CANADA

National Energy Board

Reasons for Decision

Trans Québec & Maritimes Pipeline Inc.

RHW-1-97

April 1997

1997 Tolls and Multi-Year Tolls Agreement

National Energy Board

Reasons for Decision

In the Matter of

Trans Québec & Maritimes Pipeline Inc.

Application dated 24 January 1997, as amended, for new tolls effective 1 January 1997 and for approval of a Multi-Year Tolls Agreement

RHW-1-97

April 1997

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Abbreviations

Act	*National Energy Board Act*
AFUDC	Allowance for Funds Used During Construction
Base Year	1 January 1995 to 31 December 1995
Board	National Energy Board (the)
Company	Trans Québec & Maritimes Pipeline Inc.
Current Year	1 January 1996 to 31 December 1996
Gaz Métropolitain	Gaz Métropolitain and Company, Limited Partnership
IGUA	Industrial Gas Users Association
LCT	Large Corporation Tax
NEB	National Energy Board (the)
O&M	Operating and Maintenance
ROE	Rate of Return on Common Equity
SCC	Stress Corrosion Cracking
SGT	Storage Gas Transportation
TS	Transportation and Storage
Test Year	1 January 1997 to 31 December 1997
Tolls Agreement	1997 and Multi-Year Tolls Agreement
TQM	Trans Québec & Maritimes Pipeline Inc.
TransCanada	TransCanada PipeLines Limited

Recital

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

IN THE MATTER OF an application by Trans Québec & Maritimes Pipeline Inc. for certain orders respecting tolls under Part IV of the Act, filed with the Board under File No. 4200-T028-8.

Examined by way of a written proceeding.

BEFORE:

R. Priddle	Chairman
K.W. Vollman	Vice-Chairman
A. Côté-Verhaaf	Member
R. Illing	Member

Overview

(Note: This overview is provided solely for the convenience of the reader and does not constitute part of the Reasons or Decisions, to which the reader is referred for detailed information.)

The Application

On 24 January 1997, TQM applied to the Board for new tolls to be effective 1 January 1997 and for approval of a multi-year tolls agreement (i.e. the "1997 and Multi-Year Tolls Agreement"). The application dealt with the following matters.

Negotiated Settlement

The Board approved the "1997 and Multi-Year Tolls Agreement" as submitted by TQM.

Revenue Requirement

The Board approved the applied-for Net Revenue Requirement of $65,926,000 for the 1997 Test Year.

Rate Base

The Board approved the applied-for Rate Base (Average Gross Plant = $506.8 million, Average Net Plant = $307.6 million) for the 1997 Test Year.

Depreciation Rates

The Board approved the continued use of existing depreciation rates for the 1997 Test Year.

Rate of Return on Rate Base

The Board approved the overall rate of return on rate base of 9.85% for the 1997 Test Year.

Chapter 1

Background and Application

1.1 Background

Trans Québec & Maritimes Pipeline Inc. ("TQM" or the "Company") operates natural gas transmission facilities as mandatary (agent) of TQM Pipeline and Company, Limited Partnership. The two partners are Gaz Métropolitain and Company, Limited Partnership ("Gaz Métropolitain") and TransCanada PipeLines Limited ("TransCanada"), each owning 50% of TQM.

The TQM system extends from a point of interconnection with the TransCanada system at Saint-Lazare near Montréal to a point near Québec City, in the municipality of Saint-Nicolas, on the south shore of the St. Lawrence River.

Natural gas is transmitted by TQM for TransCanada and delivered at the points of interconnection of TQM's pipeline with that of the distributor, Gaz Métropolitain.

TQM determines its cost of service for a forward test year, deducts revenues received from Gaz Métropolitain for miscellaneous transportation and storage services, and charges TransCanada 1/12th of the remaining costs each month. These costs are then included by TransCanada in its overall cost of service and recovered through tolls.

1.2 Application

By Interim Order TGI-4-96, the National Energy Board ("NEB" or the "Board") authorized TQM to charge tolls on an interim basis effective 1 January 1997. These interim tolls were to be calculated on the basis of tolls approved by the Board in its RHW-1-96 decision and were to remain interim until the end of the day preceding the day the Board's final order on TQM's 1997 tolls application comes into effect and until the Board had rendered a final decision on the rate of return on common equity for 1997.

On 24 January 1997, TQM applied under Part IV of the *National Energy Board Act* (the "Act") for new tolls, to be effective 1 January 1997, and for approval of a negotiated incentive-based settlement (i.e. the 1997 and Multi-Year Tolls Agreement). TQM proposed that all issues in its application be dealt with in writing.

The Board, in its letter dated 21 February 1997, indicated that, given the extent of agreement between TQM and Interested Parties, TQM's application would be dealt with by way of an written proceeding. The Board subsequently sent information requests to TQM which were responded to on 14 March 1997.

TQM filed revisions to its application on 18 March 1997 reflecting the Board's decision regarding the 1997 rate of return on common equity which was transmitted in a Board letter dated 14 March 1997.

Chapter 2

Negotiated Settlement

2.1 Introduction

In its 1996 Tolls Application, TQM raised the issue of a streamlined process of revising its tolls aimed at reaching agreement with interested parties of record before filing future toll applications. In issuing the Directions on Procedure for RHW-1-96, the Board directed that the issue of "introduction of an element of incentive regulation e.g. in respect of Operations and Maintenance costs" also be addressed in the 1996 Application.

TQM, after consulting with Interested Parties, advised the Board that it would be preferable to hold further discussions on the issue of incentive mechanisms and requested that the NEB postpone the issues of streamlining the process and of incentive mechanisms until the 1997 tolls application. This request was subsequently granted by the Board.

Following the conclusion of RHW-1-96, TQM initiated discussions with Interested Parties and developed a framework for a possible multi-year tolls agreement to be effective 1 January 1997. These negotiations resulted in the 1997 and Multi-Year Tolls Agreement ("Tolls Agreement") which now provides the basis for TQM's 1997 Tolls Application.

As stated in the Application, all Interested Parties from RHW-1-96 were invited to participate in the process to negotiate a multi-year tolls agreement. It appears that all parties, except IGUA, either participated or agreed to be excluded from participation in negotiations. IGUA withdrew its active participation part way into the process due to the prospect that TQM was considering extension of its pipeline to the East Coast. However, IGUA filed a letter with the Board subsequent to the filing of the Tolls Agreement stating its position that it neither supported nor opposed the settlement.

2.2 Summary of TQM's 1997 and Multi-Year Tolls Agreement

The following is a summary of the key provisions of the Tolls Agreement. Please refer to Appendix II for the complete text of TQM's Tolls Agreement.

1. The Tolls Agreement covers a five-year period from 1 January 1997 to 31 December 2001.

2. The primary objectives of the Tolls Agreement are:

   - to streamline the Part IV regulatory procedure.
   - to minimize the time required for processing TQM's tolls applications.
   - to include an appropriate framework to encourage TQM to lower O&M costs without adversely affecting pipeline safety.
   - to provide for sharing possible cost reductions with shippers.

3. The Board’s role (as described in the Tolls Agreement) regarding the implementation of the Tolls Agreement and the resulting calculation of tolls is:

- to review and approve the reasonableness of items forecast for 1997 (and subsequent years) in the Flow-Through Cost Envelope.
- to adjudicate all future disputes which might arise out of this Tolls Agreement.
- to be the arbiter of matters involving changes or additions to Rate Base.
- generally fulfil its mandate as required under the Act.

4. The determination of TQM’s Net Revenue Requirement for the purpose of calculating transportation tolls is based on the sum of:

- Incentive Cost Envelope amounts.
- Flow-Through Cost Envelope amounts.
- Flow-Through Deferral Accounts amounts.

less

- Storage Revenue amounts.

5. The Incentive Cost Envelope is made up of all Operating and Maintenance ("O&M") costs less Stress Corrosion Cracking ("SCC") costs. The Incentive Cost Envelope has been set at $7.440 million for 1997, increasing by 1.5% to $7.552 million for 1998, another 1.0% to $7.628 million for 1999 and finally by 0.5% to $7.666 million for 2000 and no increase for 2001. Variances between the actual amounts incurred for these years and the above-specified amounts will be shared equally between TQM and its shippers.

6. Insurance Costs were specified separately for each year of the Tolls Agreement starting at $443,000 for 1997 and increasing gradually to $462,000 for 2000 and 2001. However, Insurance costs are still considered part of the Incentive Cost Envelope. If actual Insurance Expenses exceed the specified amounts, the variance will be captured in a Flow-Through Insurance Cost Deferral Account to be applied to succeeding test years.

7. All other costs are to be included in a Flow-Through Cost Envelope. These costs include SCC costs, Municipal and Other Taxes, NEB Cost Recovery, Depreciation and Amortization, Income Taxes, Return on Rate Base, Non-Routine Adjustments, New O&M costs and amounts recorded in Flow-Through Deferral Accounts. Any variances will be applied to TQM’s Cost of Service in the following test year.

8. Unanticipated changes in certain costs (e.g. changes in revenues or expenses resulting from changes in applicable accounting standards - Canadian generally accepted accounting principles and Gas Pipeline Uniform Accounting Regulations) included in the Incentive Cost Envelope are to be treated as Non-Routine Adjustments and included in the Flow-Through Cost Envelope.

9. The Tolls Agreement contains provision related to Facilities Expansions. If TQM applies for and receives approval for a major facilities expansion (i.e. in excess of $5.0 million), TQM will attempt to negotiate with its interested parties to reach agreement on including new O&M costs in the Incentive Cost Envelope.

The Tolls Agreement stipulates that, should the Board approve an application for an extension to the Maritimes, the Tolls Agreement would terminate, unless otherwise agreed to between TQM and its interested parties.

10. TQM's Rate Base will be determined in each Test Year and submitted to the Board for approval.

11. Depreciation Expense will be based on approved rates in effect at 31 December 1996 or those rates approved thereafter by the NEB.

12. The rate of return on rate base is to be calculated as the weighted average of debt cost rate, including funded and unfunded debt (70% of capitalization) and rate of return on common equity (30% of capitalization).

    The rate of return on common equity shall be determined in accordance with the methodology established in the RH-2-94 Multi-Pipeline Cost of Capital proceeding and as amended in the Board's letter dated 14 March 1997. For the 1997 Test Year, the ROE has been set at 10.67%.

13. Flow-Through deferral accounts are created to record variances between actual and forecast costs relating to Insurance costs, Non-Routine Adjustments, New O&M costs, SCC costs and to record Storage Revenue.

14. Also included in the Agreement are provisions relating to the review of costs, disputes resolution and potential cost adjustments.

    In addition, the Agreement specifies that the Board's current audit function is to be retained and performed.

    There is a further provision in the Tolls Agreement which states that TQM proposes to request that the current form of the Board's Quarterly Surveillance Report be amended to reflect this Agreement and that only the year-end report be required effective as of the 1997 Test Year. TQM subsequently filed this request by way of a letter to the Board dated 14 March 1997.

15. TQM proposes that, each year in November, it will file with the Board new tolls for the upcoming Test Year with a request that tolls be made interim 1 January of the Test Year, pending final disposition by the Board.

Views of the Board

As stated in the Board's Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs dated 23 August 1994, the Board sees negotiated settlements as a means whereby pipeline companies and interested parties can choose to resolve issues and agree on the resulting tolls and tariffs without resorting to the public hearing process.

The Board views the negotiated settlement process followed by TQM in developing its Tolls Agreement as appropriate in its particular circumstances. The Board considers that TQM's Interested Parties were given a fair opportunity to participate and have their interests recognized and weighed. In addition, the resulting Tolls Agreement provides the framework to determine the Total Revenue Requirement utilized by TQM in the calculation of tolls over a multi-year period and introduces an incentive mechanism regarding Operating and Maintenance costs.

Decision

The Board approves TQM's 1997 and Multi-Year Tolls Agreement and the procedure set out therein for TQM's future toll applications. The Board directs that the provisions of the Agreement be implemented in determining TQM's Net Revenue Requirement and resulting tolls for 1997.

The Board approves TQM's request to amend the format of its Quarterly Surveillance Report in order to reflect the Tolls Agreement and to only provide the year-end report beginning with the 1997 Test Year.

The Board approves the continued use of TQM's currently approved rates of depreciation for the 1997 Test Year (see Schedule 3).

The Board also approves the following Deferral Accounts in accordance with the 1997 Tolls Agreement:

a) Incentive Costs Deferral Account;
b) Flow-Through Insurance Deferral Account;
c) Flow-Through Adjustments Deferral Account;
d) Flow-Through New O&M Costs Deferral Account;
e) Flow-Through SCC Cost Deferral Account; and
f) Flow-Through Storage Revenue Deferral Account

With respect to other related matters, the Board hereby approves:

- **the applied-for Net Revenue Requirement of $65,926,000 for the 1997 Test Year(see Schedule 1).**

- **the applied-for Rate Base (Average Gross Plant = $506.8 million, Average Net Plant = $307.6 million) for the 1997 Test Year (see Schedule 2).**

- **the overall rate of return on rate base of 9.85% for the 1997 Test Year (see Schedule 4).**

Chapter 3

Disposition

The foregoing chapters, together with Board Order TG-2-97, constitute our Reasons for Decision and our Decision in this matter.

R. Priddle
Chairman

K.W. Vollman
Vice-Chairman

A. Côté-Verhaaf
Member

R. Illing
Member

Appendix I

Order TG-2-97

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

AND IN THE MATTER OF an Application filed with the National Energy Board ("the Board") under File No. 4200-T028-8 by Trans Québec & Maritimes Pipeline Inc. ("TQM") for certain orders respecting tolls specified in a tariff pursuant to Part IV, sections 59, 60 and 65 of the Act.

BEFORE the Board on 17 April 1997.

WHEREAS by Application dated 24 January 1997 and as amended 21 March 1997, TQM sought approval from the Board, effective 1 January 1997, of fixed transportation tolls for transmission of natural gas through its pipeline facilities;

AND WHEREAS by Interim Order TGI-4-96, the Board ordered TQM to charge, in respect of the transportation service provided to TransCanada PipeLines Limited ("TransCanada"), an interim monthly toll for the 1997 Test Year, as approved by the Board in its RHW-1-96 decision, commencing 1 January 1997;

AND WHEREAS the rate of return on common equity for 1997 was reduced from 11.25% in 1996 to 10.67% pursuant to an annual adjustment mechanism originally approved in the RH-2-94 Multi-Pipeline Cost of Capital proceeding and amended in a Board letter dated 14 March 1997;

AND WHEREAS pursuant to Order RHW-1-97 the Board examined, by way of a written proceeding, the evidence of TQM with respect to the Application;

THEREFORE IT IS ORDERED THAT:

1. For accounting, tollmaking and tariff purposes, TQM shall implement procedures conforming to the Board's decisions outlined in the RHW-1-97 Reasons for Decision and with this Order.

2. Order TGI-4-96, which authorized the tolls to be charged on an interim basis pending a final decision on the said application, is revoked and the tolls that were authorized to be charged thereunder are disallowed as at the end of the day 30 April 1997.

3. The tolls which were in effect, on an interim basis, for the period 1 January 1997 to 30 April 1997 are final.

4. TQM shall charge in respect of its transportation service provided to TransCanada, a monthly toll of $5,493,833 for the period 1 May 1997 to 31 December 1997. This amount is the approved Net Revenue Requirement for the 1997 Test Year divided by 12 months.

5. In addition, TQM shall reimburse TransCanada the aggregate amount of $270,633, being the amount by which tolls set by this Order are less than the tolls charged by TQM under Board Order TGI-4-96, together with carrying charges to be calculated using the approved rate of return on rate base (i.e. 9.85%). Carrying charges on the January overpayment of $66,281 will be calculated from 20 February 1997 to 20 June 1997; carrying charges on the February overpayment of $66,281 will be calculated from 20 March 1997 to 20 June 1997; carrying charges on the March overpayment of $66,281 will be calculated from 20 April 1997 to 20 June 1997; and carrying charges on the April overpayment of $66,281 will be calculated from 20 May 1997 to 20 June 1997. TQM shall refund this aggregate amount as a credit to its 10 June 1997 billing for services rendered in May 1997.

6. TQM shall charge Gaz Métropolitain and Company, Limited Partnership ("Gaz Métropolitain"), in respect of Transportation Storage ("TS") service, a toll based upon the TS tariff attached to the Transportation and Storage Service contract dated 17 March 1987, as amended, filed with the Board under covering letter dated 10 April 1987; and Amending Agreement dated 30 October 1995 which extends the Transportation and Storage Service contract to 31 October 2000. The approved Storage Fee is $3,875 per month.

7. TQM shall charge Gaz Métropolitain, in respect of Storage Gas Transportation ("SGT") service, a toll based upon the SGT toll design approved in the RHW-1-96 Reasons for Decision dated May 1996. The approved SGT toll for the 1997 Test Year is $2.19/10^3m^3 for deliveries to Trois-Rivières and $9.02/10^3m^3 for deliveries to points located downstream of Trois-Rivières.

8. TQM shall forthwith file with the Board and serve on all parties identified in Appendix A of TQM Pipeline's Application, tolls conforming with the decisions outlined in the RHW-1-97 Reasons for Decision dated April 1997 and with this Order.

9. Those provisions of TQM Pipeline's tariffs and tolls or any portion thereof that are contrary to the RHW-1-97 Reasons for Decision or to any Order of the Board including this Order are hereby disallowed.

NATIONAL ENERGY BOARD

M. L. Mantha
A/Secretary

Appendix II

1997 and Multi-Year Tolls Agreement

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Trans Québec & Maritimes Pipeline Inc.
1997 and Multi-Year Tolls Agreement

1 Background

1.1 Trans Québec & Maritimes Pipeline Inc. (**“ TQM Pipeline ”**) is regulated by the National Energy Board (**“ NEB ”**) and, in November 1995, TQM Pipeline applied to the NEB for new tolls to be effective January 1, 1996.

In May 1996, the NEB approved a net Revenue Requirement for TQM Pipeline of $66,721,000 for the 1996 Test Year, a reduction of $82,000 from the applied-for amount. The NEB denied the request by TQM Pipeline to continue the deferral account related to Unfunded Debt and, as a result, there is no deferral account in effect in 1996 .

The NEB also approved the proposed SGT toll design for the transportation of storage gas.

1.2 For several years, TQM Pipeline’s applications for new tolls, such as the one for 1996, have been dealt with in writing for matters other than cost of capital (rate of return, capital structure, etc.). Recently, as a result of the multi-pipeline hearing on the cost of capital (RH-2-94 on rate of return on common equity and on capital structure), the NEB approved an automatic adjustment mechanism to make yearly adjustments to the approved rate of return on common equity.

In its 1996 Application, in an effort to further streamline the process of revising its tolls, TQM Pipeline proposed a procedure aiming at reaching agreement with interested parties of record before filing its future tolls applications with the NEB. In the Preliminary List of Issues of Order RHW-1-96, the NEB also included the “ introduction of an element of incentive regulation, e.g. in respect of Operating and Maintenance costs ”.

TQM Pipeline consulted its interested parties and advised the NEB that it would be preferable to further discuss the issue of incentive mechanisms; TQM Pipeline therefore asked the NEB to postpone the discussion of streamlining of the process and of incentive mechanisms for implementation as of 1997. The NEB granted this request.

2 Agreement

2.1 Following the NEB’s decision,TQM Pipeline met with RHW-1-96 Interested Parties (with the exception of Foothills, Westcoast and SOQUIP who agreed to be excluded) and, as agreed, submitted the framework of a possible multi-year tolls agreement to be effective January 1, 1997. The parties participating with TQM Pipeline in this process were:

- Alberta Department of Energy
- Canadian Association of Petroleum Producers
- Consumers’ Gas Company Ltd. (The)

- Industrial Gas Users Association
- Intragaz inc.
- Ministère des Ressources naturelles du Québec
- Ministry of Energy for Ontario
- Société en commandite Gaz Métropolitain
- TransCanada PipeLines Limited
- Union Gas Limited/Centra Gas Ontario Inc.

Note: part way into this process, the Industrial Gas Users Association (**" IGUA "**) advised that it was withdrawing its support for this process because of the announcement that TQM Pipeline would be seeking the NEB's approval to extend its pipeline system to Nova Scotia.

These above mentioned parties (excluding IGUA) are hereafter collectively referred to as **" Interested Parties "**.

2.2 As a result, TQM Pipeline and Interested Parties propose the implementation of the present Multi-year Tolls Agreement (**" Agreement "**) which will be applied to determine the Total Revenue Requirement utilized by TQM Pipeline in the calculation of tolls for the transportation of natural gas on its system, in accordance with the toll methodology and pursuant to the Transportation Tariff of TQM Pipeline approved from time to time by the NEB.

2.3 The primary objectives of this Agreement are the following:

2.3.1 to streamline the Part IV regulatory procedure, so as to modify TQM Pipeline's tolls on a yearly basis in the most efficient manner;
2.3.2 to minimize the time required by the tolls applications of TQM Pipeline, so as to generally reduce regulatory costs;
2.3.3 to include an appropriate framework for TQM Pipeline to be encouraged to maintain its Operating and Maintenance costs low, stable and predictable, without negative impingement on pipeline safety; and
2.3.4 to provide for sharing possible costs reductions with shippers.

2.4 This Agreement shall apply only to the activities of TQM Pipeline which are subject to the jurisdiction of the NEB.

2.5 The Parties enter into this Agreement with the understanding that no single component of the Agreement is to be construed as representing the position of either TQM Pipeline or any Interested Parties on the appropriate result that would be obtained in the absence of the Agreement. The Parties intend this Agreement to be viewed as a whole and that there should be no prejudice to the positions of TQM Pipeline or any Interested Parties in the future. No element of the Agreement should be considered as acceptable to either TQM Pipeline or any Interested Parties in isolation from all other aspects of the Agreement. All elements of the Agreement are inextricably linked.

2.6 The Parties agree that this Agreement does not address any costs related to an extension of the TQM Pipeline system to the Maritimes. Following any approval by the NEB of such an extension, unless otherwise agreed to between the Parties, this

Agreement shall terminate December 31st of the year immediately preceding the year such facilities are contemplated to be put in service.

2.7 The Parties agree that if this Agreement is not approved in its entirety by the NEB, or if it is subsequently materially varied by an NEB Order, the Agreement will terminate.

2.8 The Parties acknowledge that the NEB has exclusive jurisdiction over the establishment of TQM Pipeline's tolls and that any matters respecting the derivation of tolls under this Agreement shall be determined by the NEB.

2.9 Furthermore, the Parties contemplate that the NEB will play the following role regarding the implementation of this Agreement and the resulting calculation of TQM Pipeline's tolls:

2.9.1 review and approve the reasonableness of the forecast of items covered in the Flow-Through Cost Envelope;
2.9.2 adjudicate all disputes which arise out of this Agreement and which cannot be resolved amongst the Parties in accordance with the terms of this Agreement;
2.9.3 be the arbiter of matters involving additions or changes to Rate Base; and
2.9.4 generally fulfil its mandate as required under the *National Energy Board Act*.

3 Definitions

3.1 In this Agreement, the following terms have the meaning set out hereafter:

3.1.1 **Insurance Costs** means all costs related to insurance; specifically the inclusion of both Insurance Deductible and Insurance Expense costs.
3.1.2 **Insurance Deductible costs** means costs not recovered from insurers in an insurance claim. These costs are separate and distinct from Insurance Expense costs.
3.1.3 **Insurance Expense costs** means the premiums that are paid annually to the insurer.
3.1.4 **Interested Parties** means collectively the parties listed in Section 2.1 herein.
3.1.5 **Major Facilities Expansion** means an addition to the TQM Pipeline System (other than the extension referred to in section 2.6 and which addition may include related facilities at more than one geographic location) during the term of this Agreement the value of which exceeds $5,000,000.
3.1.6 **NEB** means the National Energy Board of Canada.
3.1.7 **New O & M Costs** means those Operating and Maintenance costs properly attributable to the Major Facilities Expansion(s), excluding SCC Costs.
3.1.8 **other interested parties of record** means collectively the parties who are not Interested Parties and who after the date this Agreement becomes effective express an interest in TQM Pipeline's toll proceedings and so advise TQM Pipeline in writing.
3.1.9 **Parties** means the parties to this Agreement: Interested Parties and TQM Pipeline.
3.1.10 **SGT Toll Schedule** means TQM Pipeline's SGT-SCGM Toll Schedule applicable to gas service pursuant to a storage gas transportation contract.

3.1.11 **TS Toll Schedule** means TQM Pipeline's TS-SCGM Toll Schedule applicable to gas service pursuant to a transportation and storage contract.

3.1.12 **Test Year** means the calendar year January 1st to December 31st for which the Net Revenue Requirement and resulting tolls are applicable.

3.2 In interpreting this Agreement, the Parties agree as follows:

3.2.1 **in the usual fashion:** shall be understood as being the methodology approved by the NEB, in effect and applied by TQM Pipeline prior to this Agreement having effect.

3.2.2 **variance:** references to cost or revenue variances can be negative or positive.

4 Determination of Net Revenue Requirement

4.1 The determination of TQM Pipeline's Net Revenue Requirement for the purpose of calculating transportation tolls for each Test Year of this Agreement shall be based on the following formula:

Net Revenue Requirement equals the sum of

- Incentive Cost Envelope amounts
- Flow-Through Cost Envelope amounts
- Flow-Through Deferral Accounts amounts

less

- Storage Revenue amounts.

4.2 The elements of this formula and how the applicable costs, revenues, variances and adjustments are to be calculated and applied are set out in detail in the Articles which follow.

5 Incentive Cost Envelope

5.1 The Incentive Cost Envelope is made up of the following components:

- Operating and Maintenance costs as determined under sections 5.2 and 5.3

less

- SCC Costs.

5.2 The following amounts on account of Operating and Maintenance costs, which exclude SCC Costs and New O & M Costs, will be included in the Incentive Cost Envelope for each Test Year during the term of this Agreement:

for 1997, $7,440,000
for 1998, $7,552,000
for 1999, $7,628,000
for 2000, $7,666,000
for 2001, $7,666,000.

5.3 Subject to the specific adjustments and qualifications relating to Insurance Costs set out in Article 6 hereafter, for each Test Year, the variance between the actual costs for items included in the Incentive Cost Envelope and the amount shown in Section 5.2 for such year shall be shared equally by TQM Pipeline and its shippers. To this effect, one half of such cost variance shall be recorded in an Incentive Costs Sharing Deferral Account and the calculation of such variance will then be forwarded to the NEB, Interested Parties and other interested parties of record as the case may be. If, after one month, no concerns have been raised, the contents of such deferral account shall be credited or added to the invoice for service rendered during the month immediately following.

5.4 For greater certainty, no New O & M Costs are accounted as such for those costs which relate or pertain to additions to Rate Base with a value less than $5,000,000.

6 Insurance Costs Adjustment

6.1 Each year, actual Insurance Expense costs which exceed the following amounts shall be recorded in a Flow-Through Insurance Cost Deferral Account and added to the Net Revenue Requirement in the Test Year immediately following:

for 1997 - $443,000
for 1998 - $451,000
for 1999 - $458,000
for 2000 - $462,000
for 2001 - $462,000.

6.2 Insurance Deductible costs, if any in any year, shall be recorded in a Flow-Through Insurance Cost Deferral Account and added to the Net Revenue Requirement in the succeeding Test Years in an amount for each such Test Year calculated as 1/3 of the aggregate of the insurance deductible costs experienced in the prior three years.

7 Flow-Through Cost Envelope

7.1 The Flow-Through Cost Envelope is made up of the following components:

7.1.1 SCC Costs;
7.1.2 Municipal and Other Taxes;
7.1.3 NEB Cost Recovery;
7.1.4 Depreciation and Amortization;
7.1.5 Income Taxes;
7.1.6 Return on Rate Base;
7.1.7 Non-Routine Adjustments per Section 8.2;
7.1.8 New O & M Costs per Section 9.3; and
7.1.9 Flow-Through Deferral Accounts.

7.2 TQM Pipeline will forecast the components of the Flow-Through Cost Envelope for each Test Year of this Agreement and include such forecast in the calculation of the Net Revenue Requirement filed for the approval of the NEB for toll making purposes for the applicable Test Year. It is understood that TQM Pipeline will also provide the

NEB, Interested Parties and other interested parties of record as the case may be with the information required to be filed pursuant to Part X of the Guidelines for Filing Requirements in this regard.

7.3 Each year, prior to filing its calculation of the Net Revenue Requirement for the approval of the NEB for toll making purposes for the next Test Year, TQM Pipeline will submit an estimate of such Net Revenue Requirement to Interested Parties and other interested parties of record as the case may be for their review, with the objective of obtaining their support for the Net Revenue Requirement that will ultimately be filed with the Board.

TQM Pipeline's subsequent filing with the NEB will state the result of such review. In the event that there is no objection and that the NEB is satisfied with the information filed, the NEB would then approve the tolls proposed.

In the event that an issue remains unresolved, a written or oral procedure to deal with such issue will be established by the NEB.

8 Non-Routine Adjustments

8.1 The following items are examples of unanticipated changes (at the time of concluding this Agreement) in costs that are included in the Incentive Cost Envelope but that, in any year, shall be treated as Non-Routine Adjustments for the purpose of the Flow-Through Cost Envelope:

8.1.1 changes in revenues or expenses resulting from changes in applicable accounting standards (Canadian generally accepted accounting principles and Gas Pipeline Uniform Accounting Regulations);

8.1.2 changes in costs or revenues due to orders or directives issued by a regulatory agency having jurisdiction; and

8.1.3 changes in legislation, regulations or ordinances or the issuance of orders or directives which result in changes to safety, health or environmental requirements or practices.

8.2 Each year, to the extent they have become predictable, TQM Pipeline will forecast such change in costs in the following Test Year pursuant to Section 8.1 herein and include a corresponding Non-Routine Adjustment amount in the Flow-Through Cost Envelope for that Test Year.

8.3 Each year, variances between the actual and forecast amount of Non-Routine Adjustments of such costs included in the Flow-Through Cost Envelope pursuant to Section 8.2 herein shall be recorded in a Flow-Through Non-Routine Adjustments Deferral Account and credited or added to the Net Revenue Requirement in the Test Year immediately following.

9 New O & M Costs

9.1 If and whenever, during the term of this Agreement, TQM Pipeline applies for and the NEB approves a Major Facilities Expansion, TQM Pipeline will promptly notify Interested Parties and, thereafter, the Parties will cooperate and work together in good faith with the aim of reaching agreement on a mutually acceptable means of including New O & M Costs, or any portion thereof, in the Incentive Cost Envelope. If the Parties are unable to reach such an agreement within 45 days after TQM Pipeline's notice to Interested Parties, TQM Pipeline may apply to the NEB for an order authorizing the inclusion of New O & M Costs , or any portion thereof, in the Incentive Cost Envelope and/or the Flow-Through Cost Envelope, as TQM Pipeline sees fit at the time. Interested Parties will be free to support TQM Pipeline or to advocate an alternative means for TQM Pipeline to recover New O & M Costs, or any portion thereof.

9.2 To the extent that the NEB authorizes TQM Pipeline to include an amount of New O & M Costs in the Incentive Cost Envelope, at such time these costs will be added to the Incentive Costs Envelope as shown in Section 5.2.

9.3 To the extent that the NEB authorizes TQM Pipeline to include an amount of New O & M Costs in the Flow-Through Cost Envelope, each year TQM Pipeline will forecast the amount of such New O & M Costs for the following Test Year and include such forecast in the Flow-Through Cost Envelope for that Test Year.

9.4 Each year, variances between the actual and forecast amount of such New O & M Costs included in the Flow-Through Cost Envelope pursuant to Section 9.3 herein shall be recorded in a Flow-Through New O & M Costs Deferral Account and credited or added to the Net Revenue Requirement in the Test Year immediately following.

10 Rate Base

10.1 Rate Base shall be determined in each Test Year, in the usual fashion, so as to reflect additions to and retirements from gross plant, Depreciation Expense and changes in other Rate Base components and will be submitted for NEB approval as specified in Section 7.3 herein.

11 Depreciation Expense

11.1 Depreciation Expense, unless otherwise agreed to between the Parties, shall be calculated in the usual fashion, using the depreciation rates in effect at December 31, 1996 for the TQM Pipeline system, or such other rates as may be prescribed thereafter by the NEB.

12 Return on Rate Base

12.1 The rate of return on rate base shall be calculated in the usual fashion and shall be the sum of the weighted average cost of debt, including funded and unfunded/prefunded debt (70 % of total capitalization), and the rate of return on common equity (30% of total capitalization) as each applies to TQM Pipeline.

12.2 The rate of return on common equity shall be TQM Pipeline's authorized rate of return on common equity that is determined for each Test Year in accordance with the methodology established in the NEB RH-2-94 Decision and is based on a deemed common equity component of 30% of total capitalization, or with such other methodology as may be prescribed thereafter by the NEB.

12.3 The cost of funded debt shall be determined by TQM Pipeline for each Test Year in the usual fashion and will be submitted for NEB approval as specified in Section 7.3 herein.

12.4 The cost of unfunded/prefunded debt shall be determined by TQM Pipeline for each Test Year in the usual fashion; to this effect, each year in November, forecasts of the interest rate referenced in TQM Pipeline's loan agreement in effect (presently the prime interest rate) will be obtained from the usual financial institutions for the next Test Year and an average interest cost rate for unfunded/prefunded debt will be calculated for such Test Year as referenced in the loan agreement (presently prime less 0.50%). Unless the information is no longer available from such financial institutions, the forecasts of such interest rate will be obtained from the financial institutions used by TQM Pipeline in the RHW-1-96 proceedings.

13 SCC Costs

13.1 Each year, TQM Pipeline will forecast Stress Corrosion Cracking and Pipeline Integrity Verification Program related costs(**" SCC Costs "**) for the following Test Year and include such an amount in the Flow-Through Cost Envelope for that Test Year.

13.2 Each year, variances between the actual and forecast amount of SCC Costs included in the Flow-Through Cost Envelope pursuant to Section 13.1 herein shall be recorded in a Flow-Through SCC Cost Deferral Account and credited or added to the Net Revenue Requirement in the Test Year immediately following.

14 Flow-Through Deferral Accounts

14.1 Flow-Through deferral accounts shall record variances between actual and Test Year costs relating to Insurance Costs as provided in Sections 6.1 and 6.2 herein, to Non-Routine Adjustments as provided in Section 8.3, to New O & M Costs as provided in Section 9.3, to SCC Cost as provided in Section 13.2 and to Storage Revenue as provided in Section 15.2 herein.

14.2 Carrying charges shall apply to Flow-Through deferral accounts and will be calculated monthly at the rate of return on rate base then applicable in the usual fashion.

14.3 Balances in Flow-Through deferral accounts at December 31 each year together with carrying charges shall be added or credited to the Net Revenue Requirement in the

Test Year immediately following. If it becomes necessary to estimate such balances, any variance between the actual balances and such estimate shall be returned to the appropriate deferral account as of January 1 and recorded until the following December 31, with carrying charges calculated monthly in the usual fashion.

14.4 In the event that this Agreement is terminated at any time before December 31, 2001 TQM Pipeline will apply to the NEB to include all then outstanding balances in Flow-Through deferral accounts, in the Net Revenue Requirement for the Test Year immediately following the termination of this Agreement.

14.5 All balances which accrue in deferral accounts in 2001 will be included in the Net Revenue Requirement for the immediately following Test Year regardless of whether the methodology contemplated by this Agreement is extended.

15 Storage Revenue

15.1 Each year, TQM Pipeline will forecast the revenues pursuant to its TS and SGT Toll Schedules, and pursuant to any other toll schedule approved by the NEB for gas service on its system, anticipated during the following Test Year and will credit such amount as provided in Section 4.1 herein to determine that Test Year's Net Revenue Requirement .

15.2 Each year, variances between actuals and forecast of such revenues credited pursuant to Section 15.1 herein shall be recorded in a Flow-Through Storage Revenue Deferral Account and added or credited to the Net Revenue Requirement in the Test Year immediately following.

16 Term

16.1 This Agreement and the specific parameters set out in this Agreement encompass the period January 1,1997 to December 31, 2001 inclusive.

16.2 For the period beyond the termination date of this Agreement, the Parties will enter into discussions in an effort to reset parameters, as necessary, to extend this Agreement beyond such date.

16.3 Upon termination of this Agreement TQM Pipeline's Net Revenue Requirement will be determined in accordance with the Cost of Service methodology in place prior to the commencement of this Agreement, unless otherwise determined by the NEB.

17 Miscellaneous Provisions

17.1 The NEB will retain and perform its current audit functions.

17.2 Toll design and tariff issues are not addressed by this Agreement. During the term of this Agreement, TQM Pipeline will continue to provide service in accordance with the terms and conditions in TQM Pipeline's current Transportation Tariff, as the same may be amended from time to time subject to NEB approval.

17.3 Nothing in this Agreement is intended to preclude TQM Pipeline from reflecting in its tolls or Cost of Service the costs consequences of NEB orders or directives applicable to it by virtue of a proceeding which is initiated by a person other than TQM Pipeline or by the NEB of its own motion, nor to preclude TQM Pipeline from participating in any multi-pipeline proceeding if requested to do so by the NEB or determined by TQM Pipeline to be in its best interest.

17.4 Each year in November, TQM Pipeline proposes to file with the NEB tolls applicable to the immediately following Test Year as outlined in Section 7.3 herein. TQM Pipeline also proposes to have the annual tolls from the year immediately preceding the Test Year made interim for the current Test Year, effective January 1st pending the final disposition by the NEB.

17.5 TQM Pipeline proposes to request from the NEB that the current form of the NEB Quarterly Surveillance Report be amended to reflect this Agreement and that only the year-end report be required to be filed effective as of the 1997 Test Year.

17.6 Nothing in the Agreement precludes the Parties from contesting any facilities application filed by TQM Pipeline under Part III of the NEB Act or the proposed method of recovery of both capital and operating and maintenance costs incurred from constructing and operating such facilities.

Appendix III

Compendium of Key Schedules

Schedule 1
Net Revenue Requirement for 1997
($ 000)

	Applied for	**NEB Adjustments**	**Authorized by NEB**
Operating Costs			
Operating and Maintenance	8,849	Nil	8,849
Municipal and Other Taxes	2,865	Nil	2,865
NEB Cost Recovery	400	Nil	400
Depreciation and Amortization	14,043	Nil	14,043
Income Taxes	9,679	Nil	9,679
Total Operating Costs	35,836	Nil	35,836
Return on Rate Base	30,294	Nil	30,294
Total Revenue Requirement	66,130	Nil	66,130
Storage Revenue	(204)	Nil	(204)
Net Revenue Requirement	**65,926**	**Nil**	**65,926**

Schedule 2
Average Rate Base for 1997
($ 000)

	Applied for	NEB Adjustments	Authorized by NEB
Gas Plant in Service			
Gross Plant	506,829	Nil	506,829
Accumulated Depreciation	(193,440)	Nil	(193,440)
Net Plant	313,389	Nil	313,389
Working Capital			
Cash	737	Nil	737
Materials & Supplies	622	Nil	622
Transmission Linepack	624	Nil	624
Prepayments	483	Nil	483
Total Working Capital	2,466	Nil	2,466
Other Rate Base Items			
Tax Benefit on Sponsors' Development Costs	(9,467)	Nil	(9,467)
Unamortized Debt Discount	1,163	Nil	1,163
Total Rate Base	**307,551**	**Nil**	**307,551**

Schedule 3
Existing Depreciation Rates
(%)

NEB Account	Description	Depreciation Rate
	Intangible Plant	
401	Franchises and Consents	2.75
402	Other Intangible Plant	33.33
403	Other Franchises and Consents	5.00
	Transmission Plant	
461	Land Rights	2.75
463	Measuring and Regulating	2.80
464	Other Structures and Improvements	2.95
465	Mains	2.75
467	Measuring Equipment	5.15
468	Communication Structures	10.00
	General Plant	
482	Structures and Improvements	10.00
483	Office Furniture and Equipment	7.00
484	Transport Equipment	16.00
485	Heavy Work Equipment	6.75
486	Tools and Work Equipment	7.00
488	Communication Structures	10.00
489	Other Equipment	20.00

Schedule 4
Rate of Return on Rate Base for 1997

	Amount	Capital Structure	Cost Rate	Cost Component
	($ 000)	(%)	(%)	(%)
Debt - Funded	193,692	62.98	10.05	6.33
Debt - Unfunded	21,594	7.02	4.50	0.32
Total Debt Capital	215,286	70.00		6.65
Equity	92,265	30.00	10.67	3.20
Total Capitalization	**307,551**	**100.00**		
Rate of Return on Rate Base				**9.85**

Schedule 5
Utility Income Tax Allowance for 1997
($ 000)

	Applied for	NEB Adjustments	Authorized by NEB
Utility Income after Taxes	9,842	Nil	9,842
Depreciation	14,043	Nil	14,043
Amortization of Debt Discount	173	Nil	173
Meals & Lodging	98	Nil	98
Social Activities	87	Nil	87
Large Corporation Tax	683	Nil	683
Capital Cost Allowance	(11,272)	Nil	(11,272)
Interest AFUDC	(2)	Nil	(2)
20% of Debt Issue Costs	(356)	Nil	(356)
50% of Meals & Lodging	(49)	Nil	(49)
50% of Social Activities	(44)	Nil	(44)
Taxable Income*	**13,202**	**Nil**	**13,202**
Taxes: 50% at (0.43756)/(1-0.43756)	5,136	Nil	5,136
Taxes: 50% at (0.369)/(1-0.369)	3,860	Nil	3,860
Recovery of LCT	683	Nil	683
Utility Income Tax Allowance	**9,679**	**Nil**	**9,679**

* Total does not add due to rounding.

Appendix IV

Compendium of Key Documents

Date	Description
2 December 1996	TQM letter filed request for interim tolls effective 1 January 1997
17 December 1996	Board letter re. Rate of Return on Common Equity for 1997
20 December 1996	Board letter approving interim tolls effective 1 January 1997
8 January 1997	TQM letter confirming service of interim toll letter on Interested Parties
24 January 1997	TQM filed its 1997 Tolls Application
11 February 1997	Letter to Board from IGUA confirming its position on Multi-year Tolls Agreement
21 February 1997	Board letter to TQM acknowledging receipt of Application and advising TQM of "ex-parte" processing of this Application
27 February 1997	Board IRs sent to TQM with deadline of 14 March 1997 to reply
14 March 1997	TQM provided responses to Board IRs
14 March 1997	TQM letter to the Board regarding Quarterly Surveillance Reporting Requirements
14 March 1997	Board Letter regarding Rate of Return on Common Equity for 1997
21 March 1997	TQM filed amended Application Schedules in accordance with approved rate of return on common equity for 1997