



LETTER NO. L-48-02

ROBERT J. PELLATT
COMMISSION SECRETARY
Commission.Secretary@bcuc.com
web site: <http://www.bcuc.com>

SIXTH FLOOR, 900 HOWE STREET, BOX 250
VANCOUVER, B.C. CANADA V6Z 2N3
TELEPHONE: (604) 660-4700
BC TOLL FREE: 1-800-663-1385
FACSIMILE: (604) 660-1102

Log No. 2013

VIA FACSIMILE

December 5, 2002

Mr. Dietz Kellmann
Director
Financial Development Services
BC Gas Utility Ltd.
16705 Fraser Highway
Surrey, B.C. V3S 2X7

Dear Mr. Kellmann:

Re: BC Gas Utility Ltd. ("BC Gas")
Southern Crossing Pipeline Capacity
PG&E Energy Trading, Canada Corporation

Commission Order No. C-11-99 approved a Certificate of Public Convenience and Necessity for the Southern Crossing Pipeline ("SCP") project. The Order also approved a Firm Tendered Transportation Service Agreement ("Transportation Agreement") for approximately 52,500 Mcfd of SCP capacity (from Yahk or Kingsvale to Huntingdon) with PG&E Energy Trading, Canada Corporation ("PG&E"), and accepted for filing a Peaking Gas Purchase Agreement with PG&E. The Transportation Agreement has a primary term to October 2010 and requires PG&E to pay BC Gas Utility Ltd. ("BC Gas") \$3.6 million per year. PG&E has an option to extend the agreement to October 2020.

By letter dated December 5, 2002 (the "Application"), BC Gas advised the Commission that PG&E is encountering financial difficulties. The Application requests Commission approval for a set of transactions that are designed to preserve the value of the SCP capacity contracted to PG&E for BC Gas and its customers. These transactions are summarized as follows:

- PG&E and BC Gas will terminate the Transportation Agreement and the Peaking Gas Purchase Agreement effective January 1, 2003. PG&E has also agreed to assign an equivalent amount of upstream TransCanada PipeLines Ltd. Nova/ANG ("TCPL") capacity to BC Gas effective January 1, 2003. BC Gas has agreed to make certain payments to PG&E over the period through October 2019 and PG&E has an option to convert the payment stream to a net present value payment.
- BC Gas will enter into a firm service contract with Northwest Natural Gas Company ("NWN") for 46,500 Mcfd of SCP capacity for the period November 2004 through October 2020. Effective November 1, 2004, BC Gas will also assign an equivalent amount of TCPL service to NWN.

The transactions are likely to reduce BC Gas revenue from the PG&E SCP capacity in 2003 and 2004, notwithstanding efforts to mitigate the losses. However, over the term of the transaction, BC Gas revenue will increase significantly, for the benefit of customers. The charges to be paid by NWN are substantially

greater than those in the Transportation Agreement with PG&E. The Application states that the NWN charges exceed the current short to medium term market value of the TCPL/SCP transportation path as indicated by current forward prices, while in the long term, the charges represent to cost of adding new firm transportation capacity to the region. This indicates that the charges justify contracting most of the SCP capacity to NWN rather than retaining it for the benefit of core customers. The NWN payments will also cover the cost of replacing the gas supply available under the Peaking Gas Purchase Agreement.

The Commission confirms that it is prepared to approve the foregoing agreements with PG&E, TCPL and NWN substantially as described in the Application, provided the set of transactions are completed as a package so that BC Gas customers are not unduly exposed. The Application requests confidentiality for the filed agreements and BC Gas has confirmed that the request refers to the transportation service agreement with NWN. The NWN agreement would normally become a public document when it is approved as a Tariff Supplement, unless BC Gas provides sufficient justification for holding it confidential.

In the Application, BC Gas proposes to use both the SCP and TCPL capacity as core assets until November 2004. After that date, the residual amount of SCP and TCPL capacity will likely continue to be used in that way. Recording costs and mitigation revenue related to the TCPL capacity in the Gas Cost Reconciliation Account is generally consistent with the treatment of Duke Energy Gas Transmission service, and mitigation revenue is expected to substantially offset the cost of this capacity. The Commission approves the request with respect to TCPL capacity.

Revenue from PG&E under the Transportation Agreement is margin revenue. BC Gas proposes to record mitigation revenue from the SCP capacity in the existing SCP margin recovery account. The Commission determines that, at least until November 1, 2004, variances from the forecast amount of revenue from the PG&E SCP capacity and related mitigation revenue should be recorded in a SCP third party revenue mitigation account. BC Gas is directed to track such losses and revenue as a separate category within the account. At a future date, the Commission will determine the timing and method by which balances in the sub-account are flowed to BC Gas customers.

The Application also requests approval of an incentive program for mitigation revenue related to the set of transactions. The Commission confirms that mitigation revenue related to the TCPL capacity may be included as Eligible Transportation and Storage Margin under the Gas Supply Mitigation Incentive Program for 2002/03 that was approved by Order No. G-79-02. The Commission is not persuaded that an incentive program for SCP capacity mitigation has merit, and declines to approve such an incentive.

The Application further requests Commission approval of several related matters that involve BC Gas Inc. BC Gas states that \$5.6 million will have been spent on the Inland Pacific Connector ("IPC") project by April 2003, and requests approval to recover these development and marketing expenditures from BC Gas customers in the event the IPC project does not proceed.

NWN submitted a bid for IPC capacity in the IPC Open Season, and has continued to support the project. The Application states that IPC development and marketing efforts were necessary to capture the value for SCP capacity that will be realized by the agreement with NWN. Nevertheless, BC Gas has a longstanding business relationship with NWN related to matters such as Mist gas storage. Also, BC Gas customers funded activities like the regional resource planning work, which concluded that benefits would result from moving gas from Alberta to the Pacific Northwest region. As development of the IPC project is continuing, it would be premature to make a determination on the disposition of costs in anticipation that the project may not proceed. If the IPC project is deferred substantially, the Commission is prepared to receive and review an application for approval to recover some or all IPC expenditures from BC Gas customers based on the value that IPC expenditures have had for customers, including the contribution to the present arrangement with NWN.

The Application also requests that in the event British Columbia Hydro and Power Authority (“B.C. Hydro”) exercises its Put Option to assign its SCP capacity to BC Gas Inc., BC Gas will accept return of the capacity. BC Gas may have greater flexibility than BC Gas Inc. to mitigate losses resulting from the return of this capacity. The Commission is prepared to approve the return of the B.C. Hydro SCP capacity provided BC Gas is reimbursed for any net costs or losses that result.

The purpose of the set of transactions, which BC Gas proposes in the Application, is to preserve the value of the SCP capacity currently held by PG&E. In all the circumstances, it is essential that the transactions be completed without delay. Recognizing that the evidentiary portion of the BC Gas 2003 Revenue Requirements Proceeding is closed, the Commission is treating the Application as a new order of business. The effect of the transactions will have a nominal, if any, impact on 2003 rates for BC Gas. For commercial reasons, the Commission will hold this letter confidential until January 1, 2003.

Yours truly,

Original signed by:

Robert J. Pellatt

RJP/cms