



National Energy Board

Reasons for Decision

Westcoast Energy Inc

RH-1-90

January 1991

Tolls

National Energy Board

Reasons for Decision

In the Matter of

Westcoast Energy Inc

Application Dated 27 June 1990
For New Tolls Effective
1 January 1991

RH-1-90

January 1991

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Recital and Appearances

IN THE MATTER OF the *National Energy Board Act and the Regulations* made thereunder; and

IN THE MATTER OF an application by Westcoast Energy Inc. for an order respecting tolls pursuant to *Part IV of the National Energy Board Act*; and

IN THE MATTER OF *the National Energy Board Directions on Procedure* in Order RH- 1-90.

HEARD in Vancouver, British Columbia on 10, 11, 12,15,16,17,18,19,22,23 and 24 October, and in Ottawa, Ontario on 29,30 and 31 October and 5 and 6 November 1990.

BEFORE:

W.G. Stewart	Presiding Member
R. Priddle	Member
R.B. Horner, Q.C.	Member

APPEARANCES:

J.J. Lutes R. Sirett	Westcoast Energy Inc.
P.A. McCunn-Miller J. Horte	Alberta Petroleum Marketing Commission
R.G. Panchuk	Canadian Petroleum Association
R.B. Wallace J. Haythorne	Council of Forest Industries of British Columbia and Cominco Ltd.
A.S. Hollingworth	Independent Petroleum Association of Canada
C.W. Jobe	Alberta and Southern Gas Co. Ltd. and Alberta Natural Gas Company Ltd
W.A. Jackson	Amoco Canada Petroleum Company Ltd.
C.B. Johnson	BC Gas Inc
F.C. Basham	BP Resources Canada Limited
J.M. Pelrine	CanWest Gas Supply Inc.
T.D. Downey	Cascade Natural Gas Corporation
D.K. Clark	Czar Resources Ltd.

M.M. Moseley

IGI Resources, Inc.

C.B. Woods

Mobil Oil Canada

C. Donahue

Pacific Northern Gas Ltd.

M. Decter

Unocal Canada Limited

G.W. Toews

Western Gas Marketing Limited

D. Bursey

National Energy Board

S. Scott

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Abbreviations

10 ³ m ³	thousand cubic metres
APMC	Alberta Petroleum Marketing Commission
BC Gas	BC Gas Inc.
CanWest	CanWest Gas Supply Inc.
CCA	capital cost allowance
COFI	Council of Forest Industries of British Columbia
Cominco	Cominco Ltd.
CPA	Canadian Petroleum Association
CPI	Consumer Price Index
DCF	discounted cash flow
GPIS	gas plant in service
GST	Goods and Services Tax
ICG	Inter-City Gas Corporation
Industry Task Force or Task Force	Industry Task Force on Westcoast's Tariffs and Tolls
IPAC	Independent Petroleum Association of Canada
long-Canada	long-term Government of Canada bond
M&S	materials and supplies
Mcf	thousand cubic feet
NEB Act or the Act	National Energy Board Act
NEB or the Board	National Energy Board
New RGT Shippers	shippers who are applying for new RGT facilities
NPIS	net plant in service
Northwest	Northwest Pipeline Corporation

NOVA	NOVA Corporation of Alberta
O&M	operating and maintenance
Petro-Canada	Petro-Canada Inc.
Prospective Shipper	a potential shipper requesting firm service or an existing shipper requesting an increase in its level of firm service
RFSF	request for firm service form
RGT	raw gas transmission
RH-1-89 Westcoast Reasons for Decision	"National Energy Board Reasons for Decision dated September 1989 in the Matter of an application of Westcoast Energy Inc. dated 14 April 1989 for new tolls effective 1 November 1989"
RH-2-89 Westcoast Reasons for Decision	"National Energy Board Reasons for Decision dated January 1990 in the Matter of an application of Westcoast Energy Inc. dated 5 July 1989 for new tolls effective 1 January 1990"
RH-2-87 Westcoast Reasons for Decision	"National Energy Board Reasons for Decision dated November 1987 in the Matter of an application of Westcoast Energy Inc. dated 19 December 1986 for new tolls effective 1 January 1987 and 1 January 1988"
RH-3-86 TransCanada Reasons for Decision	"National Energy Board Reasons for Decision dated May 1987 in the Matter of an application of TransCanada PipeLines Limited dated 14 July 1986 for new tolls effective 1 January 1987"
RH-6-85 Westcoast Reasons for Decision	"National Energy Board Reasons for Decision dated August 1986 in the Matter of an application of Westcoast Energy Inc. dated 1 December 1985 for new tolls effective 1 January 1986"
Suncor	Suncor Inc.
TransCanada or TCPL	TransCanada PipeLines Limited
Unocal	Unocal Canada Limited
Vancal	Vancal Properties Ltd.
Westcoast or the Company	Westcoast Energy Inc.
WestCoast Gas	WestCoast Gas Inc.

Overview

(Note: This overview is provided for the convenience of the reader and does not constitute part of this Decision or the Reasons, to which readers are referred for the detailed text and tables).

The Application and Hearing

Westcoast filed an application dated 27 June 1990 for new tolls effective 1 January 1991. The hearing, which lasted 16 days, opened on 10 October 1990 in Vancouver where the Board sat for 11 days. The hearing reconvened in Ottawa on 29 October 1990 and final argument concluded on 6 November 1990.

Revenue Requirement

The Board did not calculate the final rate base, cost of service or tolls based on its decisions, but rather has directed Westcoast to determine the final tolls and file them with the Board for its approval.

Rate Base

The Board directed Westcoast to remove \$224,000 from GPIS. This amount is equal to 50 percent of the total identifiable overruns of \$378,000 and \$70,000 related to, respectively, the new flare stack and the modifications to the control system resulting from Westcoast's purchase and expansion of Unocal's Aitken Creek processing plant.

Westcoast has been directed to remove from its applied-for GPIS the forecast amounts for those projects that had not received Board approval under Part III of the NEB Act by 1 January 1991.

The Board approved the applied-for NPIS adjustment factor of 0.986 percent to be used in calculating the NPIS adjustment for the 1991 test year.

The Company's request to change its method of valuing its line pack was approved. Westcoast applied to set a permanent value for line pack based on a fixed volume and the CanWest netback price as at 31 October 1990. This change addresses the concern raised by the Board in its RH-6-85 Westcoast Reasons for Decision regarding the complexities relating to the current method of valuing line pack.

The Board denied Westcoast's attempt to reinstate the amortization of prepaid insurance and withdrawals from materials and supplies inventory in its lead/lag study because the Company had failed to present any new evidence on this matter.

The Board accepted Westcoast's proposal to collect GST on all its billings, including those related to exports, for the purpose of the lead/lag study because the Board recognized the difficulties faced by Westcoast in differentiating between its domestic and export revenues.

Rate of Return

The Board approved Westcoast's request that the common equity ratio remain at 35 percent.

The Company requested a rate of return on common equity of 14.375 percent for 1991. The Board approved a rate of 13.75 percent, an increase of fifty basis points over the previously approved rate.

Operating Costs

Westcoast's projected full staff complement of 1,099 employees was accepted for 1991, but the Board directed Westcoast to use a vacancy-rate adjustment factor of 3.8 percent instead of the applied-for rate of 2.5 percent.

The Board approved the use of Westcoast's actual 1990 salary and wage increases in determining the 1991 test-year salaries and wages. However, the Board reduced the 1991 salary increase from 6.5 to 6 percent.

Westcoast was directed to place in a deferral account the amount of \$1,794,000 representing its Board-approved share of the cost associated with the 1990 NEB Cost Recovery Program as the regulations for this program did not come into effect until 1991. This amount, plus appropriate carrying charges, is to be deducted from the 1991 test-year cost of service. The Board also approved, for inclusion in the test-year revenue requirement, a NEB cost recovery provision of \$2,700,000 for 1991.

The Board reminded parties that Westcoast is to file a new depreciation study with the Board by 1 March 1991.

The Board approved a head office net rental cost of \$3,296,000 for 1991. Westcoast was directed to record the difference between the applied-for head office property taxes of \$900,000 and the actual taxes paid in its property tax deferral account.

Deferral Accounts

Westcoast's proposed dispositions of the existing deferral account balances were approved and the continuation of existing deferral accounts was approved, with the exception of the account to record the difference between the forecast and actual price of line pack gas. This account is no longer required as a result of the Board approving Westcoast's request for a new method of valuing its line pack.

The Board approved new deferral accounts for Interruptible Toll Revenues, Zone 2 Demand Charge Credits, Pressure Vessel Inspections, and the McMahon Plant Expansion project. The Board denied Westcoast's request for a blanket deferral account for all major capital projects.

Toll Design

On 19 October 1990, the Board issued its Decision on Westcoast's Raw Gas Transmission Facility Expansion Policy in advance of issuing its overall decision. The Board decided that the policy should include both a two-times and a one-times test in determining the level of the surcharge for new raw gas transmission facilities. The more restrictive one-times test will apply when Westcoast is constructing facilities to meet the requirements of only the initial requests for service supporting the expansion and, at the time of the application, there is little prospect for additional reserves being connected to the line. Otherwise, a two-times test will apply.

The Board found that it would be appropriate in the case of either test to recognize the incremental downstream processing revenues in the calculation of the surcharge under those circumstances where, at the time of the facilities application, there is excess capacity at the downstream processing facility that will be utilized by the incremental volumes. The Board directed Westcoast to include 50 percent of the present value of such processing revenues in determining the surcharge.

The Board also decided that the period over which the economic test shall be applied is the lesser of the term of the contract or the reserve life of the gas fields supporting the application.

On 30 October 1990, IPAC requested that the Board clarify a portion of its 19 October 1990 Decision. On 12 December 1990, the Board issued that clarification. The Board decided that when a queue for service exists at a processing plant, Westcoast should offer the available capacity to the shippers in the queue in accordance with the procedures set out in the clarification as one of the last steps in preparing RGT facility expansion applications.

The Board approved Westcoast's request to discontinue Tier 2 interruptible service. Westcoast was directed to lower its interruptible tolls. The winter and summer interruptible toll load factors were increased from 60 and 80 percent to 75 and 100 percent, respectively.

Westcoast was directed to continue to state its firm tolls on a gross basis and to continue to calculate its interruptible tolls on a gross basis for the 1991 test year. A forecast of interruptible revenues rather than the actual interruptible revenues will now be credited monthly to the firm customers. Any difference between the actual and forecast interruptible revenues for the year is to be recorded in a deferral account. The Task Force agreed that Westcoast would apply to use the *net-iterative methodology* to calculate its firm and interruptible tolls for the 1992 test year.

The Board directed Westcoast to file by 30 April 1991 the terms and conditions and toll that would apply to the interzonal backhaul service requested by BC Gas for gas originating in the United States, or to report why Westcoast was unable to negotiate satisfactory arrangements with Northwest that would allow the requested backhaul service to take place.

Tariff Matters

On 27 December 1990, the Board issued its Decision regarding changes to Westcoast's Queuing Procedures and Access Criteria. This Decision was released early so that a small amount of existing capacity, which became available at the McMahan Plant on 1 November 1990, could be contracted on a firm basis. The Board decided that when a facility expansion is approved by the Board, only those shippers for whom capacity is being provided by the expansion proposal should be allowed to advance to the head of the queue.

The Board denied Westcoast's request to extend to eighteen months the current six-month renewal notice period.

Interim Tolls

On 27 December 1990, the Board issued Order TGI-5-90 that directed Westcoast to continue charging the existing tolls on an interim basis pending the Board's final decision on Westcoast's toll application.

Chapter 1

Background and Application

By an application dated 27 June 1990, Westcoast Energy Inc. ("Westcoast" or "the Company") applied to the National Energy Board ("the Board" or "NEB") for orders pursuant to Part IV of the *National Energy Board Act* ("NEB Act" or "the Act") for, *inter alia*, new tolls effective 1 January 1991.

On 2 August 1990, the Board issued Order RH-1-90 which set down Westcoast's application for hearing on 10 October 1990 and established the Directions on Procedure and the issues to be considered. The List of Issues was subsequently revised by the Board's letter dated 17 August 1990. A copy of the revised List of Issues is attached to these Reasons for Decision as Appendix II. Also in that letter, the Board explained that the issue of the *raw gas transmission* ("RGT") facility expansion policy required an early decision because of its relevance to the GH-6-90 hearing on Westcoast's Adsett pipeline application. Westcoast's Hossitl pipeline application, which was filed on 7 September 1990, was also potentially affected. In view of this, the Board decided that the evidence and argument on that issue would be dealt with first in the RH-1-90 Westcoast proceeding.

Before the commencement of the RH-1-90 proceeding, the Industry Task Force on Westcoast's Tariffs and Tolls ("Industry Task Force" or "Task Force") met and decided to recommend to the Board that Issue No. 5 relating to the *processing plant facility expansion policy* not be considered in the RH-1-90 proceeding, but instead be deferred to the Industry Task Force for further discussion. The matter was raised by the Board at the opening of the hearing. There were no objections and the Board agreed to defer the issue. The Industry Task Force also reported to the Board that the Task Force members had reached a consensus on a compromise proposal to recommend to the Board on the method of determining the interruptible tolls on the Westcoast system. This matter is discussed in detail in section 7.2.3 of these Reasons for Decision.

The hearing convened on 10 October 1990 in Vancouver and the first matter dealt with was the RGT facility expansion policy. Hearing of the evidence and argument took three days and the Board rendered a decision from the Bench on this issue on 19 October 1990. The evidence on all other matters except for rate of return was heard in Vancouver from 15 to 24 October 1990. The proceeding resumed in Ottawa on 29 October and the hearing of the rate of return evidence continued until 31 October at which time the hearing was adjourned until 5 November 1990. Final argument was heard on the 5th and 6th of November 1990.

On 30 October 1990, the Independent Petroleum Association of Canada ("IPAC") requested that the Board clarify a portion of its RGT policy decision. The Board invited parties to comment on IPAC's concern in final argument and, as a result of comments made by Westcoast, decided to allow parties to submit additional comments in writing by 13 November 1990. The Board issued a statement of clarification on 12 December 1990.

On 27 December 1990, the Board issued its Decision regarding changes to Westcoast's Queuing Procedures and Access Criteria. This Decision was released early so that a small amount of existing capacity, which became available at the McMahon Plant on 1 November 1990, could be contracted on a firm basis.

Also on 27 December 1990, the Board issued Order TGI-5-90 (see Appendix III) that directed Westcoast to continue charging the existing tolls on an interim basis pending the Board's final decision on Westcoast's toll application.

Chapter 2

Revenue Requirement for 1991

A summary of the 1989 base year, 1990 forecast and the 1991 applied-for test year revenue requirements is shown in Table 2-1. The applied-for 1991 revenue requirement represents an 11.2 percent increase over the actual 1989 base-year amount and a 5.9 percent increase over the 1990 forecast.

The Board's adjustments are discussed in Chapters 3, 4, 5 and 6 and, in Chapter 9, the Board has directed Westcoast to revise its revenue requirement for the 1991 test year to take into account the Board's decisions set out in these Reasons for Decision.

Table 2-1

**1989 Base Year, 1990 Forecast, and Applied for 1991 Test Year
Transportation Revenue Requirements¹
(\$000)**

Particulars	1989 Base Year	Adjustments	1990 Forecast¹	Adjustments	1991 Test Year²
Operating and Maintenance Expenses	91,861	5,744	97,605	14,144	111,749
Regulatory Costs	-	675	675	2,025	2,700
Depreciation	29,086	1,114	30,200	2,187	32,387
Amortization	(144)	548	404	128	532
Taxes Other Than Income Taxes	45,045	(2,800)	42,245	3,003	45,248
Miscellaneous Operating Revenue	(3,626)	204	(3,422)	(81)	(3,503)
Insurance Deductibles	-	179	179	329	508
Foreign Exchange On Debt	850	(78)	772	215	986
Gas Used In Operations	4,969	(1,900)	3,069	(258)	2,812
Income Tax Expense	18,152	3,928	22,080	(9,558)	12,522
Return On Rate Base	<u>92,438</u>	<u>3,228</u>	<u>95,666</u>	<u>13,960</u>	<u>109,626</u>
Sub Total	278,631	10,841	289,472	26,094	315,566
Deferrals	<u>-</u>	<u>2,996</u>	<u>2,996</u>	<u>(8,757)</u>	<u>(5,761)</u>
Total Cost of Service	<u>278,631</u>	<u>13,837</u>	<u>292,468</u>	<u>17,337</u>	<u>309,805</u>
Fixed Costs	269,630	16,700	286,330	17,260	303,590
Variable Costs	<u>9,001</u>	<u>(2,863)</u>	<u>6,138</u>	<u>77</u>	<u>6,215</u>
Total Cost of Service	<u>278,631</u>	<u>13,837</u>	<u>292,468</u>	<u>17,337</u>	<u>309,805</u>

1 Net of Alberta (Zone 5) Facilities.

2 Application dated 27 June 1990 as revised by Westcoast on October 1990 (Source: Exhibit B-18).

Note: Totals may not add due to computer rounding.

Chapter 3

Rate Base and Depreciation

The actual rate base for the 1989 base year, the forecast rate base for 1990 and the applied-for rate base for the 1991 test year are shown in Table 3-1. The applied-for rate base represents a 15.6 percent increase over the actual 1989 rate base, and an 8.7 percent increase over the 1990 forecast rate base. As discussed more fully in Chapter 9, Westcoast is required to adjust the applied-for rate base to reflect the Board's decisions as set out in this and subsequent chapters.

3.1 Gas Plant in Service

Westcoast applied to transfer forecast plant additions of \$71.1 million for 1990 and \$226.5 million for the 1991 test year to gas plant in service ("GPIS").

Intervenors expressed concern regarding the cost overruns associated with the Laprise Offload project and the Pine Pass Mainline Upgrade project.

3.1.1 Laprise Offload Project

Westcoast stated that the total cost of the Laprise Offload project was \$19.2 million. This amount is \$2.1 million over the budgeted estimate of \$17.1 million included in the Company's application, as amended, to the Board for authorization to construct the facilities. As shown in Table 3-2, the Laprise Offload project included the expansion of the Aitken Creek processing plant purchased by Westcoast from Unocal Canada Limited ("Unocal").

The cost overrun of \$2.1 million for the project is solely related to the plant expansion as the actual costs for all other components of the project were less than the original estimates. Originally estimated to cost \$4.7 million, the actual cost of the plant expansion totalled \$9.5 million, for a cost overrun of \$4.8 million.

Westcoast admitted that it was an oversight on its part not to have advised the Board of the increase in cost due to the change in design of the plant. To avoid such situations in the future, Westcoast suggested that it could provide the Board with quarterly progress reports and updated cost estimates on capital projects having estimated costs of at least \$5 million.

At the hearing, the Canadian Petroleum Association ("CPA") argued that Westcoast had failed to justify the cost overrun associated with the Laprise Offload project. CPA and CanWest Gas Supply Inc. ("CanWest") argued that Westcoast acted imprudently by failing to obtain from Unocal the legal right to use the control room and the flare stack at the Aitken Creek plant and, therefore, were of the view that some of the plant expansion cost overrun should be disallowed.

The Board directed Westcoast to provide an explanation of the factors that contributed to the \$4.8 million plant expansion cost overrun to ascertain, among other things, the amount of the overrun that was associated with the flare stack and control room. This information was provided to the Board after the close of the hearing.

In that filing, Westcoast stated that the cost estimate for the expansion of the Aitken Creek plant, which was prepared in June 1987, was a factored estimate based on historical cost information from previous Westcoast processing plant and compressor station capital projects. Westcoast explained that significant scope changes were made as process engineering and detailed design progressed. The final design of the facility resulted in the addition of unbudgeted equipment. Installation of equipment proved to be more complex than originally anticipated, and the integration with the existing Unocal plant was also more difficult than originally anticipated. These factors accounted for almost 90 percent of the overrun.

Table 3-1

**1989 Base Year, 1990 Forecast, and 1991 Applied-for Test Year
Average Rate Bases¹
(\$000)**

Particulars	1989 Base Year	Adjustments	1990 Forecast²	Adjustments	1991 Test Year²
Gas Plant In Service	1,389,508	57,382	1,446,890	101,039	1,547,929
Accumulated Depreciation	<u>(565,688)</u>	<u>(27,566)</u>	<u>(593,254)</u>	<u>(30,533)</u>	<u>(623,788)</u>
Net Plant In Service	823,820	29,816	853,636	70,505	924,141
Net Plant In Service Adjustment	-	-	-	(9,112)	(9,112)
Contributions In Aid Of Construction	<u>(3,808)</u>	<u>(2)</u>	<u>(3,810)</u>	<u>(462)</u>	<u>(4,272)</u>
Plant Investment	820,012	29,814	849,826	60,931	910,757
Materials and Supplies	18,339	1,281	19,620	2,249	21,869
Line Pack Gas	3,823	178	4,001	93	4,094
Prepaid Expenses	(3,048)	374	(2,674)	6,221	3,547
Deferrals	-	(2,136)	(2,136)	(745)	(2,880)
Grizzly Valley - Tax Reassessment	-	17,025	17,025	-	17,025
Deferred Income Taxes	<u>(73,733)</u>	<u>-</u>	<u>(73,733)</u>	<u>-</u>	<u>(73,733)</u>
Average Rate Base Exclusive of Cash Working Capital	765,393	46,536	811,929	68,749	880,678
Cash Working Capital	<u>6,398</u>	<u>1,919</u>	<u>8,317</u>	<u>2,995</u>	<u>11,312</u>
Average Rate Base	<u>771,791</u>	<u>48,454</u>	<u>820,245</u>	<u>71,744</u>	<u>891,990</u>

1 Net of Alberta (Zone 5) Facilities.

2 Application dated 27 June 1990 as revised by Westcoast on 10 October 1990 (Source: Exhibit B-18).

Note: Totals may not add due to computer rounding.

Table 3-2

**Laprise Offload Project
Capital Cost Overrun Aitken Creek Plant Expansion
(\$000)**

	Estimate	Actual	Variance
Plant Purchase	5,555	4,106	(1,449)
Aitken Creek P/L Extension	4,957	4,069	(888)
NGL Pipeline	1,231	1,138	(93)
Plant Expansion	4,661	9,454	4,793
Liquid Handling-Kobes	412	274	(138)
Laprise Modifications	<u>275</u>	<u>165</u>	<u>(110)</u>
	<u>17,091</u>	<u>19,206</u>	<u>2,115</u>

Westcoast also explained that, when it agreed to purchase Unocal's hydrocarbon dewpoint control unit, Westcoast understood that it would be allowed to use Unocal's high pressure flare system and flare stack, and the control room. However, following the Company's purchase of the plant, Unocal decided to build a new, larger hydrocarbon dewpoint control unit that would require the full capacity of the existing flare system. Consequently, Westcoast had to extend its flare system piping and install its own flare stack and associated equipment at an additional cost of \$378,000.

Regarding the separation of the control systems, Westcoast stated that, when it negotiated the purchase agreement, Unocal advised it that all controls for the purchased facilities were in separate panels. This advice turned out to be inaccurate; consequently, Westcoast incurred additional costs of \$70,000.

Westcoast also stated that no contractual agreements had been signed between the two parties to ensure that Westcoast would either have the right to use these facilities or be compensated through a reduction in the purchase price.

Views of the Board

Westcoast should take all reasonable measures to ensure that it acquires facilities at the lowest cost because the cost of such facilities, if approved for inclusion in rate base, are passed through to the shippers in the tolls charged by Westcoast. The Board is of the opinion that when Westcoast acquired Unocal's plant, it acted imprudently by not ensuring that it had the legal right to use the flare stack and that the control panels were configured as Unocal had advised. The consequence of including all of the resulting extra costs in rate base would be to allow an unwarranted increase in the tolls and, consequently, to increase the return earned by Westcoast's shareholders.

While it is true that the new flare stack and the modifications to the control system are required to provide service, the Board is of the view that a portion of the associated costs should be excluded from rate base to protect the tollpayers from the

consequences of Westcoast's imprudence. The Board is of the view that 50 percent of the additional costs of these facilities is a reasonable amount to exclude in this case.

The Board is also concerned that in this situation Westcoast did not inform the Board of the significant design changes and of the related cost increases. To avoid similar future situations, the Board finds reasonable Westcoast's proposal to provide the Board with quarterly progress reports and updated estimates of costs for capital projects having estimated costs of at least \$5 million, except for those projects for which the certificate or order requires Westcoast to file monthly reports.

Decision

The Board directs Westcoast to remove \$224,000 from GPIS. This amount is equal to 50 percent of the total identifiable additional costs of \$378,000 and \$70,000 related to the new flare stack and the modifications to the control system, respectively.

Westcoast is also directed to show on a separate schedule, in future Toll applications, all projects to be included in rate base that have cost overruns in excess of the greater of \$50,000 or 10 percent of the estimated cost at the time that the construction of the facilities is approved by the Board. In that schedule, Westcoast must explain the reasons for any cost overrun.

3.1.2 Pine Pass Mainline Upgrade Project

Westcoast stated that the cost of the Pine Pass Mainline Upgrade project was originally estimated at \$3.4 million whereas the actual cost totalled \$5.0 million.

Westcoast explained that the cost overrun was related to three factors: unexpectedly high contractor costs resulting from the lack of competition between contractors due to the considerable amount of work available; the stringent specifications for the construction of temporary highway detours imposed by the British Columbia Ministry of Transportation; and the difficult working conditions.

CPA argued that Westcoast had not sufficiently justified the cost overrun associated with the project.

Views of the Board

The Board is satisfied that the causes of the overrun that Westcoast identified were of a nature that could not have been reliably predicted in advance. In view of this, the Board finds reasonable Westcoast's explanation for the cost overrun associated with the Pine Pass Mainline Upgrade.

Decision

The Board approves for inclusion in GPIS an amount of \$5.0 million for the Pine Pass Mainline Upgrade.

3.1.3 Capital Additions Transferred to Gas Plant in Service

The Board finds that the forecast costs of only those projects that have received the Board's approval under Part III of the Act prior to 1 January 1991 should be approved for inclusion in the 1991 test-year rate base.

Decision

The Board directs Westcoast to remove from its applied-for GPIS the forecast amounts for those projects that had not received Board approval under Part III of the NEB Act by 1 January 1991.

3.1.4 Forecast Test-Year Allowance for Funds Used During Construction

Decision

Westcoast is directed to calculate its forecast test-year allowance for funds used during construction to reflect the applied-for capital additions removed from GPIS in accordance with the Board's decision in section 3.1.3 and the rate of return on rate base determined in accordance with the decisions set out in sections 4.1 to 4.5.

3.1.5 Net Plant in Service Adjustment Factor

When calculating the average rate base, Westcoast is required to adjust the forecast net plant in service ("NPIS") to recognize the difference, over the last five years, between the net plant that was forecast to be put into service and the plant that actually went into service. This requirement was initiated by the Board in its RH-2-87 Westcoast Reasons for Decision to address the concern that in recent test years the approved forecast tended to exceed the actual costs of facility additions.

When calculating the rate base for the 1991 test year Westcoast has deducted an amount of \$9.1 million, representing 0.986 percent of the applied-for net plant in service amount. Intervenors did not question the NPIS adjustment factor.

Decision

The Board approves the adjustment factor of 0.986 percent to be used in calculating the NPIS adjustment for the 1991 test year. In determining its test-year rate base, Westcoast is directed to apply this factor to the NPIS determined in accordance with the Board's decisions set out in these Reasons for Decision.

3.2 Materials and Supplies

Materials and Supplies ("M&S") are forecast to increase by \$3.144 million by the end of the test year. While this amount represents a 15.6 percent increase over 1990, Westcoast explained that a substantial portion of the increase was caused by the purchase of a Spey compressor unit. Westcoast is one of the few remaining companies still using Spey compressors. Because these units are no longer being manufactured, the Company bought the compressor to obtain spare parts for those Speys still in use on the Westcoast system.

Views of the Board

The Board has considered Westcoast's explanation for the increase in M&S inventory for the test year and finds the increase, while substantial, to be reasonable.

Decision

The Board approves for inclusion in the 1991 test-year rate base an amount of \$21,869,000 for M&S.

3.3 Line Pack Gas

In its updated application of 10 October 1990, Westcoast valued its test-year average line pack at \$4.094 million based on an average unit price of \$53.81 per thousand cubic metres ("10³m³"). Westcoast explained that, under its current methodology, line pack is valued monthly based on the first-in first-out method using the volume of gas in the system multiplied by the monthly netback price for gas paid to CanWest.

Westcoast stated that it was applying to set a permanent value for line pack, based on a fixed volume and the CanWest netback price as at 31 October 1990. According to Westcoast, this approach is similar to the method used by TransCanada PipeLines Limited ("TCPL" or TransCanada). Westcoast also stated that the new approach would address the concerns raised by the Board in its RH-6-85 Westcoast Reasons for Decision regarding the complexities relating to the current method of valuing line pack. If the Board were to accept this proposal, the volume of line pack would only change when Westcoast adds or retires facilities that require line pack. The unit price would remain fixed and any monthly volume variances would be treated as gas imbalances with service customers. It will no longer be necessary to adjust the value of line pack each month for price changes. Consequently, in its application, the line pack change under "gas used in operations" has been shown as zero for the 1991 test year.

After discussions with CanWest, Westcoast estimated the average value of line pack to be \$4.143 million for the test year based on a unit price of \$54.46 per 10³m³.

No party took issue with Westcoast's proposal to set a permanent value for line pack.

BC Gas Inc. ("BC Gas") objected to the use of the 31 October 1990 netback price, arguing that it would be more prudent for Westcoast to use the summer netback price which is generally the lowest price during the year. Westcoast, however, believed that it is more appropriate to employ the methodology that it has always used to value its line pack which is based on the value of the gas on the date the volume is fixed. This method does not require Westcoast to negotiate a price with CanWest. Westcoast noted that the forecast price of gas for the month of October 1990 is representative of its average price for the test year. Westcoast was of the view that the alternative to its proposal would be to fix the volume at 31 October 1990 and continue to value its linepack monthly. CanWest agreed with the position taken by Westcoast.

Views of the Board

During the 1991 test year Westcoast will complete its change from a utility company that buys, sells, transports and processes gas to one that provides only transportation and processing services. It is the Board's view that, considering its direction to Westcoast in the RH-6-85 Decision and Westcoast's move to a transportation and processing services only pipeline, Westcoast's proposal for the valuation of line pack is appropriate. The Board believes that Westcoast's proposal to value the line pack at the netback price as at 31 October 1990 is consistent with the Company's historical practice of using the first-in first-out method, and, therefore, is preferable to the alternative put forth by BC Gas.

Decision

The Board approves Westcoast's proposed change in valuing its line pack. The Board also approves an average line pack volume of 76 084 10³m³ in 1991 and a volume of 77 988 10³m³ as at 31 December 1991. Westcoast shall adjust the volume of line pack gas only when new facilities requiring line pack are added to, or existing facilities are removed from, GPIS. The Board directs Westcoast to use the 31 October 1990 netback price in establishing the permanent value of its line pack.

3.4 Prepaid Expenses

Westcoast has forecast an average test-year debit balance of \$3.5 million in prepaid expenses. This amount represents an increase of \$6.2 million from the 1990 forecast average credit balance of \$2.7 million. Westcoast explained that the large year over-year difference is caused by two factors: an increase in catalyst replacements and a decrease in pension fund accruals.

The increase in the cost of catalysts relates primarily to replacement of the catalysts at the Fort Nelson and Pine River Plants. Westcoast explained that it is necessary to periodically replace the catalysts used in the processing plants and that the cost of the catalysts is amortized over either a four-year or eight-year period.

The decrease in the pension expense accruals is attributable to the enactment of legislation pertaining to changes in the Federal Income Tax Act relating to the ability to deduct accrued pension plan contributions. Westcoast accrues pension expenses in conformity with the recommendations of the Canadian Institute of Chartered Accountants. However, owing to the delay in the implementation of changes in the pension reform legislation until June 1990, Westcoast was unable to obtain credit for income tax purposes for forecast deductions for pension expenses.

Decision

The Board is of the opinion that Westcoast's explanation of the increase in prepaid expenses is reasonable and approves the inclusion of the average test-year balance of \$3.5 million in the rate base.

3.5 Cash Working Capital Allowance

Westcoast's application, as amended, included a cash working capital allowance of \$11.3 million based on a lead/lag study filed in the hearing. The lead/lag study employed the same methodology as was used in the previous studies done in 1979 and 1985. The latest study also included a cash working capital allowance attributable to the new Goods and Services Tax ("GST") which became effective 1 January 1991. The purpose of the cash working capital allowance is to compensate Westcoast for funds that are required, in addition to those invested in gas plant, for the ongoing operation of the pipeline.

3.5.1 Prepaid Insurance and Materials and Supplies

When determining the number of lead or lag days for other operating expenses, Westcoast included the amortization of prepaid insurance and issues from M&S inventory. As it has done in previous hearings, Westcoast argued that these items were legitimate operating expenses and that Westcoast should earn a return on these amounts from the time that they are credited to the rate base to the time that they are recovered in the tolls paid by the shippers. While the withdrawals from M&S inventory and the amortization of prepaid insurance do not result in cash outflows, Westcoast asserted that they nevertheless result in a premature retirement from the rate base.

CanWest, CPA and IPAC disagreed with the inclusion of these items in the cash working capital allowance on the basis of the Board's Decision in the RH-6-85 Westcoast Reasons for Decision in which a similar request was made and disallowed. In CanWest's opinion Westcoast should have requested the reinstatement of these items as part of its application rather than simply including them in the lead/lag study which was filed at a later date. This approach would have allowed intervenors an opportunity to review the matter and present their views on it.

Views of the Board

The Board is concerned that Westcoast did not apply for the reinstatement of these items which were disallowed in a previous Board Decision. Rather, Westcoast left it to interested parties and the Board to discover, through an examination of the lead/lag study, that Westcoast had again included these items. The Board notes that Westcoast has not advanced new arguments from those that were presented in the RH-6-85 Hearing, thus implying that circumstances have not changed. Because Westcoast presented no new evidence on this matter, the Board is of the opinion that it remains inappropriate to include these items in the lead/lag study.

Decision

Westcoast is directed to remove the amortization of prepaid insurance and withdrawals from M&S inventory in calculating its cash working capital allowance.

3.5.2 Lead/Lag Study Including GST Provision

As a result of concerns raised during cross-examination, Westcoast reduced its working capital requirement relating to GST from \$1,306,000 to \$755,000 and, consequently, its overall working capital allowance from \$11.3 million to \$10.8 million, to reflect the following:

- (a) the lead resulting from the collection of GST on sales would be 39 days rather than the eight-day lead used in the application based on the lead/lag study; and
- (b) a transitional adjustment to recognize that many invoices for operating and maintenance expenses and construction costs paid for in January and February 1991 will not be subject to GST.

In argument, CPA, CanWest and BC Gas maintained that, even after these adjustments, the cash working capital allowance was still overstated.

The key premise of Westcoast's lead/lag study is that it makes payment of capital costs and operating and maintenance ("O & M") expenses, including GST, on average on the 20th of the month and receives revenues, including GST, on the 22nd of the following month. This fundamental assumption and the results that it produced were challenged by CPA, CanWest and BC Gas. Given that Westcoast pays invoices 29 days after receipt, CanWest stated that Westcoast will on average make such payments on the 20th day of the following month. CanWest also noted that the GST for gas and services sold by Westcoast in a month is received on the 22nd of the following month; consequently, CanWest argued that a two-day lag with respect to GST was more appropriate. BC Gas stated that the reason Westcoast arrives at a cash working capital increase due to GST is because it applies the 32-day lag for O&M and construction expenditures to the payment of GST on those expenditures. According to BC Gas, the appropriate timing difference between cash receipts and cash disbursements is a lead of about 20 days, not a lag of 32 days.

BC Gas farther stated that the "GST implementation is illustrative of a flaw in the overall methodology" and that the same flaw occurs throughout the lead/lag study, not just on the GST calculation. Both CPA and BC Gas contended that Westcoast's approach results in a mismatching between the treatment of cash receipts and cash payments. They argued that Westcoast regards expenses paid in January as January expenses but regards revenues received in January as December revenues.

In reply argument Westcoast maintained its position that it does not receive revenues in advance of making expenditures. Westcoast indicated that it pays expenses and gets the associated revenues a month later. Westcoast explained that its lead/lag study has always been done in the same manner, and was concerned that, if intervenors wanted to take issue with Westcoast's existing method of calculating working capital, they should have presented evidence on it, thereby affording Westcoast the opportunity to cross-examine the parties on their proposals.

Views of the Board

The Board notes that Westcoast's lead/lag study and its basic methodology for determining the cash working capital allowance are consistent with the approach taken in previous Westcoast toll applications. The Board also notes that intervenors did not adduce any direct evidence to support their position that Westcoast's approach to determining the number of lag days is wrong. The filing of such evidence would have afforded the Board and parties an opportunity to examine the alternatives. In the absence of any alternative method on the record, the Board is not persuaded that a change from the current approach, as amended to update the GST component, is warranted.

The Board is of the view that if interested parties remain concerned that there is a need to change the approved method of determining Westcoast's cash working capital allowance, they should first raise the matter at the Task Force level. This approach would permit a full discussion of the issue. Any unresolved matters could then be brought before the Board in the next Westcoast toll proceeding. The Board would expect any party that takes issue with the current methodology to present evidence to support its position at the next toll hearing.

Decision

The Board approves Westcoast's overall methodology for determining its cash working capital allowance, including the GST component, for the 1991 test year.

3.5.3 Treatment of GST on Export Transactions

During the hearing, Westcoast indicated that it was seeking confirmation from Revenue Canada that it should collect GST from both its domestic and export shippers. Consequently, in its lead/lag study, Westcoast assumed the collection of GST on all billings by the Company.

Westcoast's rationale for charging GST on export billings is that, because of the nature of its services and the contracting practices of its shippers, Westcoast is not able to precisely identify in each zone what portion of a shipper's monthly bill is related to export transactions. In reply argument, Westcoast noted that the exclusion of GST on exports would effectively lead to an increase in the working capital requirement for the test year.

TCPL's proposal to not charge GST on export transactions, as detailed in TCPL's letter dated 20 September 1990 to all its shippers, was also noted at the hearing.

In argument, IPAC was of the view that Westcoast should not collect GST on exports or factor it into its lead/lag study until Revenue Canada rules on the Company's position.

Views of the Board

Westcoast's approach would result in GST being charged on exports even though the tax is designed to apply only to goods and services consumed in Canada. Further, the Board notes that Westcoast's practice would not be consistent with that of the other major pipelines in this regard. For example, both TCPL and Interprovincial Pipe Line Company will not be charging GST on export transactions.

However, the Board recognizes the difficulties faced by Westcoast in determining export and domestic revenues, and notes that the Company has requested confirmation of its approach from Revenue Canada. The Board also recognizes that the tollpayers will not be disadvantaged by Westcoast's inclusion of GST on exports in its lead/lag study.

Decision

The Board accepts Westcoast's proposal to collect GST on all its billings for the purpose of the lead/lag study. The Board directs Westcoast to advise it of Revenue Canada's ruling on this matter.

Chapter 4

Cost of Capital

Westcoast applied for a rate of return on common equity of 14.375 percent for the 1991 test year, on a deemed common equity component of 35 percent. The applied-for rate of return on equity is approximately 113 basis points higher than the currently approved rate of 13.25 percent. Details of the applied-for capital structure and requested rates of return are shown in Table 4-1 and discussed in detail in sections 4.1 to 4.5.

4.1 Funded Debt

Westcoast applied for a cost rate of 11.30 percent on its forecast test-year funded debt balance of \$533,068,000. The dollar amount of funded debt and the associated cost rate were determined in a manner consistent with the net proceeds methodology approved by the Board in its RH-2-89 Westcoast Reasons for Decision. Neither the Company nor interested parties commented on this methodology during the hearing.

The only funded debt issue examined during the proceeding related to the Company's expected long-term debt financing during 1990. Westcoast initially anticipated that it would place two long-term debt issues totalling \$135 million during 1990: \$75 million of Series L debentures in July and \$60 million of Series M debentures in November. These debt issues were costed at a forecast coupon rate of 12.125 percent. Using the methodology approved by the Board in its RH-6-85 Westcoast Reasons for Decision for allocating long-term debt between the Company's utility and non utility operations, Westcoast estimated that 45.42 percent of these two long-term debt issues would be allocated to the utility operations at year-end 1990. Westcoast indicated that, while it had delayed the issuance of the Series L debentures in anticipation of lower interest rates, it still intended to complete the placement of both debt issues by the end of 1990.

Table 4-1

**Applied-For Deemed Average Capital Structure
and Rates of Return for the 1991 Test Year**

	Amount (\$000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Debt -Funded	533,068	53.37	11.30	6.03
- Unfunded	<u>81,460</u>	<u>8.16</u>	11.90	<u>.97</u>
Total Debt Capital	614,528	61.53		7.00
Preferred Share Capital	34,646	3.47	7.99	.28
Common Equity	<u>349,555</u>	<u>35.00</u>	14.38	<u>5.03</u>
Total Capitalization	<u>998,729</u>	<u>100.00</u>		
Rate of Return on Rate Base				<u>12.31</u> ¹

1 As filed in Exhibit B-35.

Subsequently, in late October 1990, Westcoast informed the Board and interested parties that it had decided to go to the market and had placed \$100 million of Series L debentures at a coupon rate of 12.55 percent. Westcoast indicated that the coupon rate of 12.55 percent reflected a corporate issuance spread over long-term Government of Canada bond ("long-Canada") rates of 137 basis points. Westcoast's witness noted that the Company was impressed with being able to achieve such an issuance spread, especially in light of the recent volatility in capital markets. This \$100 million debenture issue essentially replaced the originally-proposed Series L and M debentures totalling \$135 million. Westcoast's expectation was that the \$35 million differential between the anticipated and actual long-term debt issues in 1990 would form part of its debt financing early in the test year.

Consistent with the methodology used in its original application, Westcoast estimated that 55.61 percent of the \$100 million Series L debentures would be allocated to its utility operations at year-end 1990. The Board notes that this allocation factor is an estimate and the Company will permanently allocate a portion of the Series L debentures to Westcoast's utility operations at the end of 1990.

No intervenor objected to either the applied-for amount of funded debt or the associated cost rate.

Decision

The Board accepts the forecast utility allocation factor for the Series L debentures as being reasonable. Accordingly, the Board approves the Company's revised

funded debt amount of \$533,068,000 and the revised cost rate of 11.30 percent for the test year.

4.2 Unfunded Debt

The unfunded debt component of Westcoast's utility capitalization is determined by subtracting funded debt, preferred share capital and common equity from total capitalization.

Westcoast applied for a cost rate of 11.90 percent on its forecast unfunded debt balance for the test year. During the proceeding, the Company stated that it anticipates financing its unfunded debt balance with long-term debt instruments during the test year. The applied-for rate comprised a forecast long-Canada rate of 10.60 percent and a corporate issuance spread of 130 basis points. In using an average long-Canada rate of 10.60 percent for the test year, Westcoast relied on the forecasts provided by a number of economic forecasters. They supplied Westcoast with long-Canada estimates for the test year that ranged from 10.30 to 11.25 percent. In argument, Westcoast stated that a forecast long-Canada rate of 10.60 percent for the test year compared favourably with the estimate provided by the Company's expert witnesses, namely a range from 10.25 to 10.50 percent. A Company witness stated that the high end of this range was supportive of Westcoast's forecast rate of 10.60 percent, bearing in mind the difficulties inherent in forecasting interest rates in the current economic environment.

Westcoast based its forecast corporate issuance spread of 130 basis points on recent market conditions and argued that a forecast spread of this magnitude was fully supported by the spread of 137 basis points implicit in the Company's Series L debenture issue. Based on the Company's experience with the Series L debentures, Westcoast also argued that a corporate issuance spread of 130 basis points for the test year is likely to be a conservative estimate.

The expert witness for CPA reiterated his view that unfunded debt balances should be costed using a long-term corporate rate. The witness stated that the Company's forecast long-Canada rate of 10.60 percent for the test year appeared to be conservative given current and prospective market conditions. He viewed a corporate issuance spread of 130 basis points as being reasonable for the test year; however, he noted that such a spread would be somewhat high for a pure utility having characteristics similar to that of Westcoast's utility operations.

CanWest's expert witness originally recommended that Westcoast's unfunded debt balance be costed at a long-term corporate rate of 10.65 percent. This rate was based on a long-Canada forecast for the test year of 9.70 percent and a corporate issuance spread of 95 basis points. During the hearing, the witness indicated that his original long-Canada forecast of 9.70 percent was based on, among other things, an early resolution of the Persian Gulf crisis. In this regard, the witness put forward a second forecast long-Canada rate for 1991 of 10.25 percent, on the assumption that the crisis will remain unresolved until the spring or summer of 1991. Based on this scenario, CanWest's witness was of the view that the appropriate corporate issuance spread may be as high as 115 basis points; such a spread would result in an unfunded debt rate of 11.40 percent for the test year.

Views of the Board

The Board notes that all parties who addressed this matter accepted the premise that, in the context of this case, a long-term corporate rate should be used to cost the forecast unfunded debt balance. The Board agrees that a long-term rate should be used in this

particular case given the Company's intention to finance its forecast unfunded debt balance during the test year.

In assessing the various long-Canada forecasts presented during the hearing, the Board gave no weight to the upper end of the range of results presented by Westcoast in support of its forecast average rate for the test year. Furthermore, while the Board gave weight to the suggestion that long-term interest rates will decline somewhat during the test year, it was not convinced that long-Canada rates will decline, on average, to the lower end of the range suggested by CanWest's witness. The Board finds that a long-Canada rate for 1991 in the range of 10 to 10.25 percent is reasonable. In reaching this conclusion, the Board recognizes the current uncertainty in financial markets and the inherent difficulty in making interest rate forecasts for the test year under prevailing market conditions. Further, the Board was persuaded that a corporate issuance spread in the order of magnitude suggested by the Company would be reasonable in the context of this case.

Decision

The Board finds an unfunded debt cost rate of 11.50 percent to be reasonable for the test year.

4.3 Preferred Share Capital

Westcoast applied for a cost rate of 7.99 percent on its preferred share balance of \$34,646,000 for the 1991 test year. The dollar amount of preferred share capital and the associated cost rate were both determined using the net proceeds methodology approved by the Board in its RH-2-89 Westcoast Reasons for Decision.

No intervenor objected to either the applied-for dollar amount of preferred share capital or the associated cost rate.

Decision

The Board approves a dollar amount of preferred share capital of \$34,646,000 and a cost rate of 7.99 percent for the test year.

4.4 Common Equity Ratio

Westcoast applied for a deemed common equity ratio of 35 percent, which represents no change from the currently-approved level.

Both CPA's and CanWest's expert witnesses recommended the same equity ratios of 30 percent and 34 percent, respectively, that they had put forth in the RH-2-89 Westcoast toll proceeding.

In assessing the reasonableness of Westcoast's deemed common equity ratio, the Board has typically relied on the following main factors:

- (i) the business risks associated with Westcoast's utility operations;

- (ii) the maintenance of an appropriate balance between the debt and equity elements of the deemed capitalization; and
- (iii) the maintenance of an appropriate balance between the equity financing attributed to the utility through the deeming process and that portion of the actual equity financing which implicitly underpins the Company's non-jurisdictional activities.

Westcoast's expert witnesses noted that the appraisal of business risk is to a large degree judgmental. They accepted the Board's risk evaluation expressed in the RH-2-89 Westcoast Reasons for Decision as a point of departure for their analysis.

On the assumption that the Board would provide a mechanism which would alleviate the increased risk of Westcoast's exposure to demand charge credits as a result of reduced operating flexibility¹, the witnesses concluded that the Company's business risk had remained essentially unchanged since the RH-2-89 proceeding. Accordingly, given no material change in business risk, the witnesses argued that the deemed common equity ratio should be maintained at 35 percent. They found further support for this request from having examined the greater fundamental business risks of Westcoast relative to those of TCPL and NOVA Corporation of Alberta ("NOVA"), which currently have common equity components of 30 and 31 percent, respectively.

CPA's witness expressed the opinion that the appropriate range for Westcoast's deemed common equity ratio, given the Company's utility business risk, is 30 to 32 percent. The upper limit for Westcoast is in contrast to the appropriate upper limit for TCPL, which he believed is 30 percent. In this vein, CPA's witness stated that the difference in the upper limits for the two companies recognizes his view that TCPL's business risks are slightly lower than those of Westcoast. The witness viewed Westcoast's business risk as being essentially unchanged from the time of the RH-2-89 proceeding.

CanWest's expert witness was also of the view that Westcoast's utility business risks had remained basically unchanged since the time of the last hearing. However, he viewed a deemed common equity ratio of 35 percent as being excessive in light of the utility's business risk profile. In his view, a deemed common equity ratio in the range of 32 to 34 percent is reasonable for Westcoast's utility operations given the Company's business risk level. In recognition of the need to preserve Westcoast's financing flexibility, given the expected expansion to the Company's overall system over the next few years, the witness recommended the upper end of this range for the test year.

With respect to the Board's second criterion, Westcoast's witnesses noted the similarity between the applied-for and currently-approved capital structures. Further, the witnesses found the balance between the debt and equity components of the deemed capitalization to be reasonable after they had compared Westcoast's capital structure to those approved for 25 major Canadian utilities. In this regard, they stated that the applied-for common equity ratio of 35 percent was slightly below the median ratio approved for these 25 regulated companies.

¹ Westcoast applied for a deferral account for costs incurred as a result of (i) providing demand charge credits or (ii) mitigating the cost of providing demand charge credits in Zone 2 (see Section 6.3 for a discussion regarding the Zone 2 demand charge credit deferral account).

In contrast, CanWest's witness argued that a 35 percent common equity ratio for Westcoast's utility operations was too high in relation to the Board's second criterion, noting that such a ratio is more than five percentage points higher than the average ratio currently approved for five other major Canadian gas pipelines. In suggesting that the equity ratio should be reduced by one percentage point, the witness was of the view that the Company's bond rating would not change. Consequently, the lower equity ratio would result in savings being passed on to the tollpayers. While unsure of the impact on Westcoast's bond ratings of a one percentage point reduction in the deemed equity component, Westcoast believed that a reduction in its deemed equity component to 30 percent, as suggested by CPA's witness, would be viewed negatively by the bond rating agencies.

There was considerable discussion regarding the possible cross-subsidization of Westcoast's non-regulated activities. Westcoast took the position that the concerns raised by the parties were unwarranted. In their analysis in this area, Westcoast's expert witnesses distinguished between Westcoast's recent investment in WestCoast Gas Inc. ("WestCoast Gas") and its other non-utility investments. With respect to the former, the witnesses were of the view that the Company's financing of the acquisition of InterCity Gas Corporation ("ICG") through a wholly-owned subsidiary (WestCoast Gas) approached the limits of reasonable financing; however, they believed that the financing of the ICG acquisition would likely not cause an impairment of Westcoast's credit rating. Westcoast's expert witnesses also took comfort in the fact that the bank loan assumed by WestCoast Gas is of a non-recourse nature. They assessed the probability of Westcoast having to make bank loan payments on behalf of WestCoast Gas as low. Concerning its other non-utility investments, Westcoast expressed its intention of issuing preferred shares during the test year, thus increasing the total equity underlying these investments. Westcoast also pointed out that the operating results reflected in its pro forma financial statements for 1990 and 1991 may be understated because they do not reflect the potential effect of the currently higher level of oil prices and the possibility that interest rates may be lower than originally anticipated.

CPA's witness did not perform an analysis indicating what the appropriate common equity ratio should be for Westcoast's non-utility investments. However, he did conclude that more equity than is forecast by the Company would be required to properly finance the non-utility operations. In his view, a reasonable common equity ratio for the non-utility would provide a ratio of only 30 percent for the utility. In this context, he noted the importance of examining the coverage ratios for Westcoast's non-utility operations. He found the projected coverage ratios for Westcoast's non utility segment to be inadequate when compared to non-utility corporations rated BBB by the Dominion Bond Rating Service. CPA's witness further acknowledged that the bank loan for Westcoast's investment in ICG is technically non-recourse in nature. He thought, however, that Westcoast would probably intercede if the investment were unable to generate the income necessary to meet the associated interest payments in any given period.

CanWest's witness shared the concerns of CPA's witness in the areas of inadequate non-utility common equity and coverage ratios. Concerning the ICG acquisition, the witness acknowledged that the bond rating agencies would take comfort from the non-recourse bank loan in assessing Westcoast's creditworthiness, but only to the extent that the agencies expected that Westcoast would resist supporting this debt under adverse conditions. In this regard, the witness was of the view that any substantial increase in subsidiary debt, whether it be non-recourse or not, would serve to accentuate the relative volatility of the consolidated net earnings stream of Westcoast, potentially leading to a negative effect on the cost of equity for the parent company.

Views of the Board

The Board notes the general agreement among the witnesses that the business risks of Westcoast's utility operations have remained essentially unchanged since the RH-2-89 Westcoast hearing.

The main area of contention about business risks and the appropriate balance between the debt and equity components of the utility capitalization related to whether the applied-for 35 percent deemed common equity ratio remains reasonable when compared to those of other Canadian utilities in general and, in particular, to those of other regulated gas pipelines in Canada. The Board is cognizant of the differences in risk inherent in the Westcoast system compared to those of other Canadian gas pipelines. The Board believes that Westcoast's fundamental business risks are generally somewhat greater than those of other major gas pipelines in Canada. The Board finds that the applied-for deemed common equity ratio of 35 percent remains reasonable when compared to those of other regulated companies. Furthermore, the Board continues to believe that this ratio provides adequate compensation for the Company's long-term and short-term business risks.

The Board continues to be of the view that the criterion related to possible cross-subsidization of Westcoast's non-utility operations should be given weight only in cases where persuasive evidence is provided. The Board notes that the Company's expert witnesses were of the view that, while the financing of the ICG acquisition approached the limits of what would be considered reasonable, Westcoast's credit rating would not likely be impaired. The Board shares this view. The Board has given weight, as it did in the RH-2-89 Westcoast Decision, to the fact that the rating agencies did not change the Company's debt ratings after the acquisition. The Board is not concerned at this time about the expected non utility capital structure and coverage ratios for 1991. In this regard, the Board gave some weight to the possibility that the coverage ratios forecast by Westcoast for its non-utility segment may be somewhat understated as a result of the Company not taking into account potential changes in oil prices and interest rates.

Decision

The Board approves a deemed common equity ratio of 35 percent for the test year.

4.5 Rate of Return on Common Equity

Westcoast applied for a rate of return on equity of 14.375 percent, the lower end of the range which the Company's expert witnesses found to be reasonable. The witnesses found support for the applied-for rate of return on equity through application of the comparable earnings, discounted cash flow ("DCF") and equity risk premium techniques. (see Appendix IV for a summary of the test results and final recommendations of these witnesses, as well as those of the other expert witnesses in this proceeding.)

Westcoast's witnesses continued to place greater reliance on the results of their comparable earnings test, namely 50 percent. In their updated evidence, they based their comparable earnings results on data for the years 1983 to 1990, given their view that the current business cycle will end either in 1990 or by the first half of 1991. The 40 low-risk industrials in their sample earned returns for the years 1983 to 1989 averaging 14.8 percent. The combination of the actual result for the years 1983 to 1989 with a forecast rate of 11.9 percent for 1990 resulted in an average return for the entire business cycle of 14.5 percent. The adjustment of this rate downwards by 30 basis points to account for the lower risks of Westcoast relative to the sampled companies gave a comparable earnings result of 14.2 percent. The witnesses agreed that, conceptually, a further adjustment would be required if it could be shown that industrials had earned monopolistic returns which were significantly above their cost of attracting capital; however, they found no evidence to support this premise in the circumstances of this case.

The first market-based test employed by the Company's witnesses was the DCF approach. Given the limitations inherent in this approach, the witnesses only gave their final DCF result 20 percent weight in reaching their final rate of return recommendation. A dividend yield of 2.9 percent, together with a longer-term growth component of approximately 10 percent, resulted in an initial cost of equity of about 13 percent. As in the comparable earnings technique, this result was reduced by 30 basis points to 12.7 percent for risk considerations. The adjustment of this basic rate for a market-to-book ratio of 1.15 resulted in a return on book equity of 13.9 percent.

In relation to their second market-based test, namely the risk premium approach, the Company's witnesses utilized the midpoint of a long-Canada range of 10.25 to 10.5 percent, together with an equity risk premium over long-Canada's of 3.375 percentage points. The resultant basic rate of 13.75 percent was then adjusted, as in the case of the DCF technique, for market-to-book ratio considerations to produce a required return of 15 percent. Consistent with past proceedings, the witnesses attached 30 percent weight to these results.

CPA recommended a rate of return on equity of 12.875 to 13.125 percent for the test year, with emphasis on the upper end of the range given current market conditions. In making this recommendation, CPA relied on the evidence presented by its expert witness, who employed the DCF and equity risk premium cost estimation techniques.

In his original application of the DCF technique, CPA's witness determined the investors' required rate of return for low-risk non-utilities to be 12.25 percent. This rate implied a growth factor of 9.15 percent, given the recent dividend yield of 3.1 percent experienced by his sample companies. Based on his analysis of the lower risk of pure utilities relative to low-risk industrials, he reduced his initial rate by 50 to 70 basis points, to yield a range of 11.55 to 11.75 percent. In view of the uncertainty prevailing in financial markets at the time that he filed his evidence, the witness decided to focus on the upper end of this range in reaching his final recommendation. It was noted that the witness, while continuing to give primary weight to the most recent five-year growth rates of his sample companies, also gave weight to the growth rates achieved over the most recent eight-year period. CPA's witness found the eight-year data to be supportive of the five-year data.

This witness' original risk premium results, namely 12.25 to 12.85 percent, were based on a long-Canada rate of 10.75 percent and an equity risk premium range for pure utilities of 1.5 to 2.1 percentage points. This equity risk premium range was determined by first estimating the market risk premium to be in the range of 3 to 4.2 percentage points, then adjusting that range by one-half to

reflect the lower risk of pure utilities. As in the case of his DCF analysis, CPA's witness also decided to focus on the upper end of his equity risk premium range. Using the approximate midpoint of the range resulting from focussing on the upper end of his initial DCF and equity risk premium ranges, the witness concluded that the investors' required rate of return was 12.25 to 12.5 percent. Taking into account the recent and prospective volatility in interest rates and the need for a margin of safety in his final result, the witness concluded that 12.875 to 13.125 percent represented a fair rate of return for the test year.

In late October 1990, CPA's witness presented updated evidence which took into account recent developments in financial markets. He concluded that the investors' required rate of return, as measured by both the DCF and equity risk premium techniques, had increased by 25 to 35 basis points since the filing of his original evidence in September. In particular, his DCF result changed by 30 basis points because of an increase in the dividend yield for his sample of companies and, in the case of his risk premium analysis, long-Canada rates had increased to about 11.1 percent. He concluded that the investors' required rate of return for pure utilities should be adjusted upwards by 30 basis points to a level of 12.55 to 12.8 percent. While conceding that recent events which increased the investors' required rate of return had served to erode most of the cushion for financial market uncertainty built into his original fair rate of return recommendation, he did not alter his final recommendation of 12.875 to 13.125 percent; instead, he chose to focus on the upper end of this range. He saw no need to increase his recommendation further after taking into account, among other things, his view that the prospects for lower interest rates were stronger now than at the time he prepared his original evidence.

CanWest's witness originally recommended an equity return level of 12.75 to 13.25 percent, based on the application of the comparable earnings and equity risk premium approaches. During the proceedings, the witness amended his initial long-Canada forecast for 1991, as well as his risk premium results, concluding that his final recommendation should be changed to a level of 12.95 to 13.3 percent.

CanWest's witness performed two comparable earnings analyses in relation to a sample of 29 low-risk industrials - one for the years 1982 to 1989 and the other for the years 1983 to 1991, which required a projection of corporate profits for the last two years of that cycle. The basic result in the case of the years 1982 to 1989 was an average return of 13.9 percent. He then proceeded to make two downward adjustments, each of 35 basis points in magnitude, for the lower risk of Westcoast's utility operations relative to those of his sample companies and the higher-than-required market-to-book ratios of his sample companies. In his second comparable earnings analysis, the witness projected that the average return levels for low-risk industrials in 1990 would range from 9.7 to 10.2 percent, and then improve in 1991 to a level of 10.5 to 11.4 percent. These projections, together with an average return value for his sample of companies for the years 1983 to 1989 of 14.3 percent, led the witness to conclude that the average return on equity for his sample of companies for the entire 1983 to 1991 business cycle was within the range of 13.35 to 13.5 percent. A similar 70 basis point downward adjustment for risk and market-to-book ratio considerations resulted in an equity return range of 12.65 to 12.8 percent.

In CanWest's pre-filed evidence, the equity risk premium approach focussed on the differentials between allowed equity returns for utilities and the actual yields on long-Canada bonds, corporate bonds and preferred shares. CanWest's witness conceded that, to some extent, there is an element of circularity involved when equity risk premiums are based on allowed utility rates of return; however, he did not see circularity as being a major problem in this circumstance, given the experience concerning regulatory return awards in Canada and the relative stability of achieved market-to-book

ratios for these companies during the period of 1983 to 1989. The witness saw no need to adjust his results for risk considerations, given his view that Westcoast's utility operations are of similar risk to those of the utilities in his sample. Relying more heavily on the results relative to long-Canada rates, he originally found that his equity risk premium analysis suggested a return level of 13.25 percent.

During the hearing, CanWest's witness introduced an additional equity risk premium test, which involved estimating expected risk premiums for the period from 1976 to 1990, by calculating the differential between average allowed returns for utilities and forecast long-Canada yields. He acknowledged that the results of this analysis were statistically superior to those detailed in his original evidence and noted that the equity risk premium result determined using this methodology was some 20 to 25 basis points higher than his original estimate. However, he emphasized the difficulties that he encountered in estimating several of the expected long-Canada rates on which he relied. After taking into account this supplementary risk premium result and his revised forecast of long-Canada rates for the test year (see section 4.2 for a discussion of his long-Canada forecast for 1991), the witness adjusted his final return level, as determined by the risk premium approach, to the range of 13.25 to 13.5 percent. Having given 40 percent weight to his final risk premium result, along with 30 percent weight to each of his comparable earnings analyses, he concluded that a cost of equity of 12.95 to 13.3 percent was reasonable for the test year.

Views of the Board

The Board finds that each of the cost estimation techniques put forward during the hearing should be given weight in determining a fair return on equity for Westcoast. However, in this case, the Board gave somewhat greater weight to the results presented under the risk premium approach. The Board believes that its decision on the appropriate rate of return on equity for Westcoast satisfies the principles of fairness and of maintenance of a company's financial integrity and ability to attract capital on reasonable terms.

The main areas of disagreement in the application of the equity risk premium approach centred on the magnitude of the market risk premium and the riskiness of Westcoast relative to a company of average risk. It is noted that the Company's witnesses have, in this and other proceedings before the Board, suggested that a market risk premium of 5 percentage points is a conservative estimate. The Board was not convinced that the market risk premium is of this magnitude. However, the lower end of the range suggested by CPA's witness, namely 3 percentage points, falls outside of what the Board considers to be a reasonable market risk premium range. In particular, the Board was not convinced of the reliability of the adjustment made by CPA's witness for the "lock-in" premium inherent in long-term interest rates.

Concerning the risk premium approach introduced by CanWest's witness, the Board considered the results, but found that both the methodology and the final result were not adequately tested during cross-examination, essentially because the information was filed late in the proceeding. The Board expects CanWest's witness to present similar evidence in his pre-filed testimony at the next hearing so that the merits of his approach can be fully explored.

With respect to the risk of Westcoast's utility operations relative to that of an average-risk company, the Board is aware of the difficulty inherent in attempting to quantify risk differentials. In this regard, the Board found the explanations provided by the Company's witnesses as to the magnitude of the required adjustments to be more insightful than was the case in the RH-2-89 Westcoast proceeding. While not convinced that the appropriate risk adjustment factor for Westcoast is the level suggested by its witnesses (i.e. 25 percent of the market risk premium), the Board is of the view that the risk adjustment factor suggested by CPA's witness is somewhat excessive.

In its review of the evidence on the comparable earnings approach, the Board recognizes the problems inherent in using this technique. While agreeing with CPA's witness that the basic unadjusted results of this test are distorted to some extent, the Board believes that the adjusted results can still be useful in arriving at a fair return if the problems inherent in the approach are taken into account. Having said that, the Board notes the difficulty inherent in estimating the adjustments required in the context of this test. Both witnesses who performed this test made similar downward adjustments to their basic results to reflect the lower risk of Westcoast relative to the companies in their respective industrial samples. The Board agrees that such an adjustment is required.

A main area of disagreement between the witnesses is the need for an adjustment to the basic results to reflect the extent to which the companies in the sample have earned returns in prior periods that even for a monopoly would be considered excessive. The Board agrees that, conceptually, an adjustment would be required if it can be shown that these companies did indeed earn excessive returns. While concerned that the return levels earned by some sample companies may be somewhat excessive, the Board was not persuaded that an adjustment of the magnitude suggested by CanWest's witness is required. The Board suggests that the witnesses continue to look for ways of determining the extent to which sample companies, both individually and as a group, have earned excessive returns.

In reaching its final decision, the Board is of the view that the 1990 level of earnings forecast by Westcoast's witnesses for their sample companies are unlikely to be realized. As such, the Board finds the comparable earnings results of these witnesses to be overstated. The Board also notes the comments made by CPA's witness as to the distorting effects of past high and volatile levels of inflation on rates of return on book equity. The Board remains concerned that such distortions are inherent in comparable earnings data. However, based on the evidence presented in this case, the Board was unable to determine the amount of adjustment required for this factor.

Only the witnesses for Westcoast and CPA utilized the DCF approach in attempting to determine a fair return level for the test year. Given the Board's view that the 1990 forecast level of earnings for the sample companies presented by Westcoast's witnesses is overstated and that the growth rate estimated by these witnesses was, in part, based on expected return levels for the years 1983 to 1990, the Board believes that the Company's growth estimate is somewhat overstated. The Board notes the position put forward by CPA's witness that his growth rate estimates may in fact be overstated, to

the extent his non-utility sample contains proportionately more companies which have experienced above-average, rather than below-average, growth in the past. The Board was not convinced that this is the case.

After taking into account its concerns about the application of the various cost estimation techniques, the Board finds that an increase in the approved equity return level is warranted. The Board also notes that all of the expert witnesses expect long-term interest rates to be higher in 1991 than the levels projected for the 1990 test year in the RH-2-89 Westcoast proceeding. In concluding that a long-Canada range of 10 to 10.25 percent is reasonable for the test year (see section 4.2), the Board gave weight to the evidence presented in the hearing that such rates are expected to decline somewhat throughout the test year. Based on these factors, the Board finds that a rate of return on common equity of 13.75 percent is fair and reasonable for the test year.

Decision

The Board approves a rate of return on common equity of 13.75 percent for the test year.

4.6 Rate of Return on Rate Base

The Board directs Westcoast to determine its rate of return on rate base based on the decisions set out in these Reasons for Decision.

4.7 Flow-Through Tax Calculation

The methodology for calculating the 1991 test-year flow-through income tax provision was not an issue in this hearing.

Decision

The Board directs Westcoast to adjust the 1991 test-year flow-through income tax provision to reflect the effect of the various decisions contained in these Reasons for Decision.

Chapter 5

Operating Cost

5.1 Salaries, Wages and Employee Benefits

5.1.1 Staff Complement

Westcoast's 1989 full staff complement was 935 positions. However, actual permanent and temporary person-years averaged 923 because there was a vacancy adjustment equivalent to 12 person years. For 1990, Westcoast forecast a full staff complement of 1,007 person-years, and a vacancy adjustment of 13 person-years. The increase was in large part caused by the takeover of the McMahon Plant operations from Petro-Canada Inc. ("Petro-Canada") in April 1990¹.

For the 1991 test year, Westcoast estimated a full staff complement of 1,099 person-years and a vacancy adjustment of 14 person-years. Westcoast argued that the increase in person-years for 1991, including the four person-years for the new Utility Services Marketing Division, was reasonable considering the continued transition of the system from sales to service, the continued high level of activity on capital projects, and the increased requirements for operating and maintenance necessitated by both the aging of the system and the numerous new projects coming into service.

Westcoast's estimated vacancy adjustments for the 1990 forecast year and the 1991 test year were based on the Company's actual vacancy rate in 1989 of 2.5 percent for non-organized employees. During cross-examination, Westcoast accepted the premise that a three-year average would be an appropriate method to use in determining the test year vacancy adjustment. This method would normalize the effect on the cost of service of any wide fluctuations in the vacancy adjustment that can occur from year to year.

Regarding the proposed increase in staff complement, CPA argued that the proposed increase of eight person-years in the engineering complement should be disallowed on the basis that these positions appeared to have been transferred from the Vancouver Island Pipeline project. Counter to Westcoast's assertions, CPA suggested that there is not expected to be a sufficient increase in engineering-related activity in 1991 relative to that experienced in the previous two years to justify the increase in engineering complement. CPA noted that construction engineering and design work is usually contracted out to outside engineering firms. CPA also argued that the four person-years forecast for the Utility Services Marketing Division is excessive, asserting that the work could be performed by adding one or two professionals to the regulatory administration division.

In arguing that the additional eight engineers are required, Westcoast noted that between 1989 and 1991 it will be conducting capital programs of approximately \$200 million. While Westcoast agreed

¹ Westcoast hired an additional 56 permanent employees and the equivalent of 6 casual person-years to operate the McMahon Plant in 1990. Given that Westcoast operated the plant for nine months, only the equivalent of 46 permanent person-years was included in the staff complement for 1990.

that it contracts out some of the design work in its processing plants, it also pointed out that a significant amount of this work is done by Westcoast's engineers.

In support of the new Utility Services Marketing Division, Westcoast stated that this new unit is responsible for developing utility services marketing strategies, plans and programs for the Company. The division's responsibilities are to promote the use of the Company's existing and proposed pipeline systems and to act as liaison between Westcoast and new or potential service customers.

Views of the Board

The Board finds that Westcoast's full staff complement estimated for the 1991 test year has been adequately supported. However, on the basis of the evidence presented, the Board finds that the vacancy adjustment estimates for 1991 should be based on the Company's actual vacancy experience for the three-year period 1987 to 1989. A three-year average yields a vacancy adjustment rate of 3.8 percent versus the applied-for rate of 2.5 percent. The effect of this adjustment is to increase the Company's average vacancy adjustment from 14 to 22 person-years for the 1991 test year.

Decision

The Board approves Westcoast's projected full staff complement of 1,099 for the 1991 test year. The Board directs Westcoast to use a vacancy adjustment factor of 3.8 percent for the test year.

5.1.2 Annual Rates of Salary and Wage Increase

(i) Actual Versus Approved 1990 Salary and Wage Increases

In its RH-2-89 Westcoast Reasons for Decision, the Board allowed Westcoast a salary and wage adjustment of 5.0 percent for the purpose of calculating its salaries, wages and benefits expense for the 1990 test year. However, in its current application, Westcoast's 1990 salary and wage forecast reflects the actual salary and wage increases granted by the Company of 5.7 and 5.5 percent, respectively.

Westcoast explained that the 1990 increases awarded were appropriate and necessary in order to maintain the Company's competitive position vis-à-vis other employers. Accordingly, Westcoast took the position that the appropriate point of departure for assessing the reasonableness of the test-year provision for salaries and wages is the 1990 actual costs. In this regard, Westcoast pointed out that the settlements for wage earners in the industry are essentially governed on a national basis by the results negotiated between the Energy and Chemical Workers' Union and Petro-Canada. Westcoast indicated that during 1990 it entered into a two-year collective agreement with its unionized employees that provided for increases of 5.5 and 6.0 percent for 1990 and 1991, respectively.

In granting an actual salary increase in 1990 of 5.7 percent, Westcoast noted that the salary increases awarded in the industry for 1990 ranged from 5.5 to 7.0 percent. Westcoast also stated that it is the Company's practice to wait until late January or early February before setting salary levels so as to have as much data as possible concerning actual increases awarded by others in the industry.

CPA and IPAC argued that the test-year forecast of salaries and wages should reflect the approved salary and wage increases of 5.0 percent for 1990, and not the actual increases granted by Westcoast.

These parties referred to the approach taken by the Board in its RH-3-86 TransCanada Reasons for Decision, where the Board adjusted TCPL's test year salaries downwards to reflect the approved, rather than the actual, salary levels for 1986. IPAC argued that, if the Company's shareholders choose to pay Westcoast's employees more than the Board allows, then the shareholders should pay for that decision and not the tollpayers. IPAC was of the opinion that, in situations such as this, if Westcoast disagrees with a previous Board decision, the Company should come forward and seek a review of the Board's prior decision.

Views of the Board

The Board is of the view that Westcoast must be allowed to attract and retain qualified personnel. While the Board notes that the actual salary and wage increases granted by Westcoast were in excess of the Board-approved levels, the evidence demonstrates that such increases were reasonable and in line with those granted by comparable industries. In fact, Westcoast's settlements were near the bottom of the range. Therefore, the Board is of the opinion that Westcoast has provided adequate justification for using its actual wage and salary settlements rather than the Board-approved increases as the bases for determining the 1991 test-year wages and salaries.

Regarding the concerns raised by parties that the actual awards exceeded the approved increases, the Board notes that Westcoast's shareholders and not its tollpayers absorbed the difference between the approved and actual salary and wage increases for the 1990 test year.

Decision

The Board approves the use of the actual salary and wage increases granted by Westcoast for 1990 in determining the 1991 test-year estimate.

(ii) 1991 Salary and Wage Increases

In its application, Westcoast provided for salary and wage increases of 6.5 and 6.0 percent, respectively. The proposed salary increase was based on Westcoast's survey of oil and gas companies which indicated that increases in 1991 would be in the range of 6.5 to 7.5 percent. The wage increase of 6.0 percent covers the last year of the two-year collective agreement negotiated with the unions. In addition to the general increase, Westcoast also included increases for promotions and upgrades. For its Executive and Management Group, Westcoast proposed an annual increase of 5.0 percent, plus an annual bonus package estimated at \$350,000 and an amount of \$90,000 for promotions.

In argument, Westcoast reiterated that the proposed increases are based on an analysis of surveys and studies of expected salary and wage increases in comparable industries for the test period. Westcoast is of the view that the proposed increases are required to maintain its ability to attract and retain qualified personnel.

IPAC was of the view that the Board should state explicitly that its decisions on the appropriate annual salary and wage increases should include all forms of compensation, including executive bonuses and promotions. Further, IPAC argued that all forms of compensation adjustments should be dealt with in one section of the application, and that the executive bonuses should be open for review and should be included as a visible and separate item.

Views of the Board

The Board is not persuaded that the applied-for total compensation package for salaried employees and wage earners is justified for the 1991 test year. The Board notes that, in the Towers Perrin 1990 Salary Management Survey, excerpts of which were filed late in the proceedings, the average salary increase for salaries of head office personnel located in British Columbia is forecast to be 6.1 percent for 1991. In view of that evidence, the Board would expect Westcoast to be able to keep its salary and wage increases in that range and still remain competitive.

The Board is of the view that the approved annual salary and wage increases should take into account all forms of compensation, including basic salaries, promotions and executive bonuses.

Decision

The Board directs Westcoast to adjust the 1991 test-year provision for salaries, wages and benefits to reflect an overall increase of 6 percent in salaries and wages. This 6 percent adjustment is to cover all forms of remuneration including general increases for all categories including the executive and management group, pay-for-performance, upgrades, promotions, progression, and provision for executive bonuses. Westcoast is also directed to include in future applications information respecting Executive and Management Group bonuses in a format similar to that presently provided for salaries, wages and benefits.

5.1.3 Allocation to Non-Utility

As in the past, Westcoast has allocated costs to non-utility operations on the basis of either a negotiated fixed fee or actual hours worked as recorded on employees' time sheets. The negotiated fee is charged for services provided by Westcoast to its subsidiary companies and mainly relates to salaries and general administrative costs incurred by Westcoast.

During cross-examination, Westcoast acknowledged that almost all of the fixed fees charged to subsidiary companies had remained unchanged for some time. Parties were concerned that, while Westcoast is requesting increases in its O&M costs for salary settlements and general inflation, the projected fixed fees of \$1,619,000 charged to subsidiary companies had nevertheless remained unchanged. Westcoast reviewed these fixed-fee charges and subsequently increased some of the pre-determined fixed fees, in total, by \$110,000.

CPA expressed concern that Westcoast does not appear to have a formal mechanism in place to determine whether the levels of the fixed fees remain reasonable. CPA submitted that, to ensure that the utility is not subsidizing Westcoast's subsidiaries, non-utility charges should be reviewed by the Board and established by allocating administration and general expenses in an appropriate manner.

Views of the Board

The Board continues to believe that Westcoast's general allocation methodology meets the criteria of allocating costs between utility and non-utility activities fairly and consistently, with minimal cross-subsidization. However, the Board believes that the

current procedures used by Westcoast to establish the pre-determined fixed fees need to be reviewed by the Company.

Decision

The Board approves Westcoast's procedures for allocating costs to its non-utility activities for the test year, including its revised estimate of \$1,730,000 for fixed-fee charges to its subsidiaries.

The Board directs Westcoast, in its next toll application, to identify the work performed under fixed-fee arrangements for each subsidiary, the total amount charged to each subsidiary, and the portion of the fixed fee that should be adjusted annually for inflation.

5.2 Other O&M Expenses by Cost Centre

5.2.1 Pressure Vessel Inspection and Repair

Westcoast included in O&M expenses \$745,000 for inspecting and \$900,000 for repairing stress fractures in pressure vessels in the processing plants and Northern District. Westcoast initiated the inspection program because of safety and dependability concerns that had been raised when problems with circumferential welds in pressure vessels were identified by another Canadian gas plant operator, who found that almost half of the pressure vessels that were inspected had to be either repaired or, in some cases, replaced.

Some intervenors noted that Westcoast had inspected nine pressure vessels in 1990 and that no repairs of the type Westcoast was anticipating were required. IPAC recommended that, in view of Westcoast's 1990 experience, the Board should delete the \$900,000 forecast repair costs from the cost of service.

It was Westcoast's position that, because it is very difficult to forecast the full extent of the problem and, consequently, the precise cost of repairs, the \$900,000 should be approved together with a deferral account which would protect the interests of all parties.

Views of the Board

The Board realizes that it is difficult to anticipate the need for repairs. It therefore appreciates the concerns intervenors have regarding the budgeted amount of \$900,000 for repairs. Consequently, the Board will require Westcoast to establish a deferral account for the costs associated with inspecting and repairing pressure vessels (see section 6.3.2).

Decision

The Board approves \$745,000 for the inspection of pressure vessels in Westcoast's gas processing plants and Northern District and \$900,000 for the repair of any stress fractures which may be found, subject to the Board's Decision regarding the applied-for deferral account which is set out in section 6.3.2 of this Decision.

5.2.2 General Escalation Factor for Inflation

Westcoast has historically used a forecast of the Consumer Price Index ("CPI") as a general escalation factor to determine its test-year estimate of the cost of materials and supplies when specific price information is not available from suppliers. For the 1991 test year Westcoast has used a general escalation factor of 5 percent. Westcoast stated that the 1991 inflation forecast was determined in consultation with independent forecasters and reflected an adjustment to remove the GST component.

The question arose as to whether the CPI was the appropriate general escalation factor to use when forecasting the cost of materials and chemicals. It was pointed out that there are other measures, such as industry price indices, which may be better suited for this purpose.

Views of the Board

The Board accepts the use of an estimate of the CPI as the appropriate general escalation factor for the test year, but is interested in examining the merits of using other indices. Consequently, the Board requests Westcoast, in its next toll application, to provide an assessment of the merits of using indices other than the CPI as the general escalation factor for materials and chemicals.

Decision

The Board approves the applied-for general adjustment factor for materials and chemicals of 5 percent for the 1991 test year.

5.3 NEB Cost Recovery

In its RH-2-89 Westcoast Reasons for Decision, the Board approved an amount of \$1,794,000 to be included in the 1990 cost of service in respect of the NEB cost recovery regulations. This amount represented Westcoast's proportionate share of the cost of the Board's operations. At the time of the Decision it was expected that the NEB Cost Recovery Program would become effective in early 1990. However, due to unforeseen circumstances, the program was not implemented as planned. In its 1991 application, Westcoast made provision to recover \$675,000 in the 1990 tolls and has placed the balance of \$1,119,000 in an approved deferral account to be credited to the 1991 test-year cost of service. Subsequent to the filing of Westcoast's application, the implementation of the cost recovery regulations was deferred to 1991.

Westcoast has also proposed recovering \$2,700,000 in the test-year tolls to cover its share (\$2,654,485) of the NEB 1991 budget under the cost recovery regulations.

Decision

Due to the delay in implementing the NEB Cost Recovery Program, Westcoast is directed to place the entire 1990 approved amount of \$1,794,000 in the deferral account and to credit this amount, plus appropriate carrying charges, to the 1991 test-year cost of service.

With regard to the provision for 1991, the Board approves the inclusion of \$2,700,000 in the cost of service.

5.4 Depreciation

In its RH-2-89 Westcoast Reasons for Decision, the Board directed Westcoast to undertake and file a new depreciation study. The Board reminds Westcoast and interested parties that the due date for filing this depreciation study with the Board is 1 March 1991.

5.5 Taxes Other than Income Taxes

Westcoast forecast that taxes other than income taxes would be \$45.2 million in the test year, an increase of \$3.0 million over the 1990 forecast, \$2.3 million of which is due to higher property taxes.

Intervenors expressed concern regarding the large increase in property taxes that Westcoast forecast for its head office building in Vancouver. This matter is discussed in section 5.7 under Head Office Rent.

Decision

The Board approves the applied-for test-year amount of \$45.2 million for taxes other than income taxes.

5.6 Insurance Deductibles

In the test-year cost of service, Westcoast included an amount of \$508,000 for insurance deductibles using the method previously approved by the Board. This amount compensates Westcoast for losses that it cannot recover due to the deductible clause contained in certain of its insurance policies. The amount to be included in the test year is determined by calculating the average amount of such losses over the most recent four-year period for which actual insurance losses are available (the period 1986 to 1989) and adjusting it for the effects of inflation. The amount of the 1989 unrecoverable insurance loss that was included in the calculation was \$1,408,000.

Westcoast stated that, as it has done for the last 20 years, the 1989 losses were reviewed by Westcoast's insurance manager who determined whether claims can be recovered under the Company's insurance policies. Doubtful cases were referred to an outside consultant. With respect to the large amount that was not recoverable in 1989, Westcoast concluded that 1989 had been an unusual year for insurance claims.

CPA was concerned that some of the amounts comprising the \$1,408,000 may not have been losses covered by insurance and, consequently, did not qualify as an insurance deductible.

Views of the Board

The Board believes that the existing method of calculating the amount of insurance deductibles continues to be appropriate. The Board is satisfied that Westcoast is calculating the amount for insurance deductibles using the approved procedure.

Decision

The Board approves the applied-for insurance deductible amount of \$508,000 for the 1991 test year. For clarity, the Board reiterates that the insurance deductible amount included in the cost of service is approved to compensate the Company for losses that cannot be recovered from its insurers because of the operation of the deductible clause in its policies. It follows, therefore, that losses which are not

covered by insurance cannot be included in the calculation of the amount of unrecoverable insurance losses.

In future applications Westcoast is directed to provide information respecting the calculation of the insurance deductible amount similar to that provided in response to NEB Information Request No. 22 filed as part of Exhibit B-5 in the hearing.

5.7 Head Office Rent

Prior to September 1990, the Westcoast building was owned by Vancal Properties Ltd. (Vancal"), a wholly-owned subsidiary of Westcoast. Westcoast rented the entire building from Vancal and included the cost of the rental, less rent received from a commercial tenant renting three floors, in the cost of service.

In the RH-2-89 hearing Westcoast proposed, and the Board approved, a renegotiated lease on a more standard commercial basis. Under the terms of the renegotiated lease, Westcoast paid Vancal a basic rental of \$16.00 per square foot and assumed responsibility for paying all taxes and operating costs. Westcoast also paid for leasehold improvements, while Vancal was responsible for the cost of any capital improvements.

In September 1990, the building was sold and Westcoast negotiated a lease with the new owners. Under the terms of that lease Westcoast will pay basic rent during 1991 of \$2,475,000 plus \$200,000 for parking stalls and all taxes and operating costs. The new lease is for a term of ten years with two successive five-year options because Westcoast now believes that it will require the premises at least until the year 2000. Pursuant to its undertaking in the RH-2-89 proceeding, Westcoast will continue to include in the cost of service rent based on \$16.00 per square foot (\$2.2 million per annum) through 1994.

In addition to occupying space in the Westcoast building, the Company has moved its engineering department into other rented office space in downtown Vancouver. When questioned by intervenors, Westcoast responded that it intended to vacate those premises and move the department into the three floors of the Westcoast building presently occupied by its sub-tenant once its lease expires.

Intervenors were also concerned with two other matters relating to the building, namely, a forecast increase of approximately 50 percent in property taxes from \$601,000 in 1990 to \$900,000 in 1991, and a charge of \$ 100, 000 for repairs to the roof.

IPAC argued that the Company had neither been informed of the latest assessment for its head office building, nor did it know what the 1991 mill rate would be. In IPAC's view Westcoast had failed to make a case for such a large increase.

Westcoast stated that the anticipated large increase in property taxes is based on recent large increases in assessments in Vancouver, but was unable to provide evidence of the mill rate that would likely be set. In argument, the Company stated it would be willing to accrue any difference between actual and forecast property taxes in the tax deferral account.

In the case of the \$100,000 forecast for roof repairs in 1991, Westcoast is of the opinion that this is properly chargeable to the cost of service as an operating expense pursuant to the terms of the lease.

In Westcoast's view re-roofing the building does not qualify as a capital improvement under generally accepted accounting principles and, therefore, is not the responsibility of the lessor.

Views of the Board

The Board notes that the rental cost included in the 1991 cost of service continues to reflect a basic rental rate for the head office of \$16.00 per square foot and that Westcoast has re-affirmed its commitment to continue using this rate through 1994. The Board also notes Westcoast's intention to record any difference between actual and forecast property taxes in a deferral account.

With regard to the \$100,000 included in head office rental costs for roof repairs, it is the Board's opinion that the amount is properly chargeable as an operating expense pursuant to the terms of the lease.

Decision

The Board approves the use of a basic rental cost of \$16.00 per square foot and Westcoast's forecast head office net rental cost for 1991 of \$3,296,000. However, Westcoast is directed to record the difference between the forecast property taxes of \$900,000 and the actual taxes paid in its property tax deferral account, with appropriate carrying charges, for inclusion in the Company's next toll application.

5.8 Gas Used in Operations

In its RH-6-85 Westcoast Reasons for Decision, the Board directed Westcoast to calculate an amount for lost and unaccounted-for gas by using the average of the most recent three years' actual experience. Lost and unaccounted-for gas is defined as the unaccounted-for gain or loss volumes required to balance receipts with deliveries after accounting for fuel gas and line pack changes.

In its current application Westcoast included an unaccounted-for gain of \$130,000 for sales gas based on the average of the Company's actual experience in 1987, 1988 and 1989.

In response to a concern raised by CPA, Westcoast explained that a large unaccounted-for loss was recognized in December 1989 after eleven consecutive months of gains because of a double counting of the Laprise volumes at the new Aitken Creek plant. The error occurred during the plant's first month of operation. After it made the discovery, Westcoast informed all producers using the McMahan plant that it would correct the error in a subsequent month. The correction resulted in a corresponding volume being deducted from the August 1990 McMahan plant residue gas volume. This deduction caused an unaccounted-for gain in the month of August to offset the error for December 1989. The correction was made on producers' statements for September.

Views of the Board

The Board notes that Westcoast is continuing to calculate unaccounted-for losses and gains on a three-year rolling average as per its RH-6-85 Westcoast Reasons for Decision. The Board is satisfied with Westcoast's explanation of the nature of the apparent large loss in December 1989.

Decision

The Board approves the unaccounted-for gas gain of \$130,000 for inclusion in the 1991 test year.

Westcoast is to continue calculating unaccountable gas gains and losses by using the method prescribed by the Board in its RH-6-95 Westcoast Reasons for Decision.

5.9 Other Miscellaneous Matters

5.9.1 Task Force

BC Gas was concerned that Westcoast is placing too much emphasis on majority votes in the Task Force meetings.

BC Gas was of the view that if the Task Force is unable to reach a consensus on an issue, the Task Force participants including Westcoast should not make reference to the majority views or other positions taken in Task Force meetings.

Views of the Board

The Board continues to be encouraged by the results achieved by the Task Force in resolving a number of issues outside the hearing process. This has considerably reduced the time required to hear an application. Regarding the comments of BC Gas, the Board believes that the Task Force should discuss how it wishes to deal with, or report to the Board on, matters for which a consensus was not reached.

For those matters that the Task Force resolves, the Board wishes to re-emphasize that, for the process to be of assistance to the Board in the related hearing, the Task Force must file a comprehensive report on the issues and the proposed actions. Such reports should contain at least the following information:

- (a) a concise description of the issues,
- (b) a background section describing the nature of each relevant matter,
- (c) a section summarizing the concerns raised by the Task Force members,
- (d) a clear and concise statement of resolution, and
- (e) all changes required to existing tolls, tariffs or policies (such as the RGT Facility Expansion Policy) currently filed with the Board, resulting from the resolution of the issue.

The Board believes that the above information will not only provide it with the necessary information to assure itself that the recommended proposal is the best of the alternatives and will result in just and reasonable tolls and tariffs, but will also ensure that all parties are in agreement with the modifications to the tolls, tariffs or policies that are required to give effect to the proposed changes.

5.9.2 Toll Application Filing Requirements

The Board and a number of interested parties were concerned with the level of information and explanations provided by Westcoast in support of the significant increases in rate base and cost of service items or in changes from previous Board Decisions. The Board was particularly concerned that Westcoast did not apply to re-instate certain items in the Company's cash working capital allowance that were disallowed as a result of a previous Board Decision.

Views of the Board

The Board believes that Westcoast should discuss the information to be filed in support of its toll applications at the Task Force level. This approach would ensure that the major participants at the Westcoast toll hearings are given the opportunity to address their concerns to Westcoast regarding the additional information they would like to have Westcoast file with its initial application. In the Board's view, this process would significantly reduce the number of information requests. It would give Westcoast a full appreciation of the concerns of intervenors who, in turn, would better understand the problems encountered by Westcoast in preparing a toll application.

Chapter 6

Deferral Accounts

6.1 Disposition of Existing Deferral Accounts

Westcoast has forecast the balances in its approved deferral accounts as at 31 December 1990 and has proposed amortizing these balances to the test-year cost of service in the same manner used in previous years.

Intervenors did not object to Westcoast's proposal.

Decision

The disposition of the deferral account balances proposed by Westcoast is approved.

6.2 Reinstatement of Existing Deferral Accounts

Westcoast requested continuation of the deferral accounts that were approved by the Board's Order TG-9-89.

Intervenors did not comment on this request.

Decision

The Board approves the continuation of the deferral accounts approved by Order TG-9-89, with the exception of the deferral account covering the variance related to the difference between the forecast and actual price of line pack gas. As a result of the Board's decision respecting the valuation of line pack in section 3.3 of these Reasons, this account is no longer required.

6.3 New Deferral Accounts

6.3.1 Revenue

(i) Interruptible Toll Revenue

Westcoast requested this account to record differences between the forecast of test-year interruptible toll revenue used to calculate the unit interruptible credit to the firm tollpayers and the interruptible toll revenue that is actually received. Both IPAC and BC Gas supported the request and no intervenor objected to it.

Decision

The Board approves this deferral account.

(ii) Zone 2 Demand Charge Credits

Westcoast has requested this deferral account to record all costs incurred in providing demand charge credits, and the costs associated with any mitigative measures resulting from unanticipated service interruptions in Zone 2 processing facilities. Westcoast would still be exposed to the risk of providing demand charge credits in the event of unanticipated service interruptions in Zones 1, 3 and 4.

Westcoast explained that, during the test year when it is operating at or near capacity in a processing plant, it will have little or no supply flexibility that would enable it to "operate around" an unanticipated service interruption at the plant. Westcoast explained that there is no standby processing capacity to provide backup service for these unanticipated service interruptions because the cost of providing such backup equipment would be prohibitive. The Company stated that, when it was the sole buyer and seller of gas on its system, it could secure gas from several processing plants to satisfy its sales requirements if an interruption occurred at a single plant and the other plants were not operating at full capacity. However, when it completes its transition from a sales to service oriented pipeline, Westcoast explained that it will no longer have the same degree of flexibility to secure gas from alternate plants.

Westcoast also explained that, as it becomes a pipeline that no longer provides sales services, it is being exposed to processing disruptions as a result of other parties' actions, over which it has no control. Consequently, Westcoast believes that the cost of providing demand charge credits during periods of unanticipated plant outages is a cost that should be borne by all shippers.

CPA opposed the deferral account for demand charge credits, citing the lack of demand charge credits given since 1985, with the possible exception of a small credit that may have been given in 1988. CPA suggested that the Task Force should discuss this matter with a view to developing a procedure by which shippers would provide a curtailment plan in the event of an outage. This approach might allow shippers some choices while still addressing the concerns of Westcoast regarding the need to take mitigative measures or provide demand charge credits in the event of a plant outage.

BC Gas also opposed the deferral account. BC Gas believed that a deferral account would transfer risk from service to sales customers because flexibility still exists within the sales contracts with BC Gas and Pacific Northern Gas Ltd. Furthermore, flexibility will continue to exist as a result of CanWest's diversity of supply, and Westcoast itself can bring gas in from Alberta to meet its sales obligation. Consequently, supply diversity will not be lost as customers convert from sales contracts to service contracts.

In the past during periods of peak demand, Westcoast had no operating flexibility and, therefore, could not "operate around" a disruption at a processing plant. To give Westcoast a deferral account now, in BC Gas' view, would shelter the Company from risks to which it has been traditionally exposed. BC Gas stated that customers want gas delivered when they require it, not demand charge credits. Putting an arrangement in place that reduces Westcoast's risk will not ensure that gas will flow when it is needed.

Westcoast agreed that the Task Force should discuss whether the existing procedures for handling outages could be improved. However, Westcoast stated that neither those discussions, nor shipper co-operation, which it receives in emergency situations, respond to the issue of Westcoast's obligation to provide demand charge credits and the risk the obligation poses on the Company.

Westcoast believes that since 1985 its degree of exposure to this cost has been slowly accelerating to the point where it is now a major concern. Westcoast explained it recognizes the importance of taking steps to ensure that, wherever possible, service can continue to be provided to shippers in an emergency situation, rather than giving demand charge credits.

Views of the Board

The Board believes that shippers and Westcoast, through their Task Force representatives, should review the existing curtailment procedures in the event of a plant outage. The Board recognizes that any modifications to these procedures may provide the shippers with additional flexibility in assisting Westcoast in an emergency situation. However, the Board agrees with Westcoast that such assistance does not respond to the need to provide demand charge credits. In this regard, the Board finds reasonable Westcoast's efforts to continue to provide service in a cost-effective manner during emergencies.

Decision

As Westcoast moves from a sales and service pipeline to one that provides transportation and processing services only, its operating flexibility in the event of an unanticipated operating interruption at a Zone 2 processing plant is diminished. Therefore, the Company is exposed to greater demand charge credit risks. Accordingly, the applied for deferral account to record demand charge credits and the costs associated with mitigative measures taken in situations that give rise to Zone 2 demand charge credits is approved.

6.3.2 Cost of Service

(i) Pressure Vessel Inspection and Repair

Westcoast requested a deferral account to record the difference between the Company's forecast expenditures and the actual expenditures related to the cost of repairing stress fractures in pressure vessels located in its processing plants and Northern District. Westcoast has requested this deferral account because, while it has included \$900,000 in the test-year cost of service for repairing stress fractures, it found it difficult to forecast with precision the cost of the required repairs before the vessels have been inspected. The Company also included an amount of \$745,000 to cover the estimated cost of its inspection program. Westcoast did not request a deferral account to record any variance between the estimated and actual inspection costs.

CPA, the Council of Forest Industries of British Columbia and Cominco Ltd. ("COFI/Cominco") were not opposed to this deferral account, believing that these inspections are a matter of safety and system reliability. IPAC and BC Gas were opposed on the basis that the limited number of inspections completed during 1990, the type of repairs required and the subsequent cost of those repairs had not demonstrated the need for the provision of \$900,000 for stress fracture repairs.

Views of the Board

The Board notes the small number of inspections undertaken in 1990 and the lack of cracks found in the circumferential welds. However, because this is an important safety matter, and in view of the experience in other jurisdictions (see section 5.2. 1), the Board believes that Westcoast should be encouraged to continue its current inspection program. Nevertheless, the possibility exists that Westcoast may not carry out all of the inspections contemplated, and it is not certain that the repairs will cost the amount forecast. In view of this, a deferral account is warranted.

Decision

Westcoast is directed to establish a deferral account in which it shall record:

- (1) the difference between the forecast and actual costs of inspecting the pressure vessels in the processing plants and Northern District; and**
- (2) the difference between the forecast and actual costs of repairing any cracks that the inspections uncover.**

(ii) Projects Approved Pursuant to Section 52

Westcoast applied for approval of a deferral account to record differences between forecast and actual rate base additions, and the associated capital cost allowance ("CCA"), for projects requiring approval pursuant to section 52 of the NEB Act. The Company subsequently amended the application to include other major projects on a case-by-case basis and proposed that the McMahon Plant Expansion project be considered as a major project for purposes of this deferral account.

Westcoast explained that the CCA rate for its processing plants is 25 percent while the depreciation rate for the McMahon plant is 1.4 percent. Westcoast stated that the McMahon Plant Expansion is forecast to go into service on 1 November 1991. Accordingly, Westcoast has passed the substantial tax benefit of the CCA through to its shippers in the form of lower applied-for tolls for the 1991 test year. Westcoast stated that if the start-up date should slip beyond 31 December 1991, Revenue Canada will not allow the Company to deduct the amount of CCA for the 1991 income tax year. Consequently, the return to its shareholders will be lower. Westcoast explained that it would be denied recovery of this amount if its request for the deferral account is denied.

Westcoast acknowledged that this problem is not as important in the case of transmission lines because of the much narrower spread between the CCA rate of four percent and the depreciation rate of roughly two percent. Westcoast stated that any project qualifying for deferral account treatment would be excluded from the calculation of the NPIS adjustment to GPIS.

CPA and IPAC opposed a section 52 deferral account, citing a need for discipline in the planning and preparation of cost estimates under Westcoast's fixed-toll regime. BC Gas supported a deferral account

for 1991 as opposed to a permanent account, and stated that only differences related to CCA should be included. COFI/Cominco is not opposed to such an account when costs cannot be accurately forecast.

Views of the Board

Considering that Westcoast is regulated on a fixed forward test year, the Board is not persuaded that the public interest would be served if it were to sanction a blanket deferral account for facilities approved pursuant to section 52 of the NEB Act. The Board believes that the need for such an account should be assessed on a case-by-case basis. Given the impact that a delay in the in-service date of the McMahon Plant Expansion might have on the Company's earnings, the Board is of the view that a deferral account is warranted for that project.

Decision

The Board denies Westcoast's request for a blanket deferral account for all major capital projects.

The Board approves a deferral account for the McMahon Plant Expansion project to record the differences between the actual and forecast costs, and the associated CCA. Until the Board rules on the disposition of this account, Westcoast shall exclude the capital cost associated with this project from its calculation of the NPIS adjustment factor.

Chapter 7

Toll Design

7.1 Raw Gas Transmission Facility Expansion Policy

7.1.1 NEB Decision Dated 19 October 1990

In the interest of releasing an expedited decision in this matter, the Board did not include in its decision a discussion of the views as put forth by the parties. The views of interested parties have now been included in these Reasons for Decision.

Background

In the Board's RH-6-85 Westcoast Reasons for Decision dated August 1986, Westcoast was requested to develop a policy with respect to the toll treatment of new (Zone 1)¹ facility additions and to submit the policy for review in its next toll application.

During the RH-2-87 toll proceeding held in 1987, Westcoast submitted a description of its then current RGT facility expansion policy. That policy was described as a "two-times test" because it compared the discounted present value of the incremental costs of a new facility expansion, expressed on a unit basis, to an amount equal to two-times the current RGT toll. Projects whose discounted incremental unit cost of service were greater than twice the current RGT toll would be assessed a surcharge equal to the difference.

On page 49 of the RH-2-87 Westcoast Reasons for Decision, the Board provided the following views regarding the role of Westcoast's RGT facility expansion test:

"The Board concurs with parties who have expressed the view that Westcoast's policy would be used as a guideline only. The Board reminds parties that all proposed capital additions for which Westcoast seeks authorization from the Board are considered in accordance with Parts III and IV of the NEB Act regardless of any corporate criteria used to examine such projects."

Subsequent to the RH-2-87 toll proceeding, Westcoast modified its RGT facility expansion policy in three ways. First, in instances where the total gas volumes accessible to a new pipeline were not anticipated to comprise reserves other than those provided by the initial shipper(s) requesting service, Westcoast would impose a "one-times test" which compares the discounted incremental cost of service to the RGT toll. The purpose of this test is to ensure that in those circumstances where additional reserves are either unavailable or unlikely to be developed, the project's incremental costs will be recovered from the initial shipper(s).

¹ See Appendix VI for a map of the Westcoast system - tolling zones.

The second change to Westcoast's policy was to recognize in the economic analysis the incremental Zone 2 processing revenues that would be generated if the new shipper also contracted for firm processing service at a plant which had available uncontracted capacity. Because such incremental processing revenues would have a beneficial impact on processing tolls, Westcoast considered it appropriate to add them to the RGT revenues in assessing the applicability of a toll surcharge. Under this approach, Westcoast included the incremental processing revenues in both the one-times and two-times RGT tests.

The third change in the policy was to undertake a comparison of the incremental toll revenues and the incremental cost of service on an annual basis. Those future revenue and cost streams would be discounted to their present value and the resulting cumulative difference would be calculated. If the present value of the cost stream exceeded the present value of the revenue stream, a surcharge would be required.

In its letter to Westcoast of 17 August 1989, the Board approved construction of the Pine and Commotion RGT facilities including Westcoast's proposed surcharge. The Board expressed concern that there did not appear to be any clearly established criteria to assess the appropriateness or the level of the surcharge. It therefore invited Westcoast and industry representatives to form a task force to address the matter and submit a recommendation for the Board's consideration.

Task Force - RGT Facility Expansion Policy

A Task Force was subsequently formed and held a number of meetings from October 1989 to February 1990. Its report was filed with the Board in April 1990.

The Task Force members agreed that it was necessary to develop an economic test to determine whether a surcharge should be imposed for new RGT lines. In this regard, the Task Force identified a number of issues that required resolution. These issues and the positions of the Task Force members are set out in on page 1 of Appendix V to this decision.

Consensus Issues

The Task Force members were able to reach a consensus on the following issues:

- (a) Only the operating and maintenance and property tax components of the toll should be adjusted to reflect inflation;
- (b) To calculate present values in the analysis, the rate of return on rate base should be used as the discount rate;
- (c) The level of any surcharge imposed should be reviewed annually or whenever circumstances change, (such as when a new shipper commences service on a lateral part way through a given year) to determine whether the surcharge should be reduced or eliminated;
- (d) Shippers should be permitted to make contributions in aid of construction to reduce or eliminate a surcharge;
- (e) There should be no provision for a shipper to make a balloon payment on the expiration of its service agreement; and

- (f) In the event downstream toll revenues are to be included in the analysis, only those revenues associated with underutilized processing plants should be included.

With regard to point (f), the parties generally acknowledged that if the objective were to carry out a complete incremental analysis, consideration would have to be given to crediting for underutilized facilities in all zones downstream of Zone 1, including the transmission zones, Zones 3 and 4. However, the residue gas transmission lines are accessible to all supply sources connected to the system including gas sourced in Alberta, thereby making tracking of the specific incremental volumes impractical. For that reason, the Task Force members concluded that it was appropriate to limit the inclusion of incremental downstream revenues to Westcoast's processing plants where the tracking is not difficult.

Decision

The Board finds acceptable the consensus positions reached by the Task Force on the above matters.

Issues For Resolution

The Task Force was unable to reach agreement on the following issues:

- what is the appropriate test (one-times or two-times) to be used in the economic analysis of RGT facility expansions;
- whether downstream processing revenues at underutilized processing plants should be taken into account in determining the level of the surcharge and if so, how this should be done;
- and what term or project life should be assumed in the analysis.

Need To Revise RGT Policy

The need for a RGT facility expansion policy arises from the environment created by the deregulation of the wholesale gas marketing industry and the industry's move to market-oriented pricing. In this environment, the regulatory policy must be clearly established if industry members are to be in a position to respond to changes in the market. The Board believes that an RGT policy that predefines the economic analysis and related toll treatments of new RGT projects will assist industry participants in making informed decisions. After hearing the evidence and argument of all parties in the first stage of the RH-1-90 toll proceeding, it is the Board's opinion that there is a need to revise the RGT facility expansion policy that is currently being used by Westcoast. The Board considers that such a policy should have the following attributes:

- (1) be fair and equitable;
- (2) not unjustly discriminate among shippers in different locations;
- (3) provide economic discipline;
- (4) encourage the efficient utilization of existing processing facilities;

- (5) lead to the expeditious review of small RGT facility expansions; and
- (6) provide rules and thus remove uncertainty in respect of the tolling aspect of raw gas facility expansions.

The Board will continue to determine whether facilities are in the present and future public convenience and necessity, pursuant to Part III of the *National Energy Board Act*. In this regard, the policy and the decisions made by project proponents based on the results of the application of the policy will assist the Board in its assessment of the economic feasibility of the related facilities application.

Regarding the use of the term "policy", as opposed to "guideline" or "rule of thumb", the Board does not consider this to be a critical issue. Of more concern to parties, in the Board's view, is the use the Board would make of the policy in its decision making. As all parties have recognized, the policy cannot acquire the standing of a "law" given that the Board has the statutory duty to exercise its judgment on each application. Nevertheless, the Board is of the view that to achieve the objectives of the policy it should be applied consistently over time. The Board considers that the public interest would not be well served by the added regulatory burden of reviewing the tolling approach to be applied to each application to build a RGT lateral.

The Board is satisfied that the policy set out in this decision is based on sound principles which were arrived at with the benefit of a public hearing preceded by a year's discussion in the Task Force. In view of this, the Board believes that consistent application of the policy to future applications to build RGT facilities will lead to just and reasonable tolls. The Board will always have the statutory authority to make exceptions to the policy in justifiable circumstances. However, Westcoast, as the applicant, need only demonstrate that the policy was followed to satisfy its burden of proof and the onus would then shift to the party seeking to modify the application of the policy to demonstrate the existence of circumstances that justify the different treatment.

The Board was not persuaded that this policy should be included in Westcoast's General Terms and Conditions to ensure that it is consistently applied and that Westcoast will not unilaterally alter the policy. This decision directs Westcoast to implement the policy set out herein and make copies of the policy available to any shipper or party on request. Because it is a Board-approved policy, Westcoast must seek the leave of the Board in the event it wishes to make changes. Any party that has a complaint regarding Westcoast's application of the policy may seek the appropriate remedy from the Board.

Evaluation of Proposals

In deciding on the appropriate policy, the Board considered each of the following components of the policy proposals separately:

- (a) the test to be applied in comparing the incremental Zone 1 costs against the incremental Zone 1 revenues in determining the level of the surcharge;
- (b) credits for incremental processing revenues; and
- (i) *Raw Gas Transmission Test*

Introduction

A number of Task Force members supported the continuation of Westcoast's current RGT test, referred to as a "two-times/one-times" test. These parties shared Westcoast's view that there were circumstances in which it would not be appropriate to include two-times the RGT toll revenue in the determination of the surcharge. They were of the view that, in situations where the total gas volumes accessible to a new pipeline were not anticipated to comprise reserves other than those provided by the initial shipper(s) requesting service, only one-times the RGT toll revenue should be included in the analysis. CPA proposed that a one-times test be used in all circumstances whereas IPAC recommended the use of a two-times test in all situations.

The Task Force report concluded that in most instances the construction of a new RGT pipeline would result in additional reserves being found over and above those associated with the initial shippers' volumes. Westcoast indicated that, in these circumstances, it would design the pipeline for the reserves likely to be developed in the region in order to capture economies of scale. Consequently, the "full" capital costs of the proposed pipeline (for example \$16 million) would exceed the "shipper-specific" capital cost of a pipeline (for example \$12 million) sized only to satisfy the initial shippers' volumes.

In this proceeding, as well as in the Task Force, CPA and IPAC took the position that in those situations where Westcoast over-sized the pipeline relative to the size required to satisfy the initial shippers' volumes, only the "shipper-specific" capital costs should be included in the analysis. Westcoast proposed that the "full" capital cost of the RGT expansion be used in the application of both its one-times and two-times test. It was recognized that the IPAC test, which would include two-times the RGT toll and only the "shipper-specific" capital costs of an expansion in determining the surcharge, results in the highest threshold to trigger a surcharge.

Views of the Intervenors

Westcoast indicated that, in this era of deregulation, its proposed raw gas transmission expansion policy should place some economic discipline on the construction of RGT facilities. Westcoast suggested that, for the purposes of calculating the RGT toll surcharge, the costs of a new RGT facility should be compared to two times the incremental RGT toll revenue for those expansions where the capacity of the pipeline is excess to the requirements of the initial shippers. In those cases where the RGT expansion is for shipper-specific reserves, Westcoast advocated the use of a test that measured one times the incremental RGT toll revenue against the incremental costs of the new facility.

Westcoast was of the view that a two-times test would give some recognition to the fact that rolled-in tolls are based on historical costs and a depreciated rate base. Furthermore, Westcoast recommended including the total costs associated with the RGT expansion, not just the shipper-specific costs. Therefore, including two times the RGT toll revenue would acknowledge that the capacity of the pipeline expansion exceeds the requirements of the initial shipper. For this reason, Westcoast concluded that the two-times test would provide a mechanism for recognizing the likely development of additional reserves, and hence additional firm service, in the economic analysis. Westcoast also noted that the existing RGT postage-stamp toll reflects the costs for the average RGT service and is not necessarily representative of either the shortest or longest haul on the system. Accordingly, Westcoast argued that its proposed two-times test provides some implicit recognition of these facts.

Westcoast believed that CPA's one-times test, which would only include one times the incremental RGT revenues, did not give adequate recognition to these factors and, in Westcoast's view, failed the fairness requirement of toll design.

IPAC was also opposed to CPA's one-times test, noting that once the processing credits are eliminated, CPA's approach would become an incremental or vintage toll. In IPAC's view, CPA's approach would accord rights to the existing shippers because the one-times test would give the benefit of the depreciated assets to those shippers.

IPAC proposed a two-times test which would compare two times the incremental RGT revenues to the shipper-specific costs. It was IPAC's position that such an approach would effectively evaluate new requests for service and would compare them to historical depreciated RGT costs. IPAC argued that its proposal was non-discriminatory and would allow B.C.'s gas resources to be developed to their full potential.

CPA advocated an economic test that would compare one times the RGT revenue to the incremental cost of the facilities required to serve the new shipper. If the pipeline is over-sized to serve likely future volumes, only the costs that would have been incurred had Westcoast built a shipper specific line would be included. Any shortfall between the RGT revenues and the cost of service based on the capital costs of the shipper-specific line would result in a surcharge.

CPA recommended that the Board incorporate user-pay principles into all aspects of toll design, including the RGT expansion policy. CPA noted that all of the parties to this hearing proposed that there be an economic test and that economic discipline be asserted. CPA was of the view that a new RGT expansion policy was justified because circumstances had changed as a result of the movement towards deregulation and the proliferation of requests for transmission service. In particular, CPA expressed concern about the effect of RGT expansions on the Zone 1 toll and the need for Westcoast to remain competitive with other transmission systems.

COFI/Cominco supported the adoption of the two-times tests proposed by Westcoast. COFI/Cominco was of the view that CPA's test is simply incremental pricing rather than an economic test. COFI/Cominco argued that the strict one-times test should only be used in special circumstances where it is probable that the proposal being brought forward represents the maximum volumes likely to be moved through the new facilities.

BC Gas stated that the onus should be on Westcoast to justify why the proposed gathering line should be constructed as a regulated project. If the project is going to be built as a regulated project, then BC Gas would favour a one-times test for shipper-specific or reserve-specific lines and a two-times test where there is good potential for further development.

BC Gas opposed the strict two-times test proposed by IPAC because it would carry the clear potential for the lack of collection of the full costs of laterals built for specific shippers. BC Gas recommended that for shipper-specific RGT lines, a one-times test would be more appropriate because it would be more consistent with the principle of cost-based tolls.

CanWest advocated the use of a two-times test because it would have the effect that, in some cases, shippers using the new facilities would subsidize existing shippers and, in other cases, the subsidy

would run the other way. In CanWest's view, this approach would be consistent with the rolled-in cost method.

CanWest testified that, in its view, CPA's one-time test proposal would result in incremental tolling on the Westcoast RGT system because whenever the actual cost of the RGT facility exceeded the toll revenue that the facility would generate, the applicant would be required to pay a surcharge to make up the difference.

Views of the Board

The Board is of the view that the test to be adopted must provide a consistent recognition of the expected revenues and costs of the facility expansion. In reaching its decision on the appropriate RGT test to be used, the Board gave considerable weight to the view that, to enhance the long-run viability of its whole system, Westcoast has a responsibility to size its new RGT facilities so as to encourage progressive resource development by providing adequate and economic service.

The Board was equally persuaded that, in an era of deregulation, there is a need for greater economic discipline in connecting reserves, particularly in instances where the connection is for a specific shipper or group of shippers and where there may be little prospect of connecting reserves in addition to those associated with the initial contract(s) for a shipper-specific lateral. Greater economic discipline would provide more assurance that the price for basic service would not be unduly affected by expansions to the RGT system.

The Board acknowledges that any shipper, including a new shipper that utilizes the existing infrastructure, derives a benefit from the infrastructure. However, the Board also recognizes that construction of new economic laterals will help to sustain deliverability and contribute to the long run viability of the entire system.

The Board recognizes all of the tests¹ examined in this proceeding contained an element of incremental pricing or incremental tolling in that each proposal would impose a surcharge if the incremental costs of an expansion exceeded a certain threshold. The point of debate was the level of that threshold.

The Board believes that the one-times proposal put forth by CPA would meet the desirable objective of economic discipline and would provide the greatest assurance that the price for basic service would not be unduly affected by RGT expansions. In this respect, the Board notes that, of the proposed tests, the CPA approach is the most stringent. The Board believes that, while CPA's test provides a consistent matching of shipper-specific revenues and costs, CPA's test does not give adequate weight to the benefits derived from encouraging the connection of additional reserves. In this regard,

¹ Exhibit B-14 (page 2 of Appendix V) provides a comparison prepared by Westcoast of the surcharges calculated under various scenarios using the alternative economic tests put forth by the parties.

the Board believes that CPA's approach does not strike a reasonable balance between the interests of new and existing shippers.

IPAC's proposal, which compares two times the RGT toll revenues with the "shipper-specific" costs, in the Board's view does not provide an appropriate matching of the incremental revenues and costs associated with the new RGT expansion. Furthermore, IPAC's two-times test would not differentiate between shipper-specific expansions and those that would encourage progressive resource development. Although IPAC's proposal satisfies the objective of encouraging exploration of prolific regions of gas supply it does so at the expense of economic discipline and fairness to other shippers on the Westcoast system.

Parties supporting the Westcoast proposal acknowledged that the kinds of RGT laterals that Westcoast would be installing under the Westcoast two-times test would be expanding into new areas, and the economies of scale inherent in proper sizing of the pipeline facility should be properly reflected in the tolls. They acknowledged that the facilities in all zones on the Westcoast system are sized and should continue to be sized to take advantage of economies of scale and that Westcoast should not deviate from this approach for the construction of RGT laterals.

On balance, the Board finds the proposed "two-times/one-times" test, put forth by Westcoast and supported by a number of the Task Force members, to be the most reasonable. It has the desirable attribute of encouraging development in potentially prolific areas. It would also allow the construction by Westcoast of shipper-specific laterals where it is cost effective, from the perspective of those shippers requesting new laterals, to do so.

The Board agrees with those parties that suggested that the factor of two times the RGT revenues is arbitrary. However, the Board considers that the two-times factor is reasonable in this circumstance as it provides both an appropriate level of economic discipline and a reasonable allowance for the fact that the pipe is over-sized. Furthermore, this approach would provide toll certainty and ease of administration. As well, it avoids the potential for dispute over the cost of the expansion attributable to the initial shippers, and is consistent with the inclusion of the full costs associated with the expansion.

Decision

The Board has decided that the test that will be included in the RGT facility expansion policy will be:

- (a) a two-times test in situations where Westcoast, having determined that further gas development is likely, is constructing facilities that have a capacity that is substantially greater than that required to serve the initial requests supporting the expansion. In applying the two-times test, Westcoast is directed to include the full costs of the expansion in the surcharge analysis; and**

(b) a one-times test when Westcoast is constructing facilities to meet the requirements of only the initial requests supporting the expansion.

(ii) Treatment Of Downstream Processing Revenues

Westcoast stated that it would be more beneficial to the system to add RGT pipelines behind those plants with unutilized capacity than at those plants that are capacity constrained. Westcoast advocated including a credit equal to the incremental processing revenues in the calculation of the surcharge in order to encourage shippers to develop reserves behind underutilized facilities. Furthermore, Westcoast argued that, for the economic test to be consistent, it would be appropriate to include all incremental revenues and costs in the analysis, including the incremental downstream revenue associated with the new RGT service.

For these reasons, Westcoast argued that IPAC's proposal, which would not recognize incremental downstream processing revenues, is logically inconsistent. Westcoast also suggested that BC Gas and COFI/Cominco's recommended treatments of incremental downstream processing revenues are impractical and unworkable because they would only give a credit for processing revenue if it could be demonstrated that the processing plants would otherwise not be utilized. It was Westcoast's view that the time to determine whether incremental revenue exists is at the time the calculation is made. In addition, Westcoast argued that BC Gas' suggestion that foregone interruptible revenues over the life of the contract should be included in the analysis, was not feasible nor practical and implies a precision in the two-times test which does not exist.

IPAC was of the view that including processing revenues in the analysis would cause distortions and would give undue advantage to high acid gas. It was IPAC's position that processing facilities should be examined separately. IPAC also noted that recognizing only downstream processing revenues rather than all downstream revenues was an arbitrary restriction.

CPA indicated that, in order to recognize that some benefits to other users of the Westcoast system may result from the construction of RGT facilities, relief from the payment of some or all of the surcharge may be appropriate for those shippers who contract for the associated uncontracted processing capacity. This relief would only be granted for the lesser of the term of the processing contract or the term of the RGT contract.

CPA did not accept IPAC's contention that crediting the processing revenues against the surcharge is discriminatory since doing so would benefit all tollpayers. CPA suggested that even if it were discriminatory, providing the credit for downstream processing revenues would not be unjust discrimination.

CPA rejected BC Gas' approach of re-examining the credit annually on the basis that it would not provide toll certainty and that it would be administratively impossible. CPA noted that BC Gas' recommendation of recognizing lost interruptible revenues would also create administrative difficulties. Furthermore, CPA argued that BC Gas' proposal would complicate the surcharge calculation because it would be difficult to determine if the incremental firm throughputs displaced the interruptible volumes or whether there were other factors that caused the reduction in interruptible volumes.

It was COFI/Cominco's position that it would be beneficial to the system as a whole to provide an incentive to producers to develop reserves behind processing plants that have available capacity. Therefore, COFI/Cominco supported the inclusion of downstream processing revenues in the calcula-

tion of the surcharge where there is a reasonable expectation of excess capacity. However, COFI/Cominco did not agree with Westcoast's and CPA's recommended treatment of downstream processing revenues. COFI/Cominco were concerned that the proposals of Westcoast and CPA would inevitably result in excessive credits being given. COFI/Cominco noted that BC Gas' proposal addresses COFI/Cominco's concern of only providing a credit for available capacity, but that it would inject a level of uncertainty into the process.

COFI/Cominco suggested that a credit for downstream processing should only be given under those circumstances where there is a probability that the capacity would otherwise have remained unutilized. COFI/Cominco recommended that the Board make a reasonable projection of the available downstream processing capacity to determine the extent to which a credit is warranted.

BC Gas agreed with the position taken by COFI/Cominco in regard to the treatment of downstream processing revenues. In particular, the analysis should take into account only those downstream processing revenues that would not otherwise have been generated in the absence of the new RGT line. However, rather than making a forecast of the likely downstream revenues as COFI/Cominco suggested, BC Gas recommended that the credit for processing be re-evaluated each year based on the actual utilization of downstream processing facilities at that time. Once the plant was fully contracted, the incremental processing revenues would be excluded from the surcharge calculation, and therefore would cause the surcharge to increase.

In addition to the increased RGT revenues and downstream processing revenues, BC Gas also proposed that any reduction in interruptible revenues resulting from the increased firm contracting be included in the calculation of the surcharge. BC Gas rejected the arguments that the loss of interruptible revenues would be too difficult to forecast. BC Gas noted that all forecasts are subject to uncertainty and suggested that a reasonable forecast could be provided by Westcoast.

Views of the Board

The Board is of the opinion that encouraging the utilization of excess capacity on the Westcoast system would be beneficial to all Westcoast shippers and would serve to enhance the integrity of the pipeline system. The Board also notes that with the exception of IPAC, there was broad support for including incremental downstream processing revenues as a revenue credit in the economic evaluation of RGT expansions in those cases where there is underutilized capacity at the downstream processing plant. The downstream processing revenues would be measured as the incremental processing revenues generated by the utilization of an underutilized processing facility as a result of the RGT expansion. The Board is of the view that downstream processing revenues should be recognized in the economic evaluation because the inclusion of such revenues would provide shippers with an incentive to contract for capacity that might otherwise remain unutilized.

While most parties agreed on the general principles that should be addressed by the policy, there were differing views among the intervenors as to how the incremental downstream processing revenues should be included in the analysis. The Board agrees with intervenors, such as COFI and BC Gas who were of the view that, in order to provide the appropriate economic signals and to be fair to all other shippers, the

processing revenue credit for the initial shipper(s) should ideally be limited to those periods for which there is a reasonable expectation of excess capacity.

On the other hand, the Board also found persuasive the arguments presented by CPA and Westcoast that, for the purposes of toll certainty, the processing revenue credit should be recognized at the time the RGT surcharge is established and therefore should not be altered as a result of the processing plant becoming fully utilized during the contract period. Nevertheless, the Board is concerned that this approach may overstate the likely incremental processing revenues associated with the use of the underutilized facilities, given the considerable uncertainty regarding the existence of and the difficulty associated with forecasting the amount of excess processing capacity at a specific plant over the entire term of the contract. Evidence presented by Westcoast indicated that the Fort Nelson and Pine River processing plants might be fully contracted as early as 1 November 1991 and 1 November 1992, respectively.

To balance the objectives of fairness and economic efficiency against the objective of toll certainty, the Board considers that it would be appropriate to include only part of the incremental contracted processing revenues in determining the level of the surcharge. Specifically, the Board considers it reasonable that only 50 percent of such processing revenues should be used in calculating the surcharge. The Board acknowledges that this is a compromise and, therefore, a somewhat arbitrary allocation of the processing revenues associated with the excess capacity. However, the Board is of the view that this approach will not only encourage the utilization of excess capacity and provide toll certainty, but will also recognize that the excess capacity at the downstream processing plants may not persist over the entire term of the RGT contract.

The Board also agrees with Westcoast's position that it would be neither feasible nor practical to recognize foregone interruptible revenues in the analysis, as suggested by BC Gas, in view of the fact that interruptible revenues are too difficult to forecast. Furthermore, including interruptible revenues in the analysis would imply a precision in the economic analysis which is inconsistent with its nature.

Decision¹

The Board finds that it would be appropriate to recognize the incremental downstream processing revenues in the calculation of the surcharge under those circumstances where, at the time of the facilities application, there is excess capacity at the downstream processing facility that will be utilized by the incremental volumes.

¹ As a result of concerns raised by IPAC, the Board issued a statement of clarification on this decision on 12 December 1990 (see section 7.1.2).

Therefore, the Board directs Westcoast to include 50 percent of the present value of the incremental contracted downstream processing revenues in the calculation of the surcharge under both the one-times and two-times tests where it has been demonstrated that the processing volumes are indeed incremental and the shippers have signed firm downstream processing contracts at that plant.

(iii) Terms To Be Used When Applying The Test

A key factor to be considered when determining whether a surcharge is applicable is the term over which the economic test is applied. The criteria considered by the Task Force were:

- (1) the term of the contract;
- (2) reserve life;
- (3) 10 years; or
- (4) the lesser of the above.

In the Board's opinion, Westcoast's current policy of using the lesser of the reserve life, contract term, or ten years is overly restrictive. The Board notes that the ten-year limit is arbitrary and may bear no relation to the particular circumstances of the project in question.

Evidence that was adduced indicated that it was NOVA's experience that shippers tended to consider lengthening the contract term initially contained in the application to improve the economics of the project. This had the effect of providing an incentive to the initial shippers to lengthen the term for service in the original contracts thereby reducing or eliminating the surcharge otherwise payable.

It is the Board's view that this incentive should be provided and in the present situation this can best be accomplished by applying the economic test over the lesser of the term of the contract or reserve life.

Decision

The Board has decided that the period over which the economic test shall apply is the lesser of the term of the contract or the reserve life of the gas field.

Implementation of This Policy

The Board directs that the policy set out in this decision shall become effective immediately. Westcoast is further directed to set out this policy in writing and file a copy with the Board and all interested parties to RH-1-90 by 15 November 1990. The date for filing the policy with the Board was subsequently extended to 7 January 1991 (see section 7.1.2).

7.1.2 Incremental Processing Revenue Clarification

(i) Clarification of RGT Decision

On 30 October 1990 IPAC requested that the Board clarify a portion of its 19 October 1990 decision on Westcoast's RGT Facility Expansion Policy. IPAC stated that the Board needs to specify under

what circumstances incremental processing revenues may exist "at the time of the facilities application". IPAC was of the view that "it would appear to run counter to the intent of the Decision to allow a credit for processing revenue against the cost of a new gathering line if in fact others are in the queue who will take up the processing space available and may not cause an expense in gathering line expansion". IPAC stated that it was not seeking a review of the Decision, but rather a clarification of that portion before its implementation.

As a result of comments made by Westcoast in final argument, the issue expanded from a simple clarification of the phrase "at the time of the facilities application" to a definition of the circumstances under which processing revenues should be deemed to be incremental. Consequently, the Board decided to allow parties to submit additional comments in writing by 13 November 1990. Comments were submitted by CPA, COFI/Cominco, IPAC, BC Gas, CanWest, Suncor Inc. ("Suncor"), and Unocal.

Westcoast took the position that the processing revenues should be considered to be incremental, and therefore should be used to reduce the RGT surcharge when these revenues do not result from a pre-existing service agreement held by the shippers. Westcoast's approach would apply to all plants irrespective of whether a plant was currently fully contracted. CPA supported Westcoast's position, and CPA's position was supported by Suncor and Unocal.

Westcoast wanted the Board to confirm that, in calculating the level of the RGT surcharge, Westcoast should include 50 percent of the processing revenues associated with any new processing contracts filed in support of the construction of a new RGT facility.

COFI/Cominco, IPAC, BC Gas, and CanWest disagreed with Westcoast's interpretation of the circumstances under which a credit should be given for downstream processing revenues. These parties took the position that downstream processing revenues should not be included in the calculation of the RGT surcharge if the processing plant in question is or would continue to be fully contracted in the absence of the new RGT facility. They believed that Westcoast's approach went far beyond the intent of the Board's Decision which was to encourage parties to contract for incremental processing capacity at underutilized processing plants.

Views of the Board

The Board is of the view that Westcoast's approach is not consistent with the Board's Decision on this matter, which accepted the use of a credit for downstream processing revenues to encourage prospective shippers to contract for processing capacity at underutilized plants. Westcoast's approach could result in processing revenue credits being given at plants that are currently fully contracted or being expanded. Such a result would be inconsistent with the Board's objective.

The Board is of the view that a credit should not be granted in circumstances where the available processing capacity at the downstream processing plant to be used by the shippers applying for a new RGT facility ("new RGT shippers") would otherwise be utilized. In this regard, the Board believes that a reasonable assurance that the capacity would be used in the absence of the new RGT facility would be provided if other prospective shippers in the queue ("prospective shippers") at the processing plant are prepared to contract for the available capacity with a start date before, or within a

reasonable time period following, the projected in-service date of the new RGT facility. Therefore, if a queue exists at a downstream processing plant to be used by the new RGT shippers at the time that the application is being considered, it should be tested by Westcoast. The revenue credit should be reduced or eliminated if prospective shippers are willing to contract for firm processing capacity in accordance with the terms and conditions set forth in this decision.

Concerning the meaning of "at the time of the facilities application", the reference is to the time the application is filed with the Board. When a queue exists at a processing plant, Westcoast should offer the available capacity to the shippers in the queue as one of the last steps in preparing RGT facility applications. The Board believes that it is important for parties requesting a new RGT facility to know the toll applicable prior to the expansion application being filed with the Board because this advance knowledge would avoid unnecessary costs, applications and hearings.

The Board's decision on this matter is set out below and the implications of this decision for the Hossitl Application, which is currently before the Board, are set out in section 7.1.2 (iii).

Decision

The following decision outlines the circumstances under which Westcoast should include a credit recognizing downstream processing revenues in the calculation of an RGT toll surcharge.

- 1. If no queue exists at the downstream processing plant to be used by the new RGT shippers immediately prior to the filing of the RGT facility application with the Board, a credit equal to 50 percent of the present value of the processing revenues for any new contracted processing capacity shall be included in the calculation of the surcharge.**
- 2. If a queue exists at the downstream processing plant, then Westcoast must test the queue in the following manner as one of the last steps in the preparation of the application:**
 - (a) Westcoast must canvass all prospective shippers in the queue to determine if they are interested in contracting for all or a portion of the available capacity according to the terms and conditions in subparagraph 2(b). Subject to paragraph 4, a prospective shipper's status in the queue is not affected by accepting or refusing to contract conditionally for any available capacity.**
 - (b) A prospective shipper who is willing to contract for a portion or all of the available capacity must commit to assume the requested capacity in the event that the new RGT shippers elect not to proceed with the project, and must also commit to the following terms and conditions:**

- (i) a contract demand equal to or less than that contained in its original request for firm service form ("RFSF");
 - (ii) a contract length equal to that contained in its original RFSF;
 - (iii) a start date that falls before, or within 365 days following, the projected in-service date of the facility requested by the new RGT shippers. The 365 days shall begin with the projected in-service date of the new RGT facility; and
 - (iv) if the prospective shipper also requires a new RGT facility, confirmation that a revenue credit will not be required in determining the level of the surcharge for that facility.
3. Once the queue has been tested, the processing revenue credit shall be equal to 50 percent of the present value of the processing revenues associated with the lesser of the net available contract demand and the contract demand of the new RGT shippers. The net available contract demand is defined as the total amount of the uncontracted capacity at the processing plant as at the projected in-service date of the new RGT facility less the sum of the contract demands of the prospective shippers who are willing to contract for processing service in accordance with the provisions set out in paragraph 2. For the purpose of determining the amount of uncontracted capacity at each processing plant, Westcoast is to assume that each existing contract will be renewed, unless it has otherwise been informed. No processing revenue credit will apply if the sum of the contract demands of the other prospective shippers is equal to or exceeds the available capacity.
4. If, as a result of testing the queue, the new RGT shippers decide not to proceed with the project, the available capacity shall be allocated sequentially to the prospective shippers that have agreed to assume all or a portion of such capacity.
5. The results of the queue test must be included in any application for a new RGT facility where a processing revenue credit has been taken into account in determining the level of the surcharge.
6. Any RGT facility application that is withdrawn and subsequently refiled will be considered as a new application by the Board; consequently, Westcoast shall be required to test the queue again prior to refiling the application with the Board.

Implementation of this Policy

The Board directs that the policy set out in its 19 October 1990 Decision, as clarified by this decision, shall become effective immediately. Westcoast is further directed to set out the Raw Gas Transmission Facility Expansion Policy in writing and file a copy with the Board by 7 January 1991.

(iii) Implications of the Board's Decision on the Hossitl Application

Having regard to the Fort Nelson Processing Plant Queue as at 12 October 1990, the effects of the Board's clarification on the Hossitl application are as follows:

At the time that the Hossitl Application was filed with the Board on 7 September 1990, there were five requests for firm processing capacity in the Fort Nelson Queue (three requests for Petro-Canada and one each for Sumas Energy and Mobil). The Board has decided that, to apply this RGT policy to the current application, Westcoast must canvass these three prospective shippers and, if necessary, recalculate the toll in accordance with this decision. Westcoast is required to file the results of testing the queue with the Board.

7.2 Interruptible Tolls

Westcoast presently provides two tiers of winter interruptible service for transportation north and south (Zones 3 and 4) and a single tier (Tier 1) of interruptible service for raw gas transmission and processing (Zones 1 and 2). The Tier 1 and 2 winter tolls for interruptible service are calculated by adjusting the demand component of the firm service toll for a 60 percent and 75 percent load factor, respectively. There is only one tier of interruptible service in all zones in the summer. The summer interruptible service toll is set using an 80 percent load factor.

Westcoast's firm and interruptible service tolls are stated on a gross rather than a net basis which means that the expected interruptible revenues are not taken into account in setting the tolls. Currently, Westcoast's firm shippers receive their share of the interruptible revenues in each zone as a credit to their monthly bills based on the actual interruptible revenues generated in that zone. In its RH-1-89 Westcoast Reasons for Decision, the Board recommended that the issue of gross versus net interruptible service tolls be referred to the Industry Task Force to examine whether the methodology should be changed for a future test year.

In its current application, Westcoast proposed to eliminate the second tier of winter interruptible service. Westcoast also applied to reduce the interruptible service tolls from their present levels by increasing the load factors used in their calculation to 75 percent in the winter and 100 percent in the summer.

Westcoast endorsed the solution developed by the Industry Task Force on the issue of the appropriate methodology to be used in determining Westcoast's firm and interruptible service tolls. Accordingly, Westcoast applied to the Board to continue to calculate its firm and interruptible service tolls on a gross basis for the 1991 test year. However, as specified by the compromise agreement, the monthly interruptible revenue billing credits would be based on a forecast of the annual interruptible throughputs divided by twelve and any variances between the actual and the projected interruptible revenues would be recorded in a deferral account.

7.2.1 Number of Tiers of Interruptible Service

Westcoast, CPA and BC Gas advocated the elimination of the second tier of winter interruptible service. These parties agreed that the limited demand for the second tier of interruptible service did not justify the increased complexity and costs associated with administering such a service. Westcoast also noted that if the Board were to increase the Tier 1 load factors to 75 percent in winter and 100 percent

in summer, Westcoast would see little or no need to maintain two separate tiers of interruptible service.

IPAC argued that administrative ease should not be a reason to eliminate the second tier of interruptible service; rather, the Board should consider whether there is a demonstrated need for the second tier. In IPAC's view, there is such a need because there are a number of parties who hold contracts for Tier 2 interruptible service. Consequently, IPAC suggested that the two tiers of interruptible service be maintained on Zones 3 and 4 of Westcoast's system in the winter.

COFI/Cominco stated that a flexible toll design promotes the greatest utilization of the system. For that reason, COFI/Cominco recommended that, in principle, the second tier of interruptible service should not be eliminated. However, COFI/Cominco indicated that, if the second tier were not being utilized, they would not object to its elimination. COFI/Cominco also stated that they would take some comfort in the fact that any existing Tier 2 contracts would be converted to Tier 1 if the Board were to eliminate Tier 2 service.

Views of the Board

The Board recognizes that multiple tiers of interruptible service with progressively higher tolls from one tier to the next can be used to effectively ration available capacity among competing shippers in times of curtailment. However, the Board notes that a number of parties maintained that the benefits associated with providing the second tier of interruptible service in the winter do not justify the additional administrative complexity for Westcoast. In lieu of this service, there is little justification for continuing the second tier of interruptible service at this time. Furthermore, the Board believes that, because the new Tier 1 toll will be determined at the same load factor used to determine the previous Tier 2 toll, those interruptible shippers who had previously requested Tier 2 service would not be unduly affected by switching to Tier 1.

Decision

The Board approves Westcoast's request to discontinue Tier 2 interruptible service.

7.2.2 Winter and Summer Load Factors

Westcoast recommended that its interruptible service tolls be designed to encourage a high level of firm contracting on the system. In addition, Westcoast noted that many firm shippers try to utilize any excess capacity that they may have available under their firm transportation contracts to make interruptible sales. Therefore, Westcoast argued that the selected load factors used to calculate the interruptible tolls should not result in Westcoast's interruptible rates being so low that Westcoast would be offering lower cost capacity to interruptible shippers than is available to firm shippers.

Westcoast proposed that its tolls for interruptible service be set at a level equivalent to the firm toll at a 75 percent load factor in the winter and a 100 percent load factor in the summer. The Company argued that an increase from the current winter and summer load factors of 60 and 80 percent, respectively, was justified because of the increase in firm contracting on Westcoast's system. Westcoast indicated that it initially supported a 90 percent load factor for the summer but adopted the

100 percent load factor because the majority of the Task Force members supported that level. Westcoast acknowledged that its recommended tolls were based largely on judgment rather than the result of any quantitative analysis.

COFI/Cominco were of the view that lower interruptible service tolls would result in a greater utilization of Westcoast's facilities without reducing revenues. Therefore, COFI/Cominco supported the use of Westcoast's proposed higher load factors for calculating the interruptible tolls. However, COFI/Cominco indicated a concern that Westcoast had not canvassed the shippers to determine their renewal plans and how they would likely respond to a change in the interruptible tolls. COFI/Cominco urged that Westcoast be directed to provide the Board with an analysis of the likely effect of the new interruptible tolls on the demand for interruptible service.

BC Gas maintained that the toll structure should be designed to allow firm customers to contract for firm service and interruptible customers to contract for interruptible services while maximizing the amount of interruptible revenues to the benefit of the firm tollpayers. BC Gas proposed that Westcoast's interruptible service tolls be calculated year-round on a 75 percent load factor basis. BC Gas argued that there was no evidence indicating that Westcoast's proposed lower summer interruptible tolls would increase the volumes of interruptible gas flowing in the summer. Therefore, BC Gas submitted that lower summer interruptible tolls would merely reduce the amount of interruptible revenues to the detriment of the firm tollpayers. However, if the Board were persuaded that incremental markets could be captured through a lower summer toll, BC Gas indicated it would support an interruptible service toll calculated at a 90 percent load factor. BC Gas stated that a gradual increase in the load factor used to derive Westcoast's interruptible service tolls would avoid a "toll shock" and at the same time recognize the increase in firm contracting on the Westcoast system.

IPAC was of the view that Westcoast's current interruptible tolls were set too high and discouraged potential interruptible users of natural gas from purchasing gas transported by Westcoast. IPAC believed that this resulted in lost sales to Canadian producers and lost toll revenues to Westcoast's firm shippers. IPAC also noted that the level of firm market demand and Westcoast capacity are such that it is very unlikely that shippers would shift their demand from firm to interruptible service if the interruptible tolls were reduced. Given these factors, the lack of firm capacity, and the potential for limited amounts of interruptible capacity being available, IPAC suggested that the interruptible service tolls be reduced from their current levels. IPAC recommended that the first tier of interruptible tolls be calculated based on a 100 percent load factor year round and that the toll for the second tier of interruptible service be set at a rate slightly less than the first tier in the winter. IPAC suggested that its recommended tolls would encourage the maximum usage of the Westcoast system and permit Canadian producers to attract United States and Canadian interruptible customers.

CanWest stated that, in view of the amount of firm capacity contracted on the Westcoast system, the interruptible rates should be lowered from their present levels, but the load factor at which the interruptible rates are calculated should not exceed 100 percent. CanWest supported interruptible tolls based on seasonal load factors of 90 percent in the summer and 75 percent in the winter.

CPA testified that it did not oppose the summer and winter load factors suggested by Westcoast for the calculation of the interruptible tolls.

Views of the Board

Although no intervenors presented definitive evidence that lower summer tolls would stimulate interruptible throughputs, the Board continues to be of the view that properly structured seasonal tolls can promote a more efficient use of the Westcoast system. The Board also notes that there remains broad support among the interested parties for the continued application of seasonal interruptible tolls.

The Board is of the view that, as a result of the firming-up of a considerable amount of the excess capacity on Westcoast's system in the past year, there is now less concern that low interruptible tolls will cause firm service to be displaced by gas moving under interruptible transportation. The Board also notes that, although there was some divergence between the views of intervenors as to the appropriate levels of the interruptible tolls, all of the intervenors recommended that Westcoast's interruptible tolls be reduced from their current levels. The Board is persuaded that it would be appropriate at this time to reduce the interruptible tolls while maintaining a seasonal variation.

Decision

The Board has decided that the winter and summer interruptible tolls are to be set on the basis of the firm demand toll at 75 percent and 100 percent load factors, respectively. The winter period will continue to be from 1 November to 31 March.

7.2.3 Method of Determining Interruptible Tolls

Westcoast endorsed the Task Force solution regarding the appropriate methodology for calculating Westcoast's tolls. The solution provided that for the 1991 test year Westcoast would continue to state its firm tolls on a gross basis and continue to calculate its interruptible tolls on a gross basis. However, Westcoast would provide monthly credits to its firm customers equal to one-twelfth of the forecast 1991 interruptible revenues on a zonal basis. Any differences between the actual and forecast interruptible revenues would be recorded in a deferral account and be recovered or credited to the 1992 cost of service. For the 1992 test year, the Task Force agreed that Westcoast would apply to the Board to use the net-iterative toll methodology for both its firm and interruptible tolls.

BC Gas indicated that, as a result of its regulation under Province of British Columbia Order-In-Council 953, it may be financially prejudiced if the Board were to change Westcoast's toll methodology prior to 30 September 1991. Consequently, BC Gas supported the retention of the gross toll methodology. However, BC Gas found that the agreement reached by the Task Force alleviated its concerns during the period under which it is regulated under the Order-In-Council. Therefore, BC Gas supported the Industry Task Force compromise solution on the issue of gross versus net tolls. BC Gas also noted that all other parties to the RH-1-90 proceeding subscribed to the compromise.

Views of the Board

The Board notes that the solution proposed by the Task Force on the issue of gross versus net tolls was either supported or unopposed by all of the intervenors in this hearing and that it effectively alleviates BC Gas' concerns regarding moving towards

the net-iterative methodology in 1991. The Board is of the view that the compromise agreement of the Task Force is reasonable and is consistent with the Board's views, as set out in its RH-1-89 Westcoast Reasons for Decision, that net tolls are preferable to gross tolls because they provide greater toll certainty and they remove some of the administrative billing burden faced by Westcoast and its shippers.

Decision

The Board directs Westcoast to continue to state its firm tolls on a gross basis and to calculate its interruptible tolls on a gross basis for the 1991 test year. However, Westcoast is to provide monthly credits to its firm customers equal to one-twelfth of the forecast 1991 interruptible revenues on a zonal basis. Any differences between the actual and forecast interruptible revenues will be recorded in a deferral account, together with carrying charges calculated monthly at a rate equal to one-twelfth of the approved annual rate of return on rate base. The deferred amounts together with the carrying charges shall be brought forward for disposition at the next toll hearing.

The Board notes the Task Force agreement specified that for the 1992 test year, Westcoast would apply to the Board to use the net-iterative toll methodology for both its firm and interruptible tolls. Accordingly, the Board expects Westcoast to apply to the Board to use the net-iterative approach for the 1992 test year.

7.3 Interzonal Toll

On 1 November 1991, the long-standing gas sales agreement between Westcoast and BC Gas will expire. BC Gas regards the expiration of this contract as an opportunity to be more competitive in acquiring its gas supply portfolio in an era of deregulation. In this context, BC Gas is considering gas purchases from several sources including the U.S.

BC Gas believed that to have access to gas supply from U.S. sources, a new toll would be required on the Westcoast system. BC Gas explained that a movement of U.S.-sourced gas on the Westcoast system from the international border to the BC Gas Lower Mainland delivery point near Huntingdon, B.C. would, in its view, be a downstream delivery and not an upstream diversion, and consequently would require a toll. BC Gas suggested that the tolls, for both firm and interruptible service associated with such movements, should be the difference between the Transportation South Toll to the BC Gas Lower Mainland Delivery Point near Huntingdon and the Transportation South Toll to the U.S. Border.¹

¹ Westcoast estimated that the firm service toll under the BC Gas proposal would have a monthly demand charge of 32 cents per 10^3m^3 (0.9 cents per Mcf) with no commodity charge, and the interruptible service toll would be 1.1 cents per 10^3m^3 (0.04 cents per Mcf) calculated at a 100 percent load factor (Exhibit B 10, Response to NEB Information Request 57(e)).

While not opposed to the backhaul transaction proposed by BC Gas, Westcoast took the position that the interzonal tolls requested by BC Gas are unnecessary. Westcoast stated that what BC Gas appears to be proposing is a gas exchange that would have two distinct components. The first component would be the upstream diversion to the BC Gas Lower Mainland delivery point of third party shipper gas delivered into the Westcoast system that would otherwise have been transported to the export market. The second component would be the delivery by BC Gas of an energy-equivalent volume of gas from a U.S. supply source into the Northwest Pipeline Corporation ("Northwest") system. Westcoast was of the view that it did not have the authority to divert the export-destined gas without the consent of those third parties. A further limitation cited was that Northwest cannot physically deliver gas to Westcoast at Huntingdon. Without control over the gas being delivered to Northwest in substitution for the diverted gas, Westcoast was concerned that if it were to divert gas, it would have no assurance it would be able to fulfil its redelivery obligations to third party export shippers.

Westcoast was of the view that BC Gas should make its own gas exchange arrangements directly with export shippers similar to the arrangements that are now in place for the delivery of gas from the Jackson Prairie Storage Facility located in Washington State. Westcoast noted that this type of transaction can be undertaken today by BC Gas without the need for tariff changes or tolls. While Westcoast did not object to the method by which BC Gas suggested the toll be calculated, its position was that the exchange service requested was a contractual, not a tolling, matter.

Westcoast stated that for it to carry out a gas exchange with Northwest, it would have to enter into a gas exchange agreement that would protect Westcoast if BC Gas did not fulfil its downstream delivery obligation in the U.S. Westcoast acknowledged that it could enter into an exchange arrangement that would protect it from such business risk consequences. However, as exchanges are, in Westcoast's view, contractual and not transportation matters, the Company considered it inconsistent with its role as a transporter-only to be involved in gas exchanges on behalf of its customers.

Finally, Westcoast argued that because it will soon be in the role of providing only transportation services it will not have control over the amount of gas in its system and, therefore, could not provide gas exchanges on a firm basis as required by BC Gas.

In response to Westcoast's concerns, BC Gas pointed to the fact that diversions occur on the Westcoast system now at the McMahan NGL plant without any need for shippers' consent. BC Gas also cited the example of gas moving from the McMahan plant to the Aitken Creek storage facility as evidence that backhaul arrangements are made on Westcoast's system at places where the facilities only allow gas to flow in one direction.

BC Gas stated that the alternative to a backhaul toll would be for it to construct an interconnection line with Northwest. BC Gas maintained that this alternative would cost about \$1 million and would be viable as a long-term option if an interzonal toll could not be put in place. BC Gas needs a long-term, reliable service which it argues is difficult to establish by current contractual exchanges, given the number of short-term contracts presently on the Westcoast system.

CPA maintained that BC Gas should arrange gas exchanges directly with shippers from British Columbia. In CPA's view, the contractual approach is simpler and protects all parties either directly or indirectly affected by the transaction.

COFI/Cominco and IPAC supported the proposal put forth by BC Gas as it would have the effect of increasing flexibility and competition. The impediments referred to by Westcoast were, in their view, overstated. They believed that Westcoast could protect itself from any liability in the unlikely event that the replacement gas following the diversion was not provided by BC Gas to Northwest. IPAC noted that, with the exception of backhauls on the Gordondale lateral, backhauls on the Westcoast system can only be accomplished through gas exchanges. Consequently, IPAC shared Westcoast's position that the service requested by BC Gas could only be made available on an interruptible basis. IPAC stated that the concept of backhaul and exchange arrangements is standard practice throughout the industry, and is an essential arrangement for the long-term operational efficiency of the Westcoast pipeline. COFI/ Cominco suggested that the Board should direct Westcoast to file General Terms and Conditions with the Board that would permit the requested backhaul by BC Gas.

Views of the Board

The Board is of the view that the interzonal backhaul service requested by BC Gas should be made available on the Westcoast system. The provision of this service will diversify the supply alternatives available to Westcoast's customers, which is a desirable objective in a deregulated market.

Although undertaking this new service will necessarily involve Westcoast in gas displacement and exchange arrangements, this is not inconsistent with Westcoast's role as a transporter. Backhauls and gas exchanges are mechanisms that permit the movement of gas, albeit notionally. In fact, Westcoast currently accommodates backhaul arrangements for the notional movements of gas at several points on its system, including into the Aitken Creek storage facility for McMahan-sourced gas, as well as to Gordondale for Fort Nelson-sourced gas. The Board recognizes that for those backhauls, Westcoast does control both ends of the exchange transactions - namely, the upstream diversion and the downstream substitution of gas to replace the diverted gas. Nevertheless, the upstream gas is diverted without the authorization of the third party shippers who injected the gas into the system. Such authorization is unnecessary as long as Westcoast delivers the contractual entitlement to the downstream delivery points. Westcoast is able to balance any discrepancies that might arise by ensuring that the replacement gas is available downstream through the contractual control that Westcoast exercises over the shipper who is tendering the gas for the purpose of having it backhauled.

To achieve the same type of control over backhauls from Huntingdon, Westcoast would have to enter into contractual arrangements with Northwest to ensure that the gas delivered to Northwest is in balance with the gas diverted upstream by Westcoast. It is not clear from the record whether this type of contractual arrangement has been explored with Northwest; however, Westcoast indicated that it would be possible to enter into an exchange arrangement with Northwest.

The alternative of building an interconnecting pipeline between the Northwest system and the BC Gas system would clearly be an unnecessary duplication, if this service could be provided by using the existing Westcoast facilities. In this regard, it is true that the backhaul of gas can be achieved by asking Canadian recipients to make their own arrangements with third parties to allow for the diversion of gas on the Westcoast

system in exchange for gas delivered downstream to the Northwest system. However, the Board is also persuaded that Westcoast could provide this service with little difficulty on a more long-term and reliable basis for its customers.

Given the configuration of the Westcoast and Northwest interconnection, gas cannot be delivered from the Northwest system to the Westcoast system at the Huntingdon export point. It follows that backhauls into Westcoast's Zone 4 area can only be effected when there is sufficient gas flowing to Huntingdon on the Westcoast system and sufficient gas flowing on Northwest's system at the appropriate downstream receipt locations for Northwest to make the exchanges necessary to allow delivery to deem to have taken place at Huntingdon. In view of this, it must be recognized that any backhaul service that Westcoast offers cannot be provided on a firm basis, but must be subject to interruption when the circumstances just described are not present. Moreover, any contractual arrangement that Westcoast enters into with Northwest must ensure the integrity of Westcoast's contractual obligations to deliver gas to the Northwest system at the Huntingdon export point. The Board is of the opinion that such an agreement is achievable. The key questions remaining are whether Northwest is prepared to provide backhaul service to Huntingdon, and on what terms. On these points the record was not complete and further discussions between Westcoast, Northwest and customers interested in this service are necessary.

For all of these reasons, the Board has decided that it is both possible and desirable for Westcoast to provide this service. At the same time, the Board is of the view that this service should not adversely affect the contractual rights of other shippers.

Accordingly, the Board will direct Westcoast to provide this service, but only if an agreement can be reached with Northwest ensuring that Westcoast is able to meet its contractual obligations to shippers who contract for firm service to the Huntingdon export point. The Board will therefore provide Westcoast the opportunity to attempt to negotiate these arrangements with Northwest and report back to the Board.

If these conditions can be met and the service can be provided, Westcoast will then file for Board approval the terms and conditions that it would propose for the service. The Board notes that no party objected to the toll suggested by BC Gas, being the difference between the Transportation South Toll to the delivery point of the shipper and the Transportation South Toll to the export delivery point.

Decision

The Board directs Westcoast to file by 30 April 1991 for Board approval a copy of the terms and conditions that Westcoast would propose for a backhaul service to Zone 4 Transportation South as well as a tariff setting out the toll in accordance with the methodology proposed by BC Gas, or to report why Westcoast was unable to negotiate satisfactory contractual arrangements with Northwest that would allow the backhaul service, as described above, to be established.

Chapter 8

Tariff Matters

8.1 Changes to Queuing Procedures and Access Criteria

Background

During the GH-5-90 proceedings to consider Westcoast's application for the McMahon Plant Expansion project, CPA argued that the existing Westcoast queuing procedures created certain inequities. Specifically, CPA noted that Westcoast had removed from the queue the requests for service of those prospective shippers who were unable, or unwilling, to commit to a ten-year service agreement in support of the McMahon Plant expansion. CPA believed that the existing queuing procedures allowed prospective shippers who were prepared to execute ten-year service agreements to jump ahead of those shippers in the queue that were unable, or unwilling, to execute ten-year service agreements.

On 31 August 1990, the Board granted CPN's request that the existing *Queuing Procedures and Access Criteria* be examined in the Westcoast RH-1-90 toll hearing.

The Position of Parties

To simplify and streamline the hearing process, Westcoast, with the assistance and co-operation of the interested parties that filed queuing proposals, prepared Table 8-1 that compares Westcoast's interpretation of the existing queuing procedures with the two alternatives put forth by IPAC and by CPA.

Table 8-1

Current and Alternative Queuing Procedures

Pre-Expansion Queue	Executed 10-Year Agreements	Project Approved			Project Denied		
		Post-Approval Queue ¹			Post-Denial Queue		
		Westcoast	IPAC	CPA	Westcoast	IPAC	CPA
A	-	B*	B*	B*	B	A	A
B	B*	C*	C*	C*	C	B	B
C	C*	E*	E*	E*	E	C	C
D	-	F**	F**	A	F	D	D
E	E*	H**	H**	D	H	E	E
F	F**		A	F**	-	F	F
G	-		D	G	-	G	G
H	H**		G	H**	-	H	H

¹ Post-approval queue prior to in-service date of new facilities expansion. After in-service date of the new facilities expansion, B, C and E would be removed from the queue.

* Executed 10-year agreements and allocated capacity on the new expansion.

** Executed 10-year agreements but denied capacity on the new expansion.

Source: Exhibit B-17.

With the exception of the Alberta Petroleum Marketing Commission ("APMC"), all other interested parties who took a position on the queuing issue supported IPAC's proposal.

Westcoast argued that prior to submitting its McMahan Plant expansion facilities application, it had offered prospective shippers in the original McMahan Plant queue the opportunity to execute long-term firm service agreements so as to secure the necessary contractual support for the McMahan Plant expansion. Those shippers who failed to execute and return the service agreements offered by Westcoast were removed from the McMahan Plant queue. In removing those shippers from the queue, Westcoast had relied upon its interpretation of its own tariff, notably paragraph (g) of the *Queuing Procedures and Access Criteria*, which provides, *inter alia*, that:

“ . . . A prospective shipper who fails to execute and return to Westcoast the service agreement within twenty-one (21) days of receipt thereof, shall be removed from the queue.”

Those prospective shippers, who executed and returned the service agreements but were not offered capacity as a result of the McMahan Plant expansion (i.e. shippers F and H in the preceding table), were allowed to remain in the queue, following those prospective shippers who were allocated the capacity associated with the expansion (i.e. shippers B, C and E).

Westcoast noted that the issue of amending its queuing procedures was raised before the Task Force. As a result of those discussions, Westcoast agreed to amend its queuing procedures. Westcoast adopted IPAC's proposal as shown in the Table 8-1. IPAC proposed that all prospective shippers should retain their respective positions in the queue until the applied-for facility expansion receives regulatory approval. The queue would then be restructured in descending order to recognize:

- (a) those prospective shippers who had executed 10-year firm service agreements and for whom the facility is being expanded (i.e. shippers B, C and E);
- (b) those prospective shippers who had executed 10-year firm service agreements but who did not underpin the facility expansion (i.e. shippers F and H); and
- (c) those prospective shippers who had failed to execute 10-year firm service agreements (i.e. shippers A, D and G). These shippers would be ranked in the order in which their RFSFs were received and accepted by Westcoast.

IPAC and Westcoast argued that all prospective shippers who had executed long-term service agreements in support of a facility expansion should be accorded the higher positions in the queue even though not all of those prospective shippers could be accommodated by the expansion. In their view, the higher positions should be accorded because the execution of a long-term service agreement demonstrates a substantive commitment to the Westcoast system.

CanWest argued that, while there is "nothing inherently preferable" about either of the IPAC or CPA proposals, it would be reasonable to adopt the IPAC proposal because it was accepted by the majority of the members of the Task Force, including Westcoast. CanWest further argued that prospective shippers to whom the expansion capacity has been dedicated should have a priority right to any capacity that may become available prior to the expanded facilities coming into service.

IPAC argued that there was confusion among the parties at the time of the McMahan Plant expansion hearing regarding the queuing rules that should be applied to the new capacity and for that reason, the Board's decision in this regard should be applied retrospectively so as to effect the original McMahan Plant queue. IPAC would re-instate at the bottom of the queue the prospective shippers who had failed to execute ten-year firm service agreements in support of the expansion.

Westcoast indicated that it does not concur that any queuing changes that might result from the Board's decision should be applied to cause the reordering of the McMahan Plant queue.

In final argument, Westcoast advised that a small amount of existing capacity is available at the McMahan Plant starting 1 November 1990 for allocation to the McMahan Plant queue and, therefore, requested an early decision of the Board so that this capacity could be offered to the queue as soon as possible.

CPA believed that Westcoast's interpretation of the queuing procedures was unfair in that it allows the non-expansion shippers (i.e. those who have executed firm service agreements but who were not offered capacity as a result of the expansion, shippers F and H) to bid up their positions in the queue

by executing ten year firm service agreements. CPA argued that it is inconsistent with paragraph (i)¹ of Westcoast's *Queuing Procedures and Access Criteria* to require a prospective shipper to accept something different than that requested by the shipper in its RFSF in order to maintain its position in the queue. CPA believed that the general principle of "first come, first-served" should be respected and that only those prospective shippers who have executed long-term service agreements which actually underpin the facility expansion should be allowed to move up in the queue.

CPA took the position that, upon regulatory approval of an expansion of a facility, the queue, if one exists, should be restructured so that those prospective shippers who have executed long-term firm service agreements which actually underpin the facility expansion would advance to the beginning of the queue (i.e. shippers B, C and E). In all other respects, the queue would remain the same. Those prospective shippers (shippers F and H) who had executed long-term firm service agreements, but on whose behalf the facilities were not applied for, would not advance in the queue but would retain their relative positions in the order of the date and time that their RFSFs were received and accepted by Westcoast.

CPA recognized that a situation might arise whereby a prospective shipper who was originally included in the facility expansion would be unable to fulfill its contractual obligations to Westcoast. Consequently, there might be insufficient long-term firm service commitments to justify the expansion. CPA therefore advocated the use of precedent agreements which would remain in effect until the new facilities were put in service. CPA believed that the use of a precedent agreement, as an initial first step, would better balance the intentions and commitments of both Westcoast and the prospective shippers. CPA advocated that the precedent agreement be offered to all prospective shippers irrespective of whether the shipper was included in the expansion. If signed and returned to Westcoast, the precedent agreement would commit that shipper to the full minimum term established by Westcoast if capacity on the new facility became available as a result of a shipper included in the original expansion being unable to fulfill its contractual obligations.

In argument, CPA noted that the parties to the RH-1-90 proceedings are not significantly far apart on the issue of queuing, the fundamental difference being that CPA supports the advancement of a prospective shipper's position in the queue only when that shipper has executed a long-term firm service agreement which underpins the facility expansion.

CPA argued that the Board's decision on the queuing issue should be applied to the McMahon Plant queue and that the queue should be reordered in accordance with its proposal.

In final argument, APMC supported the queuing proposal put forth by CPA because APMC believed it is the one most consistent with the principles of fairness and equity. APMC argued that a prospective shipper's access to the queue, or its ability to stay in that queue, should not be conditional upon the requirement to execute a long-term firm service agreement, where the terms of that agreement reflect Westcoast's assessment of what is necessary to ensure both the financing of the facilities expansion and the protection of the financial integrity of Westcoast's facilities.

¹ Paragraph (i) provides that:

"Where the capacity or the term of service offered a prospective shipper is other than that requested, the prospective shipper may choose to either accept the service offered and retain its position in the queue for the balance of the requested service, or reject the service offered and maintain its position in the queue."

APMC also supported the establishment of queues for service on the basis of contract years, but believed that this is a matter that should first be reviewed by the Task Force before seeking NEB approval to have such a change incorporated into the queuing procedures.

All parties who took a position on this issue believed that when a prospective shipper is offered service that exactly corresponds, among other things, to the volume and term identified in that shipper's RFSF, and the shipper refuses the service so offered, that prospective shipper should be removed from the queue. This provision is in the existing Westcoast *Queuing Procedures* and shipper a firm service agreement which does not exactly match the requested service identified in the RFSF, Westcoast should remove the prospective shipper from the queue.

Parties were also of the view that, if the applied for facilities were denied, the queue should revert to its original order prior to the time that Westcoast asked all prospective shippers to execute long-term firm service agreements.

Views of the Board

The Board agrees with CPA and APMC that the queue should be operated above all on the principle of "first-come, first-served". That principle is reflected in paragraph (h) of Westcoast's *Queuing Procedures and Access Criteria*¹. That principle is further reflected in paragraph (i), previously cited herein, which allows a prospective shipper to retain its position in the queue until the capacity and the terms of service requested are available. The confusion that arises in an expansion situation relates to this provision in paragraph (i) and the conflicting provision in paragraph (g) that allows Westcoast to remove a prospective shipper from the queue if it does not accept the minimum contract term established by Westcoast for the facility expansion. To eliminate the ambiguity that currently exists, the Board believes that the queuing procedures which apply when a facility expansion is proposed need to be amended.

The key issue is whether a prospective shipper who has executed a long-term firm service agreement, but whose request for service does not underpin a facility expansion, should be accorded a higher position in the queue over those prospective shippers who were unable, or unwilling, to enter into such a long-term firm service agreement when requested to do so by Westcoast.

While the Board concurs with those parties who have argued that the execution of a long-term firm service agreement signals a strong commitment by a prospective shipper to the pipeline system and, in particular, to the expansion, the Board does not agree that this commitment should bestow upon all prospective shippers which have executed such agreements a higher ranking in the queue. Only those shippers for whom capacity is being provided by the expansion proposal should be advanced to the

¹ Paragraph (h) provides that:

"Except as is otherwise provided in paragraph (g), a prospective shipper position in the queue shall not be affected by the volume, date of commencement, term of service, or distance requested".

head of the queue. Moreover, the queue would only be reordered in this manner if Board approval for a project is given.

While the Board believes that Westcoast should continue to have the right to establish the minimum term of the service agreements underpinning a facility expansion to ensure its financing and to protect the financial integrity of the entire Westcoast system, the Board does not believe that prospective shippers who are unable, or unwilling, to commit to the minimum term of service should be relegated to the bottom of the queue. Such shippers should be allowed to retain their positions in the queue relative to others who are not part of the expansion, based on their original RFSF dates.

It also follows, therefore, that prospective shippers who have executed long-term firm service agreements, but for whom facilities have not been advanced, should not be able to move up in the queue, but should instead retain their relative positions on the basis of the dates of their original RFSF.

This change to the queuing procedures should not be taken to mean that a prospective shipper may stay in the queue indefinitely. A prospective shipper who declines to execute a firm service agreement within twenty-one days of receipt thereof which matches in all respects the service requested in the RFSF should be removed from the queue. Paragraph (f) provides for this, and this provision should continue to apply.

The Board has considered the recommendation of CPA that Westcoast should offer prospective shippers precedent agreements instead of firm service agreements as an interim step in contracting for capacity. The Board has reviewed the provisions of the current firm service agreements entered into by Westcoast and has noted that these are similar in many respects, as to their purpose and intent, to the ones that might be found in a precedent agreement. The Board is not satisfied that there are sufficient differences between Westcoast's firm service agreements and a precedent agreement to justify the change. Therefore, the Board will not direct Westcoast to amend its queuing procedures in this regard.

The Board has noted the recommendation of APMC that, in the future, Westcoast's queues should be struck on a contract-year basis. The Board concurs with APMC that this matter should first be addressed by the Task Force to help identify any problems with the current system and to ascertain whether APMC's proposal would correct such problems before being brought forth in a future hearing. No evidence in this regard was adduced in the current proceedings.

Regarding the McMahon Plant queue, the Board believes that the conflicting provisions in the existing queuing procedures caused confusion at the time of the expansion application. To resolve this confusion, the Board is of the opinion that fairness requires that the queue be reordered in accordance with this decision.

Decision

Westcoast is directed to amend its existing queuing procedures to reflect the views of the Board set forth herein.¹ Westcoast is to submit to the Board for its approval, and to the interested parties to RH-1-90, its proposed amendments to its *Queuing Procedures and Access Criteria*, by 18 January 1991.

Westcoast is further directed to canvass those prospective shippers that were removed from the McMahan Plant queue. Shippers requesting to be reinstated shall be placed in the positions in the queue that they would have held if the directions in this decision had been followed when the queue was originally restructured at the time of the McMahan Plant expansion application.

Any changes to the Queuing Procedures and Access Criteria of the Westcoast tariff resulting from this decision shall come into effect upon the release of this decision.

8.2 Notice Period for Renewal Rights

Westcoast applied to the Board for approval to amend Article 2 of its General Terms and Conditions - Service² to extend from six months to eighteen months the written notice that a shipper must give Westcoast if it wishes to extend the term of its firm service agreement with Westcoast.

Westcoast argued that when there is excess capacity, a six-month notice period for service renewals might be appropriate because Westcoast would not be contemplating a facilities expansion. Westcoast noted, however, that today most sections of its system are capacity-constrained as reflected by the many queues of prospective shippers awaiting service. Westcoast argued that a six-month notice period for renewals in these circumstances does not allow time to plan and construct new facilities. An adequate lead time is required to determine whether and to what extent additional capacity is required, design the required expansion, secure the financing, file the applications with the appropriate

¹ For the purposes of paragraph 3(iii) of Order TG-2-91, the changes to Westcoast's Queuing Procedures and Access Criteria associated with this Decision took effect upon release of the Board's Queuing Decision on 27 December 1991.

² Article 2.02 currently provides that:

"Subject to article 2.03, a Shipper who has entered into a Firm Service Agreement shall have the right to extend from time to time the term of such Firm Service Agreement provided that:

- (a) such a Shipper provides Westcoast with notice not less than 6 months prior to the expiry of the term of such Firm Service Agreement that such Shipper wishes to extend the term of such Firm Service Agreement; and
- (b) such shipper provides Westcoast at the time of providing such notice with evidence satisfactory to Westcoast that such Shipper has either a firm gas supply or a firm market in respect of the gas to be delivered under such Firm Service Agreement and in the case of firm Transportation Storage Service that such Shipper has firm storage capacity at the Storage Reservoir."

regulatory authorities, order the hardware, and construct the facilities. Given these steps in the process of creating incremental capacity, Westcoast considers eighteen months to be a minimum notice period.

While Westcoast acknowledged that an eighteen month renewal notice will not in itself eliminate the risk that expanded facilities will be underutilized, the risk would be more manageable. Westcoast noted that the move from a six-month to an eighteen-month notice would require a transition period for the shippers and, for that reason, it had proposed that should the Board concur that an eighteen-month notice would be appropriate, this would come into effect on 1 November 1992.

In response to those interested parties that argued that an eighteen-month notice period would be unnecessary if Westcoast had simply talked to its shippers and solicited their intentions as to whether they intended to renew or not, Westcoast responded that it currently has some 150 service contracts and that efforts are made to talk to each and every one of its shippers. Westcoast noted that, in spite of such efforts, its shippers are reluctant to reveal their intentions until six months prior to the end of their service contracts, simply because they are not required to do so.

Westcoast argued that one-year service contracts automatically renewable upon six-months' notice, are, effectively, perpetual, long-term service contracts and that shippers would be foolish to contract for anything else. Westcoast cited BC Gas as an example, suggesting that that utility could go before the British Columbia Utilities Commission and argue that it could provide long-term secure gas supply to its core-market customers under such one-year service contracts.

Westcoast submitted that an eighteen-month renewal notice period does not eliminate short-term, twelve-month service contracts. In an example provided by Westcoast, a shipper would make its decision on 1 May 1991 whether to renew for the contract years starting 1 November 1991 and 1 November 1992 so that it would be giving six-months' notice with respect to the first, and eighteen months' notice with respect to the second. Then on 1 May 1992, that shipper would be required to give notice of its intentions to renew for the contract year starting 1 November 1993 (i.e. eighteen months in advance). This process would continue for as long as the shipper wants to continue service and means that, at any point in time, the shipper is committed to two one-year service contracts and to providing eighteen months' notice of its intention to renew or not.

All interested parties other than Westcoast supported the retention of the six-month notice renewal period and therefore recommended that Westcoast's request be denied.

BC Gas favoured retention of the six-month notice period but acknowledged that future circumstances might dictate that a longer lead time be required.

CPA argued that Westcoast must continue to accord its service customers a flexible portfolio of transportation service including one-year service contracts featuring the right to renew upon six months' notice. CPA submitted that this menu of service contracts is necessary to ensure that gas from the province of B.C. would not lose its competitive position in domestic and export markets.

CPA believed that the best measure of the viability of an expansion is the security of the gas supply and the gas markets underpinning the expansion, not the renewal period. CPA was of the view that long-term contracts should continue to underpin an expansion and that, in the long run, there might be a re-emergence of long-term contracting. CPA is not satisfied that imposing an eighteen month renewal notice period would enhance Westcoast's ability to plan for and to expand its pipeline system.

CanWest argued that adopting the eighteen-month notice period would reduce the overall competitiveness of B.C.-sourced gas in export markets. CanWest further argued that since there are likely to be several service contracts underpinning an expansion, the risk of termination of any one service agreement is, therefore, spread over all those contracts. Similarly, CanWest noted that if it is assumed that the markets to be served are long-term, the risk of non-renewal is further diminished since any underutilized capacity would be immediately contracted for by other shippers.

COFI/Cominco was opposed to the applied-for notice period extension noting that if Westcoast had required the additional lead time to plan and construct new facilities, it should have informally surveyed its service customers which would have revealed that current and future capacity will continue to be contracted for at a high load factor. COFI/Cominco argued for the flexibility that a six-month notice period accords Westcoast's shippers.

IPAC did not believe that extension of the notice period could be justified on the grounds of increased assurance that the related facilities would be used and useful. IPAC recommended that Westcoast be encouraged by the Board to improve its communications with its service customers. If, as a result, Westcoast believes it would be better able to convince the Board that a longer lead time is required, then the matter should be raised in a future tolls application.

Views of the Board

The Board agrees with those parties who have argued that the existing six-month renewal provision should be retained at this time as part of a menu of transportation and service options which will help assure the competitive position of B.C. sourced gas in domestic and export markets.

While the short lead time for notice of renewals may cause Westcoast some difficulty in its system planning and may contribute to the risk that once built, the facilities may become underutilized, the Board has not been persuaded that a change to an eighteen-month renewal notice provides a solution. Westcoast must adjust its long-term planning analysis to account for the existence of short-term contracts. In this regard, Westcoast's assessment of the long-term supply and markets to which its system has access would be enhanced by exchanges of information with its shippers. The Board is aware that Westcoast does talk to its shippers currently, but the Board would encourage both Westcoast and the shippers to look for ways to improve the flow of information.

Decision

The Board affirms the existing tariff provision that provides for a six-month renewal notice for firm service agreements. Westcoast's request to extend this period to eighteen months is therefore denied.

Chapter 9

Final Determination of Cost of Service and Tolls By Westcoast

The Board has not included a final approved rate base, cost of service or tolls for the 1991 test year in these Reasons for Decision.

Accordingly, Westcoast is required to revise the average rate base, cost of service and all supporting schedules for the 1991 test year to take into consideration the Board's decisions in Chapters 3 to 8 inclusive. The revised schedules and the tolls and tariffs are to be filed with the Board and served on interested parties. Sufficient information should be included to clearly explain each adjustment and, where necessary, tables or working papers should be provided to support the explanation.

Chapter 10

Disposition

The foregoing chapters, together with Order No. TG-2-91, constitute our Reasons for Decision and our Decision on this matter.

W.G. Stewart
Presiding Member

R. Priddle
Member

R.B. Horner, Q.C.
Member

Appendix I

Order TG-2-91

IN THE MATTER OF the *National Energy Board Act* ("the Act") and the regulations made thereunder, and

IN THE MATTER OF an application by Westcoast Energy Inc. ("Westcoast") dated 27 June 1990, as amended, for an order respecting its tolls and tariffs pursuant to Part IV of the Act and filed with the National Energy Board ("the Board") under File No. 1562-W5-18.

BEFORE:

W.G. Stewart
Presiding Member

R. Priddle
Member

R.B. Horner, Q.C.
Member

On Thursday, the 10th day of
January 1991.

WHEREAS, by application dated the 27th day of June 1990, as amended, Westcoast applied to the Board for an order under Part IV of the Act fixing just and reasonable tolls that Westcoast may charge, effective 1 January 1991, for the raw gas transmission, processing and residue gas transportation services that it provides and disallowing any existing tolls that are inconsistent with the just and reasonable tolls so fixed;

AND WHEREAS Westcoast has requested that the Board approve for accounting and toll-making purposes certain related procedures and deferral accounts;

AND WHEREAS the Board, by Order No. TGI-5-90, approved, on an interim basis, the tolls Westcoast may charge effective 1 January 1991;

AND WHEREAS the Board has heard evidence and submissions of Westcoast and all intervenors with respect to the application at a public hearing held pursuant to Order RH-1-90, which commenced in Vancouver on 10 October 1990;

AND WHEREAS the Board's decisions on the application are set out in its RH-1-90 Reasons for Decision dated January 1991 and in this Order;

IT IS ORDERED THAT:

1. Westcoast shall calculate new tolls conforming with the decisions outlined in the RH-1-90 Reasons for Decision and with this Order and file with the Board and serve upon all intervenors to the hearing of this application new tariffs in which those tolls are set out;

2. Westcoast shall, for accounting, toll-making and tariff purposes, implement procedures conforming with the Board's decisions outlined in the RH-1-90 Reasons for Decision and with this Order.
3.
 - (i) The tolls authorized by paragraph 1 of this order shall come into effect as of 1 March 1991.
 - (ii) Interim Order TGI-5-90 and the tolls authorized therein shall cease to be effective as of 1 March 1990.
 - (iii) Unless otherwise directed by the Decisions set out in the RH-1-90 Reasons for Decision, the changes authorized with respect to Westcoast's Tariff, including its General Terms and Conditions for Sales and Service shall come into effect as of 1 March 1991.
4.
 - (i) For services that have been billed in accordance with the tolls authorized by Interim Order TGI-5-90, Westcoast shall re-calculate those tolls in accordance with the tolls authorized by this Order and refund or charge the difference, together with carrying charges at the Board-approved rate of return on rate base, to the shippers affected; and
 - (ii) For services that have been or may be rendered before 1 March 1991 but are not yet billed, Westcoast shall bill for such service as if the tolls authorized by this Order had been in effect during the relevant period.
5. Those provisions of Westcoast's tariffs and tolls or any portion thereof that are contrary to the RH-1-90 Reasons for Decision dated January 1991 or this Order, are disallowed, as of 1 March 1991, unless otherwise directed by the Decisions set out in the RH-1-90 Reasons for Decision.

NATIONAL ENERGY BOARD

Marie Tobin
Secretary

Appendix II

List of Issues

Attachment 1 Appendix I to Order RH-1-90

In addition to the usual *NEB Part IV issues*, including rate base, cost of service and rate of return issues, the Board intends to examine during the hearing, but does not limit itself to, the following issues:

1. New Deferral Accounts

- (a) Repairing stress fractures in pressure vessels;
- (b) Interruptible toll revenue; and
- (c) Section 52 rate base additions

2. Toll Design

- (a) Number of tiers of interruptible service;
- (b) Load factors for winter and summer interruptible tolls;
- (c) Method of determining the interruptible toll:
 - (i) "Gross Toll" Method with monthly crediting of Interruptible Revenue,
 - (ii) "Net" Method as proposed by Westcoast,
 - (iii) "Net Iterative" Method; and
- (d) Interzonal toll for backhauls

3. Tariff Matters

Lead time for renewal notices.

4. Westcoast's Raw Gas Transmission Facility Expansion Policy

5. Processing Plant Facility Expansion Policy

- (a) The need for a policy; and
- (b) The factors to be considered if a policy were to be implemented.

Revised: 17 August 1990

Appendix III

Order TG1-5-90

File No.: 1562-W5-18

27 December 1990

VIA FACSIMILE

Mr. R.B. Maas
Vice-President
Marketing and Regulatory Affairs
Westcoast Energy Inc.
1333 West Georgia Street
Vancouver, British Columbia
V6E 3K9

Dear Mr. Maas:

Re: Westcoast Energy Inc. Application for Tolls Effective 1 January 1991 Hearing Order RH-1-90

As a decision on the above-referenced matter will not be rendered until after 1 January 1991, the Board has decided that Westcoast should continue to charge the existing tolls on an interim basis pending the Board's final decision. A copy of interim order TGI-5-90 is attached.

Westcoast is directed to serve a copy of this letter and the interim order on the interested parties to the RH- 1-90 toll proceeding by 31 December 1990.

Yours truly,

Marie Tobin
Secretary
Attach.

ORDER TGI-5-90

IN THE MATTER OF the *National Energy Board Act* ("the Act") and the regulations made thereunder; and

IN THE MATTER OF an application dated 27 June 1990, by Westcoast Energy Inc. ("Westcoast") for an order respecting its tolls and tariffs pursuant to Part IV of the Act and filed with the National Energy Board ("the Board") under File No. 1562-W5-18.

BEFORE the Board on Tuesday 18 December 1990.

WHEREAS by Order TG-9-89, as amended, the Board approved, effective 1 January 1990, tolls on the Westcoast system;

AND WHEREAS the Board's decision on the above-referenced application for new tolls effective 1 January 1991 will not be rendered until after 1 January 1991;

AND WHEREAS the Board finds it appropriate that the existing tolls continue to be charged on an interim basis pending the Board's final decision on Westcoast's application;

IT IS ORDERED THAT:

Pursuant to subsection 19(2) and section 59 of the Act, the existing tolls are to be charged on an interim basis for the period commencing 1 January 1991 and will remain in effect until the day before the Board's final order on Westcoast's application comes into effect.

THE NATIONAL ENERGY BOARD

Marie Tobin
Secretary

Appendix IV

Table a4-1
Summary of Various Test Results
and Final Rate of Return on Equity
Recommendations by Expert Witnesses

<u>Westcoast</u>		<u>CPA</u>		<u>CanWest</u>	
(i) <u>Comparable Earnings</u>	(%)	(i) <u>Comparable Earnings</u>		(i) <u>Comparable Earnings</u>	
Sample results for 1983-1989	<u>14.80</u>	N/A		1982-1989 (%)	1983-1991 (%)
Forecast returns for 1990, less adjustment for potential overstatement	<u>11.90</u>			Unadjusted comparable earnings results for low-risk industrials	13.35-13.50 ¹
Average return for 1983-1990	14.50			Less: Adjustments for:	
Less: Adjustment for lower risk of Westcoast relative to sample companies	<u>.30</u>			(a) lower risk of utilities	.35
	<u>14.20</u>			(b) higher-than-required market-to-book ratios	.35
(ii) <u>DCF</u>	(%)	(ii) <u>DCF (original forecast)²</u>	(%)	(ii) <u>DCF</u>	
Dividend yield for sample companies	2.90	Dividend yield for low-risk industrials	3.10	N/A	
Growth component	<u>10.00</u>	Implicit growth component	<u>9.15³</u>		
Approximate "bare-bones" cost	<u>13.00</u>	Investors' required rate of return for sample of low-risk industrials	12.25		
Less: Adjustment for lower risk of Westcoast relative to sample companies	<u>.30</u>	Less: Adjustment for lower risk of Westcoast relative to sample companies	<u>50-70</u> <u>11.55-11.75</u> (emphasis on upper end of range)		
Less: Adjustment for lower risk of Westcoast relative to sample companies	<u>12.70</u>				
Add: Adjustment for market-to-book ratio considerations	<u>1.20</u>				
	<u>13.90</u>				

¹ Assumed an average rate of return on equity level of 9.7 to 10.2 percent for 1990 and 10.5 to 11.4 percent for 1991 (Source: Exhibit C-9-4, Page 15).

² In late October 1990, CPA's witness indicated that the investors' required rate of return, as measured by both the DCF and equity risk premium approaches, had increased by 25 to 35 basis points. In the case of his DCF analysis, the dividend yield had increased to 3.4 percent.

³ Investors' required rate of return for low-risk industrials of 12.25 percent less dividend yield of 3.1 percent.

Westcoast				CPA		CanWest			
(iii) <u>Equity Risk Premium</u>	(%)			(iii) <u>Equity Risk Premium (original forecast)</u>	(%)	(iii) <u>Equity Risk Premium</u>	Risk Premium		
Long-Canada rate	10.375 ²			Equity risk premium - market as a whole	3.0-4.2	Equity risk premium result relative to:	<u>Yield (%)</u>	<u>Risk Premium (%)</u>	<u>Total (%)</u>
Add: Equity risk premium for Westcoast	<u>3.375³</u>			Times: Adjustment factor for lower risk of Westcoast	<u>.5</u>	(a) Long-Canadas - at a long-Canada rate of 9.70%	9.70	3.54	13.24
Add: Adjustment for market-to-book ratio considerations	<u>1.25</u>			Equity risk premium - utilities	1.5-2.1	- at a long-Canada rate of 10.25%	10.25	3.20	13.45
	<u>15.00</u>			Long-Canada rate	<u>12.25-12.85</u> (emphasis on upper end of range)	(b) Corporate bonds	10.65	5.37	13.62
						(c) Preferred shares	8.25		
						Risk Premium Result	13.25-13.50 ⁴		
(iv) <u>Final ROE Recommendation</u>	<u>Result (%)</u>	<u>Weighting (%)</u>	<u>Weighted Result (%)</u>	(iv) <u>Final ROE</u>	(%)	(iv) <u>Final ROE Recommendation</u>	<u>Result (%)</u>	<u>Weighting (%)</u>	<u>Weighted Result (%)</u>
				Approximate average or original DCF and equity risk premium results	12.25-12.50 ⁵	(a) Comparable Earnings - 1982-1989 - 1983-1991	13.2	30	3.96
(a) Comparable Earnings	14.20	50	7.10	Add: Adjustment re change in test results at the time	0.30	(b) Equity Risk Premium	13.25-13.50	40	5.30-5.40
(b) DCF	13.90	20	2.78	Investors' required rate of return - utilities	12.55-12.80 ⁶				
(c) Equity Risk Premium	15.00	30	<u>4.50</u>	Additional add-on	.325 ⁷				<u>13.06-13.20</u>
			<u>14.38</u>	Final ROE Recommendation	<u>12.875-13.125</u> ⁸	Final ROE recommendation			<u>12.95-13.30</u>
Final ROE recommendation			<u>14.375-14.50</u>						

¹ In late October 1990, CPA's witness indicated that the investors' required rate of return, as measured by both the DCF and equity risk premium approaches, had increased by 25 to 35 basis points. In the case of his equity risk premium analysis, the long-Canada rate had increased to about 11.1 percent.

² Midpoint of 10.25 to 10.50 percent range (Source: Exhibit B-15, Page 7).

³ Source: Exhibit B-15, Page 7. Note that based on a market risk premium of 5 percentage points, and a downward adjustment of .25 for the lower risk of Westcoast, the resultant equity risk premium would have been 3.75 percentage points (Exhibit B-2, Tab 5, Page 53).

⁴ Giving 60 percent weight to the risk premium result relative to long-Canadas (each result given equal weight), and 20 percent weight to each of the other two results, the witness found the return level suggested by this approach was in the range of 13.25 to 13.50 percent (Source: Tr. 2333).

⁵ Approximate average of the upper end of his original DCF and equity risk premium ranges (Source: Exhibit C-1-9, Page 48).

⁶ Source: Exhibit C-1-27, Page 1.

⁷ Implicit cushion added on by CPA's witness to take into account the recent and prospective volatility in interest rates and the need for a margin of safety in his final result (Source: Exhibit C-1-27, Page 2).

⁸ CPA's witness focussed on the upper end of the range of 12.875 to 13.125 percent (Source: Exhibit C-1-27, Page 2).

Appendix V
Position of Parties - Facility Expansion Policy and Comparison of
Surcharges Under Different Scenarios

Table a5-1
Westcoast Energy Inc.
Position of Parties - Facility Expansion Policy

April 1

<u>Organization</u>	<u>Revenues Included</u>		<u>Inflated Toll Revenue²</u>	<u>Costs Included</u>	<u>Discount Rate</u>	<u>Term</u>	<u>Frequency Surcharge Review</u>	<u>Contrib. in Aid/ Adjustment</u>	<u>Balloon Pmt/LOC</u>
	<u>Raw Gas</u>	<u>Processing¹</u>							
IPAC	2x	0	Yes	Shipper Specific	Return on Rate Base	Lesser of Contract or Reserve Life	Changed Circumstances/Annual	Yes/No	Yes/No
CPA	1x	1x	Yes	Shipper Specific	Return on Rate Base	Contract	Changed Circumstances/Annual	Yes/No	No ³
BCPC	1x/2x ⁴	1x	Yes	Full Costs	Return on Rate Base	Lesser of Contract or 10 Years	Changed Circumstances/Annual	Yes/Yes	No
BC Gas	1x/2x ⁴	1x ⁵	Yes	Full Costs	Return on Rate Base	Contract	Changed Circumstances/Annual	Yes/Yes	No
PNG	1x/2x ⁴	1x	Yes	Full Costs	Return on Rate Base	Contract	Changed Circumstances/Annual	Yes/Yes	No
COFI	1x/2x ⁴	1x	Yes	Full Costs	Return on Rate Base	Lesser of Contract or 10 Years	Changed Circumstances/Annual	Yes/Yes	No
Westcoast	1x/2x ⁴	1x	Yes	Full Costs	Return on Rate Base	Lesser of Contract, Reserve Life or 10 years	Changed Circumstances/Annual	Yes/Yes	No
MEMPR	1x/2x ⁴	1x	Yes	Shipper Specific	Return on Rate Base	Lesser of Contract, Reserve Life or 10 years	Changed Circumstances/Annual	6	6

1 If capacity is available.

2 O&M and Other Taxes portion of Toll revenue to be inflated consistent with cost of service treatment.

3 Currently under review.

4 Two-times if reserves available support in excess of initial shipper's volumes; if not, then on-times.

5 To be credited against surcharge, if capacity available.

6 No position taken.

Table a5-2
Comparison of Surcharges Under Different Scenarios
(cents/Mcf)

Facility Expansion Test	Adsett	Hossitl	Pine & Com	Pesh
<hr/>				
1 x RGT				
Total Project Cost	23.6	33.4	NA (2)	21.1
Shipper Specific Cost	14.8	NA(1)	23.3	15.0
2 x RGT				
Total Project Cost	9.8	20.2	NA(2)	7.9
Shipper Specific Cost	1.0	NA(1)	10.1	1.8
1 x RGT + 1x Processing				
Total Project Cost	0.0	14.9	NA(2)	4.7
Shipper Specific Cost	0.0	NA(1)	5.8	0.0
2 x RGT + 1x Processing				
Total Project Cost	0.0	1.7	NA(2)	0.0
Shipper Specific Cost	0.0	NA(1)	0.0	0.0

(1) The Project cannot be meaningfully reduced in scope and still meet the requirements of the Shipper who has executed a firm service agreement.

(2) The Project was originally designed to serve only the needs of the Shipper who originally requested the service.

Note: The above calculations were prepared by Westcoast to illustrate for each specific project the level of the surcharge under the various proposals. Therefore, they do not reflect the Board's Decision on the surcharges to be applied to the projects identified in the table.

Furthermore, the surcharges shown on the table have not taken into account the Task Force recommendation that the operating and maintenance and property tax components of the toll should be adjusted for inflation. Had this recommendation been taken into account the surcharges shown on the table would have been lower.

Appendix VI

System Map - Tolling Zones

Figure a6-1
Westcoast Energy Inc.
System Map Tolling Zones

Westcoast Energy Inc. System Map - Tolling Zones

