



National Energy Board

Reasons for Decision

**TransCanada PipeLines
Limited**

RH-4-93

June 1994

Tolls

National Energy Board

Reasons for Decision

In the Matter of

TransCanada PipeLines Limited

Application dated 8 July 1993, as amended,
for New Tolls effective 1 January 1994

RH-4-93

June 1994

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Abbreviations

Act	<i>National Energy Board Act (the)</i>
AFUDC	allowance for funds used during construction
ANR	ANR Pipeline Company
AO	Amending Order
APMC	Alberta Petroleum Marketing Commission
Bcf	billion cubic feet
Board	National Energy Board (the)
CAPP	Canadian Association of Petroleum Producers
CBRS	Canadian Bond Rating Service Limited
CDA	Central Delivery Area
Centra Ontario	Centra Gas Ontario Inc.
CEPA	Canadian Energy Pipeline Association
Company (the)	TransCanada PipeLines Limited
Consumers'	Consumers' Gas Company Ltd., The
DBRS	Dominion Bond Rating Service Limited
EDA	Eastern Delivery Area
F&V	F&V Energby Co-operative Inc.
FERC	Federal Energy Regulatory Commission
Foothills	Foothills Pipe Lines Ltd.
FS	Firm Service
FST	Firm Service Tendered
FT	Firm Transportation
FTE	full-time equivalent
GJ	gigajoule
GMi	Gaz Métropolitain, inc.
GPUC	Gas Plant Under Construction
Great Lakes	Great Lakes Gas Transmission Company
IGUA	Industrial Gas Users Association
IS	Interruptible Service
IT	Interruptible Transportation
LDC	local distribution company

MDA	Manitoba Delivery Area
Mobil	Mobil Oil Canada
Natural	Natural Gas Pipeline Company of America Ltd.
NDA	Northern Delivery Area
NEB Rules	NEB Draft Rules of Practice and Procedure (1987)
NEB	National Energy Board (the)
Northeast Group	Northeast Group (the)
Northern Natural	Northern Natural Gas Company
NSP	Northern States Power Co.
OEB	Ontario Energy Board
OM&A	Operations, Maintenance & Administration
Ontario	Ministry of Environment and Energy for Ontario
PanCanadian	PanCanadian Petroleum Limited
ProGas	ProGas Limited
PS	Peaking Service
Quebec	Procureur général du Québec
RFSF	Request for Service Form
RH	Rate Hearing, number and year (e.g. RH-4-93)
SFV	Straight Fixed Variable
SSMDA	Sault Ste. Marie Delivery Area
STFT	Short-Term Firm Transportation
STS	Storage Transportation Service
TBO	Transmission By Others
Tolls Task Force	joint industry task force initiated by TransCanada
TransCanada	TransCanada PipeLines Limited
TWS	Temporary Winter Service
U.S.	United States of America
Union	Union Gas Limited
Vermont Gas	Vermont Gas Systems, Inc.
Wascana	Wascana Energy Incorporated
Westcoast	Westcoast Energy Inc.

WFS
10³m³

Winter Firm Service
thousand cubic metres

Glossary of Terms

Explanations for certain terms used in these Reasons which appear infrequently in Board reports or which may be applicable to TransCanada only are provided for the reader's convenience.

AO-1-RH-4-93	Order amending RH-4-93 which set the location and timing for the oral hearing.
AO-2-RH-4-93	Order amending RH-4-93 which detailed the final List of Issues.
DCF Test	The Discounted Cash Flow test measures the investors' expected rate of return to the current (or a representative) market price and an estimation of future cash dividend flow.
Exit Fee	A proposed fee to be charged to shippers who provide less than 18 months notice of their intent not to renew their transportation contracts.
GH-2-93	Hearing Order in respect of TransCanada's application for 1994 and 1995 facilities.
GH-5-89	Hearing Order in respect of TransCanada's application for 1991-1992 facilities and various applications for natural gas export licences.
GH-2-87	Hearing Order in respect of TransCanada's application for 1988 and 1989 facilities and approval of its toll methodology and related tariff matters.
Lead-Lag Study Procedure	A study to determine the level of funds which must be provided by investors to sustain operations from the time a utility makes certain cash operating expenditures in the provision of service to tollpayers to the time it is reimbursed through revenues.
NEB Rules of Practice and Procedure (1987)	NEB Rules which set out the procedures for making applications, representations and complaints to the Board, the conduct of hearings and generally the manner of conducting any business before the Board.
Part III	The section of the NEB Act which deals with Construction and Operation of Pipelines.
Part IV	The section of the NEB Act which deals with Traffic, Tolls and Tariffs.
Planning and Construction Cycle	The length of time between the determination of the need for new facilities and the in-service date of these new facilities.

Renewal Fee	A proposed fee to be charged to shippers who provide less than 18 months notice of their intent to renew their transportation contracts.
RH-4-93	Hearing Order in respect of TransCanada's application for new tolls effective 1 January 1994
RH-2-92	Hearing Order in respect of TransCanada's application for new tolls effective 1 January 1993
RH-3-86	Hearing Order in respect of TransCanada's application for new tolls effective 1 January 1987.
SFV Rate Design	A rate design whereby all fixed costs are assigned to the demand toll and all variable costs are assigned to the commodity toll.
Swing Pipeline	A pipeline with uncontracted or unused capacity whose shippers with other transportation options have the capability to leave the system and return to the system at will.
TGI-3-93	Order which established interim tolls for TransCanada effective 1 January 1994.
Tolls Task Force	A joint industry Task Force initiated by TransCanada. Its membership is comprised of a wide cross-section of the natural gas industry, including representatives of the producing, marketing, brokering, pipeline, provincial government, local distribution and industrial end-user sectors.

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 TransCanada PipeLines Limited for certain orders respecting tolls under Part IV of the Act; and

IN THE MATTER OF the National Energy Board Hearing Order No. RH-4-93;

HEARD in Ottawa, Ontario on 7, 8, 9, 10, 11, 14, 15, 16, 17, 18, 21, 22, 23 and 24 February 1994 and in Calgary, Alberta on 7, 8, 9, 14, 15 and 16 March 1994.

BEFORE:

J.-G. Fredette	Presiding Member
C. Bélanger	Member
R. Illing	Member

APPEARANCES:

J.M. Murray	TransCanada PipeLines Limited
J.W. Lutes	
P.R. Jeffrey	
C.K. Yates	Canadian Association of Petroleum Producers
P.C.P. Thompson, Q.C.	Industrial Gas Users Association
T.G. Kane	ANR Pipeline Company
R.B. Brander	Centra Gas Ontario Inc.
J.H. Farrell	Consumers' Gas Company Ltd.
F.G. Hébert	Gaz Métropolitain, inc.
C.B. Woods	Mobil Oil Canada
R.W. Graw	Natural Gas Pipeline Company of America and New England Power Company
L.E. Smith	Northeast Group (the)
L.G. Keough	Northern Natural Gas Company
J.H. Smellie	Northern States Power Company (Wisconsin)
N. Mills	NOVA Corporation of Alberta
C. Hart	PanCanadian Petroleum Limited
M.A.K. Muir	ProGas Limited

G. Cameron
J.T. Horte
W.M. Moreland
J. Turchin
J. Robitaille

Union Gas Limited
Wascana Energy Incorporated
Alberta Petroleum Marketing Commission
Ministry of Environment and Energy for Ontario
Procureur général du Québec

Overview

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

The Application

On 8 July 1993, TransCanada applied to the Board for new tolls to be effective 1 January 1994. The application dealt with the issues of rate base, cost of service, rate of return, toll design and tariff matters.

The Hearing

The hearing, which lasted 20 days, was held in Ottawa from 7 February 1994 to 24 February 1994 and was completed in Calgary, where the balance of the evidence and argument was heard, between 7 March 1994 and 16 March 1994 .

Effect of the Decision on Tolls

Effective 1 July 1994, the approved 100% load factor FS toll to the Eastern Zone will be 86.32 ¢/GJ. This toll can be compared to the toll of 87.05 ¢/GJ approved by the Board for 1993 and a toll of 88.61 ¢/GJ applied for by TransCanada for 1994.

Revenue Requirement

The Board has approved a 1994 net transportation revenue requirement of \$1,590.0 million which is \$42.0 million less than the amount applied for by TransCanada. The main factors contributing to this reduction are: a lower approved rate of return on common equity; lower associated income taxes; and a reduction to Operations, Maintenance & Administration expenses of \$2.5 million.

Rate Base

The Board has approved a rate base of \$6,420.7 million for 1994. This reflects a reduction of \$0.7 million from the total applied-for rate base.

Rate of Return

The Board has approved a rate of return on common equity of 11.25%, a decrease of 100 basis points from the previously-approved rate of 12.25% and a decrease of 112.5 basis points from the applied-for rate of 12.375%.

The Board approved the retention of a common equity ratio of 30%.

Operating Costs

The Board discontinued the requirement for TransCanada to seek Board approval prior to amending its long-term contractual obligations for transportation services with other pipeline companies.

The Board approved an overall amount of \$200.7 million with respect to TransCanada's Operations, Maintenance & Administration expenses. This reflects an overall reduction of \$2.5 million from the applied-for amount of \$203.2 million

The Board directed TransCanada to file current-year forecast information in future toll applications in addition to base-year and test-year information.

Deferral Accounts

The Board denied intervenor requests for an unfunded debt deferral account.

TransCanada was directed to establish a deferral account to record all costs related to alleged environmental infractions stemming from the construction of a new pipeline in Ontario during 1991.

The Board approved the discontinuance of the Transmission Plant in Service Account and the Gas Related Costs and Purchase Price Deferral Account.

The Board denied TransCanada's request to continue the Fixed Costs in the Great Lakes Commodity Charge Deferral Account.

Toll Design and Tariff Matters

The Board approved the proposed tolling treatment for FST diversions.

The Board denied TransCanada's proposal for a fee with respect to entry into the queue for FS, FST and STS transportation service.

The Board approved assignments of positions in the queue for transportation services for name changes provided such assignments do not adversely affect other participants in the queue.

Contract Renewals

The Board rejected all proposals with respect to changes to the contract renewal provisions in TransCanada's Transportation Tariff.

Chapter 1

Background and Application

On 8 July 1993, TransCanada¹ filed an Application pursuant to Part IV of the Act for new tolls to be effective 1 January 1994. TransCanada revised this Application on 14 December 1993 and on 7 March 1994. As part of its initial Application, TransCanada filed a Tolls Task Force report containing various recommendations to the Board on issues considered by the Tolls Task Force. With respect to each issue, the report indicated whether the Tolls Task Force had reached a unanimous or partial consensus or whether it considered that the issue required further study and should therefore be referred to a future tolls case.

On 13 October 1993, the Board issued Hearing Order RH-4-93 setting down the Application for a public hearing to commence on 7 February 1994.

Hearing Order RH-4-93 was amended by AO-1-RH-4-93 and AO-2-RH-4-93 to set the location and timing of the hearing and to reflect changes to the initial List of Issues.

The public hearing held pursuant to Order RH-4-93 lasted 20 days. The hearing opened in Ottawa on 7 February 1994 and adjourned on 24 February 1994. The remaining evidentiary portion of the hearing and final argument were heard in Calgary between 7 March 1994 and 16 March 1994.

As set out in Order TGI-3-93, the Board established interim tolls for 1994 for TransCanada effective 1 January 1994. TGI-3-93 remained in effect until the Board rendered its final decision on the Application for 1994 tolls.

¹ The Board uses abbreviations for many terms in the text of its decision. The long forms can be found in the Abbreviations section which starts on page (v)

Chapter 2

Revenue Requirement

The net transportation revenue requirement authorized by the Board for the 1994 test year is \$1,589,966,168. A summary of this approved revenue requirement together with the Board's adjustments is shown in Table 2-1. In addition, the functional distribution and classification of the approved revenue requirement are set out in Appendix II to these Reasons for Decision.

Table 2-1
Transportation Revenue Requirement for the 1994 Test Year
(\$ 000)

	Application	NEB Adjustments	Authorized by NEB
Transmission by Others	355,162	-	355,162
Gas Related Expense	15,723	-	15,723
Operations, Maintenance & Administration	203,188	(2,500)	200,688
NEB Cost Recovery	7,030	-	7,030
Gas Cooling Charges	1,200	-	1,200
Depreciation	210,026	(14)	210,012
Municipal & Other Taxes	85,936	-	85,936
Income Taxes	92,102	(17,373)	74,729
Regulatory Amortizations	7,753	-	7,753
Foreign Exchange Cost	2,618	-	2,618
Return on Rate Base	701,866	(21,270)	680,596
<hr/>			
Gross Transportation Revenue Requirement	1,682,604	(41,157)	1,641,447
Miscellaneous Revenue	(50,626)	870	(49,756)
Interim Revenue Adjustment	-	(1,725)	(1,725)
<hr/>			
Net Transportation Revenue Requirement	1,631,978	(42,012)	1,589,966

Chapter 3

Rate Base and Depreciation

3.1 Gross Plant

The Board's adjustments to rate base for the 1994 test year are summarized in Table 3-1. The details of the adjustments are explained in the sections following the table.

Table 3-1
Rate Base for the 1994 Test Year
(\$ 000)

	Application	NEB Adjustments	Authorized by NEB
Utility Investment:			
Gross Plant	8,192,928	(536)	8,192,392
Accumulated Depreciation	(1,860,551)	2	(1,860,549)
Net Plant	6,332,377	(534)	6,331,843
Contributions in Aid of Construction	(1,755)	-	(1,755)
Total Plant	6,330,622	(534)	6,330,088
Working Capital:			
Cash	17,149	(208)	16,941
Goods & Services Tax Receivable, Net	(1,947)	-	(1,947)
Materials & Supplies	48,894	-	48,894
Transmission Linepack	37,952	-	37,952
Prepayments & Deposits	1,738	-	1,738
Total Working Capital	103,786	(208)	103,578
Deferred Costs:			
Average Deferred Taxes	(37,934)	-	(37,934)
Miscellaneous Deferred Taxes	33,607	-	33,607
Operating & Debt Service Deferrals	(6,274)	-	(6,274)
Other Deferred Items	(2,345)	-	(2,345)
Total Deferred Costs	(12,946)	-	(12,946)
Total Rate Base	6,421,462	(742)	6,420,720

3.1.1 Disallowed Capital Projects

TransCanada forecasted its average gross plant in service for the 1994 test year to be \$8,192,928,000. Included in this forecast were projects which were cancelled after the close of the hearing. These projects were identified as projects T94001, T94625, T94825 and T94838. Consequently, the costs related to these projects have been removed from TransCanada's applied-for rate base for the 1994 test year.

Decision

The Board approves all of TransCanada's applied-for gross plant additions except those identified as projects T94001, T94625, T94825 and T94838. The Board has reduced TransCanada's Gross Plant by \$213,154 as a result of the removal of these 4 projects.

3.1.2 Contingency Projects

TransCanada normally includes in its annual section 58 applications an amount to cover contingency projects; i.e. projects which are not foreseen at the time of the application or are of an emergency nature. Since 1991, the annual amount budgeted by the Company for contingency projects has increased from \$1 million to approximately \$11 million.

TransCanada indicated during the proceedings that since 1992, it has modified the definition of contingencies to include certain projects which could otherwise have been accommodated in separate section 58 applications. The Company also indicated that it had undertaken a number of compressor-related contingency projects which had contributed to the increase in contingency amounts. TransCanada identified these projects as economically opportune upgrades. These projects were carried out for reliability or efficiency reasons immediately when compressor unit modifications became available. The Company acknowledged that some of these projects could have been included in a separate section 58 application but, given timing and efficiency constraints, TransCanada undertook these projects in 1992 and 1993 without Part III approval. The Company was of the view that Part IV proceedings allow for as much public scrutiny of its contingency projects as does an examination pursuant to Part III.

Views of the Board

The Board does not at this time accept TransCanada's expanded definition of contingency projects.

The Board prefers to examine, pursuant to Part III whenever possible, those capital projects which can properly be applied for under section 58 as well as those identified as economically opportune upgrades.

The Board notes that further direction on this issue may be forthcoming as part of its current initiative on "Streamlining of Section 58 Applications and Related Rate Base Additions: A Possible Approach", dated 8 December 1993.

Decision

Until such time as the streamlining initiative regarding section 58 applications noted above is completed, the Board directs TransCanada to apply for approval of capital projects under section 58 whenever project scheduling allows. TransCanada is directed to discontinue treating projects which could be applied for under section 58, such as economically opportune upgrades, as contingency projects.

3.1.3 Inventory

In RH-2-92, CAPP expressed concern regarding the number of items included in TransCanada's 1993 section 58 application that were intended for inventory, such as compressor units and aero-assemblies. The Board acknowledged the concern of CAPP regarding the management of inventory for a dynamic and geographically large system such as TransCanada's and expressed the view that TransCanada should provide the Board and interested parties with a detailed description of its procedures for ensuring the optimization of the levels and locations of its inventory.

As a result, the Board directed TransCanada to file with the Board and to serve on interested parties, within 30 days of the publication of the RH-2-92 Decision, a description of its current spare parts inventory control system, together with a detailed explanation of the methodology it utilizes to optimize the levels and locations of its inventory. The Board noted that if it found that such an inventory control system was not in place, TransCanada would be required to obtain independent third party advice and to notify the Board of the advice received.

TransCanada was also directed to file with the Board and to serve on interested parties, within 180 days of the publication of the RH-2-92 Decision, its comments regarding the feasibility of establishing a shared inventory management system with other companies.

Finally, the Board directed TransCanada to file, with its next tolls application, a listing of all spare parts in inventory where the individual unit price exceeded \$50,000.

In response to these directives TransCanada submitted the following:

- a. a description of its current spare parts inventory control system to the Board and interested parties on 16 April 1993;
- b. its comments regarding the feasibility of establishing a shared inventory management system with other companies to the Board and interested parties on 13 September 1993; and
- c. as part of its 1994 Tolls Application, a listing of all spare parts in inventory where the individual unit price exceeded \$50,000.

Regarding the concept of a shared inventory system, TransCanada noted that the sharing of spares implies a common pool of jointly-owned units and that the most significant benefit would result from

a reduction in the total number of spares kept by the industry if such a reduction could be realized. However, TransCanada claimed that any industry-wide reduction of spares would dilute the availability to less than acceptable levels. Nevertheless, TransCanada noted that it has, for many years, maintained ad hoc exchange and support agreements on spares through a wide network of pipeline operators and equipment suppliers.

TransCanada noted that some of the potential problems associated with a shared inventory system are as follows:

- a. difficulty in reaching agreement over who would have priority access to spares;
- b. disagreement over who would pay for repairs, etc.;
- c. because most major components are strictly speaking not "spares", but are actually rotated in and out of service with all operating equipment, the "pool" to be shared would have to include all equipment that is in service as well as the spares which would significantly compound the difficulties associated with the questions of ownership, responsibility and liability in implementing a pool concept for spares;
- d. disagreements on repair scheduling, vendors, etc.; and
- e. difficulty in reaching agreement on the location of spares.

In conclusion, TransCanada stated that it is unlikely that the total spares required would be reduced significantly whether jointly or individually owned. TransCanada noted that, from an administrative viewpoint, shared spares ownership among companies would present management problems that could create additional expenses and thereby increase the cost of service.

TransCanada noted that, as an alternative to shared inventories, it has formal agreements in effect with other companies, namely Foothills and Great Lakes, to exchange some gas generators. In addition, TransCanada noted that it has had numerous instances where major turbine or compressor parts have been borrowed or lent during unit outage when throughput was being reduced.

TransCanada addressed the issue of its spare parts inventory control system during Tolls Task Force deliberations. By letter dated 25 January 1994, which was filed with the Tolls Task Force information, CAPP informed TransCanada that it was satisfied that tollpayers do not appear to be bearing unacceptable costs in respect of spares. During the hearing, CAPP also expressed the view that the review of TransCanada's spare parts inventory system was an exercise that benefitted both TransCanada and interested parties.

Views of the Board

Based on the information submitted by the Company, the Board is of the view that TransCanada's spares inventory control system satisfactorily optimizes the level and location of its inventory. The Board also acknowledges the problems expressed by TransCanada regarding a shared inventory system. The Board believes the review of TransCanada's inventory control system has benefitted all parties.

Decision

The Board accepts that TransCanada's current spares inventory control system satisfactorily optimizes the level and location of its inventory. The Board accepts that an intercompany system of formal exchange agreements along with selective borrowing and lending of spare parts is currently the most appropriate strategy given TransCanada's current operating environment.

3.1.4 Employee Benefit Capitalization Rate

Ontario expressed a concern regarding TransCanada's accounting methodology for capitalizing employee benefits. Ontario noted that TransCanada uses a single composite rate as opposed to two distinct rates for regular and temporary employees. Ontario contended that this methodology has resulted in TransCanada capitalizing amounts which have not been and could not be incurred by TransCanada, for the reason that temporary employees are not eligible for the majority of employee benefits.

Ontario noted that this was not just an estimating difference. Rather, it follows directly from the accounting method chosen by TransCanada. Ontario stated that it was doubly concerned because TransCanada failed to change its method when it benefitted inappropriately from the use of this method in earlier years.

Views of the Board

The Board is of the view that TransCanada's use of a single composite employee benefit rate for regular and temporary employees appears to have resulted in it capitalizing a greater amount of benefits than should have been the case. For the 1994 test year, TransCanada estimated that the regular and temporary employee benefit rates would be 29.3% and 6.0% respectively. TransCanada calculated its composite employee benefit rate by dividing total employee benefits for both regular and temporary employees by total salaries. This resulted in an estimated composite rate of 27.1%. The Board notes that applying this rate to the employee salaries which are forecast to be charged to construction in 1994 will not result in a proper assignment of employee benefits.

The Board believes that TransCanada should utilize separate employee benefit rates for regular and temporary employees.

Decision

The Board directs TransCanada to use separate employee benefit rates for regular and temporary employees effective 1 January 1994. In this regard the Board has utilized a rate of 29.3% for regular employee benefits and 6.0% for temporary employee benefits in determining the revenue requirement for the 1994 test year. As a result the Board has reduced the 1994 Gross Plant by \$222,824.

3.1.5 AFUDC and Overhead

Decision

The calculation of capitalized AFUDC and Overhead related to capital additions for the 1994 test year has been adjusted to reflect the approved rate of return on rate base (see section 4.6) as well as the removal of certain capital projects which have been cancelled (see section 3.1.1) and the reduction of the level of capitalized employee benefits (see section 3.1.4). In this regard, the Board has reduced the level of Gross Plant by \$100,378.

3.2 Working Capital

3.2.1 Cash Working Capital

In RH-2-92, TransCanada proposed to increase its cash working capital allowance from 1/12th of its annual cash operating expenses to 1/11th. CAPP claimed that TransCanada's methodology was flawed because it ignores the time between receipt of a service and payment for that service and because it assumes an inordinately long lapse between the time TransCanada makes a payment and the time it is reimbursed through revenues. The Board noted that it was not persuaded that an increase in the cash working capital was required. TransCanada was directed to file a lead-lag study procedure in its next application which would address the concerns expressed by CAPP. TransCanada addressed the cash working capital study issue during the 1994 Tolls Task Force meetings.

In RH-4-93, TransCanada applied for a continuation of its currently-approved cash working capital allowance of 1/12th of its annual cash operating expenses. In this regard, TransCanada filed a cash working capital study using the same methodology that it used in RH-2-92. In a subsequent filing, TransCanada filed 15 pages of supplemental information on the cash working capital study arising from discussions at the Tolls Task Force meetings. In CAPP's view, this filing satisfied the NEB's directive in RH-2-92.

In TransCanada's opinion, its study methodology captures the correct time lag. Based on a review of cash working capital studies prepared by other companies and other written material on this subject, the Company noted that there are two lags relevant to a cash working capital calculation: a revenue lag which equals the time from receipt of goods or service by a company to the time offsetting revenues are received, and an expense lag which equals the time from receipt of goods or service by a company to the date payment is made for the goods or services. The "net lag" is the difference between the revenue lag and the expense lag. TransCanada noted that while its study does not show both the revenue and expense lags, it does show the net lag which is the same as the studies of other companies.

TransCanada indicated that expenses are recorded when invoices are entered into the Accounts Payable system which is generally 1-2 days before the due date when they are paid. In this regard, TransCanada stated that its methodology incorporated in the cash working capital study filed as part of the Task Force material, calculated the lag from the date of the cheque to a revenue receipt date based upon the date the expense was recorded.

TransCanada stated that the most pertinent factor in determining the revenue receipt date is the date that the invoices are recorded in the accounting system and therefore recorded as expenses. TransCanada further indicated that it was willing, in the next tolls application, to file a cash working capital study that takes into consideration, the date on which expenses were recorded.

TransCanada also stated that it was willing to enhance its future studies by using statistical sampling techniques.

CAPP stated that the net lag for an expense item is the difference between the revenue lag and the expense lag. However, CAPP suggested the revenue lag is generally considered to be the time measured from the date of provision of service (assume the middle of the month i.e. the 15th) to the date when payment is received (the 22nd of the following month) which, in TransCanada's case, works out to approximately 37 days. CAPP further noted that the expense lag is generally considered to be the period of time measured from the date when service is rendered or the expense is incurred until the date when payment is made. For a typical non-salary expense item with a payment term of 30 days, CAPP suggested that TransCanada's revenue lag should be 37 days and the expense lag 30 days. This would result in a net lag of 7 days.

CAPP also expressed a concern that TransCanada does not use statistical sampling techniques in its study methodology.

Notwithstanding the fact that CAPP was of the view that TransCanada's cash working capital filing was in accordance with the Board's direction in RH-2-92, CAPP argued that the Board had made a clear decision in RH-2-92 and TransCanada effectively chose not to follow it. CAPP further noted that the issue of whether TransCanada's methodology properly accounts for the time between the receipt of a service and the payment for that service is the same as it was in RH-2-92 and there is no evidence to suggest that a review is justified.

Views of the Board

The Board notes that CAPP's major concern regarding TransCanada's cash working capital study methodology is CAPP's belief that, for those non-salary expenses where extended payment terms are offered, the Company ignores the time between the receipt of the service and the payment for that service. The Board believes that this time period can best be regarded as the time period between the receipt of an invoice for the service and the time of its payment. The Board believes that this time period is typically in the order of 30 days.

If the Board were to accept CAPP's reasoning, the net lag for TransCanada's non-salary expenses, which have payment terms of 30 days, would be reduced by approximately 30 days as TransCanada would have to consider revenues to be collected in the same month in which these expenses are paid. This is contrary to TransCanada's current assumption that revenues are always collected in the month after expenses are paid.

Except for those expenses which are paid within the first 2 days of the month but recorded as expenses in the prior month, the Board is persuaded that TransCanada is always one month behind in the collection of its revenues relative to its payments of

expenses. This results from the fact that TransCanada accounts for the payment of its non-salary expenses on a cash basis (i.e. it records expenses at the time of payment and does not appear to accrue a significant amount of expenses at year end). As a result, the Board does not believe that TransCanada's "net lag" should be reduced by approximately 30 days for these expenses. The Board believes that shippers have received in their tolls, and will continue to receive, the benefit of not having to make up this one months shortfall in TransCanada's cash flow.

The Board considers that the determination of the revenue receipt date is a key issue, and that the expense recording date is more important for making this determination than the date on which the cheque is written. This is because tolls for any given month can be assumed to reimburse TransCanada for expenses which are recorded in that month.

The Board is of the view that if TransCanada were to calculate the lag from the date of the cheque to a revenue receipt date based upon the date the expense was recorded, it would shorten the net lag for any expenses paid within the first one or two days of any given month and recorded as expenses in the prior month by approximately 30 days, as the revenue which reimburses these expenses would be deemed to be received in the same month the expense is paid.

The Board also believes that statistical sampling would enhance the credibility of the Company's study results.

Decision

The Board accepts TransCanada's request for a cash working capital allowance of 1/12th of its annual cash operating expenses for 1994. The Board has reduced the cash working capital allowance for the 1994 test year by \$208,333. As a result the Board approves a total working capital allowance of \$103,577,667 for the 1994 test year.

TransCanada is directed to file, in its next tolls application, a lead/lag study which assumes corresponding revenues are received in the month after an expense is recorded rather than the month after an expense is paid. The Board also directs TransCanada to use statistical sampling techniques in its next lead/lag study.

3.3 Depreciation

3.3.1 Depreciation Expense

Decision

The Board has reduced depreciation expense by \$14,224 and the accumulated depreciation by \$2,128 to reflect adjustments to the levels of capitalized AFUDC and Overhead (see section 3.1.5), the disallowance of costs associated with the

cancellation of certain capital projects (see section 3.1.1) and the decision related to the Employee Benefit Capitalization Rate (see section 3.1.4).

Chapter 4

Cost of Capital

TransCanada applied for a rate of return on rate base of 10.93% for the 1994 test year, 2 basis points lower than the approved rate of 10.95% for 1993. The applied-for rate of return on common equity for the 1994 test year was 12.375%, 12.5 basis points higher than the 12.25% rate approved for 1993. TransCanada applied for a deemed common equity ratio of 30% unchanged from the approved level for 1993.

Details of the applied-for deemed average capital structure and rates of return are shown in Table 4-1 and discussed in detail in sections 4.1 to 4.5.

Table 4-1
Applied-for Deemed Average Capital Structure and
Rates of Return for the 1994 Test Year

	Amount (\$ 000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Funded Debt	3,823,041	58.46	10.81	6.32
Unfunded Debt	130,208	1.99	7.21	0.14
<hr/>				
Total Debt Capital	3,953,249	60.45		6.46
Preferred Shares	624,332	9.55	7.94	0.76
Common Equity	1,961,820	30.00	12.38	3.71
<hr/>				
Total Capitalization	6,539,401¹	100.00		
Rate of Return on Rate Base				10.93

(1) Rate Base \$6,421,462 + GPUC \$117,939 = Total Capitalization \$6,539,401

4.1 Funded Debt

The funded debt component of TransCanada's deemed capital structure is comprised of bonds, debentures and medium-term notes with varying maturities. These debt instruments are denominated in Canadian and foreign currencies.

TransCanada requested an average funded debt amount of \$3,823,041,000 at a cost rate of 10.81%. The funded debt balance accounts for 58.46% of the applied-for deemed average capitalization for the 1994 test year.

Decision

The Board approves TransCanada's applied-for funded debt amount of \$3,823,041,000 at a cost rate of 10.81% for the 1994 test year.

4.2 Unfunded Debt

Unfunded debt represents that portion of TransCanada's capital structure which remains to be raised by the issuance of long-term debt. The average unfunded debt balance is derived by subtracting the average funded debt, preferred share and common equity capital from the total average capitalization for the test year.

TransCanada initially applied for an average unfunded debt amount, for the 1994 test year, of \$180,304,000 at an average cost rate of 8.12%. In subsequent revisions these were amended to \$130,208,000 and 7.21%, respectively. The primary reason for the rate reduction was the fact that TransCanada's expert witnesses lowered their short and long-term interest rate projections for 1994. This unfunded debt rate was calculated as per the Board's approved methodology which allows the use of projected short and long-term interest rates for the test year.

A discussion of the proposal for the establishment of a deferral account for unfunded debt to account for interest rate fluctuations can be found in section 6.2.

Views of the Board

The methodology used by TransCanada to calculate the applied-for rate for its unfunded debt is consistent with the methodology used by all rate of return expert witnesses for the purposes of recommending a fair rate of return on common equity. Therefore the Board is of the view that TransCanada's interest rate projections for its unfunded debt for the 1994 test year are reasonable under the circumstances.

The Board has increased the unfunded debt balance by \$27,066,220 to reflect its decisions in these Reasons (see sections 3.1.1, 3.1.4, 3.1.5, 3.2.1, 3.3.1, 4.3 and Table 4-4).

Decision

The Board approves an unfunded debt amount of \$157,274,220 at a cost rate of 7.21% for the 1994 test year.

4.3 Preferred Shares

TransCanada initially applied for a total capitalization which included preferred shares amounting to 8.83% of the applied-for capital structure. This level reflected the Board's decision in RH-2-92 which directed TransCanada to replace the \$60,000,000 in preferred shares which the Company had proposed to issue during 1993 with debt for tollmaking purposes.

However, during the course of these proceedings, TransCanada filed additional evidence in which it stated that TransCanada's management had decided not to replace this \$60,000,000 in preferred shares which the Company had proposed to issue in 1993 with debt. TransCanada's management believed that the Canadian and U.S. debt rating agencies would view the replacement of preferred shares with debt as having a negative impact on the pipeline's financial integrity which could lead to a credit downgrade. In TransCanada's view, a downgrade in its credit rating would make it more difficult to access capital markets.

Further, TransCanada stated that its management had decided that in order to maintain its financial integrity, a deemed capital structure of 60% debt, 10% preferred shares and 30% common equity would have to be maintained. In order to maintain this particular capital structure, TransCanada asked the Board to reconsider its Decision in RH-2-92 with respect to converting the \$60,000,000 in preferred shares to debt for tollmaking purposes. In particular, TransCanada indicated that it intended to issue \$90,000,000 in preferred shares in July 1994 (\$60,000,000 carried over from 1993 and an additional \$30,000,000 to maintain the preferred shares balance of the deemed capital structure at 10%). TransCanada also stated that the \$75,000,000 Series "K" preferred share issue which matures in November 1994 will either have its dividend reset at a projected rate of 5.75% or be replaced with a new preferred share issue. As a result, the applied-for preferred share component of the deemed capital structure was revised upward to 9.55%.

The expert witness on capital structure for TransCanada agreed that preferred share financing is not cost-efficient relative to debt, since preferred share dividends are paid out of after-tax income, while interest payments on debt are paid out of pre-tax income. While this witness agreed that preferred shares are more closely related to debt than to common equity, he indicated that preferred shares are not considered to be equivalent to debt.

The expert witness for CAPP/APMC stated that preferred share financing versus long-term debt adds very little to a company's financial strength. In this witness' view, both forms of financing give rise to an obligation to pay a fixed amount at fixed intervals and failure to meet such obligations could have devastating effects in financial markets.

Both CAPP and APMC stated that, for all practical purposes, preferred share financing is not meaningfully different from debt financing and, since debt financing is less expensive than preferred shares, the preferred share component of TransCanada's deemed capital structure should gradually be replaced with debt for tollmaking purposes.

IGUA expressed the view that the Board's RH-2-92 Decision with respect to preferred shares should be sustained. However, if the Board were to allow the continuation of the inclusion of preferred shares in TransCanada's deemed capital structure, IGUA suggested that this factor should be given weight when considering the appropriate common equity level for TransCanada.

Views of the Board

The Board is of the view that the decision rendered in RH-2-92 should stand and that TransCanada should consider the \$60,000,000 in preferred shares which it had proposed to issue during 1993 as debt for tollmaking purposes. However, it is not the Board's intention to signal that all maturing preferred share issues should be replaced with debt. The Board understands that financial markets do not view preferred shares as equivalent to debt, but rather, that preferred shares represent a hybrid form of capital. Evidence was presented that the replacement of the preferred share component of TransCanada's deemed capital structure with debt may affect its financial integrity. Based on this evidence, the Board is not persuaded that replacing the proposed preferred shares to be issued in 1994 with debt, excluding the \$60,000,000 carried forward from 1993, would be appropriate. The Board will continue to decide the merits of preferred share financing as such share issues mature in subsequent proceedings. For 1994, the Board will allow TransCanada to replace the Series "K" preferred shares maturing during 1994 with new preferred shares. Furthermore, TransCanada may issue the additional \$30,000,000 of preferred shares during 1994 as proposed. For the purposes of this proceeding, the Board will not direct TransCanada to consider any additional preferred shares (beyond the \$60,000,000 previously decided upon in RH-2-92) as debt, for tollmaking purposes.

Decision

TransCanada may recover for toll-making purposes, the additional \$30,000,000 in preferred shares it has proposed to issue in July of 1994. TransCanada may also replace or reissue, and recover for toll-making purposes, the \$75,000,000 Series "K" preferred shares which matures in November 1994 with preferred shares.

The Board denies TransCanada's request to reconsider its decision rendered in RH-2-92 with respect to the \$60,000,000 preferred share issue and the Company is directed to treat this amount as debt for tollmaking purposes.

The preferred share balance as applied-for has been reduced by the \$60,000,000 preferred share issue carried forward from 1993. Since this issue is proposed to be issued in mid-1994, the preferred share balance has been reduced by the paid-up equivalent for this issue of \$27,692,000. The unfunded debt balance has been increased by a similar amount.

The Board approves an average preferred share balance of \$596,640,000 at an associated cost rate of 8.02% for the 1994 test year.

4.4 Common Equity Ratio

TransCanada applied for a deemed common equity ratio of 30%, unchanged from the currently-approved level.

TransCanada stated that its business risks had not changed to the degree where a change in the common equity ratio was warranted. It was TransCanada's view that a reduction to its common equity ratio would result in a downgrading of its credit rating. TransCanada indicated that during the 1994 test year the Company planned new capital expenditures of approximately \$525 million. In addition, the Company will be required to refinance \$1.4 billion of existing debt as it matures over the next 10 years. A credit downgrade would make it more difficult for the Company to raise capital and refinance existing debt on reasonable terms.

TransCanada noted that interest coverage ratios are a very important factor in the bond rating agencies' decisions regarding a debt rating. In order to maintain its existing debt rating, and to maintain a demand for TransCanada's debt instruments at reasonable costs, the Company was of the view that its interest coverage ratio should not be materially below 2.0 times. TransCanada did agree that interest coverages could be calculated in numerous ways and that the TransCanada itself calculates these coverages differently for different purposes. Further, TransCanada agreed that there is no consistency among the bond rating agencies as to the methodology for calculating interest coverage ratios

TransCanada's expert witness on capital structure supported the applied-for equity ratio of 30% for a number of reasons. In his opinion, TransCanada's business risks have not changed to any material degree since RH-2-92. Second, the Company's non-jurisdictional operations are reasonably capitalized and no cross-subsidization exists. Finally, a decrease in TransCanada's common equity ratio would erode its financial strength and its debt rating may be lowered. He was of the view that, if TransCanada's debt were to be downgraded to a BBB High, the Company could possibly be shut out of the Canadian capital market for at least 6 months

The expert witnesses on rate of return testifying for TransCanada also agreed that there should be no change to the Company's currently approved equity ratio of 30%. They noted that the regime under which TransCanada is regulated has allowed the Company to achieve returns on common equity slightly in excess of its authorized returns. They also noted that this regulatory regime has provided the Company with low short-term business risks and these risks have not changed since RH-2-92. In addition, they were of the view that short-term business risks have not varied much from year to year since most of the sources of short-term risk are eliminated through the extensive use of deferral accounts.

TransCanada's long-term risks, according to TransCanada's rate of return expert witnesses, are trending upwards. The number of deferral accounts is one indication of the risks faced by the Company. In the future, the Board may expose TransCanada to risks against which it is currently protected through the use of these deferral accounts. The Board may also expose the Company to increased risk through other changes to the existing regulatory regime. TransCanada's business risks are increasing as a result of the rising competitive risks to which the Company is exposed, primarily from U.S.-sourced gas penetrating Eastern Canadian markets. The risk of competition from U.S.-sourced gas is not, however, a new risk for TransCanada, having been identified as early as during the GH-5-89 proceedings. Further, the expert witnesses agreed that the risk of competition from U.S.-sourced gas had not yet materialized and remained somewhat speculative.

TransCanada's expert witnesses on rate of return expressed the view that the most important factor leading to an increase in TransCanada's long-term business risks is the decline in the average transportation contract term. This change in the expiry profile of the Company's transportation contracts is a function of the shippers' right to renew contracts on an "evergreen" basis for periods of as little as one year. In their view, this system of "evergreening" is uneconomic. The minimum renewal notice period of 6 months may lead to uneconomic capacity expansions. Further, the absence of any incentive for shippers to contract for terms longer than 1 year sends incorrect pricing signals. This, in turn, raises the risk of capacity underutilization.

TransCanada's expert witnesses stated that their common equity ratio recommendation did not include any compensation for the risk of underutilization due to declining load factors. They acknowledged that the Board had not previously indicated that this was a risk that was being excluded in its determination of an appropriate common equity ratio.

In their view, TransCanada's financial risks have not changed significantly since RH-2-92. The proportion of TransCanada's capital assigned to non-jurisdictional assets declined from 14.3% in 1992 to 13.3% in 1994. Further, the debt ratio underpinning the non-jurisdictional assets declined from approximately 50% in 1992 to approximately 35% in 1994, thereby reducing the possibility of impairing TransCanada's credit rating.

In addition, they did not agree with some parties contention that TransCanada's non-jurisdictional business activities are capitalized with less than 30% common equity. While acknowledging that TransCanada's non-jurisdictional operations do benefit from the leverage which enhances its return on investment, they objected to the use of proportional consolidation to prove that the common equity underpinning TransCanada's non-jurisdictional operations is insufficient. They supported their objection by stating that TransCanada is not liable for the debt issued by enterprises in which the Company had made an investment and its exposure is limited to the extent of its equity investment.

TransCanada's management witnesses did not agree that its investment risks can be understood from the prices investors are willing to pay for the Company's securities. TransCanada argued that there was no evidence on the record which demonstrated the relationship between a company's stock price performance and the level of its common equity ratio. TransCanada suggested that, amongst other things, share prices are affected by the level of anticipated earnings rather than the level of the common equity ratio.

CAPP/APMC's expert witness on rate of return and capital structure stated that a 25% common equity ratio is appropriate for TransCanada for the 1994 test year. He based this recommendation on his view of the minimal business risk to which TransCanada is exposed, the absence of an abnormal need for financing flexibility, TransCanada's consolidated interest coverage ratios and the demonstrated acceptability of TransCanada's consolidated common equity ratio to TransCanada's investors.

In his opinion, there are three main business risks facing TransCanada. The first business risk is that tolls will not be set at a level sufficient to provide a fair rate of return on total capital invested. His view was that investors can take much confidence in the fact that the Board has consistently allowed TransCanada to recover its costs through the toll methodology under which it is regulated. There is no indication that this will not continue in the future.

The second business risk facing TransCanada is the risk that a particular period's operating and/or financing costs will exceed those utilized in toll setting, or that the revenues will fall short of what has been projected. Again he was of the view that the currently-approved toll methodology, including the

extensive use of deferral accounts, goes a long way in reducing the risk that TransCanada will be unable to collect its approved operating costs, regardless of throughput.

The third business risk which TransCanada faces is the risk that, at some point, the pipeline will become uneconomic and will be completely shut down or will be unable to recover its fixed costs, including those related to financing. According to CAPP/APMC's expert witness, TransCanada's long-term prospects are excellent and it ranks among the lowest risk Canadian companies, including other utilities.

In conclusion, he noted that TransCanada's business risks have not changed since RH-2-92.

CAPP/APMC's expert witness was of the view that TransCanada does not currently have an abnormally high need for financial flexibility. This conclusion was based on his expectation that TransCanada's new financing requirements would be flat into the foreseeable future. Further, he did not consider TransCanada's forecasted annual refinancing requirements of \$200 million to be abnormally high.

CAPP/APMC's expert witness disagreed with TransCanada's interest coverage ratio calculations which show that interest coverages for the non-jurisdictional operations are materially higher than that for the mainline operations. He calculated TransCanada's interest coverage ratios using proportional consolidation instead of the equity accounting methodology used by TransCanada for financial reporting purposes. Based on this analysis, he concluded that the interest coverage ratio for the Company's mainline operations was marginally higher than the interest coverage ratio of its non-jurisdictional assets. In his view, the Board should also concern itself with TransCanada's consolidated interest coverage ratio rather than focusing solely on the regulated operations because it is the consolidated entity which must access the capital markets and not the mainline operations. He agreed that there was no evidence of cross-subsidization between TransCanada's regulated and non-regulated operations. However, he calculated that on a consolidated basis, TransCanada's interest coverage ratio would not be significantly impacted if his recommended common equity ratio was adopted. He concluded that a 25% common equity ratio would not impair TransCanada's ability to raise funds on reasonable terms.

Finally, the expert witness for CAPP/APMC suggested that the demonstrated acceptability of TransCanada's consolidated capital structure by investors is a reason for reducing the common equity ratio below the currently authorized 30%. In his view, investors' perceptions of the investment risks in the securities of Canadian utilities can be understood from the prices they are willing to pay for these securities. At the time of his analysis, TransCanada's bonds were, along with several other high-quality utilities, yielding only 75 basis points more than long-term Government of Canada bonds. Further, despite a relatively low common equity ratio relative to other utilities in the comparison group, TransCanada's bonds did not have a materially different yield from the bonds of the other companies.

Further evidence of investors' acceptance of TransCanada's consolidated capital structure by investors comes from the equity markets. According to CAPP/APMC's expert witness, TransCanada's market-to-book ratio is currently in the order of 1.8 times. Such a high ratio suggests that investors are forecasting TransCanada's future rates of return on common equity will exceed their required rates of return. The preceding factors led him to conclude that a deemed common equity ratio of 25 to 28% would be appropriate for TransCanada. He recommended the low end of this range because of Westcoast's apparent ability to attract capital on reasonable terms with a consolidated common equity ratio which is less than 25%.

According to witnesses testifying on behalf of CAPP, deregulation has decreased TransCanada's business risks. The pipeline no longer has the risks associated with the merchant function. The gas market after deregulation is characterized by more flexible, market-oriented sales arrangements. In their view, pipeline access to many buyers and sellers has contributed to a better functioning market characterized by effective signals that act as a mechanism to balance supply and demand. Further, under deregulation, the demand for TransCanada's services has resulted in capacity expansions which have more than doubled the Company's rate base since 1989.

CAPP evaluated the long-term trends in TransCanada's risks and concluded that the Company has enjoyed a regulatory regime which has not only maintained but protected its monopoly status. Further, this regime has protected TransCanada from the perceived risks which have arisen over time. These risks, which CAPP drew from evidence submitted by TransCanada in past toll proceedings, include take or pay obligations, the absence of long-run assurance of supply, the increased risk of cost disallowances arising from large expansions, possible regulatory changes, competition from other energy sources, the trend towards competitive energy pricing, the reduction in market demand, deregulation, competition in the gas market and the number of deferral accounts.

CAPP argued that these risks have not materialized for TransCanada but rather that the shippers have had to bear these risks. In CAPP's view, TransCanada should not be compensated for risks to which it is not exposed. Short-term contracts do not increase TransCanada's risks. On the contrary, short-term contracts create an environment which improve system utilization, thereby further reducing TransCanada's already low risks.

CAPP contended that TransCanada's business risks have declined since deregulation. Further, new information presented by CAPP/APMC's expert witness indicated that a downward adjustment to TransCanada's deemed equity ratio is justified. Even if TransCanada's debt was downgraded to BBB status, CAPP stated that it is unlikely that this would have any impact on the cost of TransCanada's existing debt. The last time TransCanada's debt was rated as BBB, the actual yield on the Company's debt was that of an "A" rated company.

IGUA's view was that TransCanada's risks are relatively low and that the deemed common equity ratio should be reduced below 30%.

APMC's witness panel supported CAPP's views on TransCanada's capital structure. According to APMC, TransCanada is operating in a business environment with strong fundamentals. TransCanada is connected to a growing market. From a security-of-supply perspective, TransCanada is connected to a low-cost and established basin. Based on proven but unconnected supply reserves, the likelihood of TransCanada's system not being utilized due to supply shortages is very low.

Ontario's view was that a 28% deemed common equity ratio would be appropriate for TransCanada for the 1994 test year. Ontario stated that TransCanada's main objection to equity reduction is the fear that its debt rating will be lowered. According to Ontario, there is no evidence on record which shows that a debt rating downgrade would occur if the Company's equity ratio was reduced from its current level.

Wascana supported the recommendations of the expert witness for CAPP/APMC with respect to capital structure and rate of return issues.

Views of the Board

The Board notes that while TransCanada has not requested a change in its common equity ratio, its expert witnesses nonetheless view the Company's long-term business risks to be trending upwards.

The intervenors in this proceeding have recommended a reduction in TransCanada's common equity ratio from the current level of 30%. Evidence was presented in this proceeding which indicated that TransCanada's business risks have not changed materially since RH-2-92. Other evidence was presented which suggested that TransCanada's business risks had declined since deregulation occurred during the mid-1980s.

The Board has traditionally required evidence of changes in a pipeline's long-term business risks before considering a change to the common equity ratio. The Board agrees that the regulatory regime under which TransCanada is regulated has provided assurances that the Company will be able to recover its cost of service including a fair return for investors. However, given the evidence, the Board is not persuaded that TransCanada's business risks have declined to the point where a change in the common equity ratio is warranted.

The Board notes the argument put forward by the expert rate of return witness for CAPP/APMC that the investors' demonstrated acceptance of TransCanada's low level of consolidated common equity ratio as compared to the common equity ratios of other high-grade Canadian utilities is indicative of its low investment risk. Furthermore, investors' perceptions of TransCanada's investment risk can be understood from the prices they are willing to pay for its equity securities over its book value. However, the Board leans towards TransCanada's argument that stock prices are largely affected by the level of anticipated earnings not the level of the common equity ratio. Therefore, for the purposes of this proceeding, the Board is not persuaded that investors' acceptance of TransCanada's low level of consolidated common equity ratio and its recent market-to-book ratio of approximately 1.8 times is sufficient to warrant a change in the Company's deemed common equity ratio.

The Board notes that the issue of interest coverage ratios was discussed in some depth by the parties to this proceeding. The Board is of the view that interest coverage ratios are but one element among many taken into account by investors in determining the creditworthiness of a security.

Decision

The Board approves a deemed common equity ratio of 30% for the 1994 test year.

4.5 Return on Common Equity

TransCanada initially applied for a rate of return on common equity of 12.75%. Subsequently, as the long-term Canada bond yields continued to decline, TransCanada revised its applied-for rate of return on common equity to 12.375%.

4.5.1 Summary of Expert Witnesses' Evidence

4.5.1.1 TransCanada's Expert Witnesses

TransCanada's expert witnesses on rate of return relied on three tests to estimate a fair rate of return on common equity: the Comparable Earnings test, the DCF test, and the Equity Risk Premium test.

Comparable Earnings Test

In their view, the comparable earnings test is a measure of the fair rate of return on common equity which is based on the concept of opportunity costs. The opportunity cost principle suggests that regulated utilities should be allowed to earn a rate of return on common equity which is equivalent to the rates of return on common equity achieved by non-regulated companies which have similar overall risks.

They selected their sample companies from consumer-oriented industries due to their relative stability compared to other industrials. The initial group was limited to those companies:

- a. for which sufficient data was available;
- b. which had common equity of at least \$50,000,000;
- c. for which 125,000 or more common shares were traded in 1992; and
- d. which had not reduced dividends by more than 25% since 1983.

After obtaining a sample of companies based on the above criteria, the following 4 risk measures were used to screen out those with the most risk:

- a. the coefficient of variation of book returns;
- b. the coefficient of variation of earnings before interest and taxes;
- c. the most recent five-year beta; and
- d. the most recent five-year standard deviation of market returns.

The screening process yielded a group of 26 comparable companies. The sample companies had greater business risks than regulated utilities but these were in large part offset by their higher common equity ratios. In their view, the overall investment risk (which encompasses both financial and business risks) of the comparable companies is similar to the investment risk of regulated utilities. However, regulated utilities have experienced greater book and market stability than the low-risk industrials. They found this stability difficult to quantify in terms of the impact on investors required cost of capital.

TransCanada's expert rate of return witnesses forecasted that the average returns for their comparable companies for the current business cycle (which started in 1992) would be 11.5-13.0%. However, since TransCanada has lower overall risks, they reduced this range by 50 basis points to arrive at a range of 11.0-12.5%.

The 50 basis point adjustment resulted from their application of the DCF model to price/earnings ratios to provide an alternative method of estimating the risk/return relationship. This analysis indicated that the industrial returns require a downward adjustment of 50 basis points to arrive at an appropriate rate of return on common equity for TransCanada to account for lower investor expectations for growth in earnings.

They noted that the average market-to-book ratio for their sample of 26 industrials is 1.7 times. In a competitive environment without inflation, the market value of companies should tend to equal their book value. However, a company whose market value exceeds its book value by a large margin may be earning extra profits by exercising monopoly power. In their view, the firms in their 26 company sample do not have monopoly power and thus no adjustment for monopoly power was needed.

In summary, TransCanada's expert rate of return witnesses concluded that an appropriate rate of return on equity for TransCanada based on the comparable earnings test would be 11.0-12.5%. However, in their Additional and Reply Evidence, they stated: "We continue to view this range (11.0 to 12.5%) as too wide, and too speculative, to give as much weight to the results of the comparable earnings test as to the results of the equity risk premium test."

Further, they continued to maintain the view they had expressed in a recent toll proceeding that:

"While it constitutes "our best effort", we do not regard the results as sufficiently reliable to provide a basis for utility return awards. Indeed, we view it as unlikely that the current cycle will produce a representative level of returns that may reasonably be expected after the current industrial restructuring is completed and the companies have adjusted to the new international competitive environment. We therefore have doubts that the current business cycle will provide a basis for applying the Comparable Earnings Test."

DCF Test

According to TransCanada's expert rate of return witnesses, the DCF test measures investors' expected rate of return on common equity by reference to the current market price and an estimate of future cash dividend flow. The underlying premise of the DCF test is that the market price of a share is equal to the future cash flows to the investor discounted at a rate which reflects the investor's required rate of return for a share of a particular risk level.

They applied the DCF test to the same sample of 26 industrials used in their Comparable Earnings test. Their estimation of the dividend growth rate of 9.5% is based on data for achieved dividend growth rates over the period 1987 to 1993. The dividend yield for the third quarter of 1993, adjusted for growth, was 2.4%. Adding the growth estimate of 9.5% to an adjusted dividend yield of 2.4% gives a "bare-bones" cost of equity of 11.9%. This value was then reduced to 11.4% to reflect TransCanada's lower risk. In order to achieve a degree of financial flexibility to produce a 1.15 times market-to-book ratio, the "bare-bones" cost of 11.4% is adjusted upward to 12.5%.

TransCanada's expert witnesses stated that they "continue to regard the DCF methodology, requiring inferences as to investor expectations, as insufficiently reliable to place significant weight on the results."

Equity Risk Premium Test

According to TransCanada's expert rate of return witnesses, the Equity Risk Premium test is a measure of the market-related cost of attracting capital. The equity risk premium test is premised on the notion that equity investors require a rate of return on common equity which is higher than the rate of return for a less risky or risk-free investment. This premium results from the higher risk normally borne by the investor who chooses to invest in equity securities instead of less risky investment such as long-term Canada bonds. They performed two types of equity risk premium studies. The first was based on the DCF methodology and the second was based on historically experienced equity risk premiums.

1. DCF-Based Equity Risk Premium Study

In the first type of study, the equity risk premium was the difference between the DCF-calculated cost of equity and the yield on long-term Canada bonds. The cost of attracting equity capital for each year from 1976 to 1993 was estimated as the sum of the quarterly dividend yield, adjusted for growth and a weighted average of achieved 5 and 10-year dividend growth rates and retained earnings growth for the 5 utility companies.

In TransCanada's expert witnesses' view, the precise weight which investors attach to various measures of dividend growth cannot be estimated. For this reason, 7 weighting scenarios were developed to establish a range of investor expectations. Based on the average of all growth weighting scenarios, the equity risk premiums for the sample of 5 high-grade utilities were calculated to be 2.8-3.2%.

This methodology fails to take into account the observation that, on average, the calculated equity risk premiums have declined. This decline can primarily be attributed to a combination of the impact of the following three factors:

- a. a decline in investor perception of utility risk between 1976 and the early 1980s due to a shift in the regulatory framework, primarily the introduction of a forward test year methodology;
- b. a downward bias in recent calculated growth rates in dividends as a measure of investors' future expectations due to the declining trend in allowed returns during the latter half of the 1980s and early 1990s; and,
- c. A tendency toward a cyclical narrowing of the equity risk premiums in the contraction/recession phase of the business cycle which corresponds to the most recent years of the period of analysis.

To better represent the observed relationship between interest rates and equity risk premiums, they regressed the quarterly equity risk premiums against the corresponding long-term Canada bond yields. A second series of regressions added the 5-year betas as an independent variable. These regressions suggested an equity risk premium in the range of approximately 3.75-4.5%. Overall, it was their conclusion that the DCF-based equity risk premium test yields an equity risk premium of 4.0-4.4%

2. Equity Risk Premium Test Based on Experienced Equity Risk Premiums

For the second type of study, the equity risk premium was estimated based on historical differences between shares and bond returns. This analysis started with the estimation of the historical equity risk premium as presented in five studies of Canadian and U.S. investment returns. In estimating the required market premium from the historical differentials, they considered the following factors:

- a. reliance on longer-term periods is essential to capture all types of economic events. If there were conclusive evidence that the relative volatility of shares versus bonds had changed over time (measured by the relative standard deviation of returns), it would be appropriate to focus on the achieved equity risk premium in more recent periods, which would lead to a lower equity risk premium. However, since 1983, the relative volatility of common shares and bond returns has been equal to that of the entire post-war period;
- b. the achieved equity risk premium did not fall below 5.0% until the 1983 business cycle, when interest rate declines led to significant capital gains for bondholders. This circumstance, unlikely to be replicated in the near future, in conjunction with the relatively poor performance of the Canadian stock market, particularly since 1987, led to negative achieved premiums during the 1983-1991 cycle and, hence, a lowering of the average historic premium; and
- c. the U.S. experienced premiums have been significantly higher than the Canadian premiums.

These and other considerations lead to their conclusion that investors would reasonably require a market equity risk premium of 5.0%.

TransCanada's expert witnesses relied on three factors (betas, standard deviations of market returns and achieved market returns of gas and electric utilities relative to the market) to approximate the downward adjustment to the market equity risk premium to account for TransCanada's lower risk. In their view, a downward adjustment of approximately 30% is appropriate for TransCanada. Based on a 5.0% market equity risk premium, this adjustment resulted in a equity risk premium for TransCanada of 3.5%.

Their second method for estimating the equity risk premium based on historical data was to look directly at the achieved differentials between utility share returns and government bond returns. In their view, since utilities are more stable than other industries, the achieved returns are more likely to be closer to investor expectations than the returns for other, more risky industries. They used the TSE Utility and Gas/Electric Sub-indices as proxies for low-risk utilities. This analysis suggested that an equity risk premium of no less than 3.5% would be expected by investors for a relatively low-risk utility.

They concluded that the equity risk premium for TransCanada falls in a range of 3.5 - 4.5%. Combining the mid-point of the range for the equity risk premium, that is 4.0%, with the forecasted long-term Canada bond yield of 7.50% (based on a range of 7.25-7.75%), the "bare-bones" cost of equity was 11.5%. An adjustment for financing flexibility to achieve a market-to-book ratio of 1.15 times raised their estimate for the required rate of return on common equity to 12.6%.

In summary, giving 60% weight to the Equity Risk Premium test, 30% weight to the Comparable Earnings test, and 10% weight to the DCF test, TransCanada's expert witnesses estimated the fair rate of return on common equity for TransCanada to be 12.375% for the 1994 test year.

**Table 4-2
TransCanada's Rate of Return Witnesses' Evidence**

Test:	Investors' Required Rate of Return (%)	Adjustment for Lower Risk of Utilities (%)	Adjustment for Market to Book Ratio (%)	Req'd Rate of Return for Low Risk Utilities (%)
Comparable Earnings	11.5-13.0	(.50)	N/A	11.0-12.5
Discounted Cash Flow	12.0	(.50)	1.00	12.50
Equity Risk Premium	11.5	-	1.10	12.6
Recommended ROE for TransCanada				12.375

**Table 4-3
CAPP/APMC's Rate of Return Witness' Evidence**

Test:	Investors' Required Rate of Return (%)	Adjustment to Reflect Lower Risk of Pure Utilities (%)	Adjusted Test Results (%)	Required Rate of Return for Low-Risk Utilities (%)
Comparable Earnings	N/A	N/A	N/A	N/A
Discounted Cash Flow	9.6	N/A	N/A	9.6
Equity Risk Premium	9.5-10.0	N/A	N/A	9.5-10.0
Adjustment for "cushion"				0.50
Recommended ROE for TransCanada				10.0-10.5

4.5.1.2 CAPP/APMC's Expert Witness

CAPP/APMC's expert witness relied primarily on the Equity Risk Premium method in arriving at his recommendation of a fair return on common equity for TransCanada. A DCF analysis for Canadian utilities was included in his evidence to support the findings of the equity risk premium analysis. With regard to the Comparable Earnings test, he was of the view that the concept of comparable earnings does not necessarily have any relationship with the concept of a fair return and that the

measurement of comparable earnings (based on accounting data) provides results which are difficult to compare meaningfully across companies and across time.

DCF Test

The DCF analysis, by CAPP/APMC's expert witness, of Canadian utilities indicated that the current dividend yield for such utilities was 5.6% and that the prospective growth rate for the utilities' dividends was 4.0%. When combined these figures yielded an estimate for the investors' required rate of return on common equity for Canadian utilities of 9.6%.

Equity Risk Premium Test

According to CAPP/APMC's expert witness, the equity risk premium is defined as the incremental prospective rate of return or yield required by investors to hold shares rather than fixed income securities such as bonds and other debt securities. He asserts that the equity risk premium has been reduced over the last two decades by two fundamental changes to the economic and financial environment. The two changes are the nature of the risks associated with investments in long-term bonds and utility common shares, and the effect of various income tax changes on the premium required to attract investors from long-term bonds into common equity investments.

He estimated equity risk premiums for three different groups of companies: the Canadian equity market as a whole, a low-risk non-utilities group and a group of the lowest risk utilities. He estimated the equity risk premium required by investors prospectively for the market as a whole to be no higher than 4.5% based on the results of 5 different studies on the rates of return which could have been achieved between the years 1920 and 1992 from investments in portfolios of Canadian common shares and investments in long-term bonds.

Based on a comparison with the market portfolio on 5 different measures of risk, CAPP/APMC's expert witness estimated the risk exposure associated with the lowest-risk non-utility group to be in the order of 2/3 that of the equity market as a whole. The incremental equity risk premium for the lowest risk non-utilities group is thus approximately 3.0%.

Following a similar comparison of risk measures, he concluded that the risk exposure of the lowest risk utilities group is no more than 1/2 that of the equity market as a whole. This led to an equity risk premium of no more than 2.25% for low-risk utilities.

The forecast of CAPP/APMC's expert witness for the long-term Government of Canada bond yield for the 1994 test year is 7.25-7.75%. When combined with the equity risk premium of 2.25%, this yielded a range for the required rate of return on common equity of 9.5-10.0% for the lowest risk utilities. In arriving at the fair rate of return for TransCanada's common equity investors, the expert witness added a 50 basis point "safety cushion" to the rate of return on common equity required for the lowest risk utilities. Accordingly, the fair rate of return on common equity for TransCanada is in the range of 10.0-10.5%.

In summary, CAPP/APMC's expert witness recommended that a fair rate of return on common equity for TransCanada would be in the range of 10.0-10.5% for the 1994 test year.

Views of the Board

The Board is of the view that in light of the recent and prevailing financial market conditions, neither the DCF test nor the Comparable Earnings test currently yield reliable results. Accordingly, these tests have been given little or no weight in the Board's Decision. It remains the Board's view that these tests may prove useful under different economic conditions.

The Board is of the view that the Equity Risk Premium test was the primary measure of investors' required returns in the circumstances of this case. The Board also notes that even when all expert witnesses accept the validity of a particular test such as the Equity Risk Premium test, there are disagreements on the respective elements of the methodology and the results obtained are usually different. While the Board acknowledges that such differences are perhaps inevitable, parties should note that the usefulness of this test rests, in part, on the fact that the experts were consistent in their estimates of the basic components.

For the purposes of applying the Equity Risk Premium test, the Board concurs with the expert witnesses in this proceeding that the appropriate range for the long-term Canada bond yields for the 1994 test year is 7.25-7.75%.

The market equity risk premiums ranged from 4.5% according to CAPP/APMC's expert witness to 5.0% according to TransCanada's expert rate of return witnesses. The Board is satisfied that this range represents an appropriate estimate of the current market equity risk premium in Canada.

The final step in the Equity Risk Premium test is to adjust the market equity risk premium for TransCanada's lower risk, relative to the market as a whole. CAPP/APMC's expert witness estimated the equity risk premium for TransCanada to be approximately 2.25% or approximately 1/2 the market as a whole. TransCanada's expert rate of return witnesses estimated the equity risk premium for TransCanada to be approximately 3.5%, or approximately 2/3 of the equity market as a whole.

The Board is of the view that, based on the evidence presented in this proceeding regarding business risk, and based upon the statistical risk factors for other low-risk utilities employed by all of the expert witnesses, TransCanada is much less risky than the market as a whole. Allowing for some uncertainty with respect to the overall investment risks associated with TransCanada, the Board is of the view that an appropriate equity risk premium for the Company is in the order of 275-300 basis points

Finally, the Board believes that some allowance should be added to TransCanada's authorized return on equity for unforeseen financial circumstances or financial flexibility. For TransCanada, the Board is of the view that this allowance should be no greater than 50 basis points.

Based on the foregoing considerations, the Board is of the view that an appropriate rate of return on common equity for TransCanada is 11.25% for the 1994 test year.

Decision

The Board approves a rate of return on common equity for TransCanada of 11.25% for the 1994 test year.

4.6 Rate of Return on Rate Base

The Board approves a rate of return on rate base of 10.60% for the 1994 test year. The approved capital structure and overall rate of return are shown in Table 4-4.

Table 4-4
Approved Deemed Average Capital Structure and
Rates of Return for the 1994 Test Year

	Amount (\$ 000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Funded Debt	3,823,041	58.47	10.81	6.32
Unfunded Debt	157,274	2.40	7.21	0.17
<hr/>				
Total Debt Capital	3,980,315	60.87		6.49
Preferred Shares	596,640	9.13	8.02	0.73
Common Equity	1,961,552	30.00	11.25	3.38
<hr/>				
Total Capitalization	6,538,507¹	100.00		
Rate of Return on Rate				10.60
Base				

(1) Rate Base \$6,420,719 + GPUC \$117,788 = Total Capitalization \$6,538,507

4.7 Income Taxes

4.7.1 Flow-Through Tax Calculation

Decision

The Board has adjusted the 1994 flow-through income tax provision from \$92,102,000 to \$74,729,119, a decrease of \$17,372,881 as a result of the Board's decisions in Chapter 3 and this Chapter in respect of rate base and rate of return on rate base (see Table 4.5).

Table 4-5
Utility Income Tax Allowance for the 1994 Test Year
(\$ 000)

	Application	NEB Adjustments	Authorized by NEB
Equity Component	287,039	(23,148)	263,891
Depreciation	210,026	(14)	210,012
Large Corporation Tax - 1994	13,655	(3)	13,652
Preferred Share Dividend Tax	292	(10)	282
Drawdown of Deferred Taxes	(25,290)	-	(25,290)
Non-allowed Amortization of Debt Discount & Expense and Foreign Exchange Costs	7,121	-	7,121
Non-allowed Expenses	3,224	-	3,224
Capital Cost Allowance	(342,347)	63	(342,284)
Benefits Capitalized	(3,910)	830	(3,080)
Eligible Capital Expenses	(87)	-	(87)
Interest AFUDC	(8,136)	(23)	(8,159)
Interest Component of Income Tax Reassessment Deferral Account Carrying Charges	(1,739)	(8)	(1,747)
Issue Costs	(6,905)	-	(6,905)
Taxable Income	132,943	(22,313)	110,630
Taxes at $0.43757 \div (1 - 0.43757) \times$ Taxable Income	103,430	(17,360)	86,070
Ontario and Quebec Non-allowed Meals and Entertainment Expenses	15	-	15
Recovery of Large Corporation Tax	13,655	(3)	13,652
Income Tax on Preferred Share Dividends	292	(10)	282
Deferred Income Tax Drawdown	(25,290)	-	(25,290)
Utility Income Tax Allowance	92,102	(17,373)	74,729

Chapter 5

Operating Costs

5.1 Transmission by Others

5.1.1 Additional Service Requests

In subsection 9.3.1 of its GH-2-87 Reasons for Decision, the Board amended its previous decision in subsection 7.1.7 of the RH-3-86 Reasons for Decision to read as follows:

“... in the future TransCanada should seek approval from the Board prior to committing itself to a change in its long-term contractual obligations with other pipeline companies when the costs of transportation services provided under the contracts are included in TransCanada’s revenue requirement”.

In the RH-4-93 Hearing Order the continued appropriateness of this requirement was added as an issue in order to examine whether it is still needed in today’s efforts to lighten the regulatory burden.

TransCanada was not opposed to the continuation of the existing requirement. TransCanada stated that it could understand parties’ desire to oversee TransCanada’s long-term contractual obligations on Great Lakes, given the special relationship between TransCanada and Great Lakes, and recognizing the magnitude of TransCanada’s transportation costs on Great Lakes.

TransCanada also indicated that it notifies its stakeholders of major changes to its long-term TBO-related contractual obligations through the Tolls Task Force, with the view of achieving support for requested changes.

CAPP, GMi, and Union supported the retention of the requirement.

Views of the Board

The Board no longer considers it necessary for TransCanada to seek prior approval of changes to its long-term contractual obligations on Great Lakes and Union. In view of today’s market-responsive environment, the Board believes that TransCanada should be able to respond quickly to effect changes to its needs for capacity on these systems. With each tolls application the Board and interested parties have the opportunity to assess the prudence of any changes that TransCanada has made to its long-term contractual obligations on Great Lakes and Union, with the Board disallowing any costs found to have been imprudently incurred. The Board expects that TransCanada will continue to keep the Tolls Task Force informed of changes that it is considering to these contractual obligations.

Decision

The Board has decided to discontinue the requirement set out in subsection 9.3.1 of the GH-2-87 Decision.

5.2 Operations, Maintenance & Administration

For the 1994 test year, an in-depth review of the OM&A expense category was undertaken by parties. A number of issues were raised and discussed by parties in this area. Table 5-1 below provides a distribution of TransCanada's applied-for and authorized OM&A expenses chargeable to cost of service for the 1994 test year.

Table 5-1
Operations, Maintenance & Administration Expenses
For the 1994 Test Year
(\$ 000)

Applied-for Expenses	
Transmission Expenses - Salary Related	40,803
Transmission Expenses - Other	64,485
Departmental Expenses - Salary Related	36,756
Departmental Expenses - Other	23,967
General - Employee Benefits	20,933
General - Other Expenses	16,244
	203,188
Total Applied-for OM&A Expenses	203,188
Overall OM&A Adjustment	(2,500)
	200,688
Total Authorized OM&A Expenses	200,688

The following sections summarize the various discussions and the Board's views so as to provide the background for the Board's decision concerning the level of resources approved for OM&A expenses.

5.2.1 Salaries, Wages and Employee Benefits

TransCanada estimated the total 1994 salary expense chargeable to cost of service to be \$77,559,000 comprised of regular salaries, temporary salaries and overtime. The applied-for amount for 1994 provides for merit increases, in-range progression, promotions and other changes. The total also includes funding for the Management Incentive Program and changes in the number of FTEs charged to the regulated pipeline operation.

TransCanada estimated the 1994 employee benefit expense charged to cost of service to be \$20,933,000. This amount includes the Company's expenses related to pensions, insurance, Employee Savings Plan and other benefits.

5.2.1.1 Number of Full-Time Equivalents

TransCanada used the concept of FTEs to calculate the net number of employees utilized for the utility operation. An FTE is the equivalent of one position in terms of the number of hours worked but it can be made up of allocations from a number of different positions. For the 1994 test year, TransCanada estimated the number of regular FTEs related to the utility operations to be 1,312 which represented an increase of 8 FTEs from the 1992 base-year allocation. As far as temporary employees

were concerned, the total FTEs allocated to utility operations in the 1994 test year was 193 compared to a total of 189 temporary FTEs allocated in 1992.

Ontario argued that the increase in temporary positions for the 1994 test year in comparison to the levels approved in 1993 was too high in light of current levels of activity. Ontario submitted that the applied-for number of temporary positions should be reduced by 31 FTEs in order to provide an incentive to TransCanada to increase its efficiency and also to support the need for restraint.

5.2.1.2 Year-Over-Year Salaries and Wages Increase

TransCanada's 1994 Application included a Company-wide salaries and wages escalation factor of 2.4% for merit increases and an additional 0.5% for promotions and in-range progression. The Company submitted that an increase of this magnitude was necessary in order to keep its salaries competitive and to properly motivate its employees. The merit increase proposed for 1994 was based on a survey of 237 employers conducted by Towers and Perrin in the summer of 1993 and updated in November of 1993. The basis of comparison was oil and gas companies and companies with sales in excess of \$1 billion. TransCanada's final proposed increase was slightly below the lower end of the 2.5-3.0% range identified in the November 1993 survey update.

IGUA took the position that the increase in salaries and wages was excessive and the overall increases including a factor for promotions and in-range progression should not exceed 2.0%.

Ontario also considered TransCanada's proposed increase to be too high and submitted that the Board should limit the 1994 test year salaries and wages increase to the lower end of a 1.0-2.0% range.

5.2.1.3 Determination of an Appropriate Base-Year Amount

The 1994 salaries and wages estimate was calculated by starting with the 1992 base-year actual cost and adjusting this amount for approved staff increases and the actual increases paid by TransCanada in 1993. This amount then became the starting point for the calculations to determine the 1994 test-year salary requirement. TransCanada indicated that the 1993 salaries and wages amount included a merit increase of 2.7% and a provision of 0.5% for promotions and in-range progression. These increases are in excess of the all-inclusive escalation factor of 2% approved for TransCanada by the Board in RH-2-92. TransCanada stated that the higher increase was necessary in 1993 in order to maintain its salaries at a competitive level and properly motivate its employees. In the Company's view, if the higher increase had not been paid in 1993, then the 1994 test year requested increase would have had to be higher than proposed in order to maintain TransCanada's salaries and wages at a competitive level.

CAPP submitted that the Company should not be permitted to use the 1993 actual salaries and wages as the base for determining the salaries and wages requirement for the 1994 test year.

IGUA was of the view that it would be inappropriate to use 1993 actuals as the basis for comparison where those actual salaries and wages are a by-product of non-compliance with the Board's RH-2-92 Decision. IGUA also suggested that some form of censure is required in order to indicate to TransCanada that the Board does not agree with the Company's actions.

Ontario expressed concern that TransCanada's decision to grant higher increases was inappropriate and considered this action to be an important precedent. Ontario suggested that the resulting higher costs

should be borne by the shareholders and the Board should remove any disallowed amounts when it compares actuals to allowed rates of return and expenses.

5.2.1.4 Vacancy Rate

TransCanada estimated its 1994 test year vacancy rate to be 40 FTEs in comparison to an actual vacancy rate of 38 FTEs in 1992 and the Board-approved level for vacancies in 1993 of 30 FTEs.

Ontario was concerned that the increase of 10 positions in the vacancy rate for the 1994 test year over the approved vacancy rate for 1993 was being used by TransCanada as a basis for justifying additional regular positions. As an incentive for TransCanada to increase its efficiency, Ontario submitted that the Board should disallow 5 of the new positions being applied for on a Company-wide basis while accepting the higher vacancy rate in the 1994 test year.

5.2.1.5 Employee Benefits

TransCanada estimated that the total employee benefits charged to cost of service would be \$20,933,000 in 1994. The Company provided information comparing the employee benefits provided to TransCanada employees with the benefits provided by companies in the oil and gas sector as well as an additional comparison to companies with annual revenues in excess of \$1 billion. TransCanada indicated that, as directed in the RH-2-92 Decision, this information was prepared using samples which are virtually identical to those used to determine the Company's compensation program.

TransCanada included the full cost of a non-contributory Employee Savings Plan in its 1994 cost estimates as the Company requested the Board to review the rationale for disallowing a portion of these costs in RH-2-92. In final argument, the Company reiterated its position that the shares in the Employee Savings Plan are purchased in the open market and not from Treasury. As a result, no new equity flows to TransCanada and therefore, tollpayers are not providing both the equity and the return thereon.

Although IGUA did not make specific reference to the Employee Savings Plan, IGUA did request the Board to use the 1993 allowed amounts for salaries and benefits as the benchmark for assessing the reasonableness of TransCanada's 1994 requirements.

Ontario submitted that TransCanada did not use an appropriate sample of companies for comparing employee benefits and urged the Board to confirm its decision in RH-2-92 of limiting the allowed amount for the Employee Savings Plan contributions charged to tolls to 2.5% of salaries and wages rather than the 5% incurred by TransCanada.

5.2.1.6 Allocation of Employee Benefits to Non-Regulated Operations

TransCanada calculated the amount of employee benefits to be charged to non-regulated operations using a composite rate of 27.1% of salaries and wages.

Ontario sought clarification on the differences between the actual costs of providing employee benefits to regular and temporary employees. The responses provided by TransCanada indicated that there was a significant difference between the employee benefits for employees in each of these categories. TransCanada's calculations confirmed that if separate rates were used the ratios would be 29.3% for regular employees and 6.0% for temporary employees. Ontario submitted that, in the case of employee benefits charged to non-regulated operations, the charge was understated and the use of the

two rates would result in a reduction in the amounts charged to the regulated component of the cost of service.

5.2.2 Other Expense Items

TransCanada estimated the non-salary expenses in the OM&A budget to be \$104,696,000 for the 1994 test year.

5.2.2.1 General Escalation Factor

TransCanada requested a general escalation factor of 1.9% for the 1994 test year to allow for inflation in those expenditure categories which were not affected by any activity-related increases or decreases. This estimate was based on the November 1993 updates published by Consensus Forecasts which is based on 19 different forecasts from various Canadian institutions.

IGUA and GMi did not question the rate proposed by TransCanada but suggested that, in lieu of examining TransCanada's expenditures in detail, some form of global O&M amount should be approved. IGUA stated that this global amount could be determined as a by-product of a review of the major factors affecting TransCanada's operations and a more detailed analysis of some specific expenditure areas.

CAPP and Ontario did not comment on the concept of a global O&M amount but did suggest that the Board should continue to review TransCanada's expenditures in order to assess their reasonableness.

5.2.2.2 Donations

TransCanada applied to have \$1,782,000 in charitable donations included in the cost of service. This amount was based on the same formula used in previous years of 1/2 of 1% of the average utility income before income taxes for 3 consecutive years, including the forecast year. TransCanada indicated in its evidence that the charitable donations should be funded by tollpayers as they are a prudent cost of doing business in the various communities across the country where the Company has a presence.

CAPP submitted that it did not have any objection to TransCanada making charitable donations but was of the view that because tollpayers do not have any control over where the donations are made the expense should not be allowed in the cost of service. CAPP also indicated that there were ample precedents for disallowing charitable donations in a number of regulatory tribunals and courts in both the U.S. and Canada.

Ontario expressed the view that TransCanada's shareholders benefitted from the charitable donations made by the pipeline operation and supported CAPP's position that the expenditures should be disallowed. Ontario also proposed two other alternatives to full disallowance with one being a sharing of the donations on a 50/50 basis between tollpayers and shareholders and the other a sharing of the costs in line with TransCanada's approved debt to equity ratio of 70% for tollpayers and 30% for shareholders.

5.2.2.3 Hearing Costs

TransCanada included hearing costs of \$950,000 in its requested cost of service for the 1994 test year. In TransCanada's view, the hearing process is integral to the NEB's discharge of its mandate and these costs should be the responsibility of all shippers. TransCanada also expressed its concern that the Company only has minimal control over the hearing costs as they are largely dependent on the number of issues raised and the length of cross-examination.

CAPP suggested that it is inequitable for tollpayers to pay both TransCanada's and their own hearing costs. CAPP also stated that the portion of the hearing costs related to providing evidence on rate of return or capital structure are directly related to shareholder profit and therefore should be the responsibility of TransCanada's shareholders. CAPP acknowledged that it was not aware of any precedents for disallowing these costs but suggested that such an action could act as an incentive to achieve more settlements outside of the hearing process. In support of CAPP, Ontario agreed that hearing costs related to rate of return and capital structure should be borne by the shareholders.

5.2.2.4 Training Costs

TransCanada included increases in its training budgets of all operations for the 1994 test year. The Company indicated that the increase was required in order to make up for lower than anticipated training caused by demands relative to its construction program.

Ontario was of the view that the planned training programs were overly ambitious as the increase over 1992 levels was significantly higher than the increase in the number of permanent employees and the inflation rate over the same period. Ontario also referred to statements in TransCanada's 1992 Annual Report which indicated that employee training had increased substantially in 1992. Ontario submitted that the increase in TransCanada's training costs should be limited to the increase in the number of regular employees and the change in the inflation rate resulting in a disallowance of approximately \$400,000 in training costs for 1994.

5.2.2.5 Toronto and Washington Offices

As in previous years, TransCanada included the costs of maintaining offices in Washington and Toronto in its cost of service for the 1994 test year.

CAPP submitted that TransCanada did not provide evidence that the Toronto and Washington offices meet the "need and benefit to shippers" test and as a result the costs of maintaining these two offices should be excluded from the cost of service.

Both Consumers' and Union supported the inclusion of the expenditures associated with maintaining the Toronto office.

5.2.2.6 Corporate Memberships

TransCanada's requested cost of service included an increase of \$287,000 over the base year in its costs related to corporate memberships largely as a result of the Company's decision to become a member of the CEPA at an estimated annual cost of \$225,000.

CAPP submitted that TransCanada did not provide evidence to show that there was a need for a membership in this organization or that it would provide a benefit to shippers that would justify the

\$225,000 expenditure. In CAPP's view, the onus is on TransCanada to show that there is a "need, reasonableness and benefit to shippers" before the costs of this membership should be allowed in the cost of service.

Views of the Board

The Board noted TransCanada's and intervenor's positions concerning the various types of expenditures which the Company includes in its cost of service. The Board recognized the efforts of interested parties, within the current established cost of service methodology, to ensure that the Company is managed and operated in an efficient manner and that tolls remain competitive in the North American natural gas market. The Board also noted that the Company chose in 1993 not to conform with certain specific decisions of the Board set out in RH-2-92, thus rendering ensuing adjustments difficult, particularly if the Company continued to diverge from the Board's decisions on specific matters.

In the Board's view, the Company is ultimately responsible for determining how its allowed OM&A budget should be allocated and spent in order to ensure that the pipeline is managed and operated in an efficient and effective manner and the tolls remain competitive.

Consequently, with the objective of encouraging the Company towards adopting measures that will further improve the cost effectiveness and efficiency of its operations, the Board will approve an overall OM&A amount for tollmaking purposes for the 1994 test year. The approval of an overall OM&A amount carries with it some obligations on the part of TransCanada. The Board expects the Company to operate the pipeline within the approved global amount while ensuring that this is accomplished in a safe, reliable, cost effective and environmentally responsible manner. Notwithstanding the establishment of an overall OM&A amount, the Board will continue to expect TransCanada's future tolls applications to identify expenditures in the same detail as currently provided. In assessing the Company's requirements, the Board will put greater reliance on examining TransCanada's actual expenditures in the base year and its forecasts for the current year in determining an appropriate global amount for any given test year. In this context, the Board may randomly select certain expenses for detailed examination and TransCanada should be prepared to justify any applied-for expenses in their entirety and not solely on the basis of a general increase over previous years' expenditures.

Taking into account that half of the 1994 test year has passed, the Board has considered the evidence and arguments presented and determined that for 1994 revenue requirement purposes, the applied-for OM&A expenses should be reduced by \$2,500,000 resulting in an approved amount for OM&A expenditures of \$200,688,000. In determining an appropriate OM&A amount, the Board was cognizant of the generality of this approach but determined that a reduction of this magnitude would be feasible and not require an unreasonable amount of effort on the part of TransCanada while fostering more efficiency in the Company's operations.

The following factors were taken into consideration as part of the process to determine the appropriate amount of the projected operating and maintenance expenses.

The Board is of the view that the number of regular and temporary FTEs assigned to the pipeline operation for the 1994 test year is reasonable in light of the level of activity planned by the Company in 1994.

With respect to the proposed increases in salaries and wages for the 1994 test year, the Board considers the proposed increases of 2.4% for merit and 0.5% for promotions and in-range progression to be high in the current economic climate. The Board is of the view that a 2.0% all-inclusive increase would be more appropriate and should not affect the Company's ability to retain or recruit staff.

As a result of the additional information provided by TransCanada relating to the purchase of shares for the Employee Savings Plan, the Board is satisfied that, as far as the Company's equity is concerned, the tollpayers are not providing both the equity and return on it. In light of this information, the overall reduction in OM&A did not include any factor related to the Employee Savings Plan.

The Board has reviewed the evidence concerning the use of a single composite rate to charge employee benefits to the non-regulated operations and finds that this practice understates the amount charged to the non-regulated operations. As a result the charges to the regulated operations are overstated. From the Board's perspective, it would be more appropriate for the Company to establish separate employee benefit rates for regular and temporary employees. In arriving at this conclusion, the Board also recognizes that the use of separate rates for capitalized benefits of regular and temporary employees will have the opposite effect of increasing the cost of service and therefore, the overall reduction in OM&A has taken this factor into account.

The Board finds the general escalation rate used by TransCanada for other operating and maintenance expenses to be reasonable in light of current expectations for inflation in 1994.

The Board examined the issue of whether or not TransCanada should be allowed to recover hearing costs related to the financial issues in its cost of service. After considering the evidence and arguments submitted in this case, the Board is of the view that hearing costs represent a valid charge to the pipeline's operations and that it would not be appropriate to depart from the established policy of allowing such costs to be recovered.

Taking into consideration all of the evidence adduced in this case and the general economic conditions under which the Company operates, the Board has determined that a general reduction in TransCanada's applied-for OM&A expenses is warranted in order to restrain expenditures and increase efficiency wherever possible.

For tollmaking purposes, the Board has prorated the \$2,500,000 reduction between transmission, departmental and general expenses.

This prorationing should not preclude TransCanada from making its own assessment of how its reduced OM&A budget should be spent.

In arriving at this conclusion, the Board is of the view that the approval of an overall OM&A amount places the onus on TransCanada to ensure all of the components of its cost of service are prudently incurred and adhere to the principles of cost efficiency and effectiveness.

Decision

For tollmaking purposes, the Board approves OM&A expenses in the amount of \$200,688,000 for the 1994 test year.

5.3 Inclusion of Current-Year Information In Future Tolls Applications

The filing requirements for TransCanada's tolls applications are prescribed in the NEB Rules. Part V of the NEB Rules requires that an application shall include a summary of the applicant's total cost of service showing the booked amounts for the base year, total adjustments and the projected test-year amounts for specific cost components. TransCanada filed its 1994 tolls application in compliance with the NEB Rules.

The determination of the appropriateness of TransCanada's specific cost components primarily includes variance analysis. However, variance analysis of TransCanada's cost components is unduly complicated because the "total adjustments" information includes adjustments made to the base year to derive the approved amount for the current year, a further adjustment to derive a forecast of the current year's expenditures and a final adjustment of the current year's forecast to arrive at the test-year forecast.

TransCanada stated that it would be agreeable to filing a current-year forecast in support of the following year's application but on the condition that the current year becomes the base year. TransCanada's position is based on two main considerations, i.e. the availability of administrative resources to provide detailed comparisons of base year to current year to test year and its belief that detailed multi-year comparisons are not required to support a test year.

IGUA argued that an evaluation of expenses would be easier if information in the application included test-year forecasts compared to current-year estimates and base-year amounts. IGUA also stated that the OEB requires historic, current and forecast year amounts as part of the pre-filed information to support tolls applications which, in IGUA's experience, leads to a more focused discussion of the total amount of these claims.

Views of the Board

The Board recognizes the inherent difficulty in analyzing TransCanada's expenditure information without having the portion relating to current-year forecasts clearly identified. The Board is of the view that the determination of the appropriateness of test-year expenditures would be facilitated if TransCanada were to file current-year forecasts in addition to base-year information in its tolls application.

Decision

The Board directs TransCanada in future tolls applications to file current-year forecasts (i.e. annual amounts based on year-to-date actual data plus an estimate for the balance of the year) in addition to base-year information in order to support test-year forecast amounts.

Chapter 6

Deferral Accounts

6.1 Deferral Accounts - Materiality Criterion

In RH-2-92, the Board indicated that, in deciding on the appropriateness of individual deferral accounts, consideration is given among other things to the materiality of the potential cost/revenue variance in relation to TransCanada's earnings.

TransCanada stated that it considers materiality when deciding whether to apply for a new deferral account or to apply to continue existing deferral accounts.

Views of the Board

The Board considers that the ongoing scrutiny of individual deferral accounts should include consideration of the potential deferral account balance. The assessment of each proposed deferral account as well as the appropriateness of the continuation of existing deferral accounts will be based on the application of three criteria, namely, absence of control over the level of costs/revenues, inability to reasonably forecast the level of costs/revenues and the materiality of the potential cost/revenue deferral account balances.

Decision

The Board at this time will not attempt to place a limiting definition on materiality but will examine the appropriate measure of this criterion on a case-by-case basis as new deferral accounts are requested and as existing deferral accounts are requested to be continued.

6.2 Unfunded Debt Deferral Account

In 1993, TransCanada indicated that the over-earning amount in respect to the unfunded debt balance was approximately \$1.6 million before tax.

CAPP and APMC took the position that a deferral account should be established to record variances between the forecasted unfunded debt rate and the actual rate incurred on unfunded debt balances. They argued that a deferral account was appropriate because variations in unfunded debt rates are not forecastable, are beyond the control of TransCanada and the 1993 amount of over-earnings regarding the unfunded debt balance was material.

TransCanada stated that it was opposed to the creation of a deferral account for unfunded debt on the basis of the general regulatory principle that the unfunded component, which is represented by long-term assets in the ground, is funded by the long-term debt rate. The currently-approved methodology which uses a blend of short-term and long-term rates is already a concession.

Views of the Board

In assessing the appropriateness of establishing a deferral account for unfunded debt, the Board finds that two of its three criteria have not been demonstrated, namely, the inability to reasonably forecast the level of costs over the past number of years and the materiality of the potential cost deferral account variance.

The Board notes that TransCanada did over-earn approximately \$1.6 million on its unfunded debt balances during 1993. While this amount could be viewed as material if looked at in isolation for one year, the Board does not believe that TransCanada has consistently been overearning amounts of this magnitude. Therefore, the Board is not persuaded that an unfunded debt deferral account is warranted at this time.

Decision

The Board denies the request to establish an unfunded debt deferral account.

6.3 Environmental Litigation re: 1991 North Bay Loop Project

TransCanada has been charged under the Fisheries Act of Canada, the Ontario Water Resources Act and the Environment Protection Act of Ontario. These charges stem from the 1991 North Bay Loop Pipeline Project and allege that the Company discharged sediment into the water. These charges are currently in various stages of litigation.

In TransCanada's view, it would be appropriate to capitalize all costs including fines related to these charges on the basis that these actions resulted from construction-related activities.

CAPP and APMC argued that legal costs related to a successful defence should be expensed and recoverable from tollpayers but legal costs relating to an unsuccessful defence should not be recoverable.

Ontario was of the view that any fines resulting from convictions and legal costs for an unsuccessful defence should be assumed by TransCanada's shareholders. A portion of legal costs related to a successful defence may be recovered from tollpayers.

Centra Ontario proposed that these costs (i.e. fines, legal costs) be dealt with on a case-by-case basis and that before they are recovered either in rate base or as operating expenses, they must be specifically identified and all the circumstances examined in an appropriate tolls case. Costs which are included in the 1994 revenue requirement should be removed and deferred.

Union stated that TransCanada should be permitted to recover legal costs associated with acquittals of environmental charges. With respect to fines and related costs arising from convictions for environmental offenses, Union was of the opinion that TransCanada should only be permitted to recover these costs where the Board has satisfied itself that TransCanada acted in the most prudent and responsible manner possible.

Views of the Board

The Board is of the view that it is premature to determine the appropriateness of allowing TransCanada to recover costs associated with environmental litigation arising from the 1991 North Bay Loop project. Therefore, in the Board's opinion, a deferral account should be established to capture all legal and related costs incurred as a result of this litigation. The Board recognizes that the 1994 revenue requirement may include amounts related to this issue and considers that it would be appropriate for these amounts to be recorded in this deferral account and appropriately identified so they can be considered when final disposition of this deferral account occurs.

Decision

The Board directs TransCanada to establish a deferral account for the purpose of recording all legal and other associated costs relating to the environmental litigation associated with the 1991 North Bay Loop Pipeline Construction Project. The Board further directs that any amounts which have been included in the applied-for 1994 revenue requirement be appropriately identified and recorded in this deferral account.

6.4 Transmission Plant in Service Deferral Account

The Board first established this deferral account in 1990 on a temporary basis to accommodate variances in approved versus actual rate base additions during a period of heavy construction.

This deferral account records the notional variance in the cost of service which results from actual rate base additions differing by date and cost from those approved in the test year. It captures the consequent variations from the approved amounts of depreciation expense, return and income taxes.

Initially, TransCanada asked for continuation of this deferral account but subsequently decided to withdraw this request because, in its view, this deferral account was no longer required.

Views of the Board

The Board is of the view that the original purpose for establishing this deferral account is no longer applicable and agrees with TransCanada that this account should be discontinued.

Decision

The Board directs TransCanada to discontinue the Transmission Plant in Service Deferral Account.

6.5 Fixed Costs in the Great Lakes Commodity Charge Deferral Account

The original purpose of this deferral account was to record any variations between the forecasted fixed costs paid through commodity charges and the actual fixed costs paid through commodity charges.

TransCanada indicated that the SFV rate design was implemented on Great Lakes effective 1 April 1993. The effect of the SFV rate design was that 100% of fixed costs were recovered in the demand charge component of the rate. TransCanada stated that its request to continue this deferral account was based on the fact that there is still some uncertainty regarding the long-term rate design on Great Lakes. This uncertainty was based partially on reported concerns in the press of the impact of the SFV rate design on smaller customers. In addition, TransCanada stated that FERC had expressed some reservations with the SFV rate design and had indicated that this aspect may be re-examined in future rate hearings.

Views of the Board

The Board considers TransCanada's justification for continuation of this deferral account to be tenuous.

The Board is of the view that, because of the implementation of the SFV rate design on Great Lakes effective 1 April 1993, there is no need to continue this deferral account for the 1994 test year.

Decision

The Board denies TransCanada's request to continue the Fixed Costs in the Great Lakes Commodity Charge Deferral Account.

6.6 Other Deferral Accounts

TransCanada sought the continuation of a number of deferral accounts for the 1994 test year.

TransCanada proposed to discontinue the Gas Related Costs and Purchase Price Deferral Account for the 1994 test year.

Decision

The Board approves the continuation of the following deferral accounts for the 1994 test year:

**Great Lakes Rates
Great Lakes Exchange
Great Lakes Refund
Great Lakes Demand
Union Rates
Union Demand
Union Commodity**

**Trans Quebec & Maritimes Pipeline Inc. Toll
Demand Revenue
Income Tax Reassessment
Municipal Taxes
Future Legislative Changes to Various Taxes
CCA Variances on Compressors
Compressor Fuel
Debt Service**

Further, the Board approves the discontinuance of the Gas-Related Costs and Purchase Price Deferral Account.

6.7 Test-Year Revenue Surplus

TransCanada requested a deferral account to record the variance which is caused by the need to charge tolls on an interim basis pending the determination of final tolls for the test year.

Views of the Board

The Board has determined that the interim tolls will result in a revenue surplus for the period 1 January 1994 to 30 June 1994. The Board has reflected its estimate of this surplus in the 1994 test-year revenue requirement to be allocated to the six-month period 1 July 1994 to 31 December 1994.

Since the actual revenue surplus cannot be determined until the actual volumes for the period 1 January 1994 to 30 June 1994 are known, it is reasonable to defer any variances from the Board's estimates. This is consistent with the Board's past practice.

Decision

The Board approves a deferral account to record any variances between the actual revenue adjustment for the interim period and the amount estimated by the Board.

Chapter 7

Interim Revenue Adjustment

7.1 1994 Revenue Surplus

The estimated 1994 test-year revenue surplus is \$1,682,373 for the period 1 January 1994 to 30 June 1994. This amount represents the difference between the projected transportation revenue from the interim tolls and the approved test-year revenue requirement, as shown in Table 7-1. The Board's decision with respect to a deferral account for the 1994 interim period revenue variance is provided in section 6.7.

Table 7-1
NEB Determination of the Revenue
Surplus for the 1994 Test Year

Transportation Revenue Under Interim Tolls	1,642,189,500
Miscellaneous Revenue Under Interim Tolls	(47,133,600)
	<hr/>
Adjusted Transportation Revenue Under Interim Tolls	1,595,055,900
Approved 1994 Revenue Requirement (net of Miscellaneous Revenue)	1,591,691,154
	<hr/>
Revenue Surplus for 1994	3,364,746
Revenue Surplus for the Period 1 January 1994 to 30 June 1994	1,682,373

7.2 Carrying Charges

The Board is of the view that the test-year Revenue Surplus deferral account is a special deferral account and hence carrying charges should be calculated at a short-term rate. The Board considers a short-term rate of 5% to be appropriate for this purpose.

Decision

The Board approves the use of a short-term rate of 5% for the determination of carrying charges with respect to the test-year Revenue Surplus deferral account.

7.3 Allocation of Interim Revenue Adjustment

Carrying charges of \$42,613 have been added to the revenue surplus to arrive at the interim revenue adjustment of \$1,724,986. As the new tolls will be in effect for only six months (or one-half) of the 1994 test year, the amount of the adjustment should be multiplied by 2 to permit the full amount of the adjustment to be reflected in the tolls.

Decision

The tolls, effective 1 July 1994 have been set based on the allocation of the interim revenue adjustment over the last six months of the 1994 test year. For the purposes of calculating tolls, the interim revenue adjustment of \$1,724,986 has been multiplied by 2 to reflect the allocation over six months of the test period.

Chapter 8

Toll Design

8.1 Throughput Forecast

TransCanada's throughput forecast for the 1994 test year, as updated in its "Final Revision" dated 7 March 1994, was 61 112 10⁶m³ (2,158 Bcf) of which 31 020 10⁶m³ (1,096 Bcf) was forecast for the domestic market and 30 092 10⁶m³ (1,062 Bcf) was forecast for the export market.

TransCanada's forecast continues to be based upon: discussions with its shippers; the results of its shipper questionnaire; historical performance; and TransCanada's own assessment of the markets served by its system.

Decision

The Board accepts TransCanada's throughput forecast for cost allocation and toll design purposes.

8.2 Tolling Treatment for FST Diversions

During the summer of 1993, TransCanada and Union negotiated the provision of diversions under the FST Toll Schedule. On 16 September 1993, the draft tariff language and a brief explanation of the proposed changes were presented to the Tolls Task Force. All members were asked to relay their comments and/or questions to TransCanada as soon as possible.

TransCanada sent a letter to the Board on 22 September 1993 requesting approval of the proposed changes. TransCanada proposed that the toll to be paid for diverted volumes would be either the daily equivalent demand toll to the diversion point or the demand portion of the FST toll, whichever is higher, plus the applicable commodity toll and fuel ratio to the diversion point, plus any applicable delivery pressure charges and delivery pressure fuel ratios. The Board approved the request on 7 October 1993.

Consumers' sent a letter to TransCanada, the Board and other interested parties on 15 October 1993, stating its objection to the tolling of FST diversions as set out in the revised FST Toll Schedule. Consumers' did not agree with TransCanada's toll methodology which effectively eliminates the FST tolling differential once FST service is diverted. Consumers' position was that the FST differential recognizes the benefit that FST service provides to the TransCanada system and, in effect, compensates the FST shippers for the inferior service that they receive, as compared to FS service. It was Consumers' view that a diversion of this inferior FST service does not eliminate the benefit to TransCanada or the inferiority of the FST service and, as such, the FST toll differential should not be eliminated for FST diversions.

During subsequent discussions on this issue, Consumers', Union and TransCanada agreed on the following changes with respect to FST diversions:

- a. Downstream FST diversions will be quasi-firm all year, such that they will have a lower priority than FS and FS diversions, but a higher priority than IS.
- b. The tolling of downstream FST diversions will be the higher of the FS toll to the diversion point or area, minus the entire FST differential, or the FST toll.
- c. In the winter, upstream FST diversions will be firm, except for diversions to St. Clair, as noted below.
- d. The tolling of upstream FST diversions will be the higher of the FS toll to the diversion point or area, minus the entire FST differential, or the FST toll.
- e. In the summer, upstream FST diversions will be quasi-firm, as are all other diversions. Tolling will be the same as in (d) above.
- f. Diversions to the St. Clair point will be considered as quasi-firm all year long and will be tolled at the FST toll.

CAPP, ProGas and APMC requested that this issue be deferred to the Tolls Task Force. These parties stated that the status quo should prevail until the new FST study is considered.

IGUA, GMi, Consumers', and Union supported the proposal. In Consumers' view, there would be nothing to be gained by deferring the revised toll treatment to the Tolls Task Force.

Views of the Board

The issue of the appropriate tolling treatment for FST diversion was added to RH-4-93 in order for the Board to render a decision on the matter. Parties had ample time in this proceeding to examine the appropriateness of the proposed tolling treatment. The Board does not see the benefit of deferring this issue to the Tolls Task Force.

Based on the evidence in this proceeding, the Board finds the proposed tolling treatment for FST diversions to be reasonable. In addition, the Board is of the view that the FST diversions issue raised is not related to the FST study currently underway in the Tolls Task Force.

Decision

The Board approves the proposed tolling treatment for FST diversions.

8.3 Delivery Pressure Tolls

The Tolls Task Force unanimously resolved to continue utilizing the current toll methodology for delivery pressure charges, as approved by the Board in its RH-2-92 Reasons for Decision, until such time a review is requested by the Board or an interested party.

Decision

The Board approves the continuation of the current toll methodology for delivery pressure charges until a review is requested by either the Board or an interested party.

8.4 Backhaul Tolls

The Tolls Task Force unanimously resolved to continue the existing backhaul interruptible toll design until a review is requested by the Board or an interested party. It was further resolved that said toll design does not constitute a precedent for future toll design purposes.

The existing backhaul toll design is as follows:

Summer: No fuel or variable costs. A demand charge equivalent toll consisting of 50% of the demand charge for forward haul service on a point-to-point basis calculated at 100% load factor.

Winter: No fuel or variable costs. A demand charge equivalent toll consisting of 100% of the demand charge for forward haul service on a point-to-point basis calculated at 100% load factor.

Decision

The Board approves the continuation of the existing backhaul interruptible toll design until a review is requested by either the Board or an interested party.

8.5 IS Tolls

The Tolls Task Force unanimously resolved that the IS toll design and bidding mechanism be continued for the 1994 test year. TransCanada undertook to present another review of IS volumes, revenues and bidding to the Tolls Task Force after 31 March 1994.

The following toll design is currently approved by the Board:

Winter: 31 tiers of service, in 1% increments from 110% to the 80% load factor rate for firm service.

Summer: 26 tiers of service, in 2% increments from 140% to the 90% load factor rate for firm service.

There are two pools of service, one monthly and one weekly, with available capacity allocated 50% to each pool. Bidding takes place either monthly or weekly and service is allocated to those bidders submitting the highest bids, until all available capacity is taken up.

Decision

The Board approves the continuation of the existing IS toll design and bidding mechanism for the 1994 test year.

8.6 PS, TWS and WFS Tolls

The Tolls Task Force unanimously resolved to revise the toll design for PS, TWS, and WFS as follows:

8.6.1 PS Toll Design

The PS toll will be comprised of the following components and the PS winter period will be changed from the current 166 days (1 November -15 April) to 151 days (1 November-31 March):

- a. the commodity toll to the particular zone where the service is being provided;
- b. the daily equivalent demand toll to the particular zone where the service is being provided; and
- c. a base toll consisting of the FST Downstream Differential multiplied by a factor determined by dividing the zone demand toll by the Eastern Zone demand toll, divided by a factor of 0.13 (determined by dividing 20 days by 151 days, which is the number of days that TWS can be interrupted).

8.6.2 TWS Toll Design

The TWS toll will be comprised of the following components and the TWS winter period will be changed from the current 166 days to 151 days:

- a. the commodity toll to the particular zone where service is being provided;
- b. the daily equivalent demand toll to the particular zone where the service is being provided, multiplied by a factor of 0.87 (131 days divided by 151 days); and
- c. a base toll consisting of the FST Downstream Differential multiplied by a factor determined by dividing the zone demand toll by the Eastern Zone demand toll.

8.6.3 WFS Toll Design

The WFS toll design would be modified as appropriate by these changes to the PS and TWS toll designs. Service would be awarded between PS, TWS and WFS on the following basis:

- a. TransCanada would estimate the capacity to be available for PS, TWS and WFS by 15 June of each year.
- b. The capacity would be available for either the full winter period or for some lesser period during the winter period (e.g. December to February period). If appropriate, separate capacity may be available for PS only.
- c. Shippers will bid for the available capacity during an open season to be held from 2 July to 15 July of each year. In order to make the price of TWS and WFS more market-responsive, TransCanada proposed that potential customers also bid for the toll they are willing to pay for TWS and WFS, within a preset range. The toll would range from the 100% load factor rate for firm service in the specific zone up to the approved TWS and WFS tolls for the zone. No bidding for price was proposed for PS at this time.

Successful bidders will be selected on the following basis and priority:

- WFS and TWS will be selected on the basis of revenue maximization to the zone or delivery points where capacity has been made available.
- PS bids will be selected last, unless TransCanada has determined that a separate pool should be available for only PS shippers.
- In all cases, if the total bids for a particular period exceed the available capacity, the successful bidders will be selected via a lottery.

TransCanada received several comments from potential WFS shippers that the year-to-year nature of WFS was not attractive and this uncertainty was not reflected in the price. Therefore, TransCanada proposed to allow bids for PS, TWS and WFS capacity to be awarded for a two-year period instead of one year if, in TransCanada's sole discretion, the capacity would be available for two winter seasons.

Centra Ontario, Consumers' and Union supported TransCanada's proposals.

ProGas and APMC had concerns with the proposal to offer WFS for two winter periods. They were concerned that FS shippers would be at risk of curtailment if TransCanada incorrectly forecasted the amount of capacity available for TWS. Therefore, they recommended that this issue be deferred to the Tolls Task Force.

Views of the Board

Like the issue of FST diversions, the issues involved with PS, TWS and WFS were brought before the Board to be decided. Concerning the issues resolved by the Tolls Task Force, the Board finds the proposed changes to be appropriate. Concerning the issue of offering WFS for two winter periods should TransCanada determine that there will be capacity available for that period, the Board was not persuaded that this would place FS shippers at risk of curtailment.

Decision

The Board approves the proposed changes to PS, TWS and WFS, including the proposal to offer WFS for two winter periods.

8.7 Fuel Ratios

TransCanada forecasts monthly fuel ratios for transportation service to each zone and from specific receipt points to specific delivery points. Shippers provide compressor fuel in accordance with those forecasted fuel ratios. Any variances between forecast and actual fuel ratios are adjusted in the second subsequent month.

In final argument, F&V stated that TransCanada's 1993 actuals and forecasts of 1994 compressor fuel requirements have not been within acceptable margins of error. Moreover, F&V submitted that, throughout a year, compressor fuel requirements are subject to huge variations that appear inconsistent with the daily, weekly, and monthly FS-flow patterns.

F&V was of the view that services other than FS are the sole or most important contributors to the volatility of compressor fuel requirements. Accordingly, F&V requested the Board to establish monthly fuel ratios by individual service classification.

Views of the Board

As this issue was not raised or tested in evidence, the Board finds it difficult to assess the merits of the suggested change. The Board therefore is not persuaded that any change to the current methodology for calculating monthly fuel ratios is appropriate at this time.

Decision

The Board denies the request to establish monthly fuel ratios by individual service classification.

Chapter 9

Tariff Matters

9.1 Return Home Policy

During the summer of 1993, instances arose where parties attempting to divert their FS were denied the full diversion request because of capacity limitations. When these shippers attempted to re-nominate their FS to the contract delivery points after the nomination deadline, they found the capacity at those points had already been allocated to other shippers who had requested delivery to those points.

TransCanada subsequently spoke to all parties who expressed interest in this issue and all parties agreed to the pilot project which commenced 1 February 1994 for a one-year period. Under the pilot project, TransCanada will accept diversion "return home" re-nominations, subject to downstream operators acting within a certain time. A shipper should provide the "return home" re-nomination as a contingency at the time of the original nomination. TransCanada is of the view that the pilot project procedures will be an improvement over the existing policy for re-nominations since certain actions and times for those actions are specified in advance.

Views of the Board

The Board is encouraged that the parties affected by this issue have agreed to and implemented a tentative solution. The Board expects that parties will monitor the pilot program and that TransCanada will advise the Board of the results of the pilot program.

Decision

The Board supports the implementation of the "return home" pilot project and requests that TransCanada provide the Board with a report detailing the results of the pilot project by 1 March 1995.

9.2 Queuing Procedures

TransCanada proposed to introduce a Queue Entry Fee for FS, FST and STS transportation service requests equal to the lesser of one day's demand charge or \$10,000. TransCanada indicated that the ease of entry into the queue for existing capacity under the current Transportation Tariff provisions has resulted in speculative requests for service. TransCanada believes that such a fee would reduce the level of speculative service requests and would result in a more meaningful queue for transportation service. TransCanada proposed to return the fee, without interest, to the successful shippers in the form of a credit towards the first month's demand charges. A prospective shipper would be refunded its fee, without interest, upon withdrawal from the queue prior to a pre-determined cut-off date. The fee would be forfeited if the prospective shipper is removed from the queue for reasons such as failure

to meet conditions or failure to accept offered service. Forfeited fees and interest would be held in a deferral account and returned to all tollpayers in the subsequent test year.

TransCanada also proposed to reduce the time allotted to sign a precedent agreement from 60 to 30 days. As TransCanada only submits a precedent agreement to a shipper when that shipper is ready to execute the agreement, TransCanada argued that this change would not cause any hardship to prospective shippers.

TransCanada further requested approval of several minor wording changes to its Queuing Procedures. Among the proposed wording changes is one which would permit a shipper in the queue to assign its queue position with the prior written approval of TransCanada for reasons of a name change. Approval would only be given for such a request if the service remained the same and did not affect other participants in the queue. This option is currently not available to participants in the queue.

Centra Ontario and GMi supported the changes proposed by TransCanada.

CAPP and ProGas recommended that the Board refer the proposals to the Tolls Task Force as they had not been given full consideration there. CAPP also argued that there is no pressing need to implement any of the proposed changes at this time.

IGUA, while supporting the proposed changes, would not object to referring them to the Tolls Task Force.

Views of the Board

The Board has not been persuaded that the current queue entry provisions and precedent agreement execution period are detrimental to TransCanada or its shippers. Hence, the Board believes that the current Queuing Procedures should not be amended to include the imposition of a queue entry fee of up to \$10,000 nor should the precedent agreement execution period be reduced from 60 to 30 days.

The Board is of the view that the proposal to modify the Queuing Procedures to permit assignment of queue position for name changes is appropriate. However the Board would prefer that the wording in TransCanada's Transportation Tariff be modified to indicate that the availability of assignments is under specific conditions. This will ensure that all participants in the queue are fully aware of the conditions under which an assignment would be granted.

The Board believes that the remaining proposed amendments to the Queuing Procedures, including the provisions for assignment of queue position, are appropriate.

Decision

The Board approves the proposed amendments to TransCanada's Queuing Procedures with the exception of the imposition of a queue entry fee and the reduction in the precedent agreement execution period. TransCanada shall remove all references to a queue entry fee and reduction in the precedent

agreement execution period from its Queuing Procedures and file the amended Queuing Procedures with the Board and serve it on all interested parties.

The Board accepts the requested change to TransCanada's Transportation Tariff regarding queue position assignments (section 7.2 of the Queuing Procedures) provided the wording in the tariff includes the conditions under which an assignment of a queue position would be granted; specifically a name change, with the service request remaining the same and no other participant in the queue being affected.

9.3 Renaming of Transportation Services

TransCanada proposed that the names of its firm, interruptible and interruptible backhaul services be changed to reflect the common North American terminology for those services. Accordingly TransCanada proposed to change FS service to FT service, IS service to IT service and IS Backhaul service to IT Backhaul service.

Decision

The Board approves the requested transportation service name changes.

9.4 Payment Date of TransCanada Invoices.

In final argument, F&V raised a concern regarding TransCanada's tariff requirement that shippers must pay invoices on the working day preceding the invoice due date if that date falls on a weekend or statutory holiday. F&V argued that the payment should be required on the working day following the invoice due date.

Views of the Board

The Board is of the view that the current payment provisions are appropriate and is not persuaded that any change to the Transportation Tariff is warranted.

Decision

The Board denies the request to change the due date for payment of invoices.

9.5 Short-Term Firm Transportation

TransCanada requested approval of a new STFT service, having a minimum contract term of one month. STFT service shippers would pay the same demand and commodity tolls and would have the same priority of service and diversion rights as FS. The service would have no right of renewal. Due

to its short-term nature, STFT service would also not have any assignment rights. TransCanada also sought approval of a proposed STFT Toll Schedule and an STFT Pro-forma Contract.

TransCanada proposed to offer this service because, from time to time, it has small increments of excess capacity available for short periods of time. This capacity may become available due to the construction of facilities in advance of a 1 November contract start-up. Alternatively, capacity may become available due to contract non-renewals.

IGUA, GMi, Centra Ontario, and Union supported the introduction of STFT service.

ProGas and APMC expressed concerns that, if TransCanada overestimates the available capacity for STFT, it could end up having to prorate capacity between FS and STFT. Both parties requested that this issue be deferred to the Tolls Task Force for further discussion.

Views of the Board

By offering STFT service, TransCanada should be able to more effectively utilize its system and increase revenues for the benefit of all firm shippers. The Board was not persuaded that giving STFT and FS equal priority would result in FS shippers being curtailed. The Board accepts the priority, tolling and diversion provisions proposed for STFT service.

Decision

The Board approves the introduction of STFT service, with the same toll and priority of service and diversion rights as FS. The Board also approves the STFT Toll Schedule and the STFT Pro-forma Contract.

9.6 FST Supplementary Charge

The FST Toll Schedule includes a clause dealing with the calculation of the FST supplementary charge. This charge may be levied by TransCanada if the full FST annual contract quantity is not accepted as tendered to the FST shippers.

Consumers' expressed some concerns to TransCanada that the procedures outlined in the Company's Transportation Tariff were different than the actual operating and billing procedures currently in use. Consumers' agreed with the methods being used by TransCanada but noted that the tariff language did not properly reflect the actual procedures.

Based on discussions at the Tolls Task Force, TransCanada proposed changes to the FST Toll Schedule to address Consumers' concerns. Consumers' supported the proposed changes.

Decision

The Board approves the proposed changes to the FST Toll Schedule.

9.7 Minor Tariff Changes

TransCanada proposed a number of small wording changes or corrections in various parts of its Transportation Tariff. These proposed changes were:

- a. adding "Winter Firm Service Contract" and "WFS Contract" to the list of services under the definition section of the General Terms and Conditions;
- b. re-ordering Section XVI, Determination of Daily Deliveries, in the General Terms and Conditions to reflect actual operating procedures;
- c. adding or changing a number of receipt and delivery points under the "Receipt and Delivery Points" tab in the tariff; and
- d. adding the following sentence to section 8.1 of the FS Toll Schedule: "Contracts may be revised as of the effective renewal date to adhere to the then current Pro-Forma Firm Service Contract."

Decision

The Board approves the proposed changes to the Tariff.

Chapter 10

Contract Renewals

10.1 Renewals Policy

TransCanada's current renewals policy of a 1-year minimum contract term with renewal rights having a six-month renewal notice period was first approved by the Board in GH-2-87 (issued in July 1988). Since that Decision, no changes have been made to the policy. The policy was last reviewed in GH-5-89.

TransCanada expressed the view that, since the last review, the natural gas marketplace has experienced significant change as a result of market evolution and continued deregulation both in the U.S. and Canada. Since the implementation of the current policy, TransCanada's system has been significantly expanded to accommodate the demand for pipeline capacity to serve both new and existing markets. Recently, TransCanada and other interested parties have voiced some concern about the continued appropriateness of the current policy. To address this issue, the TransCanada 1994 Tolls Task Force formed a Renewals Sub-Committee to review the current renewals policy. The Sub-Committee was unable to reach a consensus on the existence of a problem with the current renewals policy nor on alternative policies.

This issue was originally scheduled to be heard as part of GH-2-93. However, following submissions from interested parties, the Board deferred it to this proceeding.

TransCanada proposed changes to its Transportation Tariff to address the concerns it had regarding the continued appropriateness of the current renewals policy. TransCanada cited several reasons for believing that a change was needed including: incompatibility between the renewal notice period and the planning and construction cycle; the risk to the system associated with the volume of short-term transportation contracts; increased competition from other gas sources; changes in U.S. regulation and the need for congruence between Canadian and U.S. policies; the increase in assignments and diversions; and the lack of a smooth contract expiry profile. The proposed changes would be effective for contracts expiring on or after 31 October 1994.

TransCanada proposed that the current renewals policy be modified to provide a range of renewal notice periods from 6 to 18 months with a sliding scale of fees ranging from no fee for an 18 month or greater notice of renewal or termination to a fee equal to 3% of the annual Demand Toll for a 6 month notice of renewal (Renewal Fee) or termination (Exit Fee). An 18-month renewal notice period without fee was chosen by TransCanada as it believed that this was most compatible with TransCanada's planning and construction cycle. At 18 months, TransCanada's costs to modify or terminate an expansion would be minimal. An 18-month period would also provide TransCanada with more time to find new shippers in the event of non-renewal of capacity. TransCanada indicated that the current level of short-term contract volumes is approximately the same as it has been for the past several years, and that it has been able to fully absorb non-renewed capacity into its expansions. However, with the declining average contract term, lack of a smooth expiry profile and expected smaller future expansions, the potential exists for the level of contract non-renewals to increase dramatically in the future. TransCanada was of the view that this potential increase in contract non-

renewals, when combined with the inability to fully absorb all non-renewed capacity into expansions or to seek new shippers within the short time available, would expose TransCanada and its remaining shippers to greater risk of system underutilization. TransCanada considered that its proposal would provide short-term shippers with an incentive to indicate their intentions earlier. Renewal or exit fees paid as a result of this proposal would be credited to a deferral account and would be used to offset the toll effects of future non-renewals.

CAPP expressed concern that, while the current renewals policy affords shippers with a high degree of flexibility, it might result in unnecessary system expansion. CAPP preferred to see a policy which is more compatible with TransCanada's planning and construction cycle. CAPP proposed that the minimum contract term for which automatic renewal rights apply be extended to 2 years and that the renewal notice period vary depending on whether or not TransCanada is in an expansion cycle. In an expansion cycle, CAPP considered that an appropriate notice period would be 12 months. In a non-expansion cycle, the renewal notice period would be 6 months. CAPP did not support renewal fees. CAPP argued that the TransCanada renewal fee proposal was inappropriate as it was not cost-based and did not provide the terms and conditions demanded by the market. CAPP also argued that the current renewals policy is not compatible with TransCanada's current planning and construction cycle, which could lead to overbuilding.

APMC shared the concerns expressed by CAPP regarding the potential for overbuilding and the desire to achieve a balance between the needs of shippers and those of the system. APMC proposed that the minimum contract term for which automatic renewal rights apply be extended to 2 years and that the renewal notice period be extended to 12 months. APMC argued that its proposal balanced the need of shippers for flexibility with the need for greater system planning certainty and more equitably allocated cost responsibility amongst shippers. APMC did not support renewal fees. APMC argued that the TransCanada proposal was inappropriate as it was not cost-based, would only provide the advanced renewal notice desired by TransCanada if the fees were set at the right level, and would not send the appropriate market signals. APMC also argued that the current renewals policy was inappropriate as it does not address the potential problem of overbuilding the TransCanada system. NSP and Wascana supported the APMC proposal.

Centra Ontario and Consumers' argued that the TransCanada proposal was inappropriate as it would either decrease the flexibility enjoyed by shippers or increase the cost of that flexibility. They argued that the minimum term for which renewal rights apply should remain at 1 year but that the renewal notice period could be extended to 12 months in recognition of the potential for overbuilding which exists with a 6-month renewal notice period. This proposal was also supported by Northern Natural and ProGas in argument. Quebec advocated a 1-year minimum contract term with renewal rights having a renewal notice period between 10 and 13 months.

IGUA, Union and Ontario argued for the retention of the existing policy of a minimum 1-year term and 6-months renewal notice period. They were of the view that TransCanada's proposal as well as the other proposals put forward by intervenors were premature and partial and should be rejected, arguing that more time was needed to properly develop a better solution. They also argued that TransCanada's Renewal Fee proposal in conjunction with its Contract-term Toll Differential proposal would increase inefficiencies on the system, shift risk to LDCs and other shippers who lack adequate means to mitigate or hedge against the risk and increase the incentive for shippers to use TransCanada as a "swing" pipeline. IGUA, Union and Ontario also argued that the CAPP and APMC proposals

decreased the flexibility of shippers. The view that no change is warranted was also supported by F&V, Natural, the Northeast Group and Vermont Gas.

GMi argued that none of the proposals before the Board adequately addressed the risk of non-renewal of short-term contracts. GMi proposed that the renewal notice period be extended to 18 months to provide TransCanada with the notice it required for compatibility with its planning and design cycle.

Views of the Board

In GH-5-89, the Board considered proposed revisions to TransCanada's renewals policy and determined that a change was not warranted. The evidence and arguments presented in this proceeding that shippers with short-term contracts pose a risk of system underutilization are similar to those presented in GH-5-89. Arguments have been made that circumstances have changed since GH-5-89 to the extent that a change to the renewals policy is now warranted. The Board is of the view that the evidence indicates otherwise. The volumes under short-term contracts have remained essentially the same since GH-5-89 and are expected to continue to be so into the foreseeable future. TransCanada continues to apply for expansions to its system. While the level of competition faced by TransCanada from sources of gas delivered by pipelines other than TransCanada is greater than at the time of GH-5-89, it still remains low. The experience to date with the changes in the U.S. as a result of FERC Order 636 is limited and cannot provide conclusive proof that TransCanada's current policy requires modification to be congruent with U.S. policies.

The views of the Board expressed in GH-5-89 remain valid today. The current renewals policy was authorized to provide producers, marketers and end-users with flexible transportation options based on market principles. As the market is demanding greater rather than less transportation flexibility, the Board is not persuaded that the proposed changes to the existing renewals provisions in TransCanada's Transportation Tariff are warranted.

Decision

The Board denies all proposed changes to the existing renewals provisions in TransCanada's Transportation Tariff.

10.2 Contract-term Tolling Differential Proposal

To supplement its proposed changes to the Renewals Policy, TransCanada proposed that a tolling differential be applied to all contracts based on their remaining term to expiry as of 1 January each year. TransCanada originally proposed that there be a premium of 2% for one-year contracts, and a 2% discount for 20-year contracts, to be implemented 1 January 1995. Shippers with 10-year contracts would pay the "base" toll, which contained neither a premium nor a discount. In final argument, TransCanada revised its proposal such that all 1-year contracts would pay the "base" toll, with longer-term contracts receiving a discount up to 4% for 20-year contracts.

The objectives of the proposed tolling differential would be to encourage longer-term contracts and to demonstrate that the contract would be serving a long-term market for natural gas. TransCanada submitted that its proposal would provide correct market signals by placing a value on the flexibility inherent in short-term contracts.

The level of discounts were chosen by TransCanada as being reasonable, based on discussions at the Tolls Task Force. The discounts would be rolled in to the base toll, which would vary slightly from year to year depending upon the mix of short-term and long-term contracts. If these discounts did not encourage longer-term contracts on the system, TransCanada stated that the percentages might have to be reviewed in a future tolls proceeding.

Any differences in actual discounts from the forecasted amounts would be recorded in the Demand Revenue deferral account.

TransCanada argued that its proposal would result in just and reasonable tolls which are applied equally to all shippers with the same remaining contract term. Thus, TransCanada argued that its proposal was entirely consistent with the Board's Part IV jurisdiction.

CAPP argued that the proposal should be rejected because it would not result in cost-based tolls and, in CAPP's view, it was based on two fundamentally flawed assumptions. First, CAPP disagreed with TransCanada's assumption that short-term contracts are more valuable than long-term contracts. CAPP stated that different market participants place a different value on different terms. Second, CAPP disagreed with the supposition that the pipeline would benefit from having longer-term contracts. In CAPP's opinion, it would be desirable to have a mix of contracts of various lengths.

IGUA argued that the Contract-term Toll Differential proposal constituted a radical change to the cost-based rolled-in tolling regime and it was not responsive to customer needs. In IGUA's submission, the proposal likely does not comply with section 62 of the NEB Act and is destabilizing, disruptive and unfair.

GMi and Centra Ontario argued that the Contract-term Toll Differential proposal should not be accepted because TransCanada has not succeeded in proving that it offers sufficient incentive to encourage shippers to contract long term. Also, they considered the proposal to be unjust, because it would not allow an equitable sharing of risk between shippers who have contracted short term and those who have contracted longer term.

Consumers' argued that TransCanada's proposal should be rejected because it would be contrary to section 62 of the NEB Act, in that it would violate the just and reasonable standard and because the same tolls would not be charged equally to all shippers for the same service over the same route.

Union argued that the Contract-term Toll Differential proposal, like the other renewal proposals brought before the Board, should be rejected because it represents a piecemeal approach to a broader challenge facing the industry. In Union's opinion, there is ample time to come up with a better approach to the situation facing TransCanada. It was Union's view that such an approach is likely to develop if TransCanada approaches its shippers and listens to their views about a market-oriented solution.

APMC argued that the Contract-term Toll Differential proposal should be rejected. The primary reasons were that the discounts were not cost-based, the proposal would not necessarily work, and it

would generate tolls which are not just and reasonable. On the last point, APMC agreed with the arguments made by Consumers’.

Northern Natural, ProGas, Wascana Energy and Quebec also argued that the Contract-term Toll Differential proposal should be rejected for a variety of reasons.

Views of the Board

In a market-oriented, competitive gas environment, the Board continues to believe that the buyers and sellers of natural gas should have the flexibility to determine the term and form of transportation services to meet their long-term market requirements. Further, this flexibility should be determined freely in the marketplace and not influenced by arbitrary factors that are not cost-based.

The Board finds TransCanada’s Contract-term Toll Differential proposal to be contrary to this approach by introducing arbitrary discounts based on TransCanada’s assessment of the value associated with long and short-term contracts. As testified during the hearing, different shippers place different values on different contract terms.

The Board notes that steps taken by various parties during the past decade have led to strong market fundamentals at both ends of the pipeline. In the Board’s opinion, TransCanada’s proposal would weaken the market fundamentals by impeding the interaction between buyers and sellers of natural gas.

Decision

The Board denies TransCanada’s Contract-term Toll Differential proposal.

10.3 Suspension of Shippers’ Rights

Natural, Northern Natural and ProGas submitted that TransCanada’s current tariff provisions, which permit it to suspend a shipper’s renewal rights, when in TransCanada’s sole determination those shippers are no longer serving a long-term market, are flawed. They disagreed with TransCanada’s interpretation of a long-term market as one which is served solely by TransCanada rather than a long-term market for natural gas. Natural, Northern Natural and ProGas requested that the Board clarify that a long-term market for the purposes of these provisions is a long-term market for natural gas and not just a long-term market served by TransCanada.

TransCanada responded that the provisions were included in the tariff pursuant to GH-2-87. The Board subsequently clarified TransCanada’s responsibilities in a letter to TransCanada dated 27 October 1988. In that letter, the Board placed the onus "on TransCanada to conduct its own assessment of natural gas markets and to demonstrate that a particular shipper does not serve a market requiring long-term capacity."

Views of the Board

Regarding the issue of suspension of renewal rights, the Board in its 27 October 1988 letter to TransCanada indicated that:

“TransCanada may seek information from its shippers and distributors regarding the nature of their markets for natural gas. Based on its review of such information and based on its own assessment of the natural gas markets and the continuing need for long-term pipeline capacity, TransCanada may conclude that a particular shipper is not serving a long-term market and that this shipper should not be granted an automatic right of contract renewal.”

The Board is of the view that the current tariff provisions continue to be appropriate and is not persuaded that any change is warranted at this time.

Decision

The Board finds that the provisions concerning suspension of renewal rights in TransCanada’s Transportation Tariff, as clarified by the Board letter to TransCanada dated 27 October 1988, continue to be appropriate.

Chapter 11

Tolls Task Force

TransCanada currently files a significant amount of Tolls Task Force information as part of its tolls application which includes:

- a. information on issues generated by TransCanada;
- b. responses to Information Requests prepared by TransCanada;
- c. minutes of Meetings; and
- d. details of member's positions during the Tolls Task Force and their final recorded vote.

The issue was raised regarding the value of the Tolls Task Force materials and the purpose of filing them with the Board as part of a tolls application. The Board invited interested parties to comment on this issue in final argument.

CAPP was of the view that no Tolls Task Force documentation should be filed with the Board with the exception of a document that sets out for the Board the issues that have been resolved by the Tolls Task Force and the resolutions to those issues.

IGUA stated its preference to have Tolls Task Force participants arrive at a consensus as to how filings should be accommodated before asking the Board to make any ruling in this connection.

Consumers' felt that the Tolls Task Force should revisit the type of material that should be filed with the Board on its behalf.

ProGas recommended that no materials, other than documents summarizing resolved issues be filed with the Board or filed with any tolls application.

Wascana Energy opposed the admission of Tolls Task Force information as evidence in the hearing with the exception of the Final Report of the Tolls Task Force.

APMC offered its view that no materials on matters that have not been resolved should be filed with the Board.

Ontario was of the view that the proceedings of the Tolls Task Force should be separate from the hearing process.

TransCanada, in reply argument, indicated that the Tolls Task Force should resolve the issue of what is appropriate to be filed with the Board as part of a tolls application.

Views of the Board

The Board is of the view that the final Tolls Task Force Report which is filed as part of a tolls application should report only on issues which have been resolved by the Tolls Task Force and members should arrive at a consensus on the format and nature of the material which will be filed in a tolls application by TransCanada in support of issues resolved by the Tolls Task Force. In this regard, the Board would refer parties to the Guidelines on Negotiated Settlements re: evidence to be submitted in support of a settlement.

Decision

The Board directs TransCanada not to file, as part of a tolls application, any information from the Tolls Task Force related to unresolved issues.

Chapter 12

Disposition

The foregoing chapters together with Order No. TG-3-94 constitute our Decision and Reasons for Decision on this matter.

J.-G. Fredette
Presiding Member

C. Bélanger
Member

R. Illing
Member

Calgary, Alberta
June 1994

Appendix I

Order TG-3-94

ORDER TG-3-94

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

IN THE MATTER OF an Application dated 8 July 1993, as amended, by TransCanada PipeLines Limited (“TransCanada”) pursuant to Part IV of the Act for certain orders respecting its tolls; filed with the National Energy Board (“the Board”) under File No. 4200-T001-8.

BEFORE the Board on 10 June 1994.

WHEREAS TransCanada filed an Application dated 8 July 1993, as amended, for an order fixing just and reasonable tolls that it may charge for or in respect of transportation services rendered effective 1 January 1994;

AND WHEREAS the Board, expecting that its final decision on TransCanada's Application would not be rendered until after 1 January 1994, issued Order TGI-3-93 on 3 December 1993, which authorized TransCanada to charge, on an interim basis, effective 1 January 1994, its existing tolls as authorized by the Board in its RH-2-92 Decision, pending the Board's final decision on the said Application;

AND WHEREAS a public hearing commenced pursuant to Hearing Order RH-4-93, as amended, in the City of Ottawa, in the Province of Ontario, and was completed in the City of Calgary in the Province of Alberta, during which time the Board heard the evidence and argument presented by TransCanada and all interested parties;

AND WHEREAS the Board's decisions on the Application are set out in its Reasons for Decision dated June 1994, and in this Order;

IT IS ORDERED THAT:

1. TransCanada shall, for accounting, tollmaking and tariff purposes, implement the decisions outlined in the Reasons for Decision dated June 1994 and in this Order;
2. Order TGI-3-93, 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 of the end of the day on 30 June 1994;
3. The tolls which were in effect, on an interim basis, for the period 1 January 1994 to 30 June 1994 are final;
4. TransCanada shall, for service commencing 1 July 1994, charge the tolls set out in Appendix 1 to this Order;

5. TransCanada shall forthwith file with the Board, and serve on all parties to the hearing of this Application, new tariffs, including general terms and conditions, and tolls conforming with the decisions outlined in the Reasons for Decision dated June 1994 and with this Order; and
6. Those provisions of TransCanada's tariffs and tolls, or any portion thereof, that are contrary to any provision of the Act, to the Board's Reasons for Decision dated June 1994, or to any Order of the Board including this Order, are hereby disallowed.

NATIONAL ENERGY BOARD

J.S. Richardson
Secretary

TransCanada PipeLines Limited
Transportation Tolls
Effective 1 July 1994

Particulars	Demand Toll (\$/10 ³ m ³ /mo)	Commodity Toll (\$/10 ³ m ³)
Canadian Firm Service:		
Saskatchewan Zone	192.96	0.172
Manitoba Zone	326.01	0.297
Western Zone	517.61	0.492
Northern Zone	801.93	0.775
Eastern Zone	961.85	0.955
Eastern Zone FST	-	18.730
TransGas Transportation:		
Empress & Richmond	69.05	0.021
Bayhurst & Liebenthal	54.80	0.007
Success	24.76	0.023
Export Firm Service:		
Empress to Spruce	355.52	0.329
Empress to Emerson	362.42	0.336
Empress to Niagara Falls	1,017.42	0.995
Empress to Iroquois	1,022.36	0.998
Empress to Cornwall	1,036.25	1.012
Empress to Sabrevois	1,081.87	1.058
Empress to Philipsburg	1,092.17	1.068
Empress to Napierville	1,085.99	1.062
Empress to Chippawa	1,018.04	0.996
Miscellaneous Point-to-Point Firm Service:		
Herbert to Emerson	299.41	0.273
St. Clair to Chippawa	134.34	0.107
Kirkwall to Chippawa	64.91	0.037
Parkway to Niagara Falls	71.18	0.043

TransCanada PipeLines Limited
Transportation Tolls
Effective 1 July 1994

Particulars	Demand Toll (\$/10 ³ m ³ /mo)	Commodity Toll (\$/10 ³ m ³)
Storage Transportation Service:		
Centra Gas (Manitoba)-MDA	68.90	0.043
Centra Gas (Ontario)-NDA	193.68	0.174
Centra Gas (Ontario)-SSMDA	173.60	0.153
Centra Gas (Ontario)-EDA	129.51	0.107
Kingston	121.06	0.098
Gaz Métropolitain-EDA	219.87	0.202
Consumers' Gas-CDA	29.69	0.002
Consumers' Gas-EDA	78.28	0.053
Cornwall	172.73	0.152

**TransCanada PipeLines Limited
Transportation Tolls
Effective 1 July 1994**

Particulars	Demand Toll (\$/10³m³/mo)	Commodity Toll (\$/10³m³)
Canadian Temporary Winter Service:		
Empress to Saskatchewan Zone		7.501
Empress to Manitoba Zone		12.680
Empress to Western Zone		20.153
Empress to Northern Zone		31.235
Empress to Eastern Zone		37.490
Canadian Peaking Service:		
Empress to Saskatchewan Zone		20.440
Empress to Manitoba Zone		34.540
Empress to Western Zone		54.860
Empress to Northern Zone		85.008
Empress to Eastern Zone		101.985
Winter Firm Service:		
Empress to Saskatchewan Zone		9.215
Empress to Manitoba Zone		15.575
Empress to Western Zone		24.750
Empress to Northern Zone		38.357
Empress to Eastern Zone		46.032
Empress to Emerson		17.321
Empress to Spruce		16.990
Empress to Niagara Falls		48.676
Empress to Iroquois		48.911
Empress to Cornwall		49.576
Empress to Sabrevois		51.760
Empress to Philipsburg		52.252
Empress to Napierville		51.957
Empress to Chippawa		48.706
St. Clair to Niagara Falls		6.373
St. Clair to Chippawa		6.403
Kirkwall to Niagara Falls		3.048
Kirkwall to Chippawa		3.079
Parkway to Iroquois		7.896
St. Clair to Iroquois		11.850

**TransCanada PipeLines Limited
Transportation Tolls
Effective 1 July 1994**

Particulars	Demand Toll (\$/10 ³ m ³ /mo)	Commodity Toll (\$/10 ³ m ³)
Backhaul Service:		
Dawn to Sault Ste. Marie		
Winter IS		5.812
Summer IS		2.906
Emerson to Centra Gas Manitoba Load Centre		
Winter IS		2.327
Summer IS		1.164
Dawn to St. Clair		
Winter IS		1.171
Summer IS		0.586
St. Clair to St. Clair		
Winter IS		0.915
Summer IS		0.458
Niagara Falls to Union CDA		
Winter IS		2.323

Particulars	Demand Toll¹	
	Monthly (10 ³ m ³ /mo)	Daily Equivalent (\$/10 ³ m ³)
Delivery Pressure:		
Emerson - 1 & 2	5.9897	0.19692
Emerson - 2	1.3829	0.04546
Dawn	7.0238	0.23092
Niagara Falls	5.4190	0.17816
Sudbury	0.0000	0.00000
Iroquois	22.3550	0.73496
Chippawa	4.9941	0.16419

(1) The monthly demand toll is applicable to FS and FST and the daily equivalent demand toll is applicable to STS injections, IS, PS, TWS, WFS and diversions.

Appendix II

Functional Distribution and Classification of Revenue Requirement

(\$ 000)

	Total	Metering	Transmission - Fixed	Transmission - Variable	Unaccounted for Gas
Transmission by Others	355,162	-	346,933	8,229	-
Operations & Maintenance	223,441	53,160	130,806	39,475	-
Gas Cooling Charges	1,200	-	1,200	-	-
Depreciation	210,012	2,621	207,391	-	-
Municipal & Other Taxes	85,936	658	85,278	-	-
Income Taxes	74,729	714	74,015	-	-
Regulatory Def. & Amortization	7,753	-	7,753	-	-
Foreign Exchange Loss	2,618	-	2,618	-	-
Other Operating Income	-	-	-	-	-
Return on Rate Base	680,596	6,505	674,091	-	-
Revenue Requirement	1,641,447	63,658	1,530,085	47,704	-
Sales Meter Station Charges	(241)	(241)	-	-	-
Downstream Diversion Revenue	(1,373)	-	(1,373)	-	-
Temporary Winter Service	-	-	-	-	-
Peaking Service	-	-	-	-	-
Storage Transportation Service	(31,030)	(5,985)	(24,833)	(212)	-
Interruptible Service	(413)	(164)	(249)	-	-
Delivery Pressure Revenue	(16,627)	-	(16,627)	-	-
Winter Firm Service	(72)	(3)	(68)	(1)	-
Total Miscellaneous Revenue	(49,756)	(6,393)	(43,150)	(213)	-
Interim Revenue Adjustment	(3,450)	(138)	(3,312)	-	-
Revenue Requirement for Toll Design Purposes	1,588,241	57,127	1,483,623	47,491	-

Appendix III

System Average Unit Cost of Transportation

Allocation Method	Functionalized (\$ 000)	Applicable Allocation Units (000)	Unit Costs	
Fixed Volume	57,127	171	334.45837135	\$/10 ³ m ³
Fixed Volume-Distance	1,483,623	395,629	3.75003529	\$/10 ³ m ³ -km
Variable Volume	-	61,112	0.00000000	\$/10 ³ m ³
Variable Volume-Distance	47,491	144,748,508	0.00032809	\$/10 ³ m ³ -km
Fixed FST Differential	68,419	395,629	0.17293840	\$/10 ³ m ³ -km
Variable FST Differential	-	144,748,508	0.00000000	\$/10 ³ m ³ -km

Appendix IV

List of Previously Distributed Documents

- (a) National Energy Board Hearing Order RH-4-93
- (b) Amending hearing Order AO-1-RH-4-93
- (c) Amending hearing Order AO-2-RH-4-93
- (d) Interim Toll Order TGI-3-93

Copies of these documents are available on request from:

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