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BRITISH COLUMBIA UTILITIES COMMISSION

LETTER NO. L-9-06

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VIA E-MAIL
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March 9, 2006

Mr. Scott Thomson
Vice President, Finance and Regulatory Affairs
Terasen Gas Inc.
16705 Fraser Highway
Surrey, B.C. V3S2X7

Dear Mr. Thomson:

Re: Terasen Gas Inc.
Gas Supply Mitigation Incentive Program for 2004/05

Further to your January 26, 2006 filing, the Commission accepts the calculation of incentive payments and issues the attached Commission staff report entitled "Overview of the Gas Supply Mitigation Incentive Program ("GSMIP") for 2004/05.

Yours truly,

Original signed by:

Constance M. Smith
for: Robert J. Pellatt

Enclosure
cc: Interested Parties

OVERVIEW OF THE GAS SUPPLY MITIGATION INCENTIVE PROGRAM ("GSMIP") FOR 2004/05

1.0 GSMIP Objectives

The intent of the program has not changed over the years and continues to be based on the alignment of the interests of customers, shareholders and employees. The objectives of the program remain the same from the initial introduction and continue to be based on five major elements. The current formula was approved by Order No. G-79-02 for the term between November 1, 2003 and October 31, 2004 (Appendix 1). The continuation of the formula for 2005 was approved by Order No. G-98-04 (Appendix 2). The following objectives originally established with the first program continue to serve as guiding principles for the incentive structure of the 2003/04 GSMIP.

1. Supply Security – The plan should maintain a high security of supply and not adversely affect total net gas costs.

2. Alignment of Interests – Terasen Gas should be encouraged to maximize net revenues from off-system business activities.

3. Fair and Reasonable Incentives – The objective is to encourage new incentives to capture value.

4. Simplicity – Plan should minimize administrative effort.

5. Fair and Reasonable Performance – The performance targets and productivity improvements should be fair and reasonable.

2.0 Service Quality Indicators ("SQI's")

Terasen Gas filed a report with the Commission on December 20, 2005 that outlined its performance relative to each SQI for the period November 2004 to October 2005. Commission staff reviewed the results of the report and assessed the performance under the following SQI criteria.

1. Annual Contract Plan (ACP) – Portfolio Optimization – The ACP was submitted April 27, 2004 and approved by Commission Letter No. L-36-04 on July 16, 2004. The Commercial Commodity Unbundling program was incorporated into the Essential Services model that was part of the ACP.

2. Price Risk Management Plan (PRMP) Implementation – The original PRMP for November 2004 to October 2006 was submitted in June 30, 2004 and approved by Letter No. L-43-04. The PRMP has been filed in a timely manner and implemented within the approved guidelines.

3. Counterparty Risk and Credit Exposure Management – Terasen Gas has effectively managed credit exposure and prudently avoided non-recoveries for the period in question.

   Commodity Supply Reliability – Through commodity, pipeline and storage asset diversification within the Annual Contracting Plan, Terasen Gas continued to ensure 100 percent delivery of Firm customer demand for the November 2004 to October 2005 contract year.

4. Gas Cost and Market Pricing Information – The Terasen Gas commodity cost is slightly lower than most of the other PNW utilities due to the significant amount of Station #2 gas in the portfolio. Station #2 and AECO monthly prices (which make up 85 percent of the Terasen Gas portfolio) averaged \$0.123 Cdn/GJ to \$0.31/GJ below the Rockies prices during the Nov04 to Mar05 period and \$0.14/GJ Cdn/GJ to \$0.23/GJ below this reference for the summer. This is in contrast to 2003/04 when the Terasen Gas' cost averaged higher than all other PNW utilities due to AECO prices averaging higher than Rockies prices.

Table No. 1 Comparison of the Average Utility Cost of Gas

	Terasen	Puget	Northwest Natural	Cascade	Avista
Gas cost	\$ 6.93	\$ 7.01	\$6.97	\$ 7.02	\$ 6.92

Legend:
Terasen - Terasen Gas Inc.
Puget – Puget Sound Energy Inc.
Northwest Natural – Northwest Natural
Cascade – Cascade Natural Gas
Avista – Avista Utilities

3.0 Internal Auditors Examination

In the final stage of the examination, Terasen Gas' internal auditors and Commission staff have analyzed and accepted the incentive payment calculation for 2004/05.

4.0 GSMIP Report for 2004/05

4.1 Economic Environment

Table No. 2 below illustrates the average, maximum and minimum prices for Sumas, AECO and Station #2 during the period of the report. The maximum highs for monthly and daily prices at all locations occurred in October as a result of the hurricanes. March and February were the lowest priced months for the monthly index. The Daily Index recorded the lowest prices in Nov04.

Table No.2 - Daily and Monthly Prices - 2004/05 ($Cdn/GJ)						
	Monthly Index			Daily Index Average		
	Sumas	AECO	St#2	Sumas	AECO	St#2
Nov-04	$ 8.24	$7.59	$7.51	$6.41	$6.07	$6.00
Dec-04	$ 7.20	$7.17	$6.64	$7.01	$6.54	$6.58
Jan-05	$ 6.90	$6.59	$6.04	$6.56	$6.18	$6.23
Feb-05	$ 6.58	$6.16	$6.35	$6.47	$6.22	$6.16
Mar-05	$ 6.34	$6.27	$6.30	$7.13	$7.05	$6.88
Apr-05	$ 7.51	$7.09	$7.04	$7.51	$7.38	$7.27
May-05	$ 7.56	$7.28	$7.21	$6.66	$6.63	$6.44
Jun-05	$ 6.49	$6.61	$6.43	$6.87	$6.95	$6.73
Jul-05	$ 7.01	$7.02	$6.86	$7.20	$7.09	$7.03
Aug-05	$ 6.84	$7.18	$6.91	$8.63	$8.71	$8.41
Sep-05	$ 8.84	$9.05	$8.58	$10.18	$10.54	$10.24
Oct-05	$ 10.90	$10.94	$10.36	$11.77	$11.80	$11.46
Average	$ 7.53	7.41	$ 7.18	$ 7.70	$ 7.60	$ 7.45

4.2 Currency

The exchange rate reached a low of 1.1776 US dollars (Sept05) to the Canadian dollar and hit a high of 1.3783 US dollars (May04) in the period. The exchange rate continued to be a highly volatile throughout the gas year.

4.3 Gas Supply Mitigation Incentive Plan 2004/05

The Off-System Revenue available for sharing incentive formula is $25,579,000 and the source of this revenue is made up of two components: Commodity Resale Eligible Revenue and Transport/Storage Revenue (shown in Table No. 3). Each segment has a different method of calculation to determine the applicable incentive portion shared between Terasen Gas and its customers.

Table No. 3 – Off-System Profit Components		
Transport and Storage Mitigation	$ 10,094,000	39%
Commodity Resale	$ 15,485,000	61%
Off-System Revenue	$ 25,579,000	

The Transportation/Storage Revenue is determined by month and simply added together to determine the total amount for the year. In this case the total is $10,094,000.

The Commodity Resale Eligible Revenue is calculated by taking into account a hurdle rate. The hurdle discount is 17/(Total Commodity Resale Sales volume in a year for the commodity component) or 36.5 PJ. The hurdle discount is $.466/GJ and the eligible hurdle rate then is the annual average Sumas index ($7.234/GJ) less the hurdle discount or $6.768/GJ (Average Annual Sumas Index - Hurdle Discount). The hurdle rate times the cumulative annual volume by month results in the hurdle margin.

The Commodity Resale Eligible Revenue minus the hurdle margin together with Transportation and Storage Revenue then results in the Off-System Revenue eligible for incentive or $25,578,259.

Terasen Gas' incentive is 5 percent of the first $1 million and 1.25 percent of remainder. Transportation/Storage revenue of $10,093,720 is added to revenue eligible for an incentive of $15,484,540 and results in $25,578,259. The first $20,000,000 has an incentive of $1,000,000. The remainder or $5,578,259 has 1.25 percent applied and results in $69,728. Therefore the total incentive to TGI is $1,000,000 plus $69,728 or $1,069,728.

4.4 GSMIP Report Overview and the Development of the Incentive Determination

4.4.1 Total Off-System Sales Quantity

Table No. 4

	Commodity Resale		Transport & Storage	
	PJ	$ CDNx *1000	PJ	$ CDN*1000
2000/01	28.9	$47,062	18.4	$51,193
2001/02	20.5	$16,609	27.8	$16,761
2002/03	9.6	$19,331	49.1	$11,486
2003/04	29.9	$20,576	64.3	$11,402
2004/05	36.5	$15,585	41.0	$10,094
% Change	22%	-25%	-36%	-11%

As shown in Table No. 4, Commodity Resale increased by about 6.6 PJ as a warmer than normal winter allowed term gas to be available for this activity. The extra term gas was contracted as a safety margin to avoid being at risk for spot gas during the winter period.

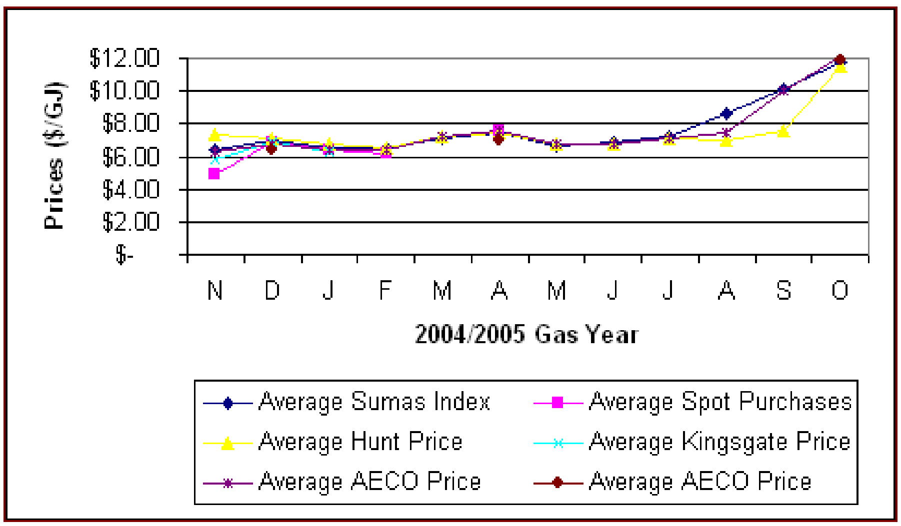
In November 2004 Terasen Gas assigned 56.5 TJ/d of Nova capacity to Northwest Natural Gas that had previously been held by PG&E as part of the Southern Crossing Pipeline ("SCP") service. This was the primary driver for less Back to Back sales (41.0 PJ vs 64.3 PJ in the prior year) in the Transportation and Storage category and a drop in this segment of about 36 percent in volume.

4.4.2 Off-System Sales Revenue

Table No. 5 - 2004/05 Sumas Price Index vs. Other Indices (Prices $/GJ)

Month	Average Sumas Index	Average Spot Purchases	Average Hunt Price	Average Kingsgate Price	Average Empress Price	Average AECO Price
N	$ 6.41	$ 4.94	$ 7.39	$ 5.78	$ 6.29	
D	$ 7.01	$ 6.89	$ 7.07	$ 6.85	$ 6.76	$ 6.39
J	$ 6.56	$ 6.37	$ 6.76	$ 6.32	$ 6.40	
F	$ 6.47	$ 6.13	$ 6.54		$ 6.40	
M	$ 7.13		$ 7.20		$ 7.19	
A	$ 7.51	$ 7.54	$ 7.42		$ 7.61	$ 6.94
M	$ 6.66		$ 6.77		$ 6.76	
J	$ 6.87		$ 6.71		$ 6.79	
J	$ 7.20		$ 7.10		$ 7.11	
A	$ 8.63		$ 7.02		$ 7.40	
S	$ 10.18		$ 7.55		$ 10.01	
O	$ 11.77		$ 11.55		$ 12.09	$ 11.90

Table No. 6 – Pricing Graph for Table No. 5



Off-System Sales

As shown in Tables No. 5 and 6, spot purchases were for the most part below the Sumas Index. When the spot price is less than the monthly, sales generated from Huntingdon, Kingsgate/Empress and AECO will result in a loss in revenue. The number of Off-System Sales transactions decreased by about 10 percent over 2003/04 as shown on Table No. 7.

Capacity Release

Capacity Release transactions decreased by 88 percent, while the number of customers stayed about the same as last year (Table No. 7).

Purchases

Purchase transactions decreased by 7 percent and the number of customers increased by 18 percent.

Table No. 7 - Off-System Activity	2003/04 Number	Change	2004/05 Number	Change
Off-System Sales Margin				
Number of customers	36	16%	31	-14%
Transactions	3070	15%	2,748	-10%
Capacity Release				
Number of customers	6	-25%	6	0%
Transactions	85	-66%	10	-88%
Purchases				
Number of customers	28	-22%	33	18%
Transactions	2833	33%	2,621	-7%
Total Transactions	5988	18%	5,379	-10%

4.4.3 <u>Total Off-System Revenue Components after the Commodity Hurdle Rate</u>

The major sources of Off-System sales revenue are shown in Table No. 8 (based on Terasen Gas Inc. GSMIP Report Appendix #1). It is broken down into the relevant components of Sales Margin, Capacity Release, Hedge Revenue Storage and Miscellaneous.

In the winter months an allocation of T-south transportation mitigation was made between GSMIP and SCP. GSMIP was assigned a 21 percent allocation and the remaining portion or 79 percent allocated to SCP for the period November 2004 to March 2005. In the months of April to October 2005, GSMIP was allocated 75 percent with 25 percent apportioned to SCP. The allocation formula was based on the total available T-South capacity once the Annual Contracting Plan was approved and the amount of SCP capacity set.

Table No. 8 - Total Off-System Revenue after the Commodity Hurdle Rate			
	2003/04	2004/05	% Difference
Sales Margin	$28,256,420	$20,094,349	-25.3%
Capacity Release	$1,582,889	$1,387,514	-12.3%
Hedge Revenue	$0	$0	0%
Storage	$297,000	127,704	-57.0%
Miscellaneous (Matched Sales & Purchases, Monthly Park/Lends, Cochrane & Philips Extraction, CanWest T-S)	$1,841,629	$3,968,692	+61.2%
Total Off-System Revenue Available for Incentive Sharing	$31,977,938	$25,578,259	-20.0%

4.4.3.1 Sales Margin - $20,094,259

There was an increase in Commodity Resale volumes; however, the resale margin decreased by 25 percent from the same period last year. The average annual resale price was below the average annual Sumas Index by $.04 Cdn/GJ and Terasen Gas used winter recallable Commodity Resale deals to mitigate this price.

Terasen Gas sold excess storage gas in the summer months when prices were approximately $.50 Cdn/GJ greater than winter prices. In addition, Terasen Gas took action to generate savings for the core market that was not recognized by the incentive mechanism. Storage gas amounting to 7.5 PJ was left in place in the summer generating additional savings of $10.9 million and avoiding additional withdrawal/injection charges of $2.1 million.

Table No. 9 indicates the trading points where the sales margin was achieved. The majority of the Sales Margin was collected at Huntingdon.

Table - 9 Sales Margin Reconciliation		
Huntingdon	$	6,931,792
Station 2, Aitken Creek, Ft.Nelson	$	28,776
Alberta (NIT)	$	17,851
Kingsgate	$	957,135
Empress	$	10,429,460
Industrial	$	1,317,784
T-South/SCP	$	411,551
Total	$	20,094,349

4.4.3.2 Capacity Release – $1.388 million

Capacity Releases, which included capacity assignments, increased by 13.8 percent over the prior year in dollar value. This was principally the result of Terasen Gas assigning a greater quantity of excess T-South capacity for the summer at $.045 Cdn/GJ margin on 18 PJ of gas.

4.4.3.3 Hedge Revenue – $0 million

There were no opportunities presented in the forward curve to capture gas price margins between the current price and the forward price.

4.4.3.4 Storage Mitigation Revenue - $.127 million

This revenue resulted from storage that was not required by the Core Market and leased out temporarily to third parties.

4.4.3.5 Miscellaneous $2.969 million

Miscellaneous Revenue is made up of the following components:

1. The Cochrane & Conoco/Phillips extraction plant contributed $.9 million of revenue. This facility extracts liquids from the gas moved by Terasen Gas to the Empress border. Conoco/Philips then sells off the liquids but the heat content of gas to Terasen's respective counterparties remains about the same. (Terasen Gas receives about $.025 Cdn/GJ for the gas that is sold at Empress).

2. In the November to October 2005 period, TGI acquired approximately 10,000 GJ/d of T-South firm service from CanWest for a one time incremental revenue gain of $.802 million. Terasen Gas effectively swapped one year T-South service for 3-year capacity from CanWest at no incremental cost.

4.4.3.6 Total Off-System Revenue Eligible for the Sharing Formula

Table No.10 – Comparison of the Total Revenue and effect from Hurdle Rate

Years	Total Revenue	Margin Ineligible due to Hurdle Rate	Total Available for Incentive Sharing	Ratio Revenue/Profit
2004/05	$272,482,083	$ 246,903,813	$ 25,578,259	1065%
2003/04	$197,709,291	$ 165,731,353	$ 31,977,938	618%
2002/03	$ 74,671,405	$ 43,855,052	$ 30,816,353	242%
2001/02	$ 49,112,762	$ 15,742,377	$ 33,370,385	147%
2000/01	$146,872,177	$ 48,617,669	$ 98,254,508	149%
1999/00	$ 85,914,477	$ -	$ 85,914,477	100%
1998/99	$ 57,434,996	$ -	$ 57,434,996	100%

As shown in Table No. 11 the total revenue available for profit sharing after applying the hurdle rate was $25,578,259 or a 25.01 percent decrease over 2004/05.

5.0 Incentive Sharing

Table No. 11 Off-System Incentive Sharing			
	Core Market	Terasen Gas Inc.	Total
Commodity Resale	$ 14,900,028	$ 584,511	$ 15,484,540
Transport & Storage	$ 9,608,503	$ 485,217	$ 10,093,720
Total	$ 24,508,531	$ 1,069,728	$ 25,578,259

As indicated in Table No. 11, the Terasen Gas share for 2004/05 is $1,069,728 and the Core Market portion amounted to $24,508,531. This reflects the agreed upon formula and provides approximately $1 million to TGI to perform the off-system sales function.

Table No. 12 indicated the relative comparison of the Incentive Sharing results over the last 7 years. Since 2001/02 gas year, Terasen Gas has received an incentive of approximately $1 million.

Table No.12
Historical Record of Incentive Sharing Results from 1998 to 2005

Years	Core Market	Terasen Gas	Total
2004/05	$24,508,531	$1,069,728	$25,578,259
2003/04	$ 30,828,214	$ 1,149,724	$ 31,977,938
2002/03	$ 29,681,149	$ 1,135,204	$ 30,816,353
2001/02	$ 32,203,255	$ 1,167,130	$ 33,370,385
2000/01	$ 95,311,415	$ 2,943,092	$ 98,254,507
1999/00	$ 83,816,615	$ 2,097,867	$ 85,914,482
1998/99	$ 56,049,121	$ 1,385,875	$ 57,434,996

6.0 Innovation

The maximization of net revenues from off-system business activities requires innovation and this is the underlying emphasis of the program. Terasen Gas is introducing one or two innovations per year and each one of then becomes part of the base program.

- Terasen Gas bought gas at Station #2 and sold it at Kingsgate to lock in 6.1 PJ and $412,000 of margin.
- The Park/lend activity was up significantly over 2003/04. This generated 5.4 PJ and $2.3 million of margin, vs. 2.5 PJ (+116%) and $0.7m (+229%) last year. This activity required constant monitoring of forward price differentials then pursuing deals with counterparties while balancing storage refills during summer.
- A one year T-South transportation agreement was swapped for 3 year term generated $802,000 of additional margin.

7.0 Conclusion

1. There was a substantial increase of 25 percent in Commodity Resale volumes; however, the spot price was less than the monthly price for the most part. The result is that the overall revenue from this category declining by 22 percent.

2. The daily price and monthly indexes actually peaked in Oct05 as a result of the hurricane season when natural gas supply was disrupted along the Gulf of Mexico.

3. Transportation and Storage revenue declined by 11 percent and volumes declined by 36 percent.

4. No hedges were put in place as no revenue could be generated by locking in the forward price.

5. Innovation was demonstrated (See Section 6).

6. An incentive profit in the order of $1,000,000 continues to provide sufficient motivation for GSMIP.

BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-79-02

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

and

An Application by BC Gas Utility Ltd.
for Approval of a Gas Supply Mitigation Incentive Program for the 2002/03 Gas Contract Year

BEFORE: P. Ostergaard, Chair)
P.G. Bradley, Commissioner)
R.D. Deane, Commissioner) October 31, 2002
N.F. Nicholls, Commissioner)

O R D E R

WHEREAS:

A. The Commission, by Order No. G-92-95, approved for BC Gas Utility Ltd. ("BC Gas") the Off-System Incentive Program ("OSIP") for a two-year period commencing January 1, 1996; and

B. As part of its May 5, 1997 Revenue Requirements Application for 1998 to 2002, BC Gas filed a revised incentive plan. During the Alternative Dispute Resolution process, it was agreed by all parties to deal with the form of gas cost incentive plan(s) that would succeed OSIP in a series of separate meetings. The following Commission Orders approved a Gas Supply Mitigation Incentive Program ("GSMIP") for each subsequent gas contract year: Order No. G-125-97 for 1997/98, Order No. G-92-98 for 1998/99, Order No. G-82-99 for 1999/2000, Order No. G-106-00 for 2000/01, and Order No. G-124-01 for 2001/02; and

C. In 2002 BC Gas, the British Columbia Public Interest Advocacy Centre ("BCPIAC") and Commission staff held a series of negotiating meetings concerning a gas supply mitigation incentive plan for the 2002/03 gas contract year, and reached agreement on the methodology, terms and conditions set out in the Settlement document that is attached as Appendix A to this Order ("GSMIP 2002/03"); and

D. By letter dated October 29, 2002, BCPIAC advised that it agreed with the GSMIP 2002/03 Settlement on behalf of the Consumers' Association of Canada (B.C. Branch) et al.; and

E. The Commission has reviewed the filing and is satisfied that the GSMIP 2002/03 should be approved.

../2

BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-79-02

NOW THEREFORE the Commission approves for BC Gas the Gas Supply Mitigation Incentive Program 2002/03 that is attached as Appendix A to this Order, for the gas contract year from November 1, 2002 through October 31, 2003.

DATED at the City of Vancouver, in the Province of British Columbia, this 5th day of November 2001.

BY ORDER

Original signed by:

Peter Ostergaard
Chair

Attachment

BC GAS UTILITY LTD.
GAS SUPPLY MITIGATION INCENTIVE PROGRAM (GSMIP) FOR THE 2002/2003 CONTRACT YEAR

The parties, consisting of Counsel representing the British Columbia Public Interest Advocacy Centre, BC Gas Utility Ltd. and the British Columbia Utilities Commission ("Commission" or "BCUC"), have met to consider revisions to the existing incentive arrangement. The parties reviewed options for the year November 2002 through October 2003 ("GSMIP 2002/03"). The parties agreed to continue with a GSMIP for the coming year that will generate sharing revenue based on mitigation recovery but will allow the Commission to disapprove of any Incentive payment if BC Gas' overall Gas Supply service is deemed not acceptable for the Contract year. To provide the BCUC the information to assess performance a number of Service Quality Indicators (SQI's) have been developed. A requirement to provide certain market information to assist Staff in its analysis is also included. BCUC Staff will review performance under the SQI's and the Commission shall have the right to disapprove of mitigation revenue sharing if it deems the performance of BC Gas under the SQI's is not acceptable. The revised mitigation sharing mechanism will continue to limit BC Gas' revenue sharing in excess of $1 million. The following objectives have not changed and should continue to serve as the guiding principles in determining the structure of GSMIP.

GSMIP Objectives and Guiding Principles

1. **Supply Security**

   The plan should discourage any activity that might adversely affect the security of supply or total net gas costs.

2. **Alignment of Interests**

   The plan should ensure that BC Gas maximizes net revenues from its off-system business activities.

3. **Fair and Reasonable Incentives**

   The plan should be structured to avoid paying incentives for activities and results already achieved, but reward new, substantial exertions by the Company.

4. **Simplicity**

   The plan should be structured in such a way that it minimizes administrative effort.

5. **Fair and Reasonable Performance Targets**

   The plan should ensure that performance targets and expected productivity improvements are just and reasonable and that the level of incentive sharing corresponds to the level of excellence demonstrated by BC Gas' gas procurement and mitigation activities.

This document sets out the terms of GSMIP 2002/03 which those participating in the meetings consider to be appropriate for implementation by BC Gas. Agreement on the terms and conditions of this arrangement involved compromise, and this settlement represents a balance of interests and consensus among the parties.

Key Components of Gas Supply

The key components of Gas Supply are sequential as follows:

1. Development of an Annual Contracting Plan to acquire an optimum mix of transport, storage and supply contracts including implementation of the Annual Contracting Plan.
2. Planning and implementing the Price Risk Management Plan.
3. Managing counterparty risk and credit exposures.
4. Ensuring 100% Firm customer commodity supply reliability.

Providing acceptable performance in these four key components should indicate that BC Gas has met the criteria of acceptable service quality for Firm customers.

GSMIP Structure

1. Term

The term of GSMIP 2002/03 will commence on November 1, 2002 and will expire on October 31, 2003. In order to determine the incentive to be received by BC Gas in 2003, the Company's performance during the gas contract year ending October 31, 2003 will be examined. If appropriate, and upon approval by the Commission, BC Gas will then withdraw from the Gas Cost Reconciliation Account any incentive amounts earned.

2. Expiration & Incentive Review

GSMIP 2002/03 is recognized as temporary or interim in nature, applying to the November 1, 2002 - October 31, 2003 contract period only. At the end of the period it will be reviewed and its disposition — i.e. abandonment, replacement or continuation — will be subject to Commission approval.

3. Service Quality Indicators

The Service Quality Indicators (SQI's) are being introduced into the GSMIP plan to provide information for the BCUC to assess the overall performance of the Gas Supply Function. Each of the SQI's will have identifiable targets that establish acceptable performance. At the year-end BC Gas is required to file a report on performance relative to the SQI's. The Commission will then determine if the results of the SQI's determine that BC Gas has provided an acceptable level of overall Gas Supply Service in the year. The SQI's are as follows:

3.1. Annual Contract Plan (ACP) - Portfolio Optimization

As part of the ACP submission, BC Gas shall provide a cost summary template that will illustrate the expected overall costs of the proposed portfolio vs. the current portfolio. Commodity and asset pricing used to determine overall costs for both portfolios will be based on forward market expectations at the time of submission. For example, if current asset costs are forecast to increase in cost for the coming contract year that will be the new baseline used in the comparator analysis.

Performance Target: The ACP must be submitted to the BCUC by March 31 of each year. The approved ACP, including any revisions throughout the year, must be successfully implemented over the contracting period recognizing those market conditions that may arise.

3.2. Price Risk Management Plan (PRMP) Implementation

BC Gas submits the PRMP to the Commission each spring to seek approval for hedging limits for the following contract periods. Once the BCUC approves the PRMP, BC Gas begins implementation within the approved guidelines. BC Gas then provides to the BCUC all trade data including submission of quarterly updates on the mark to market activities. From time to time the Staff also request information on status of the plan and BC Gas' strategy position. PRMP activities are an important part of the Gas Supply Function with the financial positions often having a significant impact on overall gas costs.

Performance Target: BC Gas is to continue to provide the PRMP in a timely fashion meeting the expectations of the Commission for approval. BC Gas is to implement the PRMP including any approved revisions within the guidelines presented in the plan including any provisions or understanding about transaction volumes within stated timelines.

3.3. Counterparty Risk and Credit Exposure Management

Implementation of financial and physical transactions necessary to optimize Gas Supply management for Firm customers creates significant credit exposure. BC Gas has a conservative and well defined credit policy that is actively managed and has avoided non-recoveries over the last 2 years of volatile markets. This has been a significant benefit to Firm customers. Credit exposure now has a significant influence on Term gas contracting and need to minimize surplus sales and associated credit risk. BC Gas is to provide a report that summarizes credit management activities over the year, outlining mitigation strategies put in place to manage marketplace dynamics and identifying any defaults.

Performance Target: BC Gas is to show that it has effectively managed credit exposure for Firm customers prudently avoiding potential non-recoveries if deemed reasonably preventable.

3.4. Commodity Supply Reliability

BC Gas must balance cost minimization with supply reliability. Ensuring that Firm customers have 100% of Firm requirements is an over-riding objective of Gas Supply. BC Gas shall provide a report to the Commission identifying any curtailments of Firm customers over the year. This report will also identify curtailments of Interruptible customers. Supply reliability also includes reliability of assets contracted by BC Gas to meet customer needs. Contract default and Interruptible curtailments are subject to market conditions so targets are not being established for them. BC Gas will also summarize reliability measures put in place for the contracting year and a summary of any supply failures of commodity, pipeline and storage assets.

Performance Target: 100% delivery of Firm customer demand.

4. Gas Cost and Market Pricing Information

This information is to be provided to the Commission on a monthly basis to provide the BCUC Staff relevant market information.

4.1. Regional Local Distribution Companies Rate Indicators

BC Gas is to provide a report that summarizes monthly Gas Costs as available for other regional LDC's such as Cascade, Puget, Avista, Northwest Natural and ATCO over the contract year. BC Gas will also provide a summary of the portfolio's utilized by each of these other LDC's and illustrate differences from the BC Gas portfolio. Determination of the regional LDC portfolios will be through review of public information and discussion with each of their respective Gas Supply departments and will therefore be an estimate only. Regulator approved and implemented financial price fixing activity and deferral treatment vary significantly between the LDC's and drive rates to a large extent so individual LDC rates could vary significantly at a given time.

4.2. BC Gas Actual Gas Costs and Market Index prices

BC Gas shall provide actual incurred monthly Gas Costs before hedging. BC Gas shall also provide data on actual Daily and Monthly Index prices at Sumas, NYMEX, AECO and Station 2. This Data will used to calculate Gas Cost proxy's for purchasing 100% of daily Firm demand at both the Sumas and AECO Daily Midpoint Index for reference. BC Gas shall also provide historical Gas Cost and market price information back to January 1997 to provide historical illustrations. Because the Sumas Daily price does not meet intra-day balancing needs and there is insufficient market liquidity to ever consider this kind of purchase strategy the comparison is only a proxy and does not define any true measure other than to show how the portfolio approach protects customers from much of the market volatility even before hedging activity.

4.3. Commodity Costs compared to Market

BC Gas develops a portfolio of pipeline, storage and commodity contracts that provide supply reliability and price diversity for Firm customers. The majority of BC Gas' Firm demand is in the Lower Mainland and is tied to the Sumas Hub. The Sumas market is currently not liquid and is subject to considerable volatility. BC Gas must be a significant contributor to managing demand variability at this location. The portfolio of assets is accepted as necessary to manage Firm customer load variability and access less volatile supply sources upstream. Value recovery realized on transport and storage assets is subject to the volatile nature of market conditions and will vary considerably from year to year. Therefore, performance on contracted assets should be based on portfolio development and recovery of available mitigation value as proposed in this plan.

The portfolio assets provide commodity purchasing options to BC Gas. BC Gas commodity buying should be reasonably competitive with market price availability. BC Gas will provide monthly data on actual Gas commodity purchase costs before hedging compared to Sumas, Station 2 and AECO Monthly and Daily Index priced gas.

5. Sharing Mechanism

Objectives

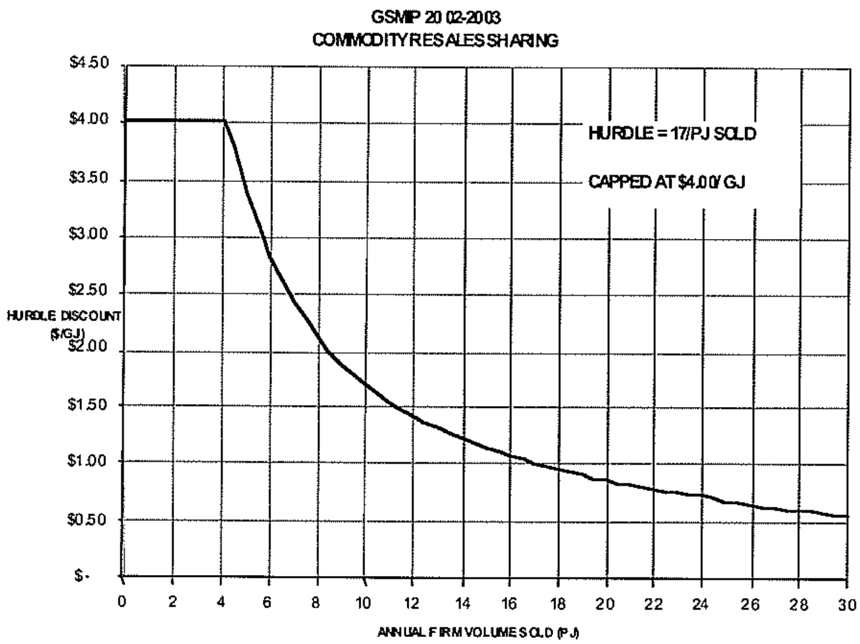
- Continue with separate commodity and transport revenue mechanisms combining the two revenues into one overall sharing allocation.
- Revise the sharing hurdle to reference total monthly gas purchase cost instead of just the fixed component. The total gas purchase cost shall be the monthly Sumas Index. The existing commodity mechanism concept of sharing on the last $1/GJ of hurdle rate revenue will continue in concept, but the hurdle for 2002/03 will be based on total gas purchase cost as identified by the Sumas Monthly Index rather than contractual fixed costs as in 2001/02.
- Revise the sharing mechanism to reflect lower available surplus Firm customer volumes using a linear adjustment to the $1/GJ hurdle rate revenue sharing proportion to maintain the potential for $1 million sharing with a high level of recovery on actual Firm volumes resold. Transport and storage revenue assumptions are factored into this mechanism to recognize this revenue contributes to the overall sharing capability to $1 million. Continue to cap total sharing at 1.25% after $1 million sharing is earned.

6. Incentive Structure Summary

BC Gas recovers mitigation revenue from recovery of revenue from surplus term gas purchased for Firm customers and third party recovery of value from unutilized Firm customer pipeline capacity and storage assets. Each of these activities are distinctly separate transactions. Eligible commodity sharing and transport and storage margin will be combined to calculate the basis for BC Gas' final incentive sharing.

a) Eligible Commodity Resale

BC Gas' commodity sharing reward is dependent primarily on how close it can come to achieving full recovery of purchase costs for core customers regardless of commodity pricing and volume available for resale. BC Gas' revenue sharing on each gas unit resold will be dependent on total surplus Firm volumes sold in the contract year. The lower the Firm volume available the higher the BC Gas sharing on total revenue recovered. The amount of resale revenue BC Gas shares is based on a discount from the Monthly Sumas Index. This discount from the Index varies based on the formula 17 / (Annual PJ sold). The formula factors in a total revenue recovery from transport and storage mitigation of $ 3 million. This formula allows BC Gas to achieve $1 million of sharing revenue if it achieves 100% full recovery of purchase costs on all re-sales and the $3 million of asset mitigation. The methodology is further detailed in the attached Definitions and on the following table.



Justification for the new Commodity Sharing Mechanism

- It will better align BC Gas and customers to margin recovery per unit resold.
- It will better incent BC Gas for overall cost optimization by reducing sharing revenue uncertainty associated with resale volume availability.

b) Transport and Storage

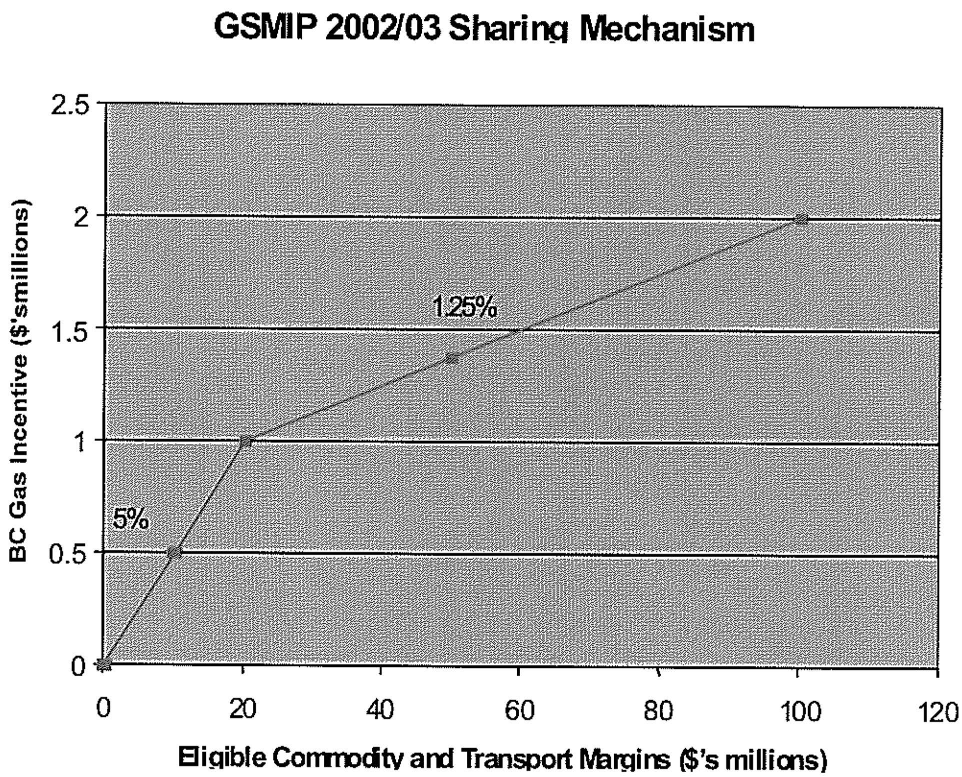
The existing transportation and storage mechanism works well and shall be continued. This activity will include the net revenue from spot gas purchases and sales transacted to recover revenue from core transportation and storage assets.

BC Gas Sharing Incentive

The parties agree to combine the transport and storage revenue with the eligible commodity revenue to create one sharing mechanism. BC Gas' incentive share will be 5% of the Total Eligible Margin up to the first $1 million sharing earned.

- When BC Gas achieves $1 million sharing, the BC Gas share will reduce to 1.25% on all remaining Total Eligible Margin.

The sharing mechanism is illustrated below:



The proposed new mechanism meets the objective of limiting BC Gas' sharing in the case of extreme mitigation revenue opportunity available but still provides reasonable sharing when minimal or more historic opportunity, such as is forecast next year, is available to be recovered by BC Gas.

7. Employee Incentives

Within the context of other incentive plans and market competitive compensation levels for employees, BC Gas will continue to recognize those Gas Supply and Industrial Services employees deemed to have directly or indirectly contributed toward the generation of net revenues achieved under this GSMIP 2002/03. Such incentive compensation will be based upon and related to the incentive earnings of BC Gas.

8. Regulatory & Management Reporting

In order for the Commission to adequately monitor and evaluate the Company's performance, the already well-developed record-keeping and reporting procedures will be continued. BC Gas will also continue with its current practice of regular quarterly filings with the Commission consisting of a summary report that details all off-system and non-core on-system activity and associated financial impacts. This report will be submitted to the BCUC within two months of the quarter-end. BC Gas will also provide an update on the status of the SQI's and Gas Cost and Market Pricing on a monthly basis within two weeks of the month-end.

BC Gas will also continue to keep distinct and separate records, for audit purposes, of its daily "Priority Schedule", which determines the available supply and its marginal costs, a daily "Load Forecast Sheet", which details all on-system supply requirements, and a "Deal Sheet" for each and every transaction that will feature all information as it relates to the economics of each transaction.

BC Gas will confer with Commission staff to ensure that these reports provide an appropriate level of disclosure and audit capability with a minimum of administrative burden. Commission staff will examine the calculation of any incentive payments received under the GSMIP 2002/03 and the Commission will make any appropriate adjustments. For the benefit of interested parties, an overview report will be issued by Commission staff at the end of the term. Such report shall provide an analysis of the effectiveness of the GSMIP 2002/03.

Definitions

Commodity-sharing Mechanism

Core Commodity Volume	All gas volumes under purchase contract as approved by the BCUC to meet Firm customers as approved in the ACP.
Surplus Volume Available	Core Commodity Volume in excess of actual Firm customer needs.
Hurdle Discount	The unit commodity resale margin hurdle discount (CDN$/GJ) from the Weighted average Sumas Monthly Index price converted to CDN$/GJ. The Hurdle Discount shall be determined at the end of the contract year once the total annual resale volume is known. The Hurdle Discount is calculated by multiplying $1.00/GJ by the factor of 17/(PJ annually resold). The Hurdle Discount is capped at 4$/GJ. For example, if total annual volume sold is 8PJ the Hurdle Discount would be 17/8 = $2.125/GJ.
Annual Average Sumas Index Price	The Annual Average Sumas Index Price shall be the weighted average of the actual monthly resale volumes times the monthly Sumas Index for each of the months divided by the total annual volumes resold.
Eligible Commodity Resale Hurdle	This is the hurdle rate before BC Gas shares in resale revenue. It is the Annual Average Sumas Index Price less the Hurdle Discount. For Example, if the annual average weighted Sumas Index price was $6.125/GJ and BC Gas sold 8PJ annually as in the example above the Hurdle Discount would be $2.125/GJ and the Eligible Commodity Resale Hurdle would be $4.00/GJ. BC Gas would share on all revenue recovery above this $4.00/GJ hurdle.
Eligible Resale Revenue	All revenue generated above the Eligible Commodity Resale Hurdle times the actual annual sales. For example, using the example above if BC Gas averaged annually $6.00/GJ recovery on 8 PJ the Eligible Resale Revenue would be 8PJ x ($6.0/GJ-$4.0/GJ) = $16 million.
Eligible Transportation and Storage Margin	The revenue received by BC Gas from third parties via assignment of Core transportation and Storage including the net revenue received by BC Gas via back to back Transport and Storage buy/sell mitigation activity.
Total Eligible Margin	Eligible Resale Revenue plus Eligible Transportation and Storage Margin.

BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-98-04

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

and

An Application by Terasen Gas Inc.
for Approval of a Gas Supply Mitigation Incentive Program for the 2004/05 Gas Contract Year

BEFORE: L.F. Kelsey, Commissioner November 3, 2004
K.L. Hall, Commissioner

O R D E R

WHEREAS:

A. The Commission, by Order No. G-92-95, approved for Terasen Gas Inc. ("Terasen Gas") (formerly known as BC Gas Utility Ltd.) the Off-System Incentive Program ("OSIP") for a two-year period commencing January 1, 1996; and

B. As part of its May 5, 1997 Revenue Requirements Application for 1998 to 2002, Terasen Gas filed a revised incentive plan. During the Alternative Dispute Resolution process, it was agreed by all parties to deal with the form of gas cost incentive plan(s) that would succeed OSIP in a series of separate meetings. The following Commission Orders approved a Gas Supply Mitigation Incentive Program ("GSMIP") for each subsequent gas contract year: Order No. G-125-97 for 1997/98, Order No. G-92-98 for 1998/99, Order No. G-82-99 for 1999/2000, Order No. G-106-00 for 2000/01, Order No. G-124-01 for 2001/02 and Order No. G-79-02 for 2002/03, which included the GSMIP settlement document attached as Appendix A; and

C. Order No. G-67-03 approved the continuance of the 2002/03 GSMIP for the 2003/04 gas contract year without any revisions to the formula or the Service Quality Indicators; and

D. By letter dated September 24, 2004, Terasen Gas proposed that the 2003/04 GSMIP should continue for a further year; and

.../2

BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-98-04

E. By letter dated October 26, 2004, the British Columbia Public Interest Advocacy Centre advised that it agreed that the 2003/04 GSMIP formula and Service Quality Indicators should continue for the 2004/05 GSMIP; and

F. The Commission has reviewed the filing and is satisfied that the GSMIP Settlement document, attached as Appendix A, should be approved for the 2004/05 gas contract year.

NOW THEREFORE the Commission approves for Terasen Gas the 2004/05 Gas Supply Mitigation Incentive Program that is attached as Appendix A for the gas contract year from November 1, 2004 through October 31, 2005.

DATED at the City of Vancouver, in the Province of British Columbia, this 9th day of November 2004.

BY ORDER

Original signed by:

L.F. Kelsey
Commissioner

Attachment

Terasen Gas

APPENDIX A
to Order No. G-98-04

Scott A. Thomson
Vice President,
Finance & Regulatory Affairs

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Tel: (604) 592-7784
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November 2, 2004

British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, B.C.
V6z 2N3

Attention: Mr. R.J. Pellatt, Commission Secretary

Dear Sir:

RE: Terasen Gas Inc. ("Terasen Gas")
Gas Supply Mitigation Incentive Program ("GSMIP") 2004/2005

The above-referenced document was submitted to the British Columbia Utilities Commission ("Commission") for approval on October 27, 2004. Subsequently, following discussions with Commission Staff, Terasen Gas made further revisions to the October 27, 2004 submission. The revised document is attached herewith for Commission review and approval.

We trust the enclosed is satisfactory. Should the Commission require further information, please contact Mike Hopkins at (604) 592-7842.

Yours very truly,

TERASEN GAS INC.

Original signed by Tom Loski

For: Scott A. Thomson

c: Dick Gathercole

TERASEN GAS INC.

GAS SUPPLY MITIGATION INCENTIVE PROGRAM ("GSMIP") FOR THE 2004/2005 CONTRACT YEAR

The parties, consisting of Counsel representing the British Columbia Public Interest Advocacy Centre, Terasen Gas Inc. ("Terasen Gas") and the British Columbia Utilities Commission ("BCUC"), have met on October 15, 2004 to review the existing incentive arrangement. The parties agree to continue with the existing GSMIP plan with the intention of rolling the plan over for the 2004/05 contract year. The GSMIP 04/05 plan will generate sharing revenue based on mitigation recovery but will allow the BCUC to disapprove of any Incentive payment if Terasen Gas overall Gas Supply service is deemed not acceptable for the Contract year. To provide the BCUC the information to assess performance a number of Service Quality Indicators ("SQI's") will be reported. A requirement to provide certain market information to assist the BCUC in its analysis is also included. BCUC Staff will review performance under the SQI's and will have the right to disapprove of mitigation revenue sharing if it deems Terasen Gas performance under the SQI's is not acceptable. The sharing mechanism will continue to limit Terasen Gas revenue sharing in excess of $1 million. It should be noted that all GSMIP mitigation activity falls within the Midstream account under the Essential Services Model for Commodity Unbundling, with GSMIP revenues affecting only rates determined through the Midstream Cost Reconciliation Account. Terasen Gas will continue to provide information regarding the Service Quality Indicators ("SQI's") so that the BCUC can assess the performance of Gas Supply service. The following objectives have not changed and should continue to serve as the guiding principles in determining the structure of GSMIP.

GSMIP Objectives and Guiding Principles

1. **Supply Security**
   The plan should discourage any activity that might adversely affect the security of supply or total net gas costs.

2. **Alignment of Interests**
   The plan should ensure that Terasen Gas maximizes net revenues from its off-system business activities.

3. **Fair and Reasonable Incentives**
   The plan should be structured to avoid paying incentives for activities and results already achieved, but reward new, substantial exertions by the Company.

4. **Simplicity**
   The plan should be structured in such a way that it minimizes administrative effort.

5. **Fair and Reasonable Performance Targets**
   The plan should ensure that performance targets and expected productivity improvements are just and reasonable and that the level of incentive sharing corresponds to the level of excellence demonstrated by Terasen Gas' gas procurement and mitigation activities.

This document sets out the terms of GSMIP 2004/05 which remain unchanged from GSMIP 2003/04.

Key Components of Gas Supply

The Key components of Gas Supply are sequential as follows:

1. Development of an Annual Contracting Plan to acquire an optimum mix of transport, storage and supply contracts including implementation of the Annual Contracting Plan.
2. Planning and implementing the Price Risk Management Plan.
3. Managing counterparty risk and credit exposures.
4. Ensuring 100% Firm customer commodity supply reliability.

Providing acceptable performance in these four key components should indicate that Terasen Gas has met the criteria of acceptable service quality for Firm Customers.

GSMIP Structure

1. Term
The terms of GSMIP 2004/05 will commence on November 1, 2004 and will expire on October 31, 2005. In order to determine the incentive to be received by Terasen Gas in 2005, the Company's performance during the gas contract year ending October 31, 2005 will be examined. If appropriate, and upon approval by the BCUC, Terasen Gas will then withdraw from the Midstream Cost Reconciliation Account any incentive amounts earned.

2. Expiration & Incentive Review
GSMIP 2004/05 is recognized as short-term in nature, applying to the November 1, 2004 - October 31, 2005 contract period only. At the end of the period it will be reviewed and its continuation will be subject to BCUC approval.

3. Service Quality Indicators
The Service Quality Indicators ("SQI's") are being continued in the GSMIP plan to provide information for the BCUC to assess the overall performance of the Gas Supply Function. Each of the SQI's will have identifiable targets that establish acceptable performance. At the year-end Terasen Gas is required to file a report on performance relative to the SQI's. The Commission will then determine if the results of the SQI's show that Terasen Gas has provided an acceptable level of overall Gas Supply Service in the year. The SQI's are as follows:

3.1 Annual Contract Plan (ACP) - Portfolio Optimization
As part of the ACP submission, Terasen Gas shall compare the expected overall costs of the proposed portfolio vs. the current portfolio. Commodity and asset pricing used to determine overall costs for both portfolios will be based on forward market expectations at the time of submission. For example, if current asset costs are forecast to increase in cost for the coming contract year that will be the new baseline used in the comparator analysis.

Performance Target: The ACP plan must be submitted to the BCUC by March 31 of each year. The approved ACP, including any revisions throughout the year must be successfully implemented over the contracting period recognizing those market conditions that may arise.

3.2 Price Risk Management Plan (PRMP) Implementation

Terasen Gas submits the PRMP to the Commission each spring to seek approval for hedging limits for the following contract periods. Once the BCUC approves the PRMP, Terasen Gas begins implementation within the approved guidelines. Terasen Gas then provides to the BCUC all trade data including submission of quarterly updates on the mark-to-market activities. From time to time the BCUC may also request information on status of the plan and Terasen Gas strategy position. PRMP activities are an important part of the Gas Supply Function with the financial positions often having a significant impact on overall gas costs.

Performance Target: Terasen Gas is to continue to provide the PRMP in a timely fashion meeting the expectations of the BCUC for approval. Terasen Gas is to implement the PRMP including any approved revisions within the guidelines presented in the plan including any provisions or understanding about transaction volumes within stated timelines.

3.3 Counterparty Risk and Credit Exposure Management

Implementation of financial and physical transactions necessary to optimize Gas Supply management for Firm customers creates significant credit exposure. Terasen Gas has a conservative and well defined credit policy that is actively managed and has avoided non-recoveries over the last few years of volatile markets. This has been a significant benefit to Firm customers. Terasen Gas is to provide a report that summarizes credit management activities over the year, outlining mitigation strategies put in place to manage marketplace dynamics and identifying any defaults.

Performance Target: Terasen Gas is to show that it has effectively managed credit exposure for Firm customers prudently avoiding potential non-recoveries if deemed reasonably preventable.

3.4 Commodity Supply Reliability

Terasen Gas must balance cost minimization with supply reliability. Ensuring that Firm customers have 100% of Firm requirements is an over-riding objective of Gas Supply. Terasen Gas shall identify any curtailments of Firm customers over the year. Terasen will also identify curtailments of Interruptible customers. Supply reliability also includes reliability of assets contracted by Terasen Gas to meet customer needs. Contract default and Interruptible curtailments are subject to market conditions so targets are not being established for them. Terasen Gas will also summarize reliability measures put in place for the contracting year and a summary of any supply failures of commodity, pipeline and storage assets.

Performance Target: 100% delivery of Firm customer demand.

4. Gas Cost and Market Pricing Information

This information is to be provided to the BCUC to provide relevant market information.

4.1 Regional Local Distribution Companies Rate Indicators

Terasen Gas is to provide monthly Gas Costs as available for other regional LDC's such as Cascade, Puget, Avista, and Northwest Natural over the contract year. Terasen Gas will also provide a summary of the portfolios utilized by each of these other LDC's and illustrate differences from the Terasen Gas portfolio. Determination of the regional LDC portfolios will be through review of public information and discussion with each of their respective Gas Supply departments and will therefore be an estimate only. Regulator approved and implemented financial price fixing activity and deferral treatment vary significantly between the LDC's and drive rates to a large extent so individual LDC rates could vary significantly at a given time.

4.2 Terasen Gas Actual Gas Costs and Market Index prices

Terasen Gas shall provide actual incurred monthly Gas Costs excluding fixed costs and hedging. Terasen Gas shall also provide data on actual Daily and Monthly Index prices at Sumas, Nymex, AECO and Station #2. This Data will used to calculate Gas Cost proxy's for purchasing 100% of daily Firm demand at both the Sumas and AECO Daily midpoint Index for reference. Because the Sumas Daily price does not meet intra-day balancing needs and there is insufficient market liquidity to ever consider this kind of purchase strategy the comparison is only a proxy and does not define any true measure other than to show how the portfolio approach protects customers from much of the market volatility even before hedging activity.

4.3 Commodity Costs compared to Market

Terasen Gas develops a portfolio of pipeline, storage and commodity contracts that provide supply reliability and price diversity for Firm customers. The majority of Firm demand is in the Lower Mainland and is tied to the Sumas Hub. The Sumas market is subject to considerable volatility.

Terasen Gas must be a significant contributor to managing demand variability at this location. The portfolio of assets is accepted as necessary to manage Firm customer load variability and access less volatile supply sources upstream. Value recovery realized on transport and storage assets is subject to the volatile nature of market conditions and will vary considerably from year to year. Therefore, performance on contracted assets should be based on portfolio development and recovery of available mitigation value as proposed in this plan.

The portfolio assets provide commodity purchasing options to Terasen Gas. Terasen Gas commodity buying should be reasonably competitive with market price availability. Terasen Gas will provide monthly data on actual Gas commodity purchase costs before hedging compared to Sumas, Station#2 and AECO Monthly and Daily Index priced gas.

5. Sharing Mechanism

Objectives

- Continue with separate commodity and transport/storage revenue mechanisms combining the two revenues into one overall sharing allocation.
- Continue with the sharing hurdle referencing total monthly gas purchase cost instead of just the fixed component. The total gas purchase cost shall be the monthly Sumas Index. The existing commodity mechanism concept of sharing on the last $1/GJ of hurdle rate revenue will continue in concept, but the hurdle for 2004/05 will be based on total gas purchase cost as identified by the Sumas Monthly Index.
- The sharing mechanism will continue to include a linear adjustment to the $1/GJ hurdle rate revenue sharing proportion to maintain the potential for $1 million sharing with a high level of recovery on actual Firm volumes resold. Transport and storage revenue assumptions are factored into this mechanism to recognize this revenue contributes to

the overall sharing capability to $ 1 million. Continue to cap total sharing at 1.25% after $1 million sharing is earned.

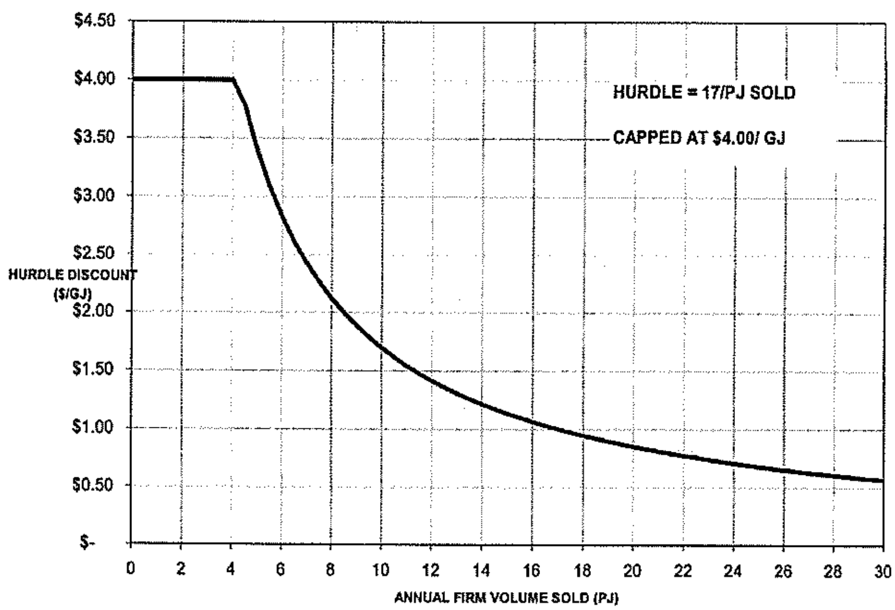
Incentive Structure Summary

Terasen Gas recovers mitigation revenue from recovery of revenue from surplus term gas purchased for Firm customers and third party recovery of value from unutilized Firm customer pipeline capacity and storage assets. Each of these activities are distinctly separate transactions. Eligible commodity sharing and transport and storage margin will be combined to calculate the basis for Terasen Gas final incentive sharing.

a) Eligible Commodity Resale

Terasen Gas commodity sharing reward is dependent primarily on how close it can come to achieving full recovery of purchase costs for core customers regardless of commodity pricing and volume available for resale. Terasen Gas revenue sharing on each gas unit resold will be dependant on total surplus Firm volumes sold in the contract year. The lower the Firm volume available the higher the Terasen Gas sharing on total revenue recovered. The amount of resale revenue Terasen Gas shares is based on a discount from the Monthly Sumas Index. This discount from the Index varies based on the formula 17/ (Annual PJ sold).

GSMIP 2004-2005
COMMODITY RESALES SHARING



b) Transport and Storage

The existing transportation and storage mechanism works well and shall be continued. This activity will include the net revenue from spot gas purchases and sales transacted to recover revenue from core transportation and storage assets.

Terasen Gas Sharing Incentive

The parties agree to combine the transport and storage revenue with the eligible commodity revenue to create one sharing mechanism. Terasen Gas incentive share will be 5% of the Total Eligible Margin up to the first $1 million sharing earned. When Terasen Gas achieves $1 million sharing, the Terasen Gas share will reduce to 1.25% on all remaining Total Eligible Margin.

The proposed mechanism meets the objective of limiting Terasen Gas sharing in the case of extreme mitigation revenue opportunity available but still provides reasonable sharing when minimal or more historic opportunity, such as is forecast next year, is available to be recovered by Terasen Gas.

6. Employee Incentives

Within the context of other incentive plans and market competitive compensation levels for employees, Terasen Gas will continue to recognize those Gas Supply employees deemed to have directly or indirectly contributed toward the generation of net revenues achieved under GSMIP 2004/05. Such incentive compensation will be based upon and related to the incentive earnings of Terasen Gas.

7. Regulatory & Management Reporting

In order for the BCUC to adequately monitor and evaluate the company's performance, the already well-developed record keeping and reporting procedures will be continued. In the interest of simplicity, it has been agreed that the year-end reporting will be reduced to include the high-level summary reports but exclude the detailed reports and graphs showing margins and volumes by day, location and customer. Terasen Gas will also continue with its current practice of regular quarterly filings with the BCUC consisting of a summary report that details all off-system and non-core on-system activity and associated financial impacts. This report will be submitted to the BCUC within two months of the quarter-end. Terasen Gas will also provide an update on the status of the SQI's and Gas Cost and Market Pricing twice per year, once after the winter and once after the summer at year-end, within two months of the season-end.

Terasen Gas will also continue to keep distinct and separate records, for audit purposes, of a daily "Load Forecast Sheet", which details all on-system supply requirements, and a "Deal Sheet" for each and every transaction that will feature all information as it relates to the economics of each transaction.

Terasen Gas will confer with BCUC staff to ensure that these reports provide an appropriate level of disclosure and audit capability with a minimum of administrative burden. The BCUC will examine the calculation of any incentive payments received under the GSMIP 2004/05 plan and will make any appropriate adjustments. For the benefit of interested parties, an overview report will be issued by the BCUC at the end of the term. Such report shall provide an analysis of the effectiveness of GSMIP 2004/05.

Definitions:

Commodity-sharing Mechanism

Core Commodity Volume	All gas volumes under purchase contract as approved by the BCUC to meet Firm customers as approved in the ACP.
Commodity Resale Volumes	All Commodity Volume purchases in the ACP, including daily-priced and monthly-priced gas, in excess of actual Firm customer needs.
Hurdle Discount	The unit commodity resale margin hurdle discount (CDN$/GJ) from the Weighted average Sumas Monthly Index price converted to CDN$/GJ. The Discount Hurdle shall be determined at the end of the contract year once total annual resale volumes are known. The Hurdle Discount is calculated by multiplying by the factor of 17/ (PJ annually resold). This equation is capped at $4/GJ. For example, if total annual volume sold is 20 PJ the Hurdle would be 17/20 = $0.85/GJ.
Annual Average Sumas Index Price	Volumes sold each month will be compared to the Sumas Index for that month. The Annual Average Sumas Index Price shall be the weighted average of the actual monthly resale volumes times the monthly Sumas Index for each of the months divided by the total annual volumes resold.
Eligible Commodity Resale Hurdle	This is the Hurdle rate before Terasen Gas shares in resale revenue. It is the Annual Average Sumas Index Price less the Hurdle. For Example, if the annual average weighted Sumas Index price was $6.125/GJ and Terasen Gas sold 20 PJ annually, the Hurdle Discount would be $0.85/GJ and the Eligible Commodity Resale Hurdle would be $5.275/GJ. Terasen Gas would share on all revenue recovery above this $5.275/GJ hurdle.
Eligible Resale Sharing	All revenue generated above the Eligible Commodity Resale Hurdle. For example, if Terasen Gas averaged annually $6.20/GJ recovery on 20 PJ the Eligible Resale Sharing would be 20 PJ x ($6.20/GJ-$5.275/GJ) = $18.5 million.
Eligible Transportation and Storage Margin	The revenue received by Terasen Gas from third parties via assignment of Core transportation and Storage including the net revenue received by Terasen Gas via back-to-back Transport and Storage buy/sell mitigation activity.
Total Eligible Margin	Eligible Commodity Resale Sharing plus Eligible Transportation and Storage Margin.