its shareholders.

LMLGUA also argues that if IPC had proceeded, only Terasen Inc. stood to benefit. IPC was proposed to address a capacity constraint at the Huntingdon market hub. If the market conditions had unfolded as was predicted by all the regional participants at the time, IPC would have provided both direct and indirect benefits to all regional consumers including Terasen Gas’ customers through increased capacity, diversity and security of supply.

**Inland Industrials**

Inland Industrials state that it does not oppose the Company’s proposals as outlined by the Application, including the recovery mechanism for the PG&E termination payments, recovery of the SCP deferral account, the use of the 6MMcfd residual SCP capacity as part of its Midstream Portfolio, termination of the BC Hydro SCP agreements, and recovery of the IPC development costs. However, it did note one exception. The Inland Industrials submit that
the IPC costs would be more appropriately allocated to the MCRA as it matches the benefits of the overall package of transactions.

Terasen Gas agrees with the principle of matching costs with the benefits that are realized as a result of those expenditures. As discussed in both the current Application and in the December 5, 2002 Application, Terasen Gas asserts the significant benefits associated with the IPC development costs include the arrangements with Northwest Natural. All of the SCP revenues associated with Northwest Natural demand charges (net of PG&E termination payments) are allocated to the delivery margin, and as such it is appropriate that the IPC development costs are also allocated to the delivery margin. Similarly, Terasen Gas cannot agree with Inland Industrials contention that the “overall impact of the full package is a net cost to the transportation customers while the midstream customers receive a net benefit”. To say so would be to ignore the significant increase in mitigating revenues allocated to the Northwest Natural arrangements.

On page 3 the Inland Industrials state appropriately that the net rate impact of the proposed assignment of the released BC Hydro SCP capacity from Terasen Inc. to Terasen Gas and the associated annual debit of $3.6 million against the MCRA and corresponding credit to the delivery margin revenue account “on the transportation customers is the same regardless of whether Terasen [Gas] or Terasen Inc. holds the released capacity. This appears to be contradicted on page 4 where it states “as noted before, the transportation customers would be better off in Terasen Inc. continued to hold the released BC Hydro capacity. The former statement is true. Transportation customers will be indifferent if Terasen Inc. continues to hold the released capacity as compared to the proposals the Company has put forward. Further, if Terasen Inc. continued to hold the capacity the identified Midstream portfolio benefits would not be realized by Terasen Gas customers.

Inland Industrials go on to argue that since the “proposed bargain” is that Terasen Inc. forego any upside from the BC Hydro SCP capacity in return for recovery of IPC development costs, that Midstream should pay for the IPC development costs, or that the total benefit of the released capacity be credited to the delivery margin. (IPC costs could be covered by crediting Midstream $3.6 + the whole IPC charge (e.g. 3.6 + 0.6 = $4.2 million) otherwise Midstream would pay $3.6 + (2.2 -3.2) to delivery margin and loose the flexibility to manage the capacity.) Again this ignores the value delivered by the NW Natural transactions. The Midstream resource portfolio is in the best position to take advantage of the value of the SCP capacity as a result of the overall portfolio that it holds involving more than $100 million in annual transactions. This includes holding the Kingsvale South Capacity that matches the SCP capacity.

Page 4, first paragraph – Inland Industrials suggest that Terasen Inc. is currently at risk for costs accumulated in various deferral accounts related to the IPC and PG&E/NWN transactions. The PGE&E and NWN transactions were approved by the BCUC in January 2003 and Terasen Inc. has not ever been at risk for these costs. The Application merely asks for approval for the treatment of the recovery of the costs only.

BCOAPO

The BCOAPO “takes no issue with the Company’s proposal to recover the PG&E termination payments and the SCP deferral balance…) and BCOAPO “takes no issue with the proposal to include the 6MMcfd residual SCP capacity in its Midstream Portfolio.”
With respect to proposed termination of the BC Hydro arrangements, BCOAPO quotes Commission Letter No. L-48-02, which stated that in event of termination of the BC Hydro arrangements that Terasen Gas will be “reimbursed for any net costs or losses that result.” Further, BCOAPO states that it accepts the Company’s proposal related to BC Hydro capacity including cost allocations, subject to the following qualification - “should the Commission approve it, BCOAPO ask the Commission to direct the Company to provide an update of the actual realized and forecast savings twelve months after the Commission issues its Order in this proceeding. BCOAPO submits that this will provide a reasonable safeguard that ratepayers will have an available remedy should any net costs or losses related to this proposal become apparent in the future.”

Terasen Gas is prepared to agree to the suggestion to provide an after the fact report (after the twelve month period ending October 31, 2006). However, the Company does have some concern with the implied treatment of variances from the Company’s estimate of the benefits associated with proposal. The Company has demonstrated that based on current market conditions there are estimated significant benefits to customers in the proposed arrangements and suggests it is prudent and rational to put these proposals in place. However, Terasen Gas is not able to predict the future and market conditions may change in a fashion that could result in benefits that are lower or higher than estimated. The Company does think it is neither rational nor reasonable to employ 20/20 hindsight in its decision—making respecting these significant portfolio resources. After the fact reviews of this type are tantamount to placing the risk of market changes on to shareholders, which is inconsistent with current practice for Midstream portfolio decisions. The Company does not think it is reasonable or appropriate for the any variances between actual and forecast benefits, be they positive or negative, to be borne by Terasen Inc. If Terasen Inc. is to continue to have the obligation of keeping Terasen Gas whole on an after the fact review basis, then a structure would need to be put in place where this risk is offset by a share in any savings realized by Terasen Gas.

BCOAPO states that as a general principle, expenditures related to IPC development costs should be to the shareholder’s account, however, given the significant net ratepayer benefits that resulted from the circumstances surrounding this issue that BCOAPO accepts the principle of the recovery of IPC expenditures. Terasen Gas accepts BCOAPO’s position that this should be considered a special case and any future like application would have to be evaluated on its on merits.

While accepting the recovery of the IPC expenditures, BCOAPO questions the proposed recovery mechanism, and suggests consideration be given to recovery of the IPC Costs by means of amortized disposition of a rate base deferral account. Although Terasen Gas prefers the proposal it has made in its Application it does not consider the BCOAPO suggestion to be an unreasonable alternative for the Commission to consider.
In summary, Terasen Gas continues to submit that the proposals included in its Application are reasonable and appropriate, and that the Application should be approved.

We trust the Commission finds this in order. Should you have any questions with respect to this application, please contact Tom Loski at (604) 592-7464.

Yours truly,

TERASEN GAS INC.

Original signed by Tom Loski

For: Scott A. Thomson

cc: Registered Intervenors