National Energy Board

Reasons for Decision

Westcoast Energy Inc.

Application Dated 12 December 1991 for
New Tolls Effective
1 January 1992

RH-1-92

August 1992

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Regulatory Support Office
National Energy Board
311 Sixth Avenue S.W.
Calgary, Alberta
T2P 3H2
(403) 292-4800
FAX: (403) 292-5503

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Office national de l'énergie
311 6e avenue s.-o.
Calgary, Alberta
T2P 3H2
(403) 292-4800
Télécopieur: (403) 292-5503

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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 certain orders respecting its tolls pursuant to subsection 19(2) and Part IV of the *National Energy Board Act*; and

IN THE MATTER OF the National Energy Board Hearing Order RH-1-92.

HEARD in Vancouver, British Columbia on 30 and 31 March and 1, 2, 3, 6, 7, 8, 9, 10, 13, 14, 15 and 16 April, and in Calgary, Alberta on 21, 22, 23 and 24 April and 5, 6 and 7 May 1992.

BEFORE:

J.-G. Fredette	Presiding Member
C. Bélanger	Member
K.W. Vollman	Member

APPEARANCES:

J.W. Lutes R.M. Sirett	Westcoast Energy Inc.
H.R. Ward	Canadian Petroleum Association
J.S. Haythorne D. Bursey	Council of Forest Industries of British Columbia, Methanex Corporation and Cominco Fertilizers
M.M. Mosely F. Wiesberg	Export Users Group (consists of IGI Resources Inc., Grand Valley Gas Co., Northwest Natural Gas Co., Intermountain Gas Co., Washington Natural Gas Co., and Washington Water Power Co.)
A.S. Hollingworth K.J. Warren	Independent Petroleum Association of Canada
B. Rogers	British Columbia Council of Carpenters
C.W. Jobe	Alberta Natural Gas Company Ltd
S.M. Richards	BC Gas Inc.

R.C. Beattie	CanWest Gas Supply Inc.
I.P. Kacir	Consumers Packaging Inc. and Hiram Walker & Sons Ltd.
C.B. Woods	Mobil Oil Canada
R.A. Cwik T.M. Sutliff	Northwest Pipeline Corporation
C.P. Donohue	Pacific Northern Gas Ltd.
S.R. Miller	Petro-Canada Inc.
W.M. Moreland	Alberta Petroleum Marketing Commission
R. Graw L.A. Boychuk	National Energy Board

Table of Contents

List of Appendices

Abbreviations

10^3m^3	thousand cubic metres
10^6m^3	million cubic metres
10^9m^3	billion cubic metres
AFUDC	allowance for funds used during construction
Amoco	Amoco Canada Petroleum Company Ltd.
APMC	Alberta Petroleum Marketing Commission
Bcf	billion cubic feet
BC Gas	BC Gas Inc.
CanWest	CanWest Gas Supply Inc.
CCA	capital cost allowance
CCPI	Cyanamid Canada Pipeline Inc.
COFI	Council of Forest Industries of British Columbia, Methanex Corporation Limited and Cominco Fertilizers
CPA	Canadian Petroleum Association
CS	compressor station
DCF	discounted cash flow
EUG	Export Users Group
Fluor Daniel	Fluor Daniel Canada Inc.
Foothills	Foothills Pipe Lines Ltd.
GPIS	gas plant in service
ICG	Inter-City Gas Corporation
IPAC	Independent Petroleum Association of Canada

long-Canada	long-term Government of Canada bond
LPSF	liquid products stabilization and fractionation
LUF gas	lost and unaccounted for gas
M & S	materials and supplies
NEB Act or the Act	National Energy Board Act
NEB or the Board	National Energy Board
NGL Plant	natural gas liquids extraction and fractionation facility
NPIS	net plant in service
O & M	operating and maintenance
Petro-Canada	Petro-Canada Inc.
PNG	Pacific Northern Gas Ltd.
PY	person year
ROE	rate of return on average common equity
Task Force	Joint Industry Task Force on Westcoast's Tolls and Tariffs
Tcf	trillion cubic feet
TransCanada or TCPL	TransCanada PipeLines Limited
Westcoast, the Company or the Applicant	Westcoast Energy Inc.
WestCoast Gas	WestCoast Gas Inc.
WestPete	Westcoast Petroleum Ltd.

Overview

(Note: This overview is provided for the convenience of the reader and does not constitute part of these Reasons for Decision. For details the reader is referred to the relevant sections of the Reasons for Decision.)

The Application and Hearing

On 12 December 1991, Westcoast applied for new tolls to take effect on 1 January 1992. The public hearing opened in Vancouver on 30 March 1992 and lasted 21 days. The Board sat for 14 days in Vancouver and adjourned on 16 April 1992. The hearing reconvened in Calgary on 21 April 1992. The evidentiary portion was concluded on 24 April 1992 and final argument and reply were heard on 5, 6 and 7 May 1992.

Tolls for 1992

On 20 December 1991, the Board approved interim tolls for Westcoast effective 1 January 1992 which were designed to yield a 5 percent increase for a typical service movement. Regarding final tolls for 1992, the Board intends to approve tolls that are uniform throughout the year. The Board estimated that final tolls for 1992 will be about 2.5 percent over tolls for 1991. Westcoast had applied for a 6.0 percent increase. The Board directed Westcoast to refund or, where applicable, recover from its customers the difference between the tolls resulting from these Reasons for Decision and the interim tolls, together with carrying charges.

Revenue Requirement

The Board estimated that its decisions will result in an approved revenue requirement of approximately $354 million for 1992, or about $12 million less than the applied for amount of $366 million.

The Board directed Westcoast to file the final tolls reflecting its decisions and to submit them for approval by the Board.

Rate Base

The Board found that Westcoast's liquid products stabilization and fractionation ("LPSF") facilities at Taylor, British Columbia are integral and essential to the pipeline system and consequently subject to regulation by the Board. Regarding the McMahon Plant expansion project the Board approved for inclusion in rate base $102.1 million for facilities constructed by Westcoast and $20.1 million related to the facilities purchased from Petro-Canada. However, the Board expressed concerns that an environmental audit of the Petro-Canada facilities and that a stress corrosion cracking inspection of the stabilizer vessels were not performed.

The Board approved for inclusion in rate base the actual costs, including overruns, of capital projects undertaken in 1991 and 1992. The Board directed Westcoast to remove, from its applied-for GPIS, the amounts related to projects that have not as of 1 August 1992 received approval under Part III of the *National Energy Board Act*.

Regarding the method of calculating allowance for funds used during construction ("AFUDC"), the Board approved the Company's proposed method of including the previous month's AFUDC in the cost base.

The Board approved $26.8 million for materials and supplies, $4.3 million for prepaid expenses, and $2.8 million and $712,000 respectively for Phase I and Phase II implementation of a new Gas Management System.

Depreciation

The Board approved new depreciation rates which have the effect of increasing Westcoast's composite depreciation rate for total plant from 2.1 percent to 2.2 percent in 1992.

Deferred Income Taxes

The Board approved a drawdown of the accumulated deferred income tax balance at a rate which would reduce utility taxable income to zero in 1992 and subsequent years until the balance is extinguished.

Rate of Return

The Board approved Westcoast's request that the deemed common equity ratio remain at 35 percent. Westcoast requested that its rate of return on equity remain at 13.75 percent. The Board approved a rate of 12.5 percent for the test year.

Operating Costs

The Board decided that Westcoast should reduce its proposed operating salaries, wages and benefits by a total of $1,059,000. This included $692,000 to reflect a reduction of 10 person years from the applied-for increase of 42 person years. The Board also decided that the year-over-year salary increase be set at 2.5 percent instead of the applied-for 3.0 percent for all salaried staff; the associated reduction was $252,000. The Board directed Westcoast to use the approved rather than actual

1991 salaries, wages and benefits increase as the base for 1992 salaries and wages, resulting in a reduction of $115,000 in the applied-for amount.

The Board accepted Westcoast's requested amount for housing expenses, but directed Westcoast to file a copy of a planned housing study with the Board after it is completed. The Board also directed Westcoast to reduce its right-of-way maintenance expenses by a total of $71,000, to reflect shared responsibility with Westcoast Petroleum.

The Board approved water hauling expenses of $175,000 at the Sikanni Plant. The Board also approved $770,000 as the utility's share of expenses to operate a corporate aircraft and $1.6 million for training and education.

The Board approved Westcoast's proposal to account for lost and unaccounted for gas through an allowance in the shippers' fuel ratios and directed Westcoast to communicate to its shippers the monthly actual losses and gains by volume and as a percentage of the total accountable gas. However, the Board denied Westcoast's request to include in rate base and amortize to cost of service over a three-year period an estimated cumulative loss of $2.4 million that the Company claimed it had suffered since 1986 under the existing methodology.

The Board directed Westcoast to retain an external consultant to carry out an independent review of Westcoast's method of separating costs between utility and non-utility. Westcoast is required to file proposed terms of reference for Board approval.

Toll Design

The Board approved the toll design proposed by Westcoast for LPSF Service at the McMahon Plant.

The Board also approved a change in the basis of calculating Liquids Recovery Service tolls from residue gas volumes to liquids content.

The Board directed Westcoast to extend Interruptible Import Backhaul Service to Compressor Station 2 and to file proposed tolls for this extended backhaul service based on the currently approved toll methodology.

Tariff Matters

The Board approved on a final basis the interim general terms and conditions and other consequential amendments related to the provision of LPSF Service and directed Westcoast to revise the existing general terms and conditions for Backhaul Service to indicate that interruptible means subject to a forward flow of gas.

Deferral Accounts

The Board approved Westcoast's proposed disposition of the currently approved cost of service and revenue deferral accounts, except that the compressor fuel balances and the other fuel gas balance within the "Gas Used in Operations" deferral account shall be allocated to each zone based on the rate base assigned to the zone.

The Board accepted Westcoast's request not to renew certain cost of service and revenue deferral accounts. The Board approved the continuation of the deferral accounts specified by Westcoast for renewal with the exception of the Coloured Gas Tax component of the Gas Used in Operations deferral account. The Board approved Westcoast's request to remove the balance in the Grizzly Valley Tax Reassessment deferral account from rate base and to transfer the amount to a new deferral account. Monies received from Revenue Canada will be credited to the new account and costs related to the appeal of the tax reassessment will be charged to this account and brought forward for disposition at the next toll hearing.

The Board approved new deferral accounts regarding LPSF Service to record differences between actual and forecast cost of service and revenue.

The Board approved a new swing gas deferral account to record the cost of swing gas when the shippers who caused imbalances cannot be identified or where no fault can be attributed to any party.

The Board approved a new deferral account to record the costs incurred in 1991 for the purchase and operation of the Petro-Canada LPSF facilities.

Chapter 1

Background and Application

By application dated 12 December 1991, Westcoast Energy Inc. ("Westcoast", "the Applicant" or "the Company") applied to the National Energy Board ("the Board" or "NEB") under subsection 19(2) and Part IV of the *National Energy Board Act* ("NEB Act" or "the Act") for an order or orders respecting interim and final tolls for 1992. On 20 December 1991, by Order TGI-5-91 (Appendix III), the Board approved certain tolls that Westcoast may charge for services provided to customers on the Company's pipeline system on an interim basis effective 1 January 1992.

In connection with two separate applications by Westcoast, the Board also issued interim orders that are to remain in effect until the Board issues its final order regarding Westcoast's application for 1992 tolls. First, on 5 December 1991, the Board issued Order TG-8-91 by which it approved interim Toll Schedules for Offline Service, including the Offline Service Tolls incorporated therein. Second, on 20 December 1991, the Board issued Order TGI-4-91 by which it approved interim general terms and conditions and tolls for Liquid Products Stabilization and Fractionation ("LPSF") Service.

On 27 January 1992, the Board issued Hearing Order RH-1-92 which set down Westcoast's application for hearing commencing 30 March 1992 and established the Directions on Procedure and the preliminary list of issues to be considered. By letter dated 27 February 1992, the Board revised the List of Issues; a copy of the revised list is attached to these Reasons for Decision as Appendix V.

In that same letter, the Board explained that it decided not to deal with two issues raised by intervenors. The first one, raised by Husky Oil Operations Ltd., was whether the existing queuing procedure to access firm service on Westcoast is appropriate. The Board deferred a review of the matter because of its understanding that Westcoast had retained a consultant to study the problems shippers have experienced with the current procedure and to recommend approaches that would improve access to and achieve an orderly development of the Westcoast system. The Company planned to table the consultant's report for discussion at the Joint Industry Task Force on Westcoast's Tolls and Tariffs ("the Task Force"). It was the Board's view that interested parties should be given an opportunity to resolve this matter among themselves before it is examined by the Board. The Board also took into consideration the submission of the Independent Petroleum Association of Canada ("IPAC") that it supported the current consultation process and that the queuing and access issue was too complex to permit a timely resolution in this hearing.

The second issue, raised by IGI Resources, Inc., was whether Westcoast's "Five Year System Development Plan" is appropriate. The Plan sets out the Company's forecast capital additions for 1992 to 1996. The Board was of the opinion that the matter of facilities additions should more appropriately be examined in a proceeding pursuant to Part III, and not Part IV, of the Act.

On 12 March 1992, the Canadian Petroleum Association ("CPA") filed a motion requesting that the Board delete the issue of "whether the depreciation rates proposed by Westcoast are appropriate" from the List of Issues. The Board found that the issue was an important part of the Company's application for 1992 tolls and denied the motion on 13 March 1992.

In a letter dated 25 March 1992, the Board issued its decision to incorporate the record of Westcoast's 21 November 1991 application to introduce LPSF Service in the record of the RH-1-92 proceeding. By letter dated 27 March 1992 to Westcoast, the Board informed parties that it would examine during the hearing the question of whether or not it has jurisdiction over the company's LPSF facilities at Taylor, British Columbia.

The Board heard evidence in Vancouver from 30 March to 16 April 1992, and in Calgary from 21 to 24 April 1992. Final argument was heard on 5 and 6 May 1992 and reply argument on 7 May 1992.

On 24 April 1992, the Board rendered a decision from the bench approving Westcoast's proposed accounting treatment for the proposed removal and replacement of the foundation for compressor unit number 5 at Station 7. In a letter dated 14 February 1992 to the Board, Westcoast explained that the foundation had deteriorated to the extent that the operating integrity of the compressor could be compromised. The Company proposed to charge the costs of dismantling the old foundation to accumulated depreciation, to treat the net book value of the original foundation as an ordinary retirement and to capitalize the cost of a new foundation. During the hearing, Westcoast emphasized the urgency of the replacement project. By application dated 3 April 1992, Westcoast applied for approval of the removal and replacement project pursuant to section 58 of the Act, and the Board granted approval by Order XG-14-92 on 27 April 1992.

Chapter 2

Burden of Proof

During the hearing and in final argument, IPAC commented on the burden of proof which Westcoast must discharge in order to persuade the Board of the prudence of the rate base expenditures set out in its application. IPAC said that it was concerned about what it considered to be a gradual shift in the onus of proof from the regulated utility to intervenors because, in its view, Westcoast appeared to be taking the position that any expenditure put forth should be approved, unless it was specifically shown by an intervenor or the Board to be one which should not be allowed. IPAC contended that it was still the obligation of the utility to advance the case that the expenditures which it has incurred were prudent and that the items included in rate base are used and useful. Furthermore, the Board should reject any notion that the initial onus for the reasonableness of expenditures included in the application rests on any party other than Westcoast.

The Council of Forest Industries of British Columbia, Methanex Corporation Limited and Cominco Fertilizers ("COFI") agreed with the comments put forward by IPAC and referred the Board to its GH-2-87 Reasons for Decision wherein the Board stated that an applicant has the burden of establishing, on the balance of probabilities, that the relief sought in the application should be granted. COFI urged the Board not to accede to the suggestion of Westcoast witnesses that the costs associated with new facilities should be considered prudent "unless significant evidence is brought forward that indeed they were imprudent".

Views of the Board

The Board has not altered its position with respect to the allocation of the burden of proof that was enunciated in the GH-2-87 Reasons for Decision. While the issue before the Board in this hearing is not the same issue that was before the Board in GH-2-87, nevertheless the principle remains applicable.

The overall concept of burden of proof has many components. In GH-2-87, the reference to the burden of proof was in the context of the applicant's overall or ultimate burden of proof which the applicant must discharge at the close of the hearing in order to obtain the relief that was requested in its application. The process by which the applicant undertakes to discharge its ultimate burden of proof begins with the initial filing of its application in which the applicant is under an obligation to present to the Board an application containing sufficient evidence amounting to a *prima facie* case in support of the relief requested. This evidence is augmented by responses to information requests, written evidence and cross-examination. Depending upon the particular strengths and weaknesses of the applicant's *prima facie* case, the onus of proof may shift to the intervenors during the course of the hearing to refute the applicant's case. Notwithstanding this perception of a shifting onus of proof, the ultimate burden of proof, or burden of persuasion as it is often called, always remains with the applicant. The applicant must satisfy the Board, on the balance of probabilities, that the relief sought in its application should be granted.

In discharging the initial burden of presenting a *prima facie* case, it is for the applicant to determine the extent and quality of the evidence that it chooses to file. Whether or not this evidence is sufficient to discharge the applicant's ultimate burden of proof is a matter to be determined in the particular circumstances of each case. Suffice it to say that intervenors are given an opportunity to cross-examine and to present their own evidence in opposition to the applicant. They need not do so as it is for each intervenor to determine the extent to which the onus of proof has shifted from the applicant. Ultimately, it is for the Board to determine, on the totality of the evidence which is before it, whether the applicant has discharged its burden of proof.

Chapter 3

Revenue Requirement for 1992

A summary of the 1991 base year, 1992 applied-for and 1992 approved (as estimated by the Board) revenue requirements is shown in Table 3-1. The 1992 applied-for revenue requirement represents an increase of 20.3 percent over the 1991 actual. Having considered the evidence adduced in this proceeding, the Board has made adjustments to certain 1992 cost of service items. They are discussed in the following chapters. Based on these adjustments and subject to final determinations as indicated in Chapter 13, the Board has estimated that Westcoast's 1992 revenue requirement would be $353.5 million or 17.1 percent above the 1991 actual.

Table 3-1
1991 Base Year, 1992 Test Year Applied-for and Approved Revenue Requirement
($000)

	1991 Actual	Change	1992 Applied-for[1]	Board Adjustments	1992 Approved (Estimated)
Operating and Maintenance Expenses	111,980	10,226	122,206	(1,258)	120,948
Regulatory Costs	2,654	718	3,372	-	3,372
Depreciation	31,976	14,299	46,275	(6,497)	39,778
Amortization	150	(6,529)	(6,379)	6,571	192
Taxes Other Than Income Taxes	45,817	5,361	51,178	-	51,178
Miscellaneous Operating Revenue	(2,909)	1,881	(1,028)	-	(1,028)
Insurance Deductibles	-	965	965	-	965
Foreign Exchange on Debt	658	192	850	-	850
Gas Substitution Costs	1,120	(1,120)	-	-	-
Gas Used in Operations	4,040	(4,039)	1	-	1
Income Tax Expense	9,804	(3,575)	6,229	(3,598)	2,631
Return on Rate Base	107,955	28,486	136,441	(7,168)	129,273
Deferrals	(11,275)		5,840	-	5,840
Revenue Requirement	**301,970**		**365,950**	**(11,950)**	**354,000**

1 Application dated 12 December 1991, as amended on 1 May 1992 (Exhibit B-81)

Note: Totals may not add due to rounding.

Chapter 4

Rate Base

4.1 The Board's Jurisdiction over the Liquid Products Stabilization and Fractionation Facilities at Taylor, British Columbia

Background

The LPSF facilities which are currently owned by Westcoast were previously owned and operated by Petro-Canada Inc. ("Petro-Canada") and are located on lands adjacent to Westcoast's existing gas processing plant located at Taylor, British Columbia (also referred to as the "McMahon Plant"). The Taylor complex was designed and constructed in the mid-1950s. The oil refinery was constructed by Pacific Petroleums Ltd. in 1956 and the gas processing plant and sulphur recovery plants were completed in 1957 by Westcoast and Jefferson Lake Petrochemicals of Canada Ltd. [now Canadian Occidental Petroleum Ltd.] respectively. The gas processing plant included an inlet separator to remove free liquids from the gas stream entering the plant, gas treatment facilities to remove acid gas and water from the gas stream, lean oil extraction facilities to remove natural gas liquids from the gas stream, and a power house. By Order MO-45-76 dated 18 November 1976, the Board approved Westcoast's purchase of the sulphur recovery plant which has since been subject to the Board's jurisdiction. The condensate pipeline which runs from the condensate storage tank (connected by process piping to the LPSF facility) to the condensate truck loading facility, has been owned and operated by Westcoast as a non-utility asset since its installation in 1986.

Since 1957, the LPSF facilities located at the refinery site have always been available to handle liquids extracted from the natural gas stream at the McMahon Plant. On 6 June 1990 Westcoast applied for Board approval to construct additional facilities to expand the gas processing capacity at the McMahon Plant. In September 1990, the Board issued Order XG-11-90 authorizing Westcoast to construct and operate the facilities applied for, which included facilities to handle the additional liquids that would result from the expanded gas processing capacity. When Petro-Canada subsequently decided to close its oil refinery at Taylor, Westcoast applied to the Board to purchase certain of the refinery assets including the liquids processing facilities. The Board approved the purchase by Orders MO-9-91 and XG-12-91 dated 14 March 1991.

By letter dated 21 November 1991 and subsequently in its tolls application dated 12 December 1991, Westcoast sought approval of interim and then final 1992 tolls for LPSF Service provided to Westcoast shippers at its McMahon Plant in Taylor, British Columbia. By Order TGI-4-91 dated 20 December 1991 the Board approved Westcoast's application for interim LPSF Service tolls. In a letter of comment dated 28 October 1991, BC Gas Inc. ("BC Gas") submitted that the LPSF facilities are not within the Board's jurisdiction and, accordingly, should not be regulated by the Board.

Responses and replies were exchanged between Westcoast and BC Gas on 19 November 1991 and 26 November 1991 respectively. By letter dated 23 December 1991, the Board invited interested parties to comment on, among other things, the jurisdictional issue by 31 January 1992. The Board, however, received no further comments in respect of the jurisdictional issue.

In a letter to Westcoast dated 27 March 1992 the Board indicated that it would examine as an issue in the hearing whether or not it has jurisdiction over the Company's LPSF facilities and issued an information request to Westcoast asking it to explain why the arguments contained in its letter to the Board dated 9 July 1984 against federal jurisdiction over Westcoast's natural gas liquids extraction and fractionation facility (the "NGL Plant") would not also apply to the LPSF facilities. A copy of the 27 March 1992 letter was filed at the commencement of the hearing and parties were invited to make submissions on the jurisdictional issue in final argument.

Westcoast's Position

At the hearing, Westcoast filed process schematics of its gas processing facilities both prior to and after the McMahon Plant expansion, reproduced here as Figures 4-1 and 4-2.

In its response to a Board information request, Westcoast provided additional background information on the McMahon Plant and a description of the process to illustrate how the expanded LPSF facilities are integral to its pipeline operation. Westcoast explained that raw gas entering the plant from the raw gas transmission pipelines is separated into gas and liquids in the inlet separator. The gas is compressed, returned to the gas plant, sweetened using an amine solution and then scrubbed with an oil which absorbs the heavy hydrocarbons, propane, butane and condensate from the treated gas. The liquids from the inlet separator flow through flash tanks where the pressure is dropped in stages (the gas from each stage is directed to the plant fuel system). The liquids then enter the stabilizers where the butane and lighter hydrocarbons are removed. The liquid portion of the stabilizer overhead is directed to the depropanizer feed tank, the vapour portion is directed to the plant fuel system, and the condensate is cooled and directed to storage. The gases from the depropanizer feed tank enter a lean oil reabsorber and the liquids from the depropanizer feed tank enter the depropanizer where the propane and lighter hydrocarbons are separated from the butane and heavier hydrocarbons. The overhead gases and liquids from the depropanizer are directed to a deethanizer where the ethane and lighter hydrocarbons are separated and sent to the plant fuel system via the reabsorber. The propane from the bottom of the deethanizer is treated to remove sulphur compounds, dried and then directed to storage. The bottoms of the depropanizer are returned to the gas plant and directed to a still where much of the entrained oil from the steam stripper is recovered. The oil from the steam stripper is also further processed in the still to remove additional natural gasoline. The overhead from the still is directed to the debutanizer where the butane is separated from the natural gasoline and treated to remove sulphur compounds. The gasoline is combined with the condensate from the stabilizer and both products are sent to storage.

FIGURE 4-1

PROCESS SCHEMATIC
PRIOR TO McMAHON PLANT EXPANSION

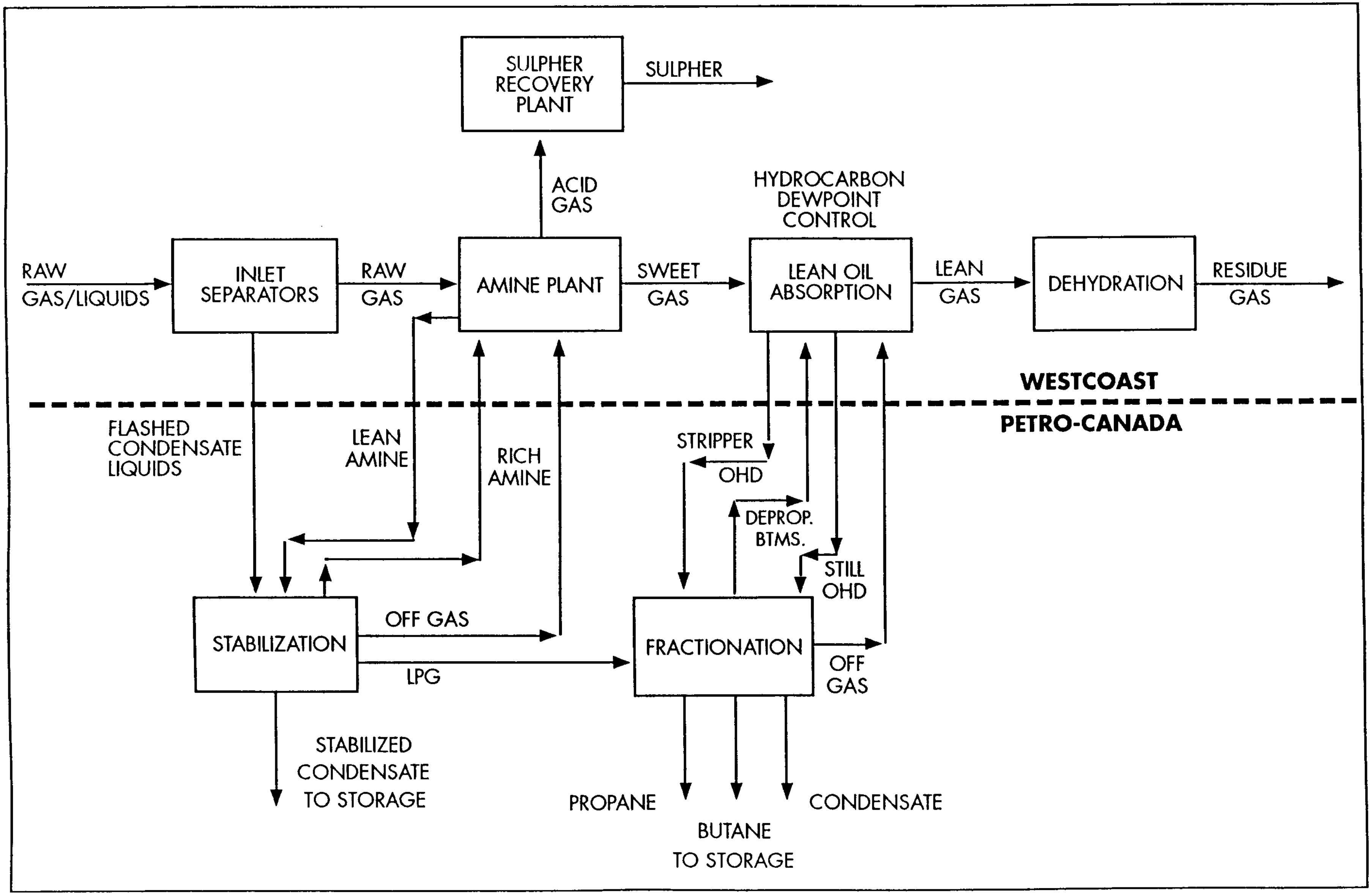
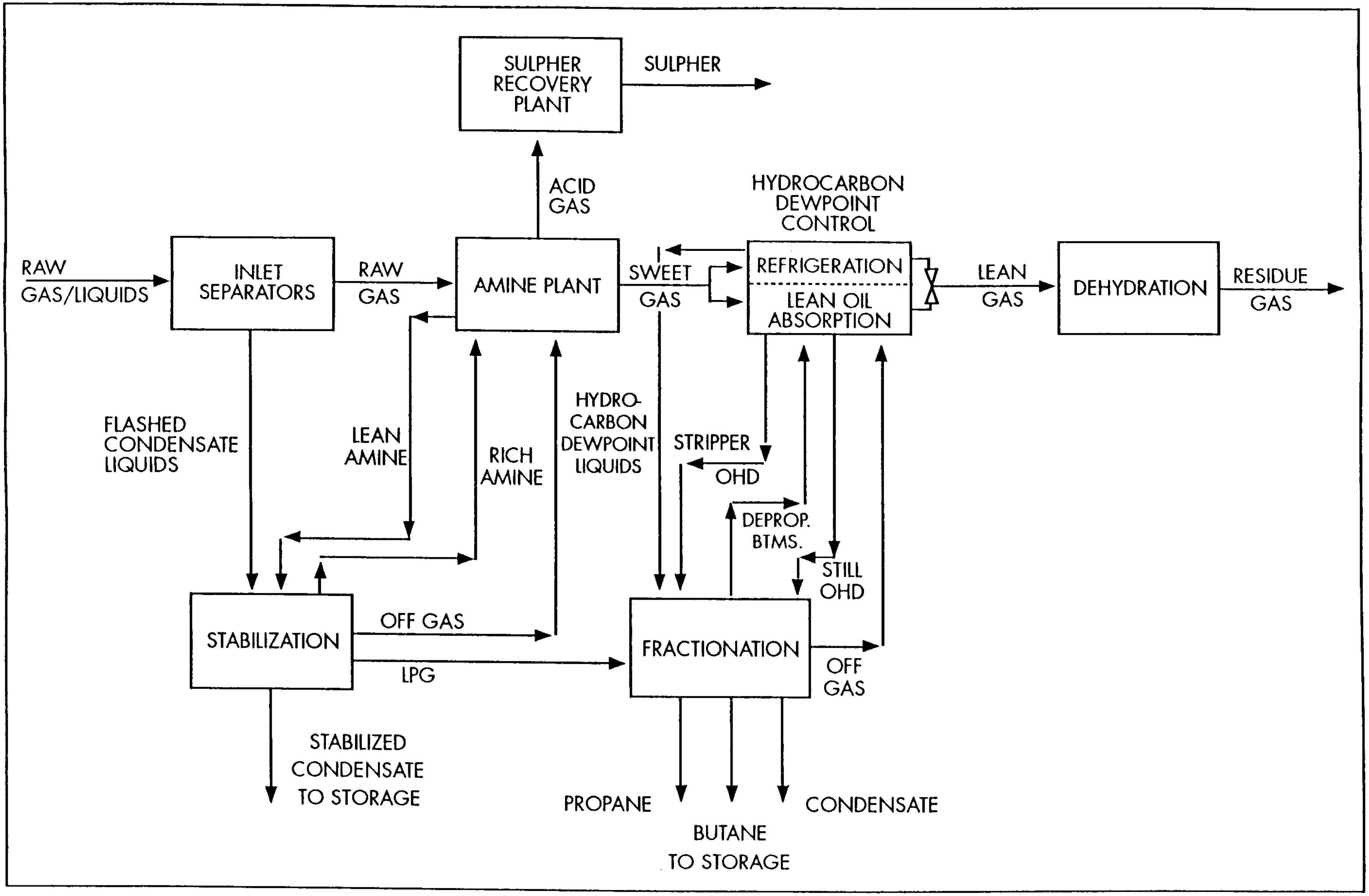


FIGURE 4-2

PROCESS SCHEMATIC
AFTER McMAHON PLANT EXPANSION



According to Westcoast, pipeline quality gas cannot be produced at the McMahon Plant without facilities available to handle the liquids recovered in the course of processing because the lean oil system is completely integrated with the fractionation system in the hydrocarbon dewpoint control facilities. Westcoast also explained that although the liquids facilities could continue to operate while either the refinery or the gas plant was out of service, the gas processing operations would have to be discontinued if the liquids facilities were not in service. During the proceeding, Westcoast's witness suggested that the post-expansion facilities are even more closely connected with the gas processing activities stating that "there is a lot of integration between the lean oil system and the fractionation system ... it is not an isolated unit sitting off by itself with a single stream going to it, which is the case in some other designs".

Although the liquids coming off the inlet separator can be stabilized and shipped, the liquids processed through the fractionation facility cannot be recovered in a single stream and put to storage for shipment off-site for subsequent fractionation because they are totally integrated with the lean oil absorption facility. Westcoast's witness admitted, however, that it is possible to modify the system to completely separate the fractionation facility from the lean oil absorption facility but that it would have to be completely redesigned, it would be extremely expensive and it would result in a much higher cost option than is currently provided.

Westcoast also indicated that certain of the liquids handled in the LPSF facilities are utilized as fuel in the operations of the gas plant. In a response to an undertaking, Westcoast advised that, of the total fuel gas requirement (peak day design basis) for the total McMahon Plant complex, 38 percent of the total supply was derived from stabilization off-gas including flash tanks and 22 percent was derived from fractionation off-gas.

In argument Westcoast stated that the LPSF facilities are real and personal property and works connected with Westcoast's existing pipeline. The LPSF facilities constitute part of its pipeline undertaking and are necessary for, or integral to, the operation of Westcoast's federally-regulated pipeline system in its day-to-day functioning as a going concern. The gas plant has always required liquids facilities and, in fact, it could not be operated without the LPSF facilities to handle the liquids extracted from the raw gas stream delivered through the pipeline system to the plant. The Westcoast system is unlike other pipelines in that it is used to transport raw gas from the wellhead, to process that gas to pipeline quality, and to deliver pipeline quality gas to its shippers and other customers in British Columbia and at the international boundary. Westcoast agreed that the fact that it owns the facilities is not a sufficient basis for federal jurisdiction but added that this issue should not be based on whether or not the LPSF facilities might be operated by other persons or in some other manner which would not attract federal jurisdiction.

Furthermore, the fact that these facilities were not regulated by the Board in the past is not a bar to a proper exercise of jurisdiction now. Westcoast compared the situation to the Taylor sulphur plant which, subsequent to its purchase by Westcoast in 1976, became subject to the jurisdiction of the Board. Westcoast distinguished its argument against federal jurisdiction of the NGL Plant contained in its letter of 9 July 1984 in that irrespective of Westcoast's ownership of the NGL Plant, that facility is functionally separate from the pipeline system; it is connected to Westcoast's residue gas pipeline downstream of the McMahon Plant and, by closing the inlet and outlet valves of the NGL Plant, it can be completely isolated from the pipeline without having any impact upon the operation of the pipeline or the McMahon Plant. The LPSF facility and the sulphur plant, however, are not functionally separate from the Westcoast system.

Views of Intervenors

CPA suggested that Westcoast's arguments against federal jurisdiction of the NGL Plant contained in its letter of 9 July 1984 apply equally to the LPSF facilities. CPA noted that the facilities at issue have been operated on a non-utility basis for more than 30 years and suggested that there is no reason why they should now become a utility operation simply because of a change in ownership. Finally, even if the Board has jurisdiction over the LPSF facilities, CPA submitted that the Board should not exercise its jurisdiction and should exclude these facilities from the regulated utility operation.

BC Gas argued that the LPSF facilities are not real or personal property or works connected with the pipeline and submitted that the fact that Westcoast is a pipeline company does not mean that all of its activities must relate to pipeline undertakings. BC Gas contended that the LPSF facilities are not essential to the Westcoast system; while these facilities may be essential to the product moved through the pipeline system, they are not essential to the pipeline system itself. BC Gas drew an analogy to an oil pipeline and suggested that while it is essential that there be pipes, pumps and storage tanks for the line to operate and while refineries at the receipt point may be essential for the economic movement of oil (the product) through the pipeline, they are not essential for the pipeline. Similarly, while stabilization and fractionation of natural gas liquids may be essential for the product, these activities are not essential to the day-to-day operation of the pipeline as a transmission system. BC Gas therefore submitted that operational integration rather than functional integration is required and suggested that the fact that the facility had been designed to be functionally integrated is not determinative of the jurisdictional issue. The LPSF facilities are not essential, necessary for or integral to the day-to-day operation of Westcoast's natural gas pipeline as they do not perform any kind of transportation function whatsoever. They are more properly characterized as a separate economic activity, namely, the marketing of natural gas liquids and, in fact, they constitute a customer for natural gas liquids extracted in the McMahon Plant.

COFI noted that other than with respect to capacity, there was little difference between the pre-expansion and the post-expansion plant and that, therefore, there was no justification for bringing the LPSF facilities or the condensate line into the utility. COFI submitted that the facilities were not essential to the system despite the physical integration. Reference was made to Petro-Canada's evidence that Amoco Canada Petroleum Company Ltd. ("Amoco") had threatened to take its liquids to another plant for servicing (if Petro-Canada did not agree to lower its prices) and to the testimony of Petro-Canada's witness that it seriously believed that the liquids could be treated and handled elsewhere.

Export Users Group ("EUG") joined with those that saw no fundamental difference between the LPSF facilities and other non-utility facilities such as the NGL Plant. With respect to the condensate line, which connects to the LPSF plant, EUG noted that for a number of years this line had performed a non-utility function and suggested that a simple change in ownership of the LPSF facilities does not warrant its inclusion in the utility operation. EUG submitted that the functions of both the LPSF plant and the condensate line have not changed and, accordingly, they should remain unregulated.

IPAC supported the Board's jurisdiction over the LPSF facilities and noted that the Board had already assumed jurisdiction in having approved the purchase of the facilities and an interim toll for the LPSF service. IPAC distinguished the 1984 NGL Plant project in that it was not an integral part of the overall Westcoast system because it could be bypassed by the gas flow on the system without detriment to Westcoast's operations. IPAC suggested that a "situation-specific" analysis is required and, on the basis of Westcoast's evidence that the McMahon Plant, in its present configuration, is not able to function without the LPSF facilities, IPAC accepted that these facilities are essential to the Westcoast pipeline operation. To further support this proposition, IPAC referred to Westcoast's evidence that natural gas could not be brought to necessary pipeline specifications in the Westcoast system without the LPSF facilities. These facilities, therefore, properly fall within federal jurisdiction and should be regulated by the Board.

Petro-Canada submitted, without commenting on the Board's jurisdiction over the LPSF facilities, that the Board should not regulate this service. It suggested that given the significant number of years during which the facilities had operated outside of any regulatory regime, there is no compelling reason that they should now be federally regulated regardless of whether or not jurisdiction exists.

Views of the Board

The resolution of this jurisdictional issue turns on whether or not Westcoast's LPSF facilities can be considered to fall within the definition of "pipeline" found in section 2 of the *National Energy Board Act*, R.S.C. 1985, c. N-7:

> "pipeline" means a line that is used or to be used for the transmission of oil or gas, alone or with any other commodity, and that connects a province with any other province or provinces or extends beyond the limits of a province or the offshore area as defined in section 123, and includes all branches, extensions, tanks, reservoirs, storage facilities, pumps, racks, compressors, loading facilities, interstation systems of communication by telephone, telegraph or radio and real and personal property and works connected therewith.

In order for a facility to be part of a pipeline and subject to the Board's jurisdiction, it must be "integral" or "essential" to the pipeline. To determine whether or not a facility is integral or essential, the Board finds guidance in the jurisprudence concerning the interpretation of s. 92(10)(a) of the *Constitution Act, 1867*, particularly the recent decisions of the Federal Court of Appeal which have specifically considered the Board's jurisdiction.

In Reference re National Energy Board Act (1987), 48 D.L.R. (4th) 596 (the "Cyanamid" case), the Federal Court of Appeal determined that a pipeline facility to be constructed and operated by Cyanamid Canada Pipeline Inc. ("CCPI") to transmit gas from its Welland plant site to TransCanada PipeLines Limited's ("TCPL") Black Horse [*sic*] Meter Station site was not subject to federal jurisdiction. The Court confirmed that for a work or undertaking to fall within federal jurisdiction it must either be an interprovincial work or undertaking or be joined to an interprovincial work or undertaking through a necessary nexus. The Court determined that mere physical connection to TCPL's interprovincial work was not sufficient to found federal jurisdiction and concluded that the proposed bypass was not vital, essential, integral or necessary to TCPL's interprovincial undertaking. MacGuigan, J.A., noted [at p. 599] that "Although TCPL would retain the right to isolate the CCPI pipeline from the TCPL system in special circumstances by closing the manually operated valves which connect the two pipelines, CCPI would normally control the flow of gas into its pipeline".

He suggested, however, [at p. 610] that if TCPL had an agreement to operate the CCPI pipeline, the line could fall within federal jurisdiction on the basis of an earlier decision of the Judicial Committee in Luscar Collieries Ltd. v. McDonald, [1927] 4 D.L.R. 85. In that case, the fact that the Luscar railway line was part of a continuous system of railways operated together by the CNR was critical to the finding that it was subject to federal jurisdiction.

In Dome Petroleum Ltd. v. National Energy Board (1987), 73 N.R. 135, the Federal Court of Appeal upheld the Board's determination that storage caverns owned by the pipeline joint venture fell within federal jurisdiction under s. 92(10)(a) of the *Constitution Act, 1867* because they were an integral and essential part of the interprovincial pipeline system. Mahoney J.A. [at p. 138] noted that whether or not facilities were integral to the Cochin pipeline system was a question of fact. Furthermore, a "situation-specific" analysis of the integral test is appropriate. In Alberta Government Telephones v. Canadian Radio-television and Telecommunications Commission, [1989] 5 W.W.R. 385 (S.C.C.), Dickson C.J. stated [at p. 410] that:

> "It is impossible, in my view, to formulate in the abstract a single comprehensive test which will be useful in all of the cases involving section 92(10)(a). The common theme in the cases is simply that the court must be guided by the particular facts in each situation, an approach mandated by this Court's decision in Northern Telecom Ltd. v. Communications Workers of Canada, [1980] 1 S.C.R. 115."

It is not sufficient that the LPSF facilities simply be an activity undertaken by Westcoast or simply relate to the Westcoast system. In Canadian Pacific Railway v. A.G. for British Columbia, [1950] A.C. 122 (Privy Council) [at p.143], it was held that the Empress Hotel which was owned and operated by the CPR was not part of the CPR's "railway" undertaking. Their Lordships reasoned that a railway company may pursue many different and perhaps unrelated activities, however, they left open the possibility that a hotel could be integral to the CPR undertaking and subject to federal jurisdiction if CPR chose to conduct a hotel solely or even principally for the benefit of travellers on its system.

The existence of a physical connection or proximity to a pipeline or an economic link between a work and an interprovincial pipeline system is also not sufficient to bring the work within the statutory definition of pipeline and federal jurisdiction. This is apparent from the comments of Dickson, C.J. in Canadian National Railway Company v. Nor-Min Supplies Limited, [1977] 1 S.C.R. 322 [at p. 332] where the Court determined that a quarry which produced crushed rock for railway ballast was not an integral part of the CNR railway system even though it was owned and operated by CNR:

> "The mere economic tie-up between the C.N.R.'s quarry and the use of the crushed rock for railway line ballast does not make the quarry a part of the transportation enterprise. The exclusive devotion of the output of the quarry to railway uses feeds the convenience of the C.N.R., as would any other economic relationship for supply of fuel or materials or rolling stock, but this does not make the fuel refineries or depots or the factories which produce the materials or the rolling stock parts of the transportation system."

It is accepted by the parties, and amply supported by the jurisprudence, that mere physical connection and a mutually beneficial commercial relationship with a federal work or undertaking is not sufficient to bring these facilities within federal jurisdiction. Westcoast's ownership is not conclusive of jurisdiction: Nor-Min [at p. 333]. Nor is a previous failure to exercise jurisdiction a bar to a finding that the Board has jurisdiction: Dome [at p. 138]. In the Board's view, the resolution of the jurisdictional issue hinges, therefore, on the factual determination of whether or not the LPSF facilities are "essential" to Westcoast's system and this in turn depends upon the extent to which the "situation-specific" test may be applied in this instance.

Westcoast currently owns and operates the LPSF facilities and condensate pipeline. Despite the lack of previous ownership of the LPSF facilities, Westcoast has utilized these facilities in conjunction with its gas plant since it was constructed in 1957. At the expanded McMahon Plant the facilities are completely integrated with the other aspects of the gas processing system, particularly the lean oil system, and it is evident that the integration is more than a mere economic or efficiency-based link. The Board is persuaded that due to the specific design, operation, and configuration of the LPSF facilities, the McMahon Plant cannot operate without the LPSF facilities. The Board considers this situation to be similar to that in Dome where the storage caverns were found to be part of the Cochin pipeline system because it could not operate in the manner contemplated without the use of the storage caverns.

The Board is cognizant of the fact that the facilities could have been designed otherwise and that they could be modified, albeit expensively, to separate the fractionation facility and reduce its integration with the lean oil system. This fact, however, is not in and of itself determinative of a lack of jurisdiction and the Board particularly notes the comments of the Judicial Committee of the Privy Council in A.G. for Ontario v. Winner, [1954] A.C. 541, as referenced in Dome [at p. 139] that:

> "*The question is not what portions of the undertaking can be stripped from it without interfering with the activity altogether; it is rather what is the undertaking which is in fact being carried on*. ... and their Lordships do not agree that the fact that [the undertaking] might be carried on otherwise than it is makes it or any part of it any the less an interconnecting undertaking." (*emphasis added*)

The Board, therefore, agrees with Westcoast that the jurisdictional issue cannot be resolved on the basis that the LPSF facilities might be operated by other persons or in some other way which does not attract the Board's jurisdiction. Rather, the Board accepts that in view of the unique design, operation and, particularly, in view of the history of the McMahon Plant, the stabilization and fractionation processes are essential to Westcoast's pipeline operation. The Board is persuaded that, unlike the NGL Plant, the configuration of these LPSF facilities is such that they cannot be operationally segregated. The Board gave weight to the fact that the facilities have been necessary for, available to and utilized in Westcoast's operation since 1957. These facilities are now owned, operated and controlled by Westcoast for the benefit of its shippers in producing pipeline quality gas and in enhancing the effective, efficient functioning of its gas transmission system. The condensate pipeline, which facilitates the delivery of the liquids processed in the McMahon Plant LPSF facility is, as well, a necessary adjunct and integral component of the overall system.

In the Board's opinion, the comments in Nor-Min, and particularly the following comments of Mahoney J.A. in Dome [at p. 140], provide additional support for the proposition that these facilities are integral to Westcoast's pipeline system and that they should be subject to the jurisdiction of the Board:

> "The terminalling facilities of a pipeline, whoever provides them and whatever the ultimate destination of shipments, are provided solely for the benefit of shippers on the line. In my opinion, when they are provided by the owner of the transportation undertaking, they are part and parcel of that undertaking. That is the case here. The joint venture's storage caverns are an integral and essential part of its Cochin system."

Decision

The Board finds that Westcoast's LPSF facilities located at Taylor, British Columbia and the condensate line which is connected to the LPSF facilities are subject to the Board's jurisdiction. This is essentially a factual determination. Considering the unique nature, design and history of the Westcoast system, the Board is satisfied, in this instance, that these particular facilities are integral and essential to Westcoast's system. The Board finds that these facilities are part of, and are utilized in an integrated fashion in the day-to-day operation of, the Westcoast pipeline system and that they are subject to regulation by the Board.

4.2 Gas Plant in Service

Details of Westcoast's actual rate base for 1991, and applied-for and approved (as estimated by the Board) rate base for the 1992 test year are shown in Table 4-1. As a result of the Board's adjustments to the applied-for rate base, as discussed in the following sections of this chapter, the 1992 test year rate base will be 24.7 percent greater than the 1991 actual. Almost half of the increase reflects transfers to gas plant in service ("GPIS") in 1991 which are included in rate base for the full 12 months of 1992 and the balance of the increase results from forecast transfers to GPIS in 1992 . In Chapter 13, the Board has directed Westcoast to revise its 1992 test year rate base to reflect the Board's decisions as set forth in these Reasons for Decisions.

Intervenors expressed concern regarding the cost overruns associated with: the McMahon Plant Expansion project; overruns incurred on several other smaller projects; the prudency of Westcoast's purchase of Petro-Canada's LPSF facilities at the Taylor complex; and the inclusion of certain plant additions Westcoast expected to complete in 1992.

Table 4-1
1991 Base Year, 1992 Test Year Applied-for and Approved
Average Rate Base[1]
($000)

	1991 Actual	**1992 Applied-for[2]**	**Board Adjustments**	**1992 Approved (Estimated)[3]**
Gas Plant in Service	1,535,688	1,811,241	-	1,811,241
Accumulated Depreciation	(610,519)	(647,891)	3,249	(644,643)
Net Plant in Service	**925,169**	**1,163,350**	**3,249**	**1,166,599**
Net Plant in Service Adjustment		(12,875)	(41)	(12,916)
Contributions in Aid of Construction	(4,400)	(4,403)	-	(4,403)
Plant Investment	**920,769**	**1,146,072**	**3,208**	**1,149,280**
Materials and Supplies	21,792	26,764	-	26,764
Line Pack Gas	3,798	3,912	-	3,912
Prepaid Expenses	4,005	4,327	-	4,327
Deferrals	(2,921)	2,920	-	2,920
Grizzly Valley Tax Reassessment	17,028	17,084	(17,084)	-
Deferred Income Taxes	(73,733)	(70,045)	(3,688)	(73,733)
Lost and Unaccounted for Gas	-	2,004	(2,004)	-
Average Rate Base Exclusive of Cash Working Capital	890,738	1,133,038	(19,568)	1,113,470
Cash Working Capital	11,031	10,641	-	10,641
Average Rate Base	**901,769**	**1,143,679**	**(19,568)**	**1,124,111**

1 Net of Alberta (Zone 5) Facilities
2 Application dated 12 December 1991, as revised on 1 May 1992 (Exhibit B-81)
3 Impact of certain Board decisions which affect rate base, including the removal of certain capital projects from GPIS, not included

Note: Totals may not add due to rounding.

4.2.1 McMahon Plant Expansion Project

On 6 June 1990, Westcoast applied to the Board pursuant to section 52 of the Act for a certificate to construct additional gas processing and sulphur recovery facilities at the existing McMahon Plant. The application included modifications to the inlet separators, a new amine train, a new hydrocarbon and water dewpoint control unit, a new condensate stabilizer and a new hydrocarbon liquids fractionation unit and associated storage and loading facilities.

A public hearing was conducted in Fort St. John, British Columbia on 20 and 21 August 1990, and subsequently the Board released its GH-5-90 Reasons for Decision and Order XG-11-90 approving the construction of the facilities.

4.2.1.1 Facilities Constructed by Westcoast

At the time of the GH-5-90 hearing, the cost for the McMahon Plant expansion was estimated at $85.9 million. Westcoast submitted that the overall expected accuracy of this cost estimate was plus or minus 30 percent. This was due to the preliminary development state of the project. Westcoast testified that more accurate cost estimates, based on a final design of the McMahon Plant expansion, would be available in December 1990, subsequent to the hearing. This cost estimate was reduced to $72.2 million in February 1991, when Westcoast decided to replace some of the facilities approved by the Board for the McMahon Plant expansion with facilities to be purchased from Petro-Canada. An updated cost estimate of $104.4 million was submitted to the Board on 6 March 1991, along with a schedule explaining the variance between estimates provided in the GH-5-90 proceeding and the 6 March 1991 update.

During the hearing, CPA and IPAC conducted extensive cross-examination on Westcoast's cost estimation process, tendering process, the engineering costs and installation costs associated with the facilities constructed by Westcoast for the expansion. CPA argued that the expansion project was carried out in a hurried and imprudent fashion, and CPA and IPAC both recommended that the Board allow into GPIS only $81,482,700 of the $102 million in actual costs incurred by Westcoast. This figure was derived from the $72.2 million estimate provided by Westcoast at the time of its purchase of the Petro-Canada facilities, less $9 million included in this estimate as a contingency for overruns and omissions, plus a 30 percent overrun added to the remaining base amount of $63.2 million, as an allowance for the plus or minus 30 percent expected accuracy interval of the original cost estimate. CPA and IPAC also cited as examples of imprudency the use of a factored estimate based on 1 percent engineering effort, the fast-tracking of the project, and the current under-utilization of the expansion project as further justification for not allowing into rate base the full project cost.

Westcoast reiterated that the Board should consider its final design estimate of $104 million, and not its "preliminary" design estimate of $85 million in evaluating the project cost. Thus Westcoast argued that the McMahon Plant expansion was completed on time and substantially on budget.

Views of the Board

The Board agrees with Westcoast that, in the light of the circumstances under which this project was undertaken, little weight can be placed on Westcoast's original cost estimate. The McMahon Plant expansion project was approved by the Board with the knowledge that the original cost estimate was preliminary and, as such, was subject to variation. The Board notes that upon the completion of a project, the primary issue to be examined in a toll hearing is whether the cost for a project was prudently incurred. As part of this examination, the Board may take into consideration the final cost in comparison with various cost estimates, which may lead to information about the prudency of the funds spent as well as the efficacy of Westcoast's project management and cost control measures. Based on the evidence before it, the Board is satisfied that the Applicant has discharged its burden of proof and is persuaded that the costs for this project were incurred prudently.

Decision

The Board approves for inclusion in GPIS an amount of $102,056,000 for the McMahon Plant expansion facilities constructed by Westcoast under Order XG-11-90.

4.2.1.2 Facilities Acquired from Petro-Canada

In January 1991, the Board received an application from Westcoast to purchase from Petro-Canada certain facilities located adjacent to the McMahon Plant. Petro-Canada had announced that it intended to close its refinery at Taylor, B.C. The proposed purchase included Petro-Canada's LPSF facilities, water effluent facilities, a hydro substation and other buildings and equipment, at a cost of $20,350,000. The purchase of these facilities would replace some of the facilities that the Board had approved for construction under Order XG-11-90.

The application to purchase the Petro-Canada facilities included $4.2 million for Petro-Canada's existing LPSF facilities, $7 million for the upgrade of these facilities by Petro-Canada to Westcoast's specifications, $3 million for the water effluent facilities, $1 million for a hydro substation and $5.2 million for other buildings and equipment. The Board approved the purchase and upgrade of the Petro-Canada facilities under Orders MO-9-91 and XG-12-91.

At this hearing, CPA argued that a performance test as stipulated in the purchase agreement had not been performed by Westcoast. CPA noted that there was no stress corrosion cracking inspection of the stabilizers, no independent evaluation of the value of the facilities and no environmental audit of the facilities performed. It suggested that this combination of omissions served to indicate that there was a much lower standard of care exercised by Westcoast than what one would expect in the case of a prudent purchaser. CPA also argued that the incremental liquid volumes which the McMahon Plant expansion was designed to handle have not materialized. In the opinion of CPA, this indicated that the $7 million upgrade of the LPSF facilities was not justified. Thus CPA suggested a total exclusion from rate base of the purchase price paid for assets acquired from Petro-Canada. In addition to the purchase price, CPA also recommended the exclusion from rate base of other expenditures associated with the Petro-Canada facilities, including $336,000 in legal and survey costs, $1.98 million in sunk design and cancellation charges related to the LPSF facilities which were part of the original McMahon Plant expansion project, $1.5 million for the water effluent treatment facilities, $1.5 million for the butane storage facilities included in the McMahon Plant expansion, $655,000 for a condensate line and $38,000 for air-monitoring equipment.

COFI contended that the purchase was not at arm's length. It suggested that normal due diligence had not been conducted by Westcoast with respect to this purchase, and recommended that any environmental liability incurred by Westcoast as a result of purchasing the Petro-Canada facilities should not be borne by tollpayers. It also recommended that the Board order an environmental audit of the purchased facilities at this time.

BC Gas argued that the purchase price was excessive considering the age of the facilities and the future environmental implications that could be associated with the purchase. BC Gas argued that the price paid was not a true negotiated price, in that it appeared to be based primarily on costs avoided by Westcoast and on the fact that Westcoast would not be required to build certain facilities which were part of the original McMahon Plant expansion project. BC Gas contended that there was no real market value placed on the purchased facilities, and that Westcoast should have been motivated to negotiate a much lower price, based on its knowledge that Petro-Canada intended to close its oil refinery. In summary, BC Gas argued that there was an "abysmal failure by Westcoast to exercise the normal degree of prudence expected of a utility in an asset acquisition for rate base". It recommended that no LPSF costs be allowed into rate base. With regard to the water effluent facilities, the hydro substation and the miscellaneous buildings, BC Gas argued that, should the Board allow them into rate base, it had to be on the condition that any future environmental costs and any future maintenance costs attributable to the age of the facilities would not be charged to tollpayers.

Petro-Canada recommended that a portion of the LPSF capital costs be deferred and excluded from rate base at this time, since the facility is currently under-utilized. The percentage of costs deferred from rate base could be addressed annually, based on the current utilization of the facility.

Westcoast testified that Fluor Daniel Canada Inc. ("Fluor Daniel"), an engineering firm, provided an estimate of the cost to upgrade the LPSF facilities. Fluor Daniel estimated that it would have cost at least $12.5 million for any company other than Petro-Canada to do the upgrades. The Company also argued that the purchase of the

Petro-Canada water treatment facilities was justified since the facilities had been jointly used by Westcoast and Petro-Canada prior to the closure of the Petro-Canada refinery. Westcoast estimated that the construction cost of a new facility meeting Level A effluent standards would be approximately $10.5 million. Likewise it argued that the purchase of the hydro substation at a cost of $1 million was necessary to meet the increased electrical power demand resulting from the McMahon Plant expansion, and that the construction of a new substation would have cost $1.2 million. The additional buildings purchased for $5.2 million had been used by Westcoast prior to the closure of the Petro-Canada refinery, and Westcoast estimated that the replacement cost for these facilities would have been $6.8 million for the buildings alone, and an additional $1.7 million for the building contents, vehicles and equipment.

Westcoast testified that it did not perform an environmental audit of the facilities at the time of purchase. The Company indicated that the terms of the purchase and sales agreement adequately provide for the allocation of future environmental liability between itself and Petro-Canada. Westcoast also submitted that, because the purchased facilities were in operation, it was only possible to perform an external visual inspection of the facilities during the 30-day inspection period specified in the purchase contract. However, internal inspections of the equipment were carried out where possible by Westcoast personnel during total plant outage.

Views of the Board

One of the questions raised in this proceeding was whether $4.2 million was a "reasonable" price for Westcoast to pay for the existing 35-year old LPSF facilities. The $4.2 million figure was determined by reference to an arrangement between Petro-Canada and Amoco, wherein Amoco was given the right of first refusal to purchase the LPSF facilities, in the event that Petro-Canada decided to discontinue operation of the facilities. The Board finds this to be an adequate indication of fair value for the original LPSF facilities and is of the view that no compelling evidence was adduced to suggest that $4.2 million was not a reasonable purchase price for these facilities, especially in the light of the cost of other alternatives available to Westcoast. The Board also considers $7 million a reasonable cost for the upgrade of the LPSF facilities performed by Petro-Canada, when compared to the $12.5 million estimate provided by Fluor Daniel.

The Board notes that Westcoast did not seek an independent valuation of the remainder of the purchased facilities. Instead, Westcoast had relied mainly on costs avoided by not having to construct or purchase new facilities as justification for the prudency of the purchase price of the Petro-Canada facilities. While the evidence adduced in this proceeding has not led the Board to conclude that these expenditures were imprudently incurred, the Board is concerned that Westcoast has relied on internal assessments only.

The Board is mindful of the potential future environmental liability which Westcoast might incur as a result of the purchase of these facilities and is concerned that an environmental audit for the purpose of assessing the risk of any future environmental liability was not carried out by Westcoast. In addition, the Board is concerned that a stress corrosion cracking inspection of the stabilizer vessels was not performed. In the absence of baseline data at the time of purchase, it may be difficult for Westcoast to demonstrate to the Board in the future that any cracks in the stabilizer vessels or environmental contamination at the site occurred after the purchase of these facilities by Westcoast.

Decision

The Board approves for inclusion in GPIS the amount of $20,116,000 paid by Westcoast for the purchase and upgrade of the Petro-Canada facilities under Order XG-12-91.

4.2.2 Capital Cost Overrun Report

The Company's 1992 toll application included a Capital Cost Overrun Report, which listed all projects that had a cost overrun in excess of the greater of $50,000 or 10 percent of the estimated cost provided to the Board at the time Westcoast applied for these facilities, and an explanation for each cost overrun. This overrun report was included in accordance with a direction of the Board in its RH-1-90 Reasons for Decision.

Having reviewed the projects included in this report, CPA suggested that several of the cost overruns were incurred imprudently. CPA recommended that only the original estimated amount of $1,342,000 for the acid gas compressor be allowed into rate base, rather than the forecasted final cost of $2,094,000. CPA also suggested that the overruns for the replacement of the crossover pipe at the Grizzly Valley Pipeline, and overruns for the waste heat boiler steam separators at the Pine River Plant, warranted careful review by the Board.

IPAC suggested that the Board should order Westcoast to report overruns of over 5 percent or $10,000 to the Board and interested parties. The association was concerned that Westcoast apparently does not monitor cost overruns of lesser amounts or percentage variances than currently required by the Board unless the total of these cost overruns is significant.

Westcoast contended that the costs of all projects were fully justified. It argued that the majority of cost overruns incurred were due to revisions to the preliminary cost estimates submitted by the Company at the time of applying for approval under Part III of the Act. Such revisions often resulted from the completion of project engineering and design. Other cost overruns were attributed to changes in the complexity of a project from that envisaged at the time of Board approval and to delays caused by suppliers or contractors which in turn necessitated changes in projects to accommodate Westcoast's narrow outage windows for its plants.

Views of the Board

The Board recognizes that regulatory approvals under Part III of the Act are often based on very preliminary engineering and cost estimates, and notes that a difference between an original cost estimate and the final cost is not in and of itself evidence of poor cost control or imprudence. While the Board finds Westcoast's explanations of 1992 capital cost overruns to be reasonable, it encourages Westcoast to endeavour to submit more complete cost estimates in the future, where feasible.

The Board considers that requiring Westcoast to report and explain its overruns of 5 percent or $10,000 would lead to an unnecessary level of detail. The Board is concerned with Westcoast's failure to apply under section 21 of the Act for a variation of a Board decision in cases where the reason for a cost overrun is the result of a significant change in the scope of a project from that originally approved by the Board. The Board reminds Westcoast that approval of a cost overrun is a matter to be handled under Part IV of the Act (i.e. in a toll proceeding), while approval of a change in scope involving a change in the design of a project is required through an amending order, made under section 21 of the Act.

> **Decision**
>
> **The Board approves for inclusion in GPIS the costs of the projects included in Westcoast's Capital Cost Overrun Report.**

4.2.3 Plant Additions Transferred to Gas Plant in Service

In respect of plant additions during the test year, Westcoast provided a list of construction projects that it expected to complete in 1992 and forecast amounts of completed plant costs transferred each month to GPIS. Some of the projects the Company expected to be completed in 1992 had not been approved by the Board as of the date of its 1992 tolls application or, in some instances, the application had not been made.

Westcoast was of the view that the projects to be included in the 1992 test year rate base should include those projects already approved by the Board under Part III of the Act at the time of its decision in the RH-1-92 proceeding. EUG opposed the inclusion in GPIS of those projects for which Westcoast had not received Part III approval as of the beginning of the test year. EUG cited the Board's decision in the RH-1-90 Reasons for Decision that directed 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. EUG argued that Westcoast's proposal for a floating cut-off date approach was not consistent with the forward test year regulatory framework in use for Westcoast since 1986. Under this regulatory approach, the Applicant is obliged to make, in advance of the test year, a forecast of what will be added to the GPIS during the year. Such a forecast should not include projects not yet approved, as established by the Board in its RH-1-90 Reasons for Decision. In reply, Westcoast noted that the RH-1-90 Reasons for Decision was issued in January 1991 in respect of the 1991 test year whereas the Board's Reasons for Decision in the RH-1-92 proceeding would not be issued until some time into the 1992 test year.

Views of the Board

The Board is of the view that for the purposes of determining plant additions to GPIS during the test year, it should use the most current information available. Accordingly, the Board is prepared to accept for inclusion in forecast plant additions, those projects which have been approved under Part III of the Act at the time that the Board rendered its decisions in this proceeding.

Decision

The Board directs Westcoast to remove from the applied-for GPIS the forecast amounts for projects which have been denied or which have not as of 1 August 1992 been approved by the Board under Part III of the NEB Act.

4.2.4 Net Plant in Service Adjustment Factor

As directed in the RH-2-87 Reasons for Decision, for the purpose of alleviating the Board's concern that the costs of actual plant additions tend to be lower than the approved forecast, Westcoast adjusted downward the forecast net plant in service ("NPIS") by 1.248 percent or by $12.9 million reflecting a moving five-year (1987-91) average of variances between the forecast and actual NPIS. In accordance with the Board's direction in the RH-1-90 Reasons for Decision, Westcoast excluded from the NPIS Adjustment Account the capital cost of the McMahon Plant expansion. As well, since the Company requested deferral treatment for the LPSF, the hydro substation and the water effluent facilities purchased from Petro-Canada, the net plant related to those items was also excluded from the NPIS Adjustment Account.

Intervenors expressed no concerns regarding this adjustment.

Decision

The Board accepts the NPIS adjustment factor of 1.248 percent for the 1992 test year.

4.2.5 Allowance for Funds Used During Construction

For the 1992 test year Westcoast applied for a revision to its methodology for calculating Allowance for Funds Used During Construction ("AFUDC"). The Company proposed to compound the monthly AFUDC by including the previous month's AFUDC in the AFUDC base. Previously, Westcoast calculated the AFUDC using 1/12th of the applied-for rate of return on rate base and the average monthly balances of the construction work in progress, that is, there was no compounding of AFUDC. The proposed compounding methodology increased the 1992 test-year AFUDC from $6.125 million without compounding to $6.386 million, or by $261,000. The Company contended that by not compounding AFUDC, the cost of financing the AFUDC was borne by its shareholders and that the revised methodology would place AFUDC on the same footing as return on rate base which was also collected monthly by Westcoast. It argued that the proposed methodology was consistent with the compounding methodology approved by the Board for TCPL in the RH-1-91 Reasons for Decision. The Company acknowledged that the compounding would result in an effective AFUDC rate higher than the rate of return on rate base. The Company, however, indicated that it would not delay completion of projects in order to earn the extra return on AFUDC.

CPA opposed Westcoast's proposal to compound its AFUDC monthly. It argued that the proposal results in gas plant under construction earning a higher rate of return than GPIS.

Views of the Board

The Board considers that the proposed inclusion of the previous month's AFUDC in the cost base, which has the effect of allowing Westcoast to compound AFUDC, is appropriate as it provides a reasonably close approximation of the Company's borrowing costs.

> **Decision**
>
> **The Board approves, for the purpose of calculating AFUDC for the 1992 test year, Westcoast's request to include the previous month's AFUDC in the cost base.**

4.3 Materials and Supplies

Materials and Supplies ("M & S") were forecast to increase by $4.5 million (19 percent) in the 1992 test year over the 1991 base year. Westcoast explained that the major reason for this was the aging of heavy equipment. Much of this equipment is no longer manufactured. To ensure the continuing reliability of the system the Company believed that it is necessary to acquire additional machines and parts as they become available to serve as spare parts. In addition throughput has increased requiring a larger inventory of supplies and materials.

EUG objected to the substantial increase in M & S on the grounds that in the RH-1-90 Reasons for Decision, Westcoast was granted a $3.1 million increase for spare parts of equipment that is no longer manufactured but still in use on the Westcoast system. The group was of the opinion that a significant portion of the increase requested by Westcoast had already been granted in RH-1-90 and that the level of spare parts was excessive and unnecessary. EUG recommended that the Board disallow $3.1 million of the requested increase.

CPA was concerned with the low inventory turnover ratio which was forecast at 45 percent for the 1992 test year, the high level of inventory relating to aged machines and the effect this would have on rate base when those machines were replaced. The association argued that no increase should be allowed in the M & S inventory.

Decision

The Board considers that the increase in M & S inventory for the test year, while substantial, is reasonable in the light of the circumstances faced by Westcoast and the Board approves for inclusion in the 1992 test-year average rate base an amount of $26.8 million.

4.4 Prepaid Expenses

The only issue raised with regard to prepaid expenses was pension accruals. Westcoast estimated that pension accruals would decrease from an average 1991 base year amount of $2 million to a zero monthly balance throughout the 1992 test year. The Company explained that this was a result of making pension payments on a monthly basis. CPA questioned this method of accounting for pension expenses for two reasons. First, Westcoast made the same assumption for the 1991 test year but, in fact, Westcoast did not make monthly payments in that year. Secondly, pension expenses are payable only in March of the following year for tax purposes and CPA argued that they therefore do not result in a monthly cash outflow.

Views of the Board

The Board notes that Westcoast provided a schedule detailing monthly pension payments in this proceeding and accepts the Company's assertion that it would make pension payments on a monthly basis in 1992.

Decision

The Board accepts Westcoast's approach of accruing pension payments on a monthly basis in the 1992 test year and approves the $4.3 million average test year balance for prepaid expenses.

4.5 Gas Management System

Westcoast testified that Phase I of the gas management system project had been completed in November 1991, on time and on budget and that Phase II of the project is to be completed in 1992. The Company's application included in rate base $2,815,000 for Phase I and $712,000 for Phase II of the project for the 1992 test year.

CPA and IPAC both expressed concerns with the performance of the gas management system. CPA argued that as the system is not yet operating properly the costs should not be included in rate base.

Views of the Board

The Board does not consider the problems experienced by Westcoast in implementing the Gas Management System unusual for a project of this nature.

Decision

The Board approves the requested amounts of $2,815,000 for Phase I and $712,000 for Phase II of the Gas Management System for inclusion in rate base.

Chapter 5

Depreciation

Westcoast applied for new depreciation rates which would increase the composite rate from 2.1 percent in 1991 to 2.6 percent in 1992. The applied-for depreciation expense of $46.3 million represents an increase of $14.3 million or 44.7 percent over 1991. Of the $14.3 million, approximately $8.2 million is due to proposed increases in depreciation rates while the balance results from an increase in rate base.

5.1 The 1990 Depreciation Study

The proposed depreciation rates were provided in a depreciation study based on 1990 gas reserves and production filed by Westcoast in March 1991 ("the 1990 Depreciation Study"). The Company carried out this study in response to a Board directive in the RH-2-89 Reasons for Decision.

Westcoast's current depreciation rates are based on a methodology approved by the Board in its RH-6-85 Reasons for Decision. Under the approved methodology, net depreciable plant in a given rate base section is divided by the reserve life index of the gas available to that section to yield annual depreciation expense. This amount is then divided by the gross plant in service for that section to obtain the depreciation rate. For the purpose of calculating reserve life index, Westcoast is required to include proved gas reserves presently connected to its pipeline system, unconnected proved reserves as well as a provision for trend gas. However, in calculating depreciation rates, the costs of connecting such unconnected gas and trend gas are not included. In this proceeding, Westcoast argued, as it did in the RH-6-85 proceeding, that it is not appropriate to include unconnected proved gas reserves and trend gas without also including the estimated cost of connecting such gas.

The 1990 Depreciation Study examined three different depreciation cases. Case 1 was based on reserve life indices which include proved gas, both connected and unconnected, but exclude trend gas. The applied-for depreciation rates are based on Case 2 of the study which is consistent with the Board's approved methodology. In Case 2, Westcoast calculated reserve life indices using estimates of reserves which included proved reserves, both connected and unconnected, plus a ten-year forecast of future reserve discoveries (trend gas) and using production rates at the actual 1990 levels. The time at which the assets would become obsolete or uneconomical to operate was set as the upper limit of a reserve life index to a maximum of 40 years. According to Westcoast, the maximum of 40 years is a generally accepted industry standard and is used in situations where the expected useful life of an asset exceeds 40 years but cannot be reliably estimated and clearly demonstrated. To derive the applied-for depreciation rates, historical plant costs as at 1990 year-end were used.

Case 3 uses the same methodology as Case 2 to calculate reserve life index. However, an estimate of the future capital cost of maintaining and replacing the existing pipeline system over the next 10 years was added to the depreciation base.

Westcoast stated that the applied-for increase in composite depreciation rate was largely due to a decline in reserve life indices caused by the increase in annual production from 239 billion cubic feet ("Bcf") in its 1985 Depreciation Study to 406 Bcf in the 1990 Depreciation Study. This increase in the denominator is only partially offset by the increase in the proved and trend gas reserves which went from 9.3 trillion cubic feet ("Tcf") in the 1985 study to 11.95 Tcf in the 1990 study.

For miscellaneous plant facilities, such as field offices and other support facilities, a proposed composite depreciation rate was determined on the basis of the ratio of total depreciation expense to total gross plant for all the pipeline and processing plant sections. Depreciation rates for general plant, including office furniture and equipment, tools and transportation equipment, were calculated using estimated useful life and other methods.

The 1990 Depreciation Study did not include any provision for the effect of negative salvage, which would continue to be recorded on an as-incurred basis.

5.2 Estimates of Gas Reserves

Westcoast's forecast of gas reserves available to its system (proved gas reserves plus 10-year trend gas) was 339 10^9m^3 or 11.95 Tcf as at 1990 year-end. This estimate included gas available to the Westcoast system from northeastern British Columbia and the Territories but excluded the Deep Basin and Ring-Border supply areas since gas from these areas is directed to the system of NOVA Corporation of Alberta.

Westcoast indicated that its estimates of proved reserves included probable reserves for cases where detailed assessments for specific pools were available. Regarding trend gas, the Company stated that its assessment was based on historical finding rates for large supply areas and on an average of proved reserves per well combined with a projection of industry activity for smaller geographical and lesser developed areas. Upon request by the Board, Westcoast also filed the Company's estimates of remaining undiscovered potential for its gas supply areas by rate base sections as at 1990 year-end.

CPA contended that insufficient independent analysis on Westcoast's estimates of reserves had been conducted and that the matter of reserves estimation for depreciation purposes should be deferred until technical discussions had been completed. On 12 March 1992 the association filed a motion seeking to remove the depreciation rate issue from this proceeding. This request was denied by the Board. During the hearing, CPA filed another motion asking the Board to require Westcoast to provide a further response to its request for information on established reserves or, in the alternative, information on ultimate potential gas reserves. After obtaining clarification from Westcoast on its gas reserves data by way of an information request, on 15 April 1992 the Board ruled that Westcoast had satisfactorily answered the alternative request of CPA.

On 21 April 1992, CPA filed supplementary evidence on depreciation. Based on its understanding of previous Board decisions the association contended that Westcoast's approach of restricting trend gas to a 10-year forecast of reserve discoveries was inconsistent with Board directives. In CPA's opinion, trend gas should include any gas which is anticipated to be found at any time in the future and which could be transported on Westcoast's pipeline system. On this basis, CPA replaced the Company's 10-year trend with Westcoast's estimate of remaining undiscovered potential as of 31 December 1990 and derived its own schedule of depreciation rates applicable to Westcoast. In all other respects, including a 40-year cap on reserve life, the same methodology as employed in the 1990 Depreciation Study was used. This approach yielded a composite depreciation rate of 2.0 percent for total plant and 1.6 percent for the pipeline system, using 1990 year-end plant balances as the depreciation base. CPA argued that Westcoast's estimate of remaining undiscovered potential is the better estimate of gas that would be available to the pipeline. CPA also pointed to many recent public announcements of discoveries and studies indicating greater potential reserves. These factors had not been reflected in Westcoast's estimates of reserves provided in the 1990 Depreciation Study.

CPA recommended that the Board adopt the composite depreciation rate for the pipeline system of 1.6 percent shown in its supplementary evidence. Further, CPA argued that technical discussions involving interested parties in an appropriate forum, such as the Task Force, or an ad hoc technical committee, should be undertaken.

IPAC also believed that there was insufficient independent analysis of the estimates of gas reserves underpinning the 1990 Depreciation Study. IPAC submitted that the gas reserves used in the study were too low. Therefore, the matter of depreciation rates should be deferred to the 1993 tolls hearing. In the alternative, IPAC argued, the Board should use Westcoast's estimate of remaining undiscovered potential because IPAC agreed with CPA that those figures are the best evidence of gas available to the Westcoast system. IPAC recommended that the Board reduce Westcoast's composite depreciation rate for the pipeline system to 1.6 percent as proposed by CPA. IPAC also supported CPA's proposal for a technical task force to review estimates of reserves and the appropriateness of the production assumptions used.

COFI argued that the depreciation issue be further deferred to allow for technical discussion and analysis regarding reserves and that no change in depreciation rates be made. EUG argued that the Board's decision in the RH-1-84 Reasons for Decision respecting TCPL's depreciation provides a clear precedent for using remaining undiscovered potential as the appropriate measure for reserve life. EUG recommended that the Board accept the 2.0 percent composite rate for total plant proposed by CPA and that the matter of gas reserves be addressed by the Task Force and brought back to the Board for adjudication at the next rate hearing.

In reply argument, Westcoast indicated that accepting intervenors' recommended depreciation rates based on remaining undiscovered potential reserves would be unfair to the Company because that would represent a change in methodology. Westcoast had understood that depreciation methodology would not be an issue in this case. Further technical discussion concerning reserves would only delay matters without serving any useful purpose.

Furthermore, Westcoast argued that by comparison with the 2.5 percent depreciation rate that the Board approved for TCPL, the Company's proposed rate of 2.6 percent is appropriate, particularly in the light of the fact that processing plants make up over 50 percent of its depreciable assets.

5.3 Views of the Board

The Board is persuaded that Westcoast's applied-for depreciation rates for general plant, which generally reflect the useful life of the underlying assets, are reasonable.

The Board continues to be of the view that depreciation rates for Westcoast's pipeline system should be set by reference to gas reserves available to the Company's system, including a provision for future discoveries. In this regard, the Board considers the Company's estimate of gas reserves, except for the specific instances discussed below, acceptable.

With respect to undiscovered potential or future discoveries (trend gas) that should be considered for depreciation purposes, the Board notes that Westcoast has used a 10-year forecast, as was done in the Company's 1985 Depreciation Study, which was considered in the RH-6-85 proceeding. The Board also recognizes the uncertainty associated with forecasts of this nature. The Board therefore considers it inappropriate to set depreciation rates on the basis of the total remaining undiscovered potential reserves as suggested by CPA. On the other hand, the Board is of the view that Westcoast's estimate of undiscovered potential is overly conservative for the purpose of setting depreciation rates. Specifically, the Board is persuaded that Westcoast's approach of basing its assessment on historical gas finding rates for large supply areas and on average proved reserves per well and projected industry activity for small, less developed areas could underestimate future discoveries. Furthermore, the Board is concerned that Westcoast's current assessment of undiscovered potential may not fully reflect available information. For these reasons, the Board has given weight to gas reserves data used in preparing its June 1991 study "Canadian Energy Supply and Demand, 1990-2010".

Based on evidence adduced in this proceeding, the Board accepts Westcoast's applied-for depreciation rates for obsolete compressor equipment, and for the Beaver River, Pointed Mountain, Aitken Creek and Fort St. John gas gathering systems as well as the Grizzly Valley raw gas and mainline systems. The Board also accepts the applied-for rates for the 16-inch and the 26-inch pipelines. Further, the Board is satisfied with the applied-for depreciation rates for Boundary Lake and Pine River processing plants.

The Board is of the view, however, that the depreciation rates for the Alces Pipeline, Sikanni Pipeline, and Fort Nelson raw gas transmission system as well as the Sikanni, McMahon-Aitken Creek and Fort Nelson processing plants should be lower than the applied-for rates. In reaching this conclusion, the Board has relied on its higher estimates of remaining established reserves.

As for the remaining three mainline rate base sections (Fort Nelson mainline, Station 1 to 2 and Station 2 to Huntingdon), the Board is of the view that lower depreciation rates than those applied for are appropriate. The Board has included a somewhat greater provision for undiscovered potential for these sections than the 10-year trend gas estimate used by Westcoast. The Board believes that the mainline transmission system would continue to operate as long as sufficient volumes of gas are available to be transported from the Westcoast system's supply areas to gas consuming areas within British Columbia and in export markets. The Company's system is the principal transmission system capable of transporting large volumes of gas from remote regions of British Columbia and the Territories. Nevertheless, in the light of the uncertainties involved in estimating reserves far into the future, the Board has also used a 40-year cap on estimated reserves life.

Regarding the inclusion of future capital additions for the purpose of calculating depreciation rates, the Board continues to be of the view that including such costs would result in depreciation rates which are excessive when they are applied to existing facilities. Current tollpayers would be put in the inequitable position of having to bear some of the costs of such facilities before they are constructed. As indicated in the RH-6-85 Reasons for Decision, in the event that the forecast facilities are never constructed, the recovery of the cost of existing facilities would be at a higher rate than would otherwise be required, resulting in an over-recovery of capital.

Decision

The Board approves, effective 1 January 1992, the new depreciation rates set out in Appendix II. These rates yield a composite depreciation rate for total plant of 2.2 percent in 1992.

Chapter 6

Deferred Income Taxes

Westcoast proposed to draw down its deferred income tax balance of approximately $73.7 million by amortizing it to cost of service on a straight line basis over a 10-year period commencing January 1992. The Company made this proposal in order to dampen the impact of the increases in tolls on its shippers. Westcoast stated that amortizing deferred taxes for the purpose of reducing increases in cost of service is appropriate in the circumstances of today, namely, that demand for increased pipeline capacity persists despite low natural gas prices and that incremental unit cost of new capacity is generally above existing toll levels. Westcoast submitted that its proposal to amortize deferred taxes is designed to be directly linked with the Company's proposed depreciation rate increases and that having regard to the Company's cash flow and other financial considerations, the rate of this drawdown should not be accelerated to less than 10 years.

Westcoast had accumulated the deferred tax balance of some $73.7 million during the years 1978-82 when the Company was regulated on the normalized basis of accounting for income taxes. Since 1983, the Board has approved the use of the flow-through income tax method. In its RH-1-83 Reasons for Decision the Board indicated that there should be no drawdown of previously accumulated deferred income taxes before crossover had occurred, at which time Westcoast might apply for a disposition of the balance. In 1984, Westcoast had applied to not draw down the accumulated deferred taxes when crossover was expected to occur in 1985. The Company's request was approved by the Board.

In this proceeding, Westcoast stated that with the construction of additional facilities in recent years, the crossover point would not be reached for some time. During the hearing, it was established that if assets in service as of 1 January 1983 were considered as a separate pool, crossover had occurred.

Regarding the question of whether the proposed drawdown would result in a departure from cost-based tolls, Westcoast stated that as a regulated utility employing the taxes payable basis to determine cost, a drawdown would restore the accounts to reflect the recording of income taxes on a taxes-payable basis for the years 1978-82. The Company contended that its proposal is no more or less a departure from cost-based tolls than is the taxes-payable method.

CPA stated that since the Board has adopted the flow-through method, maintaining the accumulated deferred taxes has resulted in a hybrid accounting treatment. Amortizing the deferred tax balance as quickly as is practicable would minimize the period over which concerns, if any, with a departure from cost-based tolls might exist. CPA took the position that intergenerational equity is best served through the use of the flow-through method and the amortization of accumulated deferred taxes. The association did not consider the amortization of deferred taxes as a method to ameliorate toll increases resulting from increased depreciation or other cost of service but rather as a "refund" to shippers who, CPA argued, had paid for an over-recovery of income taxes in higher tolls than otherwise during the period when Westcoast was regulated on a normalized tax accounting basis. CPA did not propose a specific amortization period but recommended the approach of using deferred taxes to reduce utility taxable income to zero. During the hearing, Westcoast stated that the Company could live with the CPA proposal if interested parties agreed with it.

IPAC supported a drawdown of deferred taxes in the manner proposed by CPA. The association argued that the assets employed by Westcoast to provide service at the time income taxes were collected on a normalized basis had reached the crossover point. Therefore, it would be appropriate for the Board to allow a drawdown. Further, the drawdown issue should be determined independently from proposed changes to depreciation rates. IPAC agreed with Westcoast that a drawdown of deferred taxes is not a departure from cost-based tolls.

COFI objected to connecting a drawdown of deferred taxes to an increase in depreciation and preferred the continuation of the current practice of not drawing down deferred taxes until crossover has occurred. In the alternative, should the Board approve amortization, COFI supported CPA's proposal.

Views of the Board

The deferred income tax balance of some $73.7 million which Westcoast proposed to draw down was accumulated during the period 1978 to 1982 when Westcoast was permitted to collect income taxes in the cost of service on a normalized basis. It was recognized that the collection from customers in 1978-82 of a provision for income taxes in excess of those then currently payable and the accumulation of a deferred tax balance would protect a future generation of customers from having to pay income taxes applicable to Westcoast's income (on an accounting basis) earned during a period when capital cost allowance ("CCA") claimable for income tax purposes on facilities in use during 1978-82 was higher than depreciation expense. The future generation of customers that the normalized tax method was designed to protect would be those customers using the pipeline system after crossover has occurred, i.e. when CCA would have declined below the level of depreciation expense, resulting in an income tax liability higher than that provided for in the then current tolls.

It was established in this proceeding that crossover has occurred in respect of those assets which gave rise to the accumulated deferred income tax balance. The Board is therefore persuaded that intergenerational equity would be served by allowing a drawdown at this time. In reaching this conclusion, the Board notes that virtually all interested parties supported Westcoast's proposal for a drawdown.

Regarding amortization, the Board is of the view that the rate at which the deferred tax balance is to be amortized to cost of service should take into consideration the implication of a drawdown for Westcoast's cash flow and coverage ratios. The Board considers that the amortization approach of reducing utility taxable income to zero properly balances the competing interests of parties to this proceeding. In the Board's view, this amortization approach provides for an appropriate matching of costs and revenues.

Decision

The Board approves a drawdown of the accumulated deferred income tax balance of approximately $73.7 million. Westcoast shall amortize to the cost of service commencing January 1992 the amount required to reduce utility taxable income to zero in 1992 and subsequent years until the deferred tax balance is extinguished.

Chapter 7

Capital Structure and Cost of Capital

Westcoast applied for a rate of return on average common equity ("ROE") of 13.75 percent for the 1992 test year, using a deemed common equity component of 35 percent. Details of the applied-for capital structure and requested rates of return are shown in Table 7-1.

Table 7-1

Applied-For Deemed Average Capital Structure and Rates of Return for the 1992 Test Year

	Amount ($000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Debt - Funded	694,205	57.36	11.14	6.39
- Unfunded	57,737	4.77	10.50	.50
Total Debt Capital	751,942	62.13		6.89
Preferred Share Capital	34,723	2.87	7.97	.23
Common Equity	423,589	35.00	13.75	4.81
Total Capitalization	1,210,254	100.00		
Rate of Return on Rate Base				11.93[1]

1 As filed in Exhibit B-81

7.1 Common Equity Ratio

Westcoast applied to maintain its deemed common equity ratio at the currently approved level of 35 percent.

As in the past, in determining the appropriate common equity ratio for Westcoast the Board considers primarily the business risks faced by Westcoast's utility operation, the maintenance of an appropriate balance between the debt and equity elements of the deemed capitalization, and 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 is left implicitly to underpin the Company's non-jurisdictional activities.

With respect to business risk, Westcoast was of the view that for the 1992 test year it is exposed to risks similar to those considered by the Board in the RH-1-90 proceeding. Westcoast's expert witnesses accepted the Board's risk evaluation in that case as the appropriate point of departure for their own analysis, which focused on change in risks. On the assumption that the Board would grant the requested deferral accounts, these witnesses perceived no material change to Westcoast's test-year risks since the RH-1-90 proceeding. Consequently, the witnesses believed that it is important to maintain the deemed common equity ratio at 35 percent. The witnesses also found additional support for their position by comparing the business risks of Westcoast to those of TransCanada. They concluded that in the short term there is very little difference in risks between these two companies, but that in the longer run Westcoast's risks are significantly higher. Further, this differential in risks has remained essentially unchanged.

CPA/Alberta Petroleum Marketing Commission's ("APMC") expert witness reiterated the position he took in the RH-1-90 proceeding that the appropriate range for Westcoast's deemed common equity ratio, given the Company's utility business risk, is 30 to 32 percent. In his view, the upper limit of 32 percent for Westcoast would be comparable to that of 30 percent for TCPL. The differential in the upper limits is to reflect the slightly higher longer term risks of Westcoast. In the view of this witness, Westcoast's business risks are essentially unchanged in the 1992 test year from the 1991 base year.

Regarding business risk, IPAC stated that it does not accept the premise that the Board's evaluation of Westcoast's risk in previous rate cases provides an appropriate point of departure for the 1992 test year. Based on its assessment of Westcoast's domestic and export markets and the Company's operating situation, IPAC expressed the opinion that Westcoast is exposed to very little risk for 1992. As for Westcoast's longer term business risk, IPAC submitted that there is more likelihood that such risks would fall on tollpayers rather than on Westcoast's shareholders.

COFI was of the view that Westcoast's risks have decreased because utilization of the pipeline is higher and Westcoast is no longer responsible for upstream *force majeure*.

EUG argued that there is no significant difference between the risks of Westcoast and those of TCPL.

With respect to a balance between the debt and equity elements of the deemed capitalization, Westcoast's expert witness noted that the proposed capital structure is similar to that approved in the RH-1-90 proceeding. A comparison with capital structures approved by regulatory boards for 26 major Canadian utilities indicated that, in descending order, Westcoast's debt ratio continues to lie in the top quartile, and the applied-for common equity ratio of 35 percent is below the median approved ratio of 37.3 percent.

CPA/APMC took the position that the equity ratio should be reduced by five percentage points to 30 percent and that such an adjustment would not affect the Company's financial integrity.

During cross-examination, Westcoast's expert witnesses expressed the view that such a lowering of equity ratio would be viewed negatively by bond rating agencies as the Board would be seen as departing from its practice of evaluating equity ratio in relation to business risk.

The issue of the possible cross-subsidization of the Company's non-utility operations by the utility was canvassed extensively in this proceeding. In their analysis, Westcoast's expert witnesses separated Westcoast's non-utility investments in two groups, namely, WestCoast Gas Inc. ("WestCoast Gas"), a wholly owned subsidiary used as the vehicle to hold the local distribution operations acquired from Inter-City Gas Corporation ("ICG"), and "other" investments. Regarding WestCoast Gas, the Applicant stated that the only significant change since the last toll proceeding is that the Company's equity in WestCoast Gas will increase from $171 million at the end of 1991 to $208 million by year-end 1992. Westcoast also pointed out that in the RH-1-90 Reasons for Decision the Board shared the view of the Company's expert witnesses that the financing of the ICG acquisition would not likely impair Westcoast's credit rating.

With respect to the other investments, the Applicant stated that the only change since the RH-1-90 proceeding is that it intends to have Westcoast Petroleum Ltd. ("WestPete") raise $150 million of common equity, $120 million of which will be used to reduce the Company's equity investment in WestPete making the funds available to finance Westcoast's rate base. The completion of this public offering of WestPete shares, together with other transactions planned for 1992, would effectively eliminate the debt that is attributed to WestPete and would reduce Westcoast's involvement in the oil and gas exploration and production business. The Applicant also noted that debt ratios at 1992 year-end would be reduced from their 1991 year-end levels. Westcoast was of the opinion that these developments should alleviate any concerns the Board may have regarding the financing of Westcoast's non-utility operations.

In his evidence, the expert witness for CPA/APMC included an analysis of the pro-forma capital structure of Westcoast, which assumed that the capital requirements of the utility, WestCoast Gas, Foothills Pipe Lines Ltd. ("Foothills") and Pacific Coast Energy Corp. (based on their deemed capital structure) would be met before those of the non-regulated operations. The result of this analysis indicated that Westcoast's non-regulated segment would be left with a common equity ratio of some 9 percent at 1991 year-end and about 28 percent at 1992 year-end. In argument CPA/APMC stated that Westcoast does not have sufficient common equity to support the requested 35 percent level for the utility when recognition is given to the amount of common equity that is required to ensure that its other business divisions do not increase the risks of Westcoast to the detriment of the utility tollpayers. It would be unfair to provide Westcoast with a particular equity ratio if that amount of equity is not available to support the pipeline activities.

IPAC expressed doubts that the proposed WestPete equity issue of $150 million would materialize in 1992. The evidence of the expert witness for IPAC also contained an analysis of the consolidated equity of Westcoast, which assumed that available equity would be used to support investments in the following order, the pipeline operation, the gas distribution business and then Westcoast's other activities. The result of this analysis suggests that a 35 percent deemed equity component in the pipeline operation would leave insufficient equity to underpin the non-pipeline operations.

Views of the Board

In determining the appropriate capital structure for Westcoast's utility operations, the Board is guided, among other things, by its evaluation of the business risks of the utility. Based on the evidence before it in this regard, the Board is of the view that the business risks of Westcoast's utility operations have remained essentially unchanged since the RH-1-90 proceeding. As to whether the applied-for 35 percent deemed common equity remains reasonable, the Board continues to believe that fundamental business risks inherent in the utility operations of Westcoast are somewhat greater than those of TCPL. The Board finds that the applied-for deemed common equity ratio of 35 percent is reasonable and provides an appropriate balance between debt and equity elements of the utility's capital structure. Turning to the possible cross-subsidization of Westcoast's non-utility operations by the utility, the Board is primarily concerned with whether the Company's debt cost is adversely affected by Westcoast's non-utility activities. In this regard, the Board is not persuaded that this would occur in the test year.

Decision

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

7.2 Funded Debt

Westcoast applied for a rate of 11.14 percent on its forecast funded debt balance of $694,205,000 for 1992. The dollar amount of funded debt and the associated cost rate were determined using the net proceeds methodology approved by the Board in its RH-1-90 Westcoast Reasons for Decision. No intervenor objected to the applied-for amount of funded debt or the associated cost rate.

Decision

The Board approves the Company's funded debt amount of $694,205,000 and the rate of 11.14 percent for the 1992 test year.

7.3 Unfunded Debt

Westcoast applied for a cost rate of 10.50 percent on its forecast unfunded debt balance for the 1992 test year. During the proceeding, the Company stated that it anticipated financing its unfunded debt balance with long-term debt instruments by mid-1992. The applied-for rate is based on a forecast yield of 9.25 percent for a 20-year long-term Government of Canada bond ("long-Canada") for the test year and a corporate issuance spread of 125 basis points. Westcoast relied on the forecasts provided by a number of economic forecasters. These forecasters estimated long-Canada rates for the test year that ranged from 8.69 to 9.64 percent. In argument, Westcoast noted that the forecast long-Canada rate of 9.25 percent for the test year compared favourably with the midpoint estimate provided by the expert witnesses of the Company and that of CPA/APMC, namely 9.375 percent.

Westcoast based its forecast corporate issuance spread of 125 basis points on prevailing market conditions and considered it conservative.

The expert witness representing CPA/APMC reiterated his view that Westcoast's unfunded debt balances should be costed using a long-term corporate rate and considered the Company's forecast long-Canada rate of 9.25 percent for the test year as well as the corporate issuance spread of 125 basis points reasonable.

In argument EUG was of the view that the appropriate approach in determining the unfunded rate is to combine the use of a forecast long-Canada rate of 8.8 or 8.9 percent with the proposed spread of 125 basis points.

Views of the Board

The Board agrees with parties that for Westcoast a long-term corporate rate should be used as the cost rate for unfunded debt. The Board is of the view that the approach of applying a corporate spread to a forecast long-term Government of Canada bond rate is a reasonable means of estimating that rate. In assessing the various long-Canada forecasts provided during the hearing, the Board considers that a forecast long-Canada rate in the range of 9.0 to 9.25 percent is reasonable. Further, the Board is persuaded that a corporate issuance spread in the order of 125 basis points for the test year is acceptable.

> **Decision**
>
> **The Board finds an unfunded debt cost rate of 10.50 percent to be reasonable for the 1992 test year.**

7.4 Preferred Share Capital

In its application, Westcoast continued to allocate the entire $35 million issue of 7.68 percent preferred shares to the utility operation of the Company. Using the modified net proceeds method approved by the Board in its RH-2-89 Reasons for Decision, Westcoast applied for a cost rate of 7.97 percent on a preferred share balance of $34,723,000 for the 1992 test year.

No intervenor objected to 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 $34,723,000 and a cost rate of 7.97 percent for the 1992 test year.

7.5 Rate of Return on Common Equity

Westcoast applied for an ROE of 13.75 percent. This rate was based on the test results and analysis of Westcoast's expert witnesses, who recommended an ROE in the range of 13.5 to 13.75 percent (Table 7-2). In arriving at this range, Westcoast's expert witnesses used comparable earnings, discounted cash flow ("DCF") and equity risk premium techniques.

The comparable earnings test was based on data from a sample of 28 low-risk industrial companies over the period 1983 to 1991. In the view of Westcoast's expert-witnesses, this period which comprises the last complete business cycle, is reflective of the expected business conditions during the test year. For the period 1983 to 1990 the sample companies achieved returns averaging 14.2 percent. Combining the actual result for 1983 to 1990 with an estimated return for 1991 of 7.7 percent resulted in an average return for the entire business cycle of 13.5 percent. Adjusting this rate downwards by 25 basis points to account for the lower risks of Westcoast relative to the sample companies resulted in a comparable earnings result of 13.25 percent.

In this proceeding the Company's expert witnesses placed virtually no weight on the result of their DCF analysis. The witnesses stated that in the light of the depressed earnings level of Canadian industrial companies, the current relatively high stock market evaluations are grounded on the expectation of a significant recovery of earnings. There is considerable uncertainty as to when that rise will be experienced and what the longer term growth prospects will be. Further, forecast growth rates in dividends are so low as to be incompatible with current market conditions.

For the risk premium approach, the Company's expert witnesses utilized a projected long-Canada yield of 9.25 to 9.50 percent, together with an equity risk premium over long-Canadas of 3.5 percentage points. The resulting "bare-bones" cost of 12.75 to 13.0 percent was then adjusted for market-to-book ratio considerations to produce a required return of 14.1 percent. To arrive at their final recommendation, the Company's expert witnesses relied equally on the results of their comparable earnings test and the equity risk premium technique. The witnesses had initially proposed an ROE range of 13.5 to 13.75 percent and recommended that the Board focus on the upper end of 13.75 percent. During the hearing, based on more up-to-date data, they made a slight downward revision and recommended the range of 13.5 to 13.75 percent.

CPA/APMC recommended a rate of return on equity of 12.0 to 12.25 percent for the test year, with emphasis on the lower end of the range, on a deemed common equity component of 30 percent. In making this recommendation, CPA/APMC relied on the evidence presented by their expert witness, who employed the DCF and equity risk premium techniques (Table 7-2).

In his application of the DCF technique, the witness for CPA/APMC determined the investors' required rate of return for low-risk non-utilities to be 11.0 percent. This rate implied a growth factor of 8.4 percent, given the dividend yield of 2.6 percent experienced by his sample companies. Based on his analysis concerning the lower risk of pure utilities relative to low-risk industrials, the witness reduced his initial rate by 60 to 80 basis points, resulting in a range of 10.25 to 10.50 percent. The witness decided to put less emphasis on this technique because of the unsettled conditions currently prevailing in the financial markets.

The witness' risk premium results, namely 11.2 to 11.80 percent, were based on an estimate that the prevailing yield over the test period on long-Canadas would be 9.4 percent and an equity risk premium range for pure utilities of 1.8 to 2.4 percentage points. This equity risk premium range was determined by first estimating the market risk premium to be in the range of 4.5 to 5.7 percentage points and reducing this by a "purchasing power" risk premium of 1 percentage point to arrive at the range of 3.5 to 4.7 percentage points. This range was then reduced by one-half to reflect the lower risk of pure utilities. To take into account the uncertainties currently prevailing in the financial markets, the witness added a "cushion" of approximately 50 basis points to arrive at a recommended rate of return of 12.0-12.25 percent for Westcoast. During cross-examination the witness stated that if the deemed equity ratio were to be maintained at 35 percent his recommendation would be 25 basis points less. In argument, COFI supported the evidence and recommendations provided by the CPA/APMC witness.

EUG was of the view that the appropriate approach to determine the rate of return on equity was to use the equity risk premium technique with a 20-year long-Canada rate projection of 8.8 or 8.9 percent. This rate was derived by using the Consensus Forecast yield estimate of 8.7 percent for a 10-year long-Canada plus the average spread established by the CPA/APMC expert witness of 13 basis points.

As mentioned previously, the expert witness for IPAC commented on certain financial aspects of Westcoast's toll application. Regarding the level of earnings experienced by Westcoast, the IPAC expert witness concluded that Westcoast had earned "excess returns" over the 1983-91 period. Based on this conclusion and his views on Westcoast's business risk, capital market conditions, and the capital structure of the utility operation, IPAC recommended that Westcoast should be granted a return on equity which reflects a 30 percent deemed equity component and a return on equity in the range of 12 to 12.50 percent. In the event that the Board maintained a 35 percent deemed equity component, IPAC recommended a return on equity in the range of 11.75 to 12.25 percent.

Views of the Board

In determining an appropriate allowable ROE for Westcoast, the Board has relied on all three methods used for assessing a fair and reasonable return on common equity. Nevertheless, in this proceeding, the Board gave somewhat greater weight to the results of the risk premium approach. The Board is of the view that its findings in this regard satisfy the principles of fairness to shareholders and tollpayers and of maintaining the Company's financial integrity and ability to attract capital on reasonable terms.

Regarding the risk premium approach the main areas of disagreement between the expert witnesses were: first, the magnitude of the reduction to the market risk premium required to reflect the lower risk of utilities; second, whether a "purchasing power" or "lock-in" premium exists; and third, whether alleged discrepancies between achieved and expected returns for bonds should be recognized. The Board notes that the expert witnesses for Westcoast and CPA/APMC are in general agreement that the market risk premium is no less than 4.5 percent. The Board recognizes that these expert witnesses disagreed on what is the upper end of the range for market risk premium. As for the adjustment factor needed to reflect the lower risks of Westcoast, the Board considers the CPA/APMC's proposed factor somewhat excessive. With respect to the concept of purchasing power premium, the Board is of the view that such a "premium" may exist. However, in a low expected rate of inflation environment, the Board is not persuaded that it would be of a magnitude proposed by the expert witness for CPA/APMC. For the purposes of determining the allowable ROE for Westcoast in this decision, the Board has not taken this "premium" into consideration. Further, the Board does not consider it reasonable, for the purposes of determining a required rate of return, to assume that debt or equity investors necessarily achieved their expected returns.

In its review of the evidence presented concerning the comparable earnings approach, the Board is cognizant of the problems inherent in using this technique. As an example, the Board notes the statement of the CPA/APMC witness that the existence of past higher than current rates of inflation can seriously distort the results of the comparable earnings test. Nevertheless, the Board considers the test results presented by the Company's witness helpful.

With respect to the DCF technique, the Board agrees with the expert witnesses for Westcoast and CPA/APMC that, under current capital market conditions, little reliance can be placed on the test results.

Having considered all of the evidence before it, the Board finds that a decrease in the allowable rate of return on common equity from that granted in the RH-1-90 Reasons for Decision is warranted. In reaching this conclusion, as it has done in prescribing the unfunded debt rate for Westcoast, the Board has given weight to a forecast long-Canada rate for the test year in the range of 9.0 to 9.25 percent. This, together with the Board's judgement as to the magnitude of equity risk premium and the expected rate of return of companies comparable in risks to Westcoast, has led the Board to conclude that a rate of return on common equity of 12.50 percent is fair and reasonable for the test year.

Decision

The Board finds that a rate of return on common equity of 12.50 percent is fair and reasonable for the 1992 test year.

Table 7-2
Required Rate of Return on Equity
Recommendations of Expert Witnesses

	Westcoast			**CPA/PMC**	
(i)	**Comparable Earnings**	(%)	(i)	**Comparable Earnings)**	
	Sample results for 1983-1990	14.20		N/A	
	Estimated return for 1991	7.70			
	Average return for 1983-1991	13.50			
	Less: Adjustment for lower risk of Westcoast relative to sample companies	.25			
		13.25			
(ii)	**DCF**		(ii)	**DCF**	
	Dividend yield for sample companies	2.10		Dividend yield for low-risk industrials	0
	Growth component	10.00		Implicit growth component	0 4
	Approximate "bare-bones" cost	12.10		Investor's required rate of return for sample of low-risk industrials	0
	Less: Adjustment for lower risk of Westcoast relative to sample companies	.30		Less: Adjustment for lower risk of Westcoast relative to sample companies	0 8
	Adjusted "bare-bones" cost	11.80			0 5 .
	Add: Adjustment for market-to-book ratio considerations	1.15			
		12.95			

Table 7-2
Required Rate of Return on Equity
Recommendations of Expert Witnesses

Westcoast

(iii)	**Equity Risk Premium**			(%)
	Long-Canada rate			9.375
	Add: Equity risk premium for Westcoast			3.50
	Add: Adjustment for market-to-book ratio considerations			1.225
				14.10
(iv)	**Final ROE Recommendation**			
		Result (%)	Weighting (%)	Weighted Result (%)
	a) Comparable Earnings	13.25	50	6.625
	b) DCF	12.95	-	
	c) Equity Risk Premium	14.10	50	7.05
	Final ROE Recommendation			13.5-13.75

CPA/APMC

(iii)	**Equity Risk Premium**	(%)
	Equity risk premium -market as a whole	4.50-5.70
	Less: Purchasing power risk premium	1.00
	Times: Factor for lower risk of Westcoast	0.50
	Equity risk premium - utilities	1.80-2.40
	Long-Canada rate	9.40
		11.20-11.80
(iv)	**Final ROE Recommendation**	
	Investor's Required Rate of Return for Westcoast	11.25-11.75[1]
	Additional "cushion"	0.50[2]
	Final ROE Recommendation	12.00-12.25

1 The CPA/APMC witness placed greater emphasis on the Equity Risk Premium results in determining the required rate of return for Westcoast.

2 The additional 50 basis points represent a "cushion" to reflect current unsettling financial market conditions.

7.6 Rate of Return on Rate Base

The Board directs Westcoast to calculate its rate of return on rate base in accordance with these Reasons for Decision.

7.7 Income Tax Provision on Flow-through Basis

Views of the Board

The Board has estimated the financial impact of the decisions contained in these Reasons for Decision. With respect to the 1992 income tax provision on a flow-through basis, the Board has utilized CCA to the extent necessary to eliminate the Company's utility taxable income only. As CCA utilized is less than the maximum allowable, the unutilized amount should be carried forward to future years for the purpose of determining the utility income tax provision.

For the 1992 test year, the utility income tax provision would only consist of the large corporations tax which the Board estimates at $2.6 million.

Decision

The Board has adjusted Westcoast's 1992 income tax provision on a flow-through basis to reflect the decisions contained in these Reasons for Decision.

Chapter 8

Operating Costs

8.1 Salaries, Wages and Employee Benefits

Westcoast's salaries, wages and benefits expense and related issues were of concern to several interested parties. As set forth in the following subsections, based on the evidence on record, the Board finds it reasonable to adjust downward the applied-for 1992 salaries, wages and benefits expenses by $1.07 million.

8.1.1 Person Year Utilization

For estimating salaries and wages for the 1992 test year, Westcoast projected a utilization of 1,140 person years ("PY"), net of a vacancy adjustment of 13 PYs. The test year estimate was an increase of 47 PYs from the actual 1,093 PYs utilized in 1991. Westcoast calculated the test year vacancy rate adjustment, as directed by the Board in its RH-1-90 Reasons for Decision, using actual vacancy rates experienced during the three-year period 1989 to 1991.

The Company justified the increase in PY utilization on the basis of additional facilities and increased operating and maintenance ("O & M") requirements arising from the higher level of throughput projected for 1992. The Company stated that an additional 22 PYs were required in 1992 for the O & M of the expanded McMahon Plant facilities; two PYs for the operation of new pipeline facilities; and a net increase of three PYs for field operations in Northern District, Southern District and Pine River Plant. The balance of the applied-for increase in PYs were for Vancouver departments mainly in engineering, materials and purchasing, and accounting. Westcoast explained that a part of the increase in PY utilization reflected annualization of staff additions made in 1991 and a reduction in the overtime budget for 1992.

Several intervenors, notably CPA, IPAC and BC Gas, expressed concerns with the increase in PY utilization proposed by the Applicant. CPA stated that many of the explanations provided by Westcoast to justify the increases did not satisfactorily substantiate the proposed additions. CPA questioned the change in circumstances at Westcoast which warranted an increase from 1,005 PYs in 1990 to a proposed level of 1,140 in 1992. CPA noted that Westcoast reduced the number of casual employees by converting some of these positions to permanent status which carries a much higher cost of salaries and benefits. In CPA's view at least some of Westcoast's proposed permanent PY additions were not necessary for the test year. CPA recommended that the 22 PY increase related to the expanded McMahon Plant be allowed and argued that, of the rest of the requested PY increases (25), the Board should disallow 23 PYs. IPAC and BC Gas agreed with CPA.

Views of the Board

The Board accepts the requirement for the additional 22 PYs for the operation of the expanded McMahon Plant and 2 PYs for the operation of new pipeline facilities. The Board, however, is not fully convinced by the justification provided for many of the remaining staff additions.

In reviewing Westcoast's PY requirements the Board is cognizant of the current economic climate and recognizes that the measures taken in all sectors of the economy, particularly the oil and gas producers, to restrain and, in many instances, to reduce labour costs. The Board is of the view that Westcoast should keep its staffing increase at a modest level.

In view of the foregoing, the Board finds it reasonable to disallow salaries and benefits of 10 PYs, which is about one percent of the Company's work force, from the forecast O & M expense for 1992. The Board believes that a restraint on staffing increase in the order of magnitude indicated will not hamper the pipeline's operation and safety.

Based on Westcoast's figure for the average salaries and benefits cost per employee of $69,200 in 1991, the Board estimates that this would reduce the applied-for salaries and benefits expenses by $692,000.

Decision

Westcoast is directed to reduce the salaries, wages and benefits portion of the operating and maintenance expense proposed for 1992 by $692,000 to reflect a reduction of 10 PYs from the applied-for level.

8.1.2 Year-Over-Year Salary and Wage Increases

For the 1992 test year Westcoast proposed year-over-year salary increases of 2.75 percent for Executive Management and 3.25 percent for other salaried staff, with an additional provision for progression within ranges. For wage earners, Westcoast proposed a general increase of 3.0 percent. Westcoast stated that a 3.0 percent wage increase had recently been agreed to in an industry settlement and that it hoped to settle for the same increase with its unionized employees.

Westcoast contended that the proposed salary increases were in line with industry patterns and provided results of salary surveys to support its claim. Westcoast maintained that it was not appropriate to focus solely on the proposed percentage increases without giving consideration to the reasonableness of the Company's salary ranges in comparison to salaries paid by other employers in the market for similar skills. Westcoast testified that even after the proposed increases, the Company's salaries would decline from approximately 97 percent of "market value" at the end of 1990 to approximately 96 percent in 1992.

Westcoast argued that it was inappropriate to judge the reasonableness of Westcoast's proposed salary increases in light of the rationalization currently taking place in the upstream oil and gas sector in Calgary. Westcoast did not hire its salaried employees from the exploration and development sector of the oil and gas industry. The Company was not hiring employees to work in Calgary. Westcoast contended that it must attract and retain clerical staff, management staff and professionals in Vancouver and elsewhere in British Columbia, including remote northern communities. Westcoast held the view that the proposed 3.25 percent increase for salaried staff accurately reflected the minimum required to ensure that Westcoast maintained a competitive position which would enable it to attract and retain qualified staff.

Intervenors did not oppose the 3.0 percent increase for wage earners, given that it reflected the national wage settlement. However, several intervenors opposed the proposed increase of 3.25 percent for salaried staff.

CPA believed that Westcoast, as a part of the natural gas industry, should exercise the same control and restraint as other sectors of the industry. CPA noted that the federal government has implemented a significant salary restraint program this year. CPA recommended that the increase should be in line with the levels in the upstream sector and government restraint programs. CPA presented the results of a survey of its member companies in respect of salary increases awarded or contemplated for 1992. The survey suggested that on a weighted average basis, salaries in the upstream oil and gas companies would increase 1.3 percent in 1992. CPA submitted that Westcoast's overall increase for salaries, benefits package and bonus program, exclusive of the wage increase, should be limited to 1.3 percent.

IPAC argued that pay policy in the upstream industry should have a significant influence on Westcoast's salary awards. IPAC made no specific recommendation about the level of salary increase for Westcoast but it submitted that there was no justification for any increase greater than the 2.5 percent recently allowed for Foothills by the Board.

EUG joined with CPA and IPAC and expressed serious concerns over Westcoast's ever increasing salaries and wages. It took issue with Westcoast's contention that the proposed increase in salaries and wages reflected increases in throughput. It noted that over the previous three years Westcoast salaries and wages had increased at a significantly faster rate than had throughput. COFI supported CPA's submission regarding salary increases.

Views of the Board

The Board accepts the wage increase of 3.0 percent which is the same as the increase agreed to by unionized employees working for companies similar to Westcoast in an industry-wide settlement. However, after considering the evidence adduced in this proceeding, the Board has concluded that for all salaried staff, including executives, an overall salary increase of 2.5 percent for 1992 is reasonable. The Board estimates that this would reduce the total salary and wage expenses by $280,000 and employee benefits by $42,000 for a total of $322,000. This would result in a reduction of $252,000 in O & M expenses and of $70,000 in salaries, wages and benefits charged to capital and non-utility.

Decision

For 1992, the Board approves a year-over-year salary increase of 2.5 percent for all salaried staff and an increase of 3 percent for wage earners.

8.1.3 Executive and Management Bonus Program

In 1989, Westcoast introduced the Executive and Management Bonus Program as part of the total compensation package. The Company stated that the integration between the existing salary package and the bonus program was effected by lower salary in exchange for participation in the bonus program. The Company views the bonus program as being a necessary component in providing Westcoast's executives and managers a total compensation package comparable to those found in other companies in the market. Evidence adduced in this proceeding indicates that the amount of an individual's bonus is determined by the performance of the Company, the performance of the person's division, and the performance of the individual.

Intervenors questioned Westcoast regarding the performance measures, how they relate to corporate objectives and how tollpayers benefit from these measures. IPAC believed that Westcoast's bonus plan was generous and beyond the bounds of reasonableness. It suggested that the Board should require the Company to submit a comparative study for the Board to assess the reasonableness of the Company's plan.

Views of the Board

The Board considers that executive and management bonuses can be an acceptable element of the remuneration paid by regulated pipelines. In considering whether a regulated company's bonus program is reasonable, the Board is of the opinion that bonuses should be viewed in the context of the total compensation package - salary, bonuses and benefits - necessary to attract and retain executives and managers. The Board accepts that there is a place for the bonus program in Westcoast's executive and management compensation package and having considered the evidence on record for the 1992 test year, the Board is prepared to accept the bonus plan cost as proposed.

Decision

The Board accepts the applied-for bonus plan costs for 1992.

8.1.4 Base Year Salary and Wage Levels

The evidence showed that in the base year 1991, the actual salary and wage increases implemented by the Company of 6.5 percent exceeded the Board-allowed increase of 6.0 percent. Consequently, the base year salaries, wages and benefits charged to operations exceeded the Board-approved level by about $115,000. Westcoast stated that the cost of implementing salary and wage increases in excess of the Board-approved levels was absorbed by the company's shareholders for 1991. It conceded, however, that in the test year and in subsequent test years this cost would be borne by the tollpayers.

Westcoast contended that the applied-for test year salaries should be based on the actual rather than approved salary and wage increases for the base year. Westcoast maintained that salary adjustments granted by the Company in 1991 were necessary to attract and retain qualified personnel in competition with other employers in the same labour market. Accordingly, it is the actual level of increase granted by Westcoast that must form the base for the increases granted in the test year.

IPAC was concerned with Westcoast awarding salary increases higher than the Board-approved levels. IPAC argued that this inflates the Company's salary base for subsequent years. IPAC submitted that Westcoast should be directed to base the proposed salary increases on the maximum allowed by the Board in the previous year.

CPA noted that the salaries and wages charged to O & M expense had been consistently higher than those approved by the Board. CPA stated that the Board should not condone this approach.

Views of the Board

The Board is of the view that for the purpose of calculating salaries, wages and benefits for the 1992 test year, the 1991 base year amount should be adjusted to reflect the annual salary and wage increases allowed in the RH-1-90 Reasons for Decision. Accordingly, the applied-for salaries, wages and benefits charged to operations should be reduced by $115,000.

> **Decision**
>
> **The Board directs Westcoast to reduce the 1992 test year provision for operating salaries, wages and benefits by $115,000.**

8.2 Other Operating and Maintenance Expenses

8.2.1 Training and Education

Westcoast proposed to increase training and education expenses from $925,000 in the 1991 base year to $1,560,000 in the 1992 test year. CPA, IPAC, COFI, and EUG all expressed concern over this increase. Westcoast cited as reasons for the significant increase in 1992 the following: heavy workloads in 1991 required postponing necessary safety and technical training which has to be made up in the test year; many employees are reaching retirement age and employees must be trained to fill these positions; many employees have been in their current positions for less than five years; and changes in job requirements owing to increased workloads.

Views of the Board

The Board acknowledges the concerns of intervenors with respect to the substantial increase in training and education proposed by Westcoast. However, the Board is of the opinion that in the circumstances faced by the Company the overall training and education budget is reasonable.

Decision

The Board approves the amount of $1,560,000 requested by Westcoast for training and education for the test year.

8.2.2 Housing

Westcoast supplies employees with housing in the Northern and Southern Districts and at the Fort Nelson and Pine River Plants. Westcoast justified this expense as follows: historical precedent, in that the Company has supplied housing for 35 years; the remoteness of the work sites; and lower response times to equipment failures when staff is living on-site. In cross-examination CPA argued that the test year budget for employee housing was excessive (e.g. over $6,000 per unit in Fort Nelson) and that it had not been justified as necessary for the safe, efficient and reliable operation of the pipeline. Westcoast replied that the Fort Nelson area had a very high rate of employee attrition and housing conditions were cited as a significant element of employee dissatisfaction. Westcoast explained that company houses in the area are 25 years old and that, in order to address employee dissatisfaction and reduce turnover, Westcoast was upgrading company-supplied housing. The Company expects housing expenses to fall to approximately $3,000 a unit when the currently proposed upgrading is completed.

IPAC questioned the need for Westcoast to supply housing at all in areas which can no longer be considered "remote". Westcoast stated that a study on the need to supply housing in the more populated areas along its system was being planned.

Decision

The Board accepts Westcoast's explanation for housing expenses and approves the amounts requested. The Board directs Westcoast to file a copy of the planned housing study with the Board upon completion.

8.2.3 Rights-of-way Shared with Westcoast Petroleum Ltd.

During cross-examination by IPAC, Westcoast acknowledged that it shared pipeline rights-of-way with WestPete for 770 kilometres between Fort St. John and Kamloops. Westcoast admitted it absorbed all of the expenses related to the maintenance of the shared rights-of-way. These maintenance costs were recorded in the accounts for brush clearing expenses in the Northern District and brush clearing and river and creek stabilization expenses in the Southern District. IPAC suggested that WestPete bear one-third of these costs and that efforts be made to collect a reasonable amount from WestPete for past benefits received in relation to the maintenance of rights-of-way.

Views of the Board

With respect to the pipeline rights-of-way shared by Westcoast and WestPete, the Board agrees with IPAC that one-third of the relevant maintenance expenses should be allocated to WestPete. The Board estimates that one-third of applicable maintenance expenses in the Northern District and that two-thirds in the Southern District relate to the shared rights-of-way and should be allocated in this manner. However, the Board does not agree with IPAC's recommendation that past benefits received by WestPete should be considered in setting tolls for the test year.

Decision

For the purposes of the 1992 test year, the Board directs that Westcoast reduce brush clearing expenses in the Northern District and brush clearing and river and creek stabilization expenses in the Southern District by a total of $71,000. Westcoast may wish to propose a different method of allocating rights-of-way maintenance expenses at its next toll proceeding.

8.2.4 Water Hauling at Sikanni Plant

Westcoast forecast an expense for water hauling at the Sikanni Plant of $303,000 in the 1992 test year. CPA argued that the forecast amount for water hauling was not reasonable in that it represented the maximum amount Westcoast could have to spend and not what Westcoast expected to spend in the test year. During cross-examination by CPA, Westcoast maintained that the reduction in actual water hauling expenses to $37,000 in 1991 from $172,000 in 1990 was an anomaly. The Company explained that some very wet wells were "shut in", resulting in lower water expenses for that year.

BC Gas noted that the $303,000 proposed by Westcoast for water hauling expenses was 700 percent of 1991 actual amounts.

Views of the Board

Westcoast applied for $303,000 in expenses for water hauling at the Sikanni Plant for 1992 as it has for every test year since 1989. The Board notes that actual expenses in 1988 were $236,000 and have decreased in every year since. The Board is of the view that Westcoast's practice of budgeting for the maximum possible amount is inappropriate.

Based on trends over the 1988-91 period the Board has estimated a reasonable amount for water hauling expenses in the 1992 test year to be $175,000.

Decision

The Board disallows the proposed water hauling expenses at the Sikanni Plant of $303,000 and approves instead $175,000 for the 1992 test year.

8.2.5 Corporate Aircraft

Westcoast applied for $770,000 in expenses related to the operation of its corporate aircraft, the BA-125. IPAC expressed concerns with the level of these expenses and maintained that neither an appropriate level of detail on expense allocation nor an adequate economic justification for the use of the aircraft had been provided.

Views of the Board

The Board notes that expenses for operating the corporate aircraft would be allocated for 1992 on the basis of time logged.

Decision

Based on the evidence before it, the Board is not persuaded that the utility's share of the expenses for using the BA-125 aircraft is unreasonable and approves the amount requested for the 1992 test year.

8.3 Lost and Unaccounted for Gas

Westcoast proposed to change its method of accounting for lost and unaccounted for ("LUF") gas commencing 1 January 1992. Under its proposal, the Company would include an allowance for LUF gas in the shippers' fuel gas ratios on a monthly basis and the allowance would be adjusted monthly to reflect the Company's actual experience on a trailing three-month basis. This would replace the current method of forecasting LUF gas based on the previous three years' actual experience and then buying and selling gas monthly to balance the LUF gas account.

In support of its proposal, Westcoast indicated that the current method is no longer appropriate because it no longer has contracts with gas suppliers that would allow it to balance its LUF gas gains and losses monthly through sales and purchases of gas.

According to Westcoast, during the period when the current method was in operation, it had incurred a cumulative LUF gas loss of $2,404,000. Westcoast therefore proposed to add this loss to rate base effective 1 January 1992 and amortize this amount to cost of service over a three year period.

To address concerns that the proposed method would reduce the incentive for Westcoast to control LUF gas, the Company stated that it controls LUF gas by investigating major changes in delivery point volumes and by carrying on a monthly preventive maintenance program involving monitoring of facilities and calibration. Also, Westcoast indicated that it had recently installed more accurate electronic measurement apparatus at its export point.

With respect to the recovery of the cumulative loss, Westcoast argued that the existing method of accounting for LUF gas is in the nature of a deferral account and is designed to keep all parties whole. The Company argued that its relatively high cumulative loss is due to its raw gas transmission and processing functions. For example, a significant source of LUF gas gains and losses arises from the gathering of raw gas of different heat contents from a multitude of receipt points with different metering systems.

CPA objected to Westcoast's proposed change in methodology because it would allow Westcoast to recover actual costs incurred over the period the current method of accounting for LUF gas has been in effect. Further, CPA submitted that the change is not advisable because fluctuations in fuel ratios resulting from LUF gas would be concealed and Westcoast would have no incentive to control LUF gas. CPA recommended that Westcoast change to a method where the Company would forecast a LUF gas amount, the Board would rule on the forecast and Westcoast would bear the risks or receive the benefits of any variance between the forecast and actual volumes. CPA conceded, however, that an estimate for LUF gas could be included in the fuel ratios if Westcoast is required to identify it separately and continue to be responsible for justifying variances between actual and forecast volumes.

CPA also objected to Westcoast's proposal to recover the cumulative loss because it would amount to the retroactive recovery of costs alleged not to have been recovered in prior years. CPA noted that, in the RH-6-85 proceeding, the Board denied a deferral account for LUF gas.

While BC Gas was not opposed to Westcoast's proposal to change the method of accounting for LUF gas, it contended that the proposal to recover the cumulative loss should not be allowed. BC Gas submitted that the Company's latter proposal raises concerns related to intergenerational equity because it would impose costs on tollpayers that were not using Westcoast's system during the period that costs were incurred while not charging other parties, such as Northwest Pipeline Corporation, who are no longer customers of Westcoast.

Views of the Board

The Board considers Westcoast's proposed method of accounting for LUF gas gains and losses acceptable. The Company no longer has a merchant function and now acts solely as a transporter of natural gas. In the Board's view, the proposed method is more consistent with Westcoast's current operating and contractual arrangements.

However, the Board is of the view that this new method should be closely monitored to ensure that Westcoast continues to take steps to minimize the amount of LUF gas. To this end, the Board considers that Westcoast should provide to its shippers monthly information on actual losses and gains by volume and as a percentage of total accountable gas.

Regarding Westcoast's proposal to recover cumulative LUF gas losses in its cost of service, the Board notes that, under the forward test year, cost of service regulatory framework approved for Westcoast in 1986, regulation is on a prospective basis. In other words, estimated rather than actual cost is used, except in specified situations such as those where deferral accounts have been approved. In its RH-6-85 Reasons for Decision, the Board approved the current method of determining LUF gas which entails forecasting LUF gas by reference to actual gains and losses for the previous three years. In that Decision, the Board specifically denied Westcoast's request for a deferral account for LUF gas and reaffirmed the current method which does not involve a deferral account in its RH-1-90 Reasons for Decision.

If the Board were to approve the recovery of the cumulative losses as proposed, the decision would have the same effect as the Board having approved a deferral account for LUF gas since 1986. For these reasons, the Board is of the view that the Company's proposal should not be allowed.

Decision

The Board approves, effective 1 January 1992, Westcoast's proposal to account for lost and unaccounted for gas by including an allowance in the shippers' fuel ratios on a monthly basis and adjusting this allowance to reflect the Company's actual experience on a trailing three-month basis. The Board directs Westcoast to determine monthly actual LUF gas losses and gains by volume and as a percentage of the total accountable gas and to provide this information to its shippers. The Board intends to closely monitor the efficacy of the methodology approved in this decision to ensure that Westcoast takes suitable steps for minimizing the amount of gas lost and unaccounted for.

Regarding the cumulative loss of $2,404,000 in Westcoast's LUF gas account, the Board denies the Company's request to include in rate base and to amortize this amount to cost of service over a three-year period.

8.4 Allocation of Costs to Non-Utility Activities

Noting that there has been a significant increase in the number of Westcoast's subsidiaries, intervenors expressed concern about the reasonableness of Westcoast's allocation of costs, particularly salaries, wages and benefits, to its non-utility operations. CPA also had concerns regarding the fixed fee arrangement Westcoast has with its subsidiaries.

CPA argued that Westcoast had no articulated policy on the separation of utility and non-utility costs. For example, the allocation of salary-related expenses between utility and non-utility for the test year was not based on estimates of time spent by employees on the two activities but rather on predetermined percentages derived from historical data. CPA contended that this approach could distort the allocation of expenses between utility and non-utility activities. CPA expressed concern with allocating 6.3 percent of the total salaries to non-utility and assigning all overtime costs to the utility.

As a specific example where Westcoast did not allocate costs to its non-utility activities, IPAC cited the evidence pertaining to maintenance costs associated with rights-of-way which Westcoast shares with WestPete, a wholly owned subsidiary (see section 8.2.3). As discussed in section 8.2.5, IPAC was also concerned with the level of expenses allocated to the utility for operating the BA-125 corporate aircraft and with Westcoast's ownership of that aircraft. The evidence showed that the aircraft was used to fly, on occasion, to the Company's various processing plants. IPAC contended that the limited use did not justify the expense related to the particular aircraft. IPAC recommended that this matter should be further examined in the next toll case.

CPA submitted that Westcoast be directed to conduct a study of costs and benefits and actions required to create a separate, stand-alone NEB-regulated entity. This would enable the Board and interested parties to assess the practicalities of regulating the utility on a stand-alone basis.

Westcoast argued that the Board had dealt with the utility/non-utility allocation issue in all recent rate cases. It refuted CPA's contention that the Board had expressed an ongoing concern with respect to unfair allocation of costs between utility and non-utility. Westcoast cited the Board's findings in the RH-2-89 and RH-1-90 Reasons for Decision respectively that Westcoast's allocation of costs between utility and non-utility for the 1990 test year met "..the tests of fairness, reasonableness and absence of cross-subsidization" and for the 1991 test year were made "fairly and consistently, with minimal cross subsidization".

Views of the Board

The Board addresses the utility/non-utility allocation in most toll proceedings to satisfy itself that the allocation remains fair and reasonable. As non-utility activities form an increasingly large proportion of the operations of Westcoast, it is more important than ever that the Board ensure that utility tollpayers do not subsidize Westcoast's non-utility activities.

The Board is not persuaded that the Company's allocation of the 1992 test-year salaries, wages and benefits to non-utility is unreasonable and accepts the allocation. However, the Board is concerned with Westcoast having borne all the maintenance costs of shared rights-of-way with WestPete.

In the light of the significant increase in the number of subsidiaries of Westcoast, the ever-widening range of activities in which the non-utility subsidiaries are involved and the continuing concerns expressed by intervenors, the Board believes that, while a study for the purposes of determining the costs and benefits of creating a separate stand-alone NEB-regulated utility as proposed by CPA is not required, a review of Westcoast's cost allocation process would be beneficial. The Board is of the view that Westcoast should retain an external consultant to: independently review Westcoast's method of separating costs between utility and non-utility operations; recommend cost separation approaches that are fair and reasonable to tollpayers and do not result in cross-subsidization; and develop a written policy on allocation of costs between utility and non-utility operations.

Decision

Except for the expenses of maintaining the rights-of-way shared with Westcoast Petroleum Ltd., the Board accepts Westcoast's allocation of costs between its utility and non-utility activity for the test year. The Board directs Westcoast to carry out an independent external review of the Company's method of separating costs between utility and non-utility. Westcoast is directed to file proposed terms of reference for this review with the Board for approval within 60 days of the release date of these Reasons for Decision. The Board expects that the Company will file a review report with the Board, serving copies on interested parties to this proceeding, within 6 months of the date on which the Board approves the terms of reference for the review.

8.5 Cost Restraint

For the 1992 test year, Westcoast requested an O & M budget of $122.2 million. This is a 9.1 percent increase ($10.2 million) over the 1991 base year amount and is made up of salary and wage increases of $5.1 million and an equal amount in other O & M expenses. Westcoast maintained that these are the minimum required amounts to ensure the safe, reliable and efficient operation of the pipeline system.

CPA argued that in the light of difficulties currently being experienced by the oil and gas industry, Westcoast has not exercised cost restraint. CPA argued that the increase in O & M expenses at three times the inflation rate is unacceptable. IPAC, COFI, BC Gas, and EUG all supported CPA's position.

CPA proposed significant expense reductions by line items. As well, the association suggested that the Board order a management audit of Westcoast's head office and main regional offices to determine, for example, functions which can be eliminated, or activities which can be reduced in order to assess potential manpower savings and to determine areas of activity which could be performed by outside consultants at lower cost.

Views of the Board

The Board recognizes that Westcoast has an obligation to operate its pipeline system safely and reliably. However, in a North American natural gas market that is becoming increasingly integrated, the Board is of the view that Westcoast must control its costs in order to provide services to its shippers at reasonable tolls without jeopardizing safety and reliability as well as to maintain and enhance its competitiveness. Nevertheless, the Board is not persuaded that there is evidence of Westcoast having shown a disregard for cost economies. In particular, the Board is not convinced that the time and expense of a regulator-ordered management audit of Westcoast is warranted at this time.

Chapter 9

Toll Design

9.1 Throughput Forecast

Westcoast forecast an annual demand for the 1992 test year of 13 901.6 10^6m^3 (490.7 Bcf). Approximately 43 percent of this annual demand is forecast for the export market.

Decision

The Board finds Westcoast's 1992 test year throughput forecast to be reasonable and accepts the forecast for cost allocation and toll design purposes.

9.2 Liquid Products Stabilization and Fractionation Service

By letter dated 21 November 1991, Westcoast requested approval of an interim LPSF Service toll, which would allow the Company to provide service when the purchase of the underlying facilities from Petro-Canada is completed. In its 12 December 1991 application for 1992 tolls, Westcoast revised the proposed LPSF toll based on estimated 1992 cost of service. By Orders TGI-4-91 and TGI-5-91, the Board approved an interim LPSF toll for 1992.

Westcoast explained in its application that three different toll designs had been considered by Westcoast and the major shippers involved in liquids activities at McMahon Plant, namely, Amoco, CanWest Gas Supply Inc. ("CanWest") and Petro-Canada. These alternatives were based on allocation methods using capital expenditures expressed in historical dollars, in current dollars, and in a mix of historical and current dollars respectively.

With the historical dollar basis, the parties felt that too much of the McMahon Plant cost of service was allocated to the LPSF function because, in comparison to the facilities assigned to the treatment function which were of older vintages, the LPSF facilities were capitalized mostly in 1991 dollars. The current dollar basis resulted in a situation where capital cost directly identified with the LPSF function was less than the actual cost of the facilities. When no agreement on allocation method was reached between Westcoast and the major shippers, a commodity toll based on mixed dollars was calculated and eventually used in the application. In deriving the applied-for LPSF toll, the sunk design and cancellation costs of $1.98 million associated with the LPSF facilities, which were part of the original McMahon Plant expansion project, were assigned to LPSF service.

During the hearing, Westcoast reduced its forecast of the volume of liquids to be processed by the LPSF facilities. Mainly as a result of this reduction, the tolls proposed for the LPSF service increased from $11.35 to $14.15 per cubic metre of liquid products, or by about 25 percent.

Westcoast testified that CanWest and Amoco agreed with the applied-for tolls, but not Petro-Canada. The latter maintained that LPSF tolls under all three methods were too high because they were all in excess of a fee that it charged Amoco for LPSF service under an agreement that it still had with Amoco. This agreement has been in effect since February 1980 and was amended in October 1990 as a result of negotiations which, according to Petro-Canada, were unrelated to the sale of the Petro-Canada LPSF facilities. The October 1990 revisions modified the clauses related to daily processing capacities, lowered the processing fee and lengthened the term of the contract.

Petro-Canada elaborated that it was obliged to reduce the fee as of 1 April 1992. This resulted in an average fee of $8.94 per cubic metre of liquid products for 1992. Petro-Canada stated that it agreed to a fee reduction after Amoco had threatened to terminate the agreement and to fractionate stabilized liquids elsewhere. The term of the Amoco/Petro-Canada agreement was also changed in October 1990 to run on a firm basis to the year 2000, with the possibility of yearly extensions to the year 2005.

In October 1990, Petro-Canada approached Westcoast for the sale of, among other things, its LPSF facilities and a purchase and sale agreement was signed on 7 January 1991. Westcoast said that, during negotiations, it had provided preliminary estimates of LPSF tolls to Petro-Canada in late December 1990. Those estimates were lower than the LPSF toll proposed in the current application. During the hearing, Westcoast explained that the calculation of these preliminary tolls did not take into consideration a number of capital expenditures now allocated to the LPSF service.

According to Petro-Canada, while it knew that there was a risk that the LPSF toll that it would be paying to Westcoast could turn out to be higher than the fee it received from Amoco, it proceeded with the sale. Petro-Canada believed that the toll charged by Westcoast would be fair and reasonable and that it would reflect commercial realities, so that Petro-Canada's exposure to the risk of losses under its contract with Amoco would be minimal.

Westcoast said that it did consider proposing an LPSF toll that reflected the Amoco/Petro-Canada agreement but rejected the option because Amoco and CanWest were opposed to it. The Company suggested that should the Board accept an LPSF toll that is not cost-based, any unabsorbed costs should be allocated to the liquids recovery function so as to direct these costs to the McMahon Plant shippers who have liquids in their gas stream.

In argument, Westcoast amended its proposal and stated that the appropriate LPSF toll should be calculated using the current dollar allocation methodology (as described in its response to NEB information request number 42) and assigning the $1.98

million in cancellation charges to the cost of completing the expansion of the McMahon Plant. Westcoast estimated that these steps, taken together, would result in an LPSF toll of about $\$10.70/m^3$. First, Westcoast argued that, had it constructed the new LPSF facilities approved as part of the McMahon Plant expansion project, there would have been a need to allocate some of the costs of those facilities to other McMahon Plant functions. Otherwise, the toll based on its incremental LPSF facilities would have been in the range of $71.41 to $95.85 per cubic metre depending on the allocation method used.

Second, in the Company's opinion, the acquisition of the existing Petro-Canada facilities resulted in the most cost-effective solution for handling the entire liquids stream at the McMahon Plant. In reference to the significant negative economic impact on Petro-Canada arising from pre-existing contractual arrangements, Westcoast suggested that the economic efficiencies achieved should not be realized at the expense of any third party.

Furthermore, Westcoast argued that the chosen cost allocation methodology should result in tolls which are consistent with the continued use of a rolled-in toll methodology on the Westcoast system. In the light of existing private contractual arrangements, Westcoast believed that an LPSF toll based on its final proposal satisfied this criterion.

Petro-Canada was of the opinion that the applied-for tolls, including that proposed by Westcoast in final argument, discriminated against Petro-Canada considering the arrangements that were already in place. It also believed that the tolls do not reflect commercial realities. According to Petro-Canada, the tolls are almost twice as high as commercial charges for a similar service offered elsewhere.

In reference to its agreement with Amoco, Petro-Canada explained that it expects the fee to remain significantly lower than the toll and that it is not allowed to pass on to Amoco its costs associated with the Westcoast LPSF tolls. Based on the toll of $10.70 estimated by Westcoast in final argument, Petro-Canada estimated that the cumulative shortfall could amount to about $9 million by the year 2000.

While its preference was that the Board not regulate the LPSF facilities, Petro-Canada proposed, in the alternative, two toll design methodologies. First, the LPSF toll could be based on the calculation of the processing fee as defined in the Amoco/Petro-Canada agreement. Any shortfall or under-recovery in revenue would be estimated at the start of a test year and included as part of the demand revenue requirement for the liquids recovery function and a deferral account would capture any variance associated with this forecast revenue. This was Petro-Canada's preferred option. Petro-Canada stated that this methodology would not only respect the pre-existing contractual arrangements but would also promote the use of the facility by customers who have other options.

In the alternative, Petro-Canada recommended that a portion of the identifiable capital costs allocated to the LPSF function be deferred from inclusion in the LPSF toll design methodology at this time. Westcoast found the proposal unacceptable because it simply deferred a final resolution of the toll design issue to a later date and created uncertainties as to how the deferred balance would be dealt with in the future.

CPA, COFI, EUG and BC Gas also proposed that the LPSF service be excluded from utility operations; only IPAC disagreed. IPAC explained that, if the facilities were not regulated, its members, who tend to move smaller volumes, could wind up with less favourable processing fees than would apply to other larger users.

BC Gas submitted that the Petro-Canada agreement with Amoco is private and that contractual issues should be left to these parties and Westcoast to resolve, without involving Westcoast's tollpayers. BC Gas submitted that the tollpayers should not be asked to bail out Petro-Canada from an improvident contract.

BC Gas claimed that Westcoast's tolls at the McMahon Plant do not accurately reflect the costs of the different services that are provided. BC Gas argued that Westcoast's evidence indicated that the Company was capable of directly identifying certain O & M expenses with specific services. Westcoast's shortcut approach of allocating O & M expenses indirectly on the basis of plant investments could create cross-subsidization of one service by other services. In its opinion, Westcoast should identify all expenses that can be allocated to specific services offered at the McMahon Plant. Tolls could then be recalculated and discussed by the Task Force.

IPAC stated also that it intends to revisit the matter of the appropriate toll for the LPSF service in future toll proceedings when shippers will have the benefit of actual experience with volumes moving through the facilities.

Views of the Board

The Board is of the view that service tolls should generally be based on historical cost. However, the Board is prepared to depart from the traditional approach of setting tolls based on historical costs in view of the circumstances specific to the provision of LPSF Service at the McMahon Plant. Having considered the LPSF toll design proposals before it, the Board is persuaded that the method recommended by Westcoast in argument is the most appropriate.

Decision

The Board finds that the LPSF service toll should be calculated by using the current dollar allocation methodology (as described in Case 2 of Westcoast's response to NEB information request number 42) and by allocating $1.98 million in cancellation charges to the cost of completing the expansion of the McMahon Plant.

9.3 Liquids Recovery Service

Westcoast provides liquids recovery service to shippers at the Taylor Processing Plant. The applicable demand and commodity tolls for this service use residue gas volumes as the allocation unit. In this proceeding, Petro-Canada proposed that liquids recovery tolls be based on liquids content of individual gas streams rather than residue gas volumes.

During the hearing, Westcoast agreed that the change is reasonable. No other intervenor commented on this proposal.

Views of the Board

The issue of the appropriate basis for calculating liquids recovery tolls was last examined in the RH-2-87 toll proceeding. In its Reasons for Decision in that proceeding, the Board accepted Westcoast's proposal to change from a liquids residue gas equivalent to a residue gas basis for the purpose of simplifying the toll. Since then, liquids recovery tolls have increased significantly. The tolls paid by a customer under the existing toll design, because they reflect the average liquids content of the gas of all of the Taylor Processing Plant shippers, may be materially different from those that the customer would pay under a toll design based on specific liquids content.

Further, in the Board's view, service tolls should reflect as closely as possible the costs associated with processing or transporting a shipper's gas, with minimum reliance on averages.

Decision

The Board directs Westcoast to change the basis for calculating liquids recovery tolls from residue gas volumes to liquids content.

9.4 Backhaul Service

Westcoast introduced an Interruptible Import Backhaul Service on 1 January 1992 pursuant to the Board's directions contained in the RH-1-90 Reasons for Decision. This service allows the notional movement of gas from the export delivery point on the Westcoast system near Huntingdon, B.C., to the Company's Pacific Northern Gas Ltd. ("PNG") delivery point as well as the Inland and Lower Mainland delivery areas.

In this proceeding, IPAC proposed that Westcoast extend this backhaul service to all locations on its pipeline system. As backhaul service is already available in Zone 4 from Huntingdon to Compressor Station ("CS") 4A, the take-off point of PNG, and as gas can already flow in either direction in Zone 3, IPAC's proposal would amount to making the service available from CS 4A to CS 2, the border point between Zones 3 and 4.

As it did during the RH-1-90 proceeding, Westcoast expressed its opinion that backhaul service is not required on its system. Westcoast also stated that issues related to extension of backhaul service should be discussed at a Task Force meeting to determine whether there is demand for the service.

Under cross-examination by IPAC, Westcoast stated that, since January of this year when backhaul service was introduced, it has received only one request for such service. That request was turned down because it involved backhaul movements north of CS 4A. Further, Westcoast did not believe that a market for gas north of that station exists.

Regarding tolls, Westcoast proposed continuing the existing backhaul toll methodology, namely, that tolls be set at levels equivalent to the forward interruptible tolls of the same distance. The backhaul tolls would be calculated based on the 75 percent/100 percent winter/summer differential in load factors applied to the firm demand toll component, plus a commodity toll component. Even though Westcoast recognized that fuel is not used to provide backhaul services, it took the position that commodity backhaul tolls should include the cost of fuel gas and the tax on that fuel. Since interruptible backhaul service revenues are credited to shippers who pay the forward haul tolls, movements in both directions would contribute equally to the fixed cost of service and share the fuel and coloured gas tax savings.

In its direct evidence, IPAC stated that an interruptible backhaul service increases the flexibility for producers to market their gas. Under cross-examination, the association conceded that there is not a huge market for backhaul service north of CS 4A. IPAC also stated that it would reconsider its support for these services, should it be demonstrated in future that the service caused de-contracting or off-loading of Westcoast's forward haul firm services. In final argument, IPAC added that there is no need to have this matter considered by the Task Force.

Regarding tolls, IPAC stated that it is prepared to accept the existing toll design. IPAC also argued that including the cost of fuel gas in designing a backhaul toll is justifiable because a backhaul cannot take place unless there are facilities present for the forward haul and fuel is used for the forward haul. Also, charging a backhaul toll and fuel to a backhaul shipper is merely a means of crediting tolls otherwise payable by forward shippers.

COFI, in final argument, stated that backhaul service provides more flexibility and use of the entire system. COFI saw no need to limit the service to one zone or to refer this matter to the Task Force. It also recommended that fuel cost not be included in the tolls.

Views of the Board

The Board continues to be of the opinion that the provision of backhaul service diversifies the sources of gas supply available to Westcoast's customers. Extending backhaul service, as suggested by IPAC, would further increase the flexibility of shippers to market their gas.

Regarding the toll design for backhauls, the Board considers Westcoast's proposal that the tolls be set at the equivalent forward haul interruptible tolls of the same distance reasonable.

Decision

The Board directs Westcoast to extend its Interruptible Import Backhaul Service to Compressor Station 2 and to file proposed tolls for this extended backhaul service based on the currently approved toll methodology within 60 days of the release date of these Reasons for Decision.

Chapter 10

Tariff Matters

10.1 Terms and Conditions for LPSF Service

By Order TGI-4-91, the Board approved certain general terms and conditions related to the provision of LPSF service on an interim basis effective 1 January 1992. During the hearing, Petro-Canada raised three concerns.

The first one relates to sub-section 22.17 of the "General Terms and Conditions - Service" where Westcoast has the right to sell the liquid product which does not meet specifications ("off-spec product") and to allocate the proceeds, less its costs, to the shippers on a pro-rata basis. This sub-section also specifies that Westcoast will attempt to re-blend the off-spec product when conditions permit. Petro-Canada submitted that the allocation assumes that the costs associated with the product being off-spec should always be loaded on the customers, even though the fault may lie with Westcoast.

Westcoast contended that the production of off-spec product is a consequence of starting up and operating the processing plant. The primary function of the McMahon Plant is to produce residue gas, and the fractionation plant is an adjunct to the gas treatment plant. Westcoast would continue to operate the fractionation facilities even when there are operating problems and would later try its best to re-blend the off-spec product.

In final argument, Petro-Canada recommended that the Board allow Westcoast the right to recover its costs only in situations where Westcoast was not negligent or was not at fault.

Petro-Canada's second concern related to the priority of deliveries as spelled out in sub-sections 22.01, 22.02 and 22.03. Petro-Canada submitted that the availability of firm LPSF service seems to be limited to those shippers who hold firm service for the treatment and liquids recovery services at the McMahon Plant, without allowing parties who may bring a liquified petroleum gas stream from another plant to obtain firm service. Petro-Canada argued that any shipper whose volumes were considered in the design and sizing of the LPSF facilities, such as the liquids from Esso's Boundary Lake facilities, should be permitted to obtain firm service.

Westcoast replied that the exclusion is necessary because the primary function of the fractionation facility is to process liquids associated with the flow of raw gas to the gas plant. If firm fractionation service were available to any customer who may not take treatment service, the liquids processing plant could be booked entirely, leaving no capacity for the gas treated at the plant.

Finally, Petro-Canada was concerned with the shrinkage factors for liquid products found in sub-section 22.07c. Petro-Canada suggested that the sub-section should specify that shrinkage factors reflect only the processing undertaken on individual liquid streams. For liquids which are stabilized elsewhere, such as the Esso's Boundary Lake liquids, Petro-Canada submitted that the factors should recognize only the shrinkage that would occur in the fractionation facility. Westcoast replied that it has calculated a factor for the Boundary Lake liquids based only on the shrinkage that occurs in the fractionation facility.

No other intervenor commented on the interim general terms and conditions for LPSF service.

Views of the Board

The Board considers Westcoast's general terms and conditions related to the provision of LPSF service acceptable. However, the Board is cognizant of the fact that Westcoast has very limited experience with operating LPSF facilities. The Board is prepared to consider, in future proceedings, revisions that would improve the terms and conditions under which LPSF service is provided.

Decision

The Board approves the "General Terms and Conditions - Service" and other consequential tariff amendments related to the provision of LPSF service.

10.2 Terms and Conditions for Backhaul Service

In this proceeding, Westcoast reaffirmed its position that backhaul service cannot be provided on a firm basis since the service is available only when there is sufficient gas flowing in the forward direction. Under cross-examination by COFI, the Company agreed that in the case of backhaul movements, interruption is of a different nature when compared to other gas movements. As well, Westcoast agreed to consider revising the general terms and conditions to reflect the fact that availability of this service is subject to a forward flow of gas. Further, the Company pointed out that, operationally, its Gas Control Department already recognizes this difference between the "interruptible" nature of backhaul service and that of other services.

Decision

The Board directs Westcoast to revise its general terms and conditions to indicate that, with respect to the availability of backhaul service, interruptible means subject to a forward flow of gas.

Chapter 11

Deferral Accounts

11.1 Disposition of Existing Deferral Accounts

Westcoast calculated the actual balances as at 31 December 1991 in its deferral accounts authorized by Order TG-2-91. The Company proposed to recover the balances from or, where applicable, to credit them to the 1992 cost of service of the appropriate toll zones or functions and in two instances from specific customers. The only objection from intervenors was with regard to Westcoast's proposed method for disposing of the compressor fuel balance within the "Gas Used in Operations" deferral account. Westcoast stated that the deferral balance for compressor fuel relates to an underrecovery of compressor fuel costs during 1991 from sales customers, mainly BC Gas and PNG. However, the sales agreements with them terminated as of 31 October 1991. Westcoast proposed to recover the deferral balances from these two customers through a one-time charge to their monthly service bill. The charge for BC Gas would be $1,082,000 and $15,000 for PNG.

BC Gas objected to the proposed method of disposition on the grounds that it runs contrary to the methodology used in the disposition of similar deferral account balances in the past. BC Gas pointed out that when Northwest Pipeline Corporation declared *force majeure* in respect of its agreement with Westcoast in the late 1980s, certain residual costs were recovered from domestic tollpayers. This intervenor argued that the allocation proposed by Westcoast is outside the Board's jurisdiction to approve. BC Gas maintained that it was a sales customer of Westcoast in 1991 and any additional amounts sought by Westcoast for that period are a private contractual matter governed by the sales agreement between the two parties. BC Gas argued that the 1991 tolls are not subject to review by the Board in this hearing and that the only effective allocation is an allocation of the deferral amount to the cost of service of all tollpayers.

In reply argument, Westcoast stated that its proposal was not a retroactive adjustment to 1991 tolls, nor was it an attempt to collect under the sales agreements, but rather it was a recovery of costs in 1992 tolls by way of allocating these costs to the service contracts of BC Gas and PNG.

Views of the Board

Regarding the deferral balances related to compressor fuel and other fuel gas, the Board considers that it has the discretion to authorize the disposition of deferral account balances through tolls that Westcoast may charge its current customers only. In this regard, since BC Gas and PNG are no longer sales customers of the Company, the Board is of the view that these deferred costs should be borne by the general body of tollpayers. To recover cost deficiencies at this time from BC Gas and PNG specifically would be tantamount to retroactive rate-making.

The Board approves the Company's proposals concerning the disposition of other existing deferral accounts.

Decision

The Board approves the disposition of the currently approved cost of service and revenue deferral account balances as proposed by Westcoast, except that the compressor fuel balance and the other fuel gas balance within the "Gas Used in Operations" deferral account shall be allocated to each zone based on the rate base assigned to the zone.

11.2 Continuation of Existing Deferral Accounts

Westcoast indicated that it would not require in 1992 the following deferral accounts currently authorized by Order TG-2-91.

Cost of Service

Utility Exchange
Other Fuel Gas (a sub-account of "Gas Used in Operations")
Income Tax Adjustment Pension - carrying charges
1990 Cost of Service Deferral Account Variances
Vancouver Island Pipeline Project
McMahon Plant Expansion Project
Salary and Wage Escalation Deferral

Revenue

1990 Revenue Deferral Account Variances

In addition, the Company did not seek renewal of the "Purchase of Petro-Canada Facilities" deferral account (see section 11.4.3) that it applied for in this application.

Westcoast requested that the currently approved deferral accounts listed below be continued.

Cost of Service

Property Taxes
Foreign Exchange
Gas Used in Operations
NEB Cost Recovery
Income Tax Rate Change
Zone 2 Demand Charge Credits
Pressure Vessel Inspection and Repairs
Income Tax Reassessment

Revenue

Contract Demand Volumes
Interruptible Revenue

Of the deferral accounts that Westcoast applied to maintain, CPA argued that the Coloured Gas Tax component of the "Gas Used in Operations" deferral account was unnecessary. CPA stated that Westcoast should bill each shipper, on a current basis, for the coloured gas tax in direct proportion to the fuel supplied by the shipper. COFI agreed with the CPA's position. Westcoast took the position that while there would be no real difficulties in implementing CPA's proposal, the current deferral account approach requires less elaborate bookkeeping procedures.

Views of the Board

The Board is of the view that a deferral account should be allowed to continue only in situations where the underlying cost of service (or revenue) item remains beyond the control of the Company. The Board believes that a simpler bookkeeping procedure is not an adequate justification for continuing the Coloured Gas Tax deferral account. Westcoast should charge shippers directly for coloured gas tax.

Decision

The Board accepts Westcoast's request not to renew the cost of service and revenue deferral accounts identified by the Company. The Board approves the continuation of the deferral accounts specified by Westcoast for renewal with the exception of the Coloured Gas Tax component of the "Gas Used in Operations" deferral account which the Board directs Westcoast to discontinue.

11.3 Grizzly Valley Tax Reassessment

Westcoast received a settlement of $20.3 million in 1985 from parties sued by the company for the cost of replacing the original Grizzly Valley pipeline, which failed while in service. In 1989, Revenue Canada reassessed Westcoast about $13 million in income taxes and interest penalties related to the $20.3 million settlement. This reassessment and another $2.5 million relating to an earlier Grizzly Valley pipeline reassessment were paid to Revenue Canada, pending an appeal. In the RH-2-89 proceeding, the Board approved Westcoast's proposal to add the $15.5 million paid to Revenue Canada, together with $1.5 million in carrying charges, to rate base in January 1990. This amount would be amortized to the cost of service only when the appeal process had been completed. With legal fees of $59,000 added in December 1991, this account stood at $17.1 million at 1991 year end. During this hearing, Westcoast informed the Board that in March 1992 the Federal Court of Appeal had dismissed Revenue Canada's reassessment. Westcoast stated that it expected to know around 15 May 1992 whether Revenue Canada would appeal that decision.

By letter dated 22 May 1992, Westcoast confirmed that Revenue Canada would not appeal the court decision. Accordingly, Westcoast requested, in accordance with its earlier submissions, that the Board direct it to remove the $17.1 million from rate base effective 1 January 1992 and to transfer this amount to a new Grizzly Valley deferral account. The proceeds from Revenue Canada would be credited to this new deferral account and all costs incurred in the appeal process, including income taxes paid on interest received from Revenue Canada, would be charged to this account. Carrying charges at the rate of return on rate base would be applied to the account and the net amount would be credited to the 1993 cost of service. Westcoast estimated that this amount would be $2.3 million.

Decision

The Board approves Westcoast's proposal as outlined in its letter of 22 May 1992 concerning the regulatory treatment of the Grizzly Valley tax reassessment.

11.4 New Revenue and Cost of Service Deferral Accounts

11.4.1 1992 LPSF Cost of Service and Revenue Variances

By Order TGI-4-91, the Board approved cost of service and revenue deferral accounts for the LPSF service on an interim basis effective 1 January 1992. All revenues resulting from the interim LPSF toll would be credited to this revenue deferral account and all cost of service items associated with providing this service charged to the cost of service deferral account. During the hearing, Westcoast said that, for the LPSF service, it would accept a commodity-only toll for the recovery of both fixed and variable costs associated with providing the service on the condition that the Board would approve a revenue deferral account to capture the variance in revenue that is due to its throughput forecast. Westcoast also stated that Amoco, CanWest and Petro-Canada agreed with the account.

CPA also agreed that the revenue deferral account would be required until Westcoast gained some experience with the service. However, CPA believed that, if the Board should approve a demand/commodity type toll, the account would not be required because existing accounts such as the Zone 2 Demand Charge Credit or the Contract Demand Volume deferral accounts are available to record the variances.

Views of the Board

The Board recognizes that Westcoast has very limited experience with operating LPSF facilities. In particular, the Board notes the difficulties experienced by the Company in forecasting throughput for the new service. The Board therefore considers that Westcoast will require deferral treatment regarding cost of service and revenue variances related to LPSF service. The Board will examine the continued need for these deferral accounts in the next toll hearing.

Decision

The Board approves on a final basis the following deferral accounts allowed on an interim basis by Board Order TGI-4-91: a cost of service deferral account to record the difference between the actual and forecast cost of service for LPSF service; and a revenue deferral account to record the difference between the actual and forecast LPSF revenue.

11.4.2 Swing Gas

Westcoast requested a new deferral account for recording the net cost of any gas purchased by the Company in situations where Westcoast required gas to maintain linepack and system operating flexibility when shippers had under-delivered system requirements. Westcoast explained that, with the expiry of its purchase and sale agreement with CanWest on 1 November 1991, it could no longer correct linepack imbalances by ordering either more or less gas from CanWest. Westcoast is now obliged to place gas supply orders based on the daily deliveries and fuel requirements of shippers.

To support its position that deferral treatment for swing gas is required and that the general body of tollpayers should bear the cost, Westcoast gave examples where gas imbalances are caused and swing gas is required. For example, under the current General Terms and Conditions, shippers can take up to 2.5 percent more gas than authorized without incurring penalties. Shippers may also deliver 2.5 percent less gas than they had advised Westcoast. Gas imbalances may result. In Westcoast's opinion, since gas is being taken and delivered within the allowances established in the General Terms and Conditions, and imbalance still occurs, no fault can be attributed to any party. As well, in a raw gas transmission system gathering gas containing liquids, hydrocarbons and water from many producing wells, a freeze-off might occur causing an imbalance. Westcoast would not be able to identify the shipper or shippers responsible for the freeze-off.

Westcoast stated that whenever it could identify the shipper who had caused a large imbalance, the cost of swing gas would be charged to that shipper. The Company indicated that it had discussed with its customers several means of minimizing the use of swing gas such as the inclusion of delivery imbalance penalties and shipper renomination rights in the general terms and conditions for service.

CPA did not oppose the approval of the deferral account for 1992 on the basis that the cost of swing gas is a new element of Westcoast's service which may be difficult to forecast this year. IPAC supported the establishment of a swing gas deferral account. BC Gas submitted that, most of the time, Westcoast should be able to identify the shippers who caused imbalances and that these shippers should be charged directly. BC Gas argued that approval of the account would remove the incentive for Westcoast to identify who caused imbalances. In the opinion of BC Gas, the Board should deny Westcoast's request for a swing gas deferral account. In the alternative, BC Gas argued that, should the Board grant this deferral account, deferral treatment would be available only in cases where Westcoast, after making a genuine effort to assign responsibility, cannot identify the shippers who had caused the imbalances.

Views of the Board

Since November 1991, Westcoast is no longer involved in buying and selling gas on its own account. Considering Westcoast's limited experience operating in this new environment, the Company cannot be expected to forecast accurately the volume and therefore the cost of swing gas required. The Board is persuaded that Westcoast's request for a swing gas deferral account is reasonable.

The Board is of the view that, as much as possible, the cost of swing gas should be charged to those shippers who cause linepack imbalances requiring the use of swing gas. Nevertheless, the Board agrees with Westcoast that, when gas is being delivered and taken within the provisions of its General Terms and Conditions and imbalances occur, no fault can be attributed to any party. Therefore, the deferral treatment should be used only when the shippers who cause imbalances cannot be identified or where no fault can be attributed to any party.

The Board expects Westcoast to keep records of instances where swing gas is used so that, upon request, the Company can substantiate deferral treatment.

> **Decision**
>
> **The Board approves the establishment of a swing gas deferral account. Deferral treatment is available when the shippers who cause gas imbalances cannot be identified or where no fault can be attributed to any party.**

11.4.3 Purchase of Petro-Canada Facilities

Westcoast completed the acquisition of Petro-Canada facilities, approved by Orders MO-9-91 and XG-12-91, on 31 December 1991 rather than on 1 January 1992, which the Board had understood to be the closing date by virtue of the Company's 29 November 1991 letter. In doing so, Westcoast availed itself of CCA relating to the LPSF facilities in 1991. There is no specific regulatory authorization that would permit Westcoast to carry forward the costs associated with the purchase and operation of the LPSF facilities from Petro-Canada to 1992. For this reason, Westcoast applied for a "Purchase of Petro-Canada Facilities" deferral account in its 12 December 1991 application. The balance of this proposed deferral account, which is made up mainly of income tax savings related to CCA claimable in 1991, is estimated to be $788,000. Westcoast proposed to credit this amount to 1992 cost of service in Zone 2.

During the hearing, Westcoast proposed three alternatives for creating this proposed deferral account: (1) reviewing Order TGI-4-91; (2) reconsidering the Company's application dated 12 November 1991 concerning a cost of service deferral account to record all cost of service items associated with providing LPSF service in 1991; or (3) including the LPSF facilities purchased from Petro-Canada in the "McMahon Plant Expansion Project" deferral account.

No intervenor expressed an opinion on this matter during this proceeding.

Views of the Board

By Order TGI-5-91, the Board approved interim tolls for 1992 on the basis of Westcoast's 12 December 1991 application, which included the proposal regarding a "Purchase of Petro-Canada Facilities" deferral account. In issuing this Order, the Board did not dispose of Westcoast's request for the deferral account. The Board has approved, by Order AO-1-TGI-5-91 dated 22 July 1992 (Appendix IV), the deferral account mentioned above on an interim basis. Regarding the final disposition of this deferral account, the Board agrees with Westcoast's proposal to credit the account balance to 1992 cost of service in Zone 2.

With respect to the alternatives advanced by Westcoast, the Board does not consider the approach of including the LPSF facilities purchased from Petro-Canada in the "McMahon Plant Expansion Project" deferral account appropriate because that account was set up in the context of Westcoast constructing new LPSF facilities at the McMahon Plant, a course of action later abandoned. The Board agrees with Westcoast that it could have amended Order TGI-4-91 or reconsidered the Company's 21 November 1991 application to achieve the same purpose. However, the Board considers that, since Westcoast requested this deferral account in an application for 1992 tolls, it is more appropriate to grant interim approval of the request by amending Order TGI-5-91.

Decision

The Board approves the establishment of a "Purchase of Petro-Canada Facilities" deferral account for the purpose of recording costs incurred in 1991 for the purchase from Petro-Canada and the operation of LPSF facilities at Taylor, British Columbia. Regarding disposition, the Board approves Westcoast's proposal of crediting the balance of $788,000 to 1992 cost of service in Zone 2.

Chapter 12

Interim and Final Tolls

By Order TGI-5-91 dated 20 December 1991, the Board approved tolls that the Company may charge for services provided to customers on the Westcoast system on an interim basis effective 1 January 1992. These interim tolls were designed to yield an increase of 5 percent for a typical service movement from Zone 1 to the export point of Zone 4.

Having considered all of the evidence before it, the Board is of the view that final tolls for 1992 should be uniform, i.e., be charged at the same level throughout 1992. The Board has estimated that final tolls for 1992 set in this manner would give rise to an increase of approximately 2.5 percent over 1991 tolls for a typical service movement from Zone 1 to the point of export of Zone 4. In Westcoast's amended application, the Company requested a 6.0 percent increase. Accordingly, Westcoast will be required to refund to (and in some cases recover from) the Company's customers the difference between the tolls resulting from these Reasons for Decision and those approved in Order TGI-5-91, together with carrying charges at the approved rate of return on rate base.

Decision

The Board intends to approve final tolls for 1992 which are uniform throughout the 1992 calendar year. Westcoast is directed to refund to or, where applicable, to recover from the Company's customers, the difference between the tolls resulting from these Reasons for Decision and those approved in Order TGI-5-91, together with carrying charges at the rate of return on rate base approved for 1992.

Chapter 13

Further Filings by Westcoast

In these Reasons for Decision, the Board has estimated the impact of its decisions on 1992 cost of service and tolls on the basis of information available to it in this proceeding. The Board has not included a final approved rate base, cost of service or tolls for the 1992 test year.

Accordingly, Westcoast is required to file for Board approval revised information on rate base and cost of service together with supporting schedules reflecting the Board's decisions in Chapters 4 to 12 inclusive. These revisions and the tolls and tariffs are to be filed with the Board forthwith and served on interested parties. Westcoast's filings should include detailed explanations and, where necessary, supporting tables or working papers.

Chapter 14

Disposition

The foregoing chapters, together with Order TG-6-92 (Appendix I), constitute our Decision and Reasons for Decision on this application.

J.-G. Fredette
Presiding Member

C. Bélanger
Member

K.W. Vollman
Member

Calgary, Canada
August 1992

Appendix I

Order TG-6-92

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 12 December 1991, as amended, for approval of both interim and final tolls pursuant to subsection 19(2) and Part IV of the Act and filed with the National Energy Board ("the Board") under File No. 4200-W005-5.

BEFORE the Board on 30 July 1992.

WHEREAS, Westcoast, by application dated 12 December 1991, as amended, applied to the Board for an order or orders under subsection 19(2) and Part IV of the Act fixing just and reasonable tolls that Westcoast may charge, effective 1 January 1992, for raw gas transmission, processing and residue gas transportation services that it provides;

AND WHEREAS the Board, in expectation that it would not render a final decision regarding Westcoast's tolls until the completion of a public hearing, issued Order TGI-5-91 as amended and approved, on an interim basis, the tolls which Westcoast may charge effective 1 January 1992;

AND WHEREAS the Board held a public hearing pursuant to Hearing Order RH-1-92, as amended, in Vancouver, British Columbia commencing 30 March 1992 and in Calgary, Alberta;

AND WHEREAS the Board's decisions on the application are set out in its RH-1-92 Reasons for Decision dated August 1992 and in this Order;

IT IS ORDERED THAT:

1. Westcoast shall calculate new tolls in accordance with the decisions set out in the RH-1-92 Reasons for Decision and with this Order and shall forthwith file with the Board for approval and serve on all intervenors to the RH-1-92 proceeding, new tariffs implementing these new tolls;

2. Westcoast shall, for accounting, toll-making and tariff purposes, implement procedures to conform with the Board's decisions outlined in the RH-1-92 Reasons for Decision;

3. Order TGI-4-91, which authorized interim tolls and terms and conditions for the provision of Liquid Products Stabilization and Fractionation ("LPSF") Service as well as cost of service and revenue deferral accounts for LPSF Service, on an interim basis effective 1 January 1992, is revoked as at the end of the day on 31 July 1992;

4. Order TG-8-91, which approved the Toll Schedules for Offline Service, including tolls incorporated therein, on an interim basis effective 1 January 1992, is revoked as at the end of the day on 31 July 1992;

5. Order TGI-5-91, which authorized tolls that Westcoast may charge on an interim basis pending a final decision on the above-mentioned application, is revoked and the tolls that have been authorized thereunder are disallowed as of the end of the day on 31 July 1992;

6. Westcoast shall charge on a final basis, for service commencing 1 January 1992, tolls authorized by paragraph 1 of this order;

7. The Board's decisions set out in its RH-1-92 Reasons for Decision, and the changes to Westcoast's Tariff authorized in this Order are to take effect on a final basis as of 1 January 1992;

8. Westcoast is directed to refund that part of the tolls charged by the Company under Order TGI-5-91 which is in excess of the tolls determined by the Board to be just and reasonable in this Order or, where applicable, to recover the amount by which the tolls contemplated in this Order exceed the tolls charged by the Company under Order TGI-5-91, together with carrying charge on the amount so refunded or recovered at the rate of return on rate base approved in the RH-1-92 Reasons for Decision;

9. The refund or recovery authorized by this Order shall be effected without delay;

10. Westcoast shall file with the Board forthwith, and serve on all interested parties to the RH-1-92 proceeding, new tariffs, including general terms and conditions, and tolls conforming with the decisions set out in the RH-1-92 Reasons for Decision dated August 1992 and with this Order; and

11. Those provisions of Westcoast's tolls and tariffs, or any portion thereof, that are contrary to any provision of the Act, to the Board's RH-1-92 Reasons for Decision dated August 1992 or to any Order of the Board including this Order, are hereby disallowed.

NATIONAL ENERGY BOARD

J.S. Richardson
Secretary

Appendix II

Depreciation Rates

Section:		Depreciation Rates (%)[1] Applied for	Approved
	Zone 1		
4	Fort Nelson Raw Gas Transmission System	2.7	2.2
5	Beaver River Pipeline	0.8	0.8
6	Pointed Mountain Pipeline	0.8	0.8
9	Fort St. John Raw Gas Transmission System	2.2	2.2
9A	Aitken Creek Raw Gas Transmission System	2.2	2.2
13A	Grizzly Valley Raw Gas Transmission System	1.6	1.6
	Zone 2		
3	Fort Nelson Processing Plant	2.9	2.3
8	McMahon Plant	2.4	2.3
8A	Aitken Creek Plant	2.4	2.3
11	Boundary Lake Processing Plant	3.7	3.7
13B	Pine River Processing Plant	1.5	1.5
14A	Sikanni Gas Plant	7.3	6.1
	Zone 3		
2&2A	Fort Nelson Mainline and Aitken Creek Transmission Line		
	Obsolete Compressor Equipment	3.6	3.6
	Balance	2.5	1.5
7	Mainline Station 1 to 2	2.0	1.5
10A&B	16" and 26" Pipeline	1.4	1.4
13C	Grizzly Valley Transmission System	1.4	1.4
14B	Sikanni Pipeline	7.3	6.1
15	Alces Pipeline	10.8	9.2

Section:		Depreciation Rates (%)[1] Applied for	Approved
	Zone 4		
1	Mainline - Station 2 to Huntingdon		
	Obsolete Compressor Equipment	3.7	3.7
	Balance	2.0	1.5
	Zone 5		
12	Alberta Pipeline System (WEI)	1.4	1.4
12	Alberta Pipeline System (WTCL - Alta)	4.5	4.5
	Miscellaneous Facilities	2.2	1.8
NEB Acct.	General Plant		
482	Structures and Improvements	4.5	4.5
483	Office Furniture and Equipment	12.2	12.2
484	Transportation and Equipement		
	under 5 tons GVW	17.0	17.0
	over 5 tons GVW	6.5	6.5
	Aircraft BA 125-700	4.5	4.5
	Aircraft Islander C-FSTJ	7.2	7.2
485	Heavy Work Equipment	5.7	5.7
486	Tools and Work Equipment	10.0	10.0
488	Communications Equipment	10.0	10.0
489	Other Equipment	5.0	5.0
	Total Plant[1]	**2.6**	**2.2**

1 Composite depreciation rates for total plant are estimated by using 1992 average plant balances.

Appendix III

ORDER TGI-5-91

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

IN THE MATTER OF an application dated 12 December 1991 by Westcoast Energy Inc. ("Westcoast") for approval of both interim and final tolls effective 1 January 1992 pursuant to subsection 19(2) and Part IV of the Act, filed with the Board under File No. 4200-W005-5.

BEFORE the Board on 20 December 1991.

WHEREAS Westcoast has filed an application dated 12 December 1991 ("the application") for approval under Part IV of the Act to change its approved tolls to yield an increase in a typical service movement from Zone 1 to the export point of Zone 4 of 5%, effective 1 January 1992;

AND WHEREAS the Board expects that it will not render a final decision regarding Westcoast's final 1992 tolls until the completion of a public hearing process;

IT IS ORDERED, PURSUANT TO SUBSECTION 19(2) AND SECTION 59 OF THE ACT, THAT:

1. Westcoast shall charge tolls based on the 1 January 1992 net tolls listed on page 11 of the application on an interim basis effective 1 January 1992;

2. For accounting and toll-making purposes, each of the cost of service and revenue deferral accounts authorized in Order TG-2-91 are continued on an interim basis until the Board's final order regarding Westcoast's 1992 tolls comes into effect;

3. For accounting and toll-making purposes, Westcoast's request for a cost of service deferral account to record the net cost of any gas purchased by Westcoast where Westcoast requires gas to maintain line pack and system operating flexibility where shippers are under-delivering system requirements is approved on an interim basis;

4. For accounting and toll-making purposes, Westcoast's request for deferral accounts to record the differences, if any, between the actual and forecast deferral account balances for 1991 is denied;

5. With respect to Liquid Products Stabilization and Fractionation Service, for the purposes of this order, the Board denies the company's request for a deferral account to record the differences between Westcoast's forecast of Test Year Liquid Products Stabilization and Fractionation Service revenue and the toll revenue actually received during 1992 from providing this service; and

6. This interim order will remain in effect until the day the Board's final order concerning Westcoast's 1992 tolls comes into effect.

NATIONAL ENERGY BOARD

G. A. Laing
Secretary

Appendix IV

Order AO-1-TGI-5-91

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

IN THE MATTER OF an application dated 12 December 1991 by Westcoast Energy Inc. ("Westcoast") for approval of interim and final tolls pursuant to subsection 19(2) and Part IV of the Act, filed with the Board under File No. 4200-W005-5.

Before the Board on 22 July 1992.

WHEREAS Westcoast requested a "Purchase of Petro-Canada Facilities" cost of service deferral account in its 12 December 1991 application for 1992 tolls;

WHEREAS Westcoast proposed to record in the applied-for deferral account certain costs associated with the purchase and operation of the liquid products stabilization and fractionation ("LPSF") facilities at Taylor, British Columbia from Petro-Canada. These costs included operating and maintenance expenses and the tax impact of Capital Cost Allowance claimed under the Income Tax Act respecting the year 1991;

WHEREAS the Board has not disposed of Westcoast's application for this deferral account under Order TGI-5-91 or any other order of the Board that would allow Westcoast to record therein these costs;

AND WHEREAS the Board has not yet issued its final order regarding Westcoast's tolls for 1992;

IT IS ORDERED THAT, pursuant to subsection 21(1) and section 59 of the Act, Order TGI-5-91 be amended by adding paragraph 2.1:

"2.1 For accounting and toll making purposes, Westcoast's request for a deferral account to record the costs associated with the purchase and operation of the LPSF facilities purchased from Petro-Canada in 1991 is approved on an interim basis;"

NATIONAL ENERGY BOARD

J.S. Richardson
Secretary

Appendix V

List of Issues Contained in Hearing Order RH-1-92 as Amended

This list is intended to assist parties in defining the key issues to be addressed at the hearing. This will not preclude the Board from dealing with other matters which are normally raised by virtue of the Board's mandate pursuant to Part IV of the Act, including rate base, cost of service and rate of return.

At the hearing, the Board will consider, *inter alia*, the following matters:

1. Whether the depreciation rates proposed by Westcoast are appropriate.

2. Whether Westcoast's utility deferred income taxes should be drawn down and, in the context of this determination, whether fixed assets acquired or constructed during the period Westcoast was regulated on a normalized basis of accounting for income taxes should be treated as a separate pool.

3. Whether the person year utilization and the salary and wage increases proposed for the 1992 test year are appropriate.

4. Whether the cost of service and revenue deferral accounts currently authorized should be continued in the test year.

5. Whether a new cost of service deferral account regarding the net cost of "swing gas" should be allowed.

6. What is the appropriate toll methodology for Liquid Products Stabilization and Fractionation Service?

7. Whether the approved toll methodology and terms and conditions for Import Backhaul Service remain appropriate.

8. Whether the company's domestic and export throughput forecasts for the 1992 test year are reasonable.

9. What is the appropriate methodology to functionalize the processing costs at McMahon?

10. What is the appropriate accounting treatment for Lost and Unaccounted For Gas (LUF Gas)? Furthermore, whether Westcoast's proposal to recover a LUF Gas deficiency as at 31 December 1991 in its cost of service over three years is reasonable.

11. Whether the costs paid by Westcoast for the purchase of portions of the Petro-Canada Taylor refinery in 1991 were incurred prudently. Further, what are the costs and facilities that should be included in rate base in connection with this purchase?

12. Whether the current methodology for determining Westcoast's cash working capital requirement remains appropriate.

13. What is the appropriate toll methodology and terms and conditions for Backhaul Services at points other than those covered in the approved Import Backhaul Service for Zone 4, Transportation - Southern?

14. What is the appropriate treatment of the costs associated with implementation of Westcoast's gas management system?

15. Whether the current toll methodology for liquids recovery remains appropriate given the current utilization of the facilities used to perform those services. Furthermore, what is the proper disposition of revenues from these services?

16. Whether the costs of mainline capacity not subject to firm binding long term contracts should be paid by shippers, especially shippers not in a position to receive any benefit, either currently or in future, from such capacity.

Appendix VI

Westcoast Energy Inc.
System Map - Tolling Zones