National Energy Board

Office national de l'énergie

Reasons for Decision

TransCanada PipeLines Limited

RH-1-2002

July 2003

Tolls and Tariff

National Energy Board

Reasons for Decision

In the Matter of

TransCanada PipeLines Limited

2003 Tolls and Tariff Application

RH-1-2002

July 2003

Cat No. NE22-1/2003-4E
ISBN 0-662-34489-8

This report is published separately in both official languages.

Copies are available on request from:
The Publications Office
National Energy Board
444 Seventh Avenue S.W.
Calgary, Alberta, T2P 0X8
E-Mail: publications@neb-one.gc.ca
Fax: (403) 292-5503
Phone: (403) 299-3562
1-800-899-1265

For pick-up at the NEB office:
Library
Ground Floor

Printed in Canada

N° de cat. NE22-1/2003-4F
ISBN 0-662-89324-7

Ce rapport est publié séparément dans les deux langues officielles.

Demandes d'exemplaires :
Bureau des publications
Office national de l'énergie
444, Septième Avenue S.-O.
Calgary (Alberta) T2P 0X8
Courrier électronique : publications@neb-one.gc.ca
Télécopieur : (403) 292-5503
Téléphone : (403) 299-3562
1-800-899-1265

Des exemplaires sont également disponibles à la bibliothèque de l'Office
(rez-de-chaussée)

Imprimé au Canada

Table of Contents

List of Figures

List of Tables

List of Appendices

Abbreviations

1996-1999 Incentive Settlement	TransCanada’s 1996-1999 Incentive Cost Recovery and Revenue Sharing Settlement
2001-2002 S&P Settlement	TransCanada’s 2001-2002 Mainline Service and Pricing Settlement
2003 Tolls Application or Application	TransCanada's 2003 Tolls and Tariff Application
ASL	Average Service Life Depreciation Procedure
Bcf/d	Billion cubic feet per day
Board or NEB	National Energy Board
CA	Cogenerators Alliance. An incorporated association representing Tractebel Power Inc., TransAlta Energy Corporation, Lake Superior Power Limited Partnership, and Cardinal Power of Canada, L.P.
CAPP	Canadian Association of Petroleum Producers
CDA	Central Delivery Area
Centra	Centra Gas Manitoba Inc.
Combination Plan	Combination Pension Plan
Court	Federal Court of Appeal
DB Plan	Defined Benefit Pension Plan
DC Plan	Defined Contribution Pension Plan
Eastern Utilities	Collectively refers to EGD, Gaz Métropolitain and Union
EGD	Enbridge Gas Distribution Inc.
ELG	Equal Life Group Depreciation Procedure
Enbridge	Enbridge Pipelines Inc.
EnCana	EnCana Corporation
FERC	Federal Energy Regulatory Commission (US)
FGIP	Fuel Gas Incentive Program

FSG	Firm Shippers Group. Consists of Coral Energy Canada Inc., Mirant Canada Energy Marketing Ltd., PG&E National Energy Group (Pittsfield Generating Company, L.P., Selkirk Cogen Partners, L.P., and USGen New England, Inc.), New York State Electric and Gas, and Rochester Gas and Electric.
FST	Firm Service Tendered
FT	Firm Transportation
Gaz Métropolitain	Société en commandite Gaz Métropolitain
GFI	Gannett Fleming Inc.
GFR	Guidelines for Filing Requirement
GJ	Gigajoule
GLGT	Great Lakes Gas Transmission Company
GLJA	Gilbert Laustsen Jung Associates Ltd.
GPUAR	Gas Pipeline Uniform Accounting Regulations
IC	Incentive Compensation
IGUA	Industrial Gas Users Association
IT	Interruptible Transportation
LDC	Local Distribution Company
LTIC	Long Term Incentive Compensation
Mainline	TransCanada's Mainline Natural Gas Transmission System
MMcf/d	Million cubic feet per day
NEB Act	National Energy Board Act
OIS	Overrun Interruptible Service
OM&A	Operations, Maintenance & Administration
Ontario	Minister of Energy for the Province of Ontario
PJ	Petajoule
Quebec	Procureur Général du Québec
R&O	Repairs and Overhauls

RAMP	Revenue and Asset Management Program
Review Application	TransCanada's Application for Review and Variance of the RH-4-2001 Decision and related Orders
RSUP	Restricted Share Unit Program
Simplot	Simplot Canada Limited
STFT	Short-Term Firm Transportation
STS	Storage Transportation Service
SWDA	Southwest Delivery Area
SWZ	Southwest Zone
TAI	Technical Associates Inc.
TBO	Transportation by Others
TJ	Terajoule
TQM	Trans Quebec and Maritimes Pipeline
TransCanada	TransCanada PipeLines Limited
TTF	TransCanada's Tolls Task Force
Union	Union Gas Limited
US or USA	United States of America
Westcoast	Westcoast Transmission Company Limited
WCSB	Western Canada Sedimentary Basin

Recital and Appearances

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

IN THE MATTER OF an Application filed by TransCanada PipeLines Limited (TransCanada) pursuant to Part IV of the NEB Act, for orders fixing and approving tolls that TransCanada shall charge for transportation services provided on its Mainline between 1 January 2003 and 31 December 2003; and

IN THE MATTER OF Hearing Order RH-1-2002;

Heard in Calgary, Alberta on 26, 27, 28 February 2003, 3, 5, 6, 7, 10, 11, 17, 18, 19, 20, 21, 24, 25, 26 March 2003, 1, 2, 3, 4, 7, 9, 10, 11, 22, 23, 24, 25, 28 April 2003, 12, 13, 14 and 16 May 2003.

BEFORE:

J.S. Bulger	Presiding Member
D.W. Emes	Member
C.L. Dybwad	Member

Appearances	Company	Witnesses
C.K. Yates, Q.C. P. Keys W.M. Moreland	TransCanada PipeLines Limited	R. Barham R. Boulter P. R. Carpenter K. Che S. Emond M. Feldman L. Hobbs A. Jamal L.E. Kennedy D. King B. Langford P. Milne J. Murta N. Myers M. Ritsch T. Robinson S. Schock W.M. Stout R. Tarvydas R.J. Turner J. Van der Put R.A. Whitmore G.J.W. Zwick

Appearances	Company	Witnesses
N.J. Schultz	Canadian Association of Petroleum Producers	R.M. Cusson D. Gilbert M.J. Ileo R.R. Moore P.M. Nettleton M. Pinney G.J. Protti A. Safir B. Troicuk
P.C.P. Thompson, Q.C.	Industrial Gas Users Association	R.B. Cooper D. Coté P.L. Fournier M.W. Passi
R. Power	Alliance Pipeline Ltd.	
C. Chancellor	Androscoggin Energy, L.L.C	
N. Gretener	ATCO Pipelines	
C. Worthy	BP Canada Energy Company	
B. Czarnecki B. Ridley	Centra Gas Manitoba Inc.	
R.J. King	Cogenerators Alliance	G.E. Briden U. Valiante
K.F. Miller	Coral Energy Canada Inc.	A.G. MacBurnie
J.H. Farrell	Enbridge Gas Distribution Inc.	F.A. Brennan W.G. Foster B.B. Henning M.D. Sloan
C. Low	Enbridge Pipelines Inc.	
B. Fraser	EnCana Corporation	
K.F. Miller	Firm Shippers Group	D.D. Jacques T.M. Lange A.G. MacBurnie M.L. Perlman M.P. Stauft

Appearances	Company	Witnesses
R.R. Moore	Imperial Oil Resources	
L.-A. Leclerc	Marketing D'Énergie HQ Inc.	
K.F. Miller	Mirant Canada Energy Marketing, Ltd.	T.M. Lange
K.F. Miller M.L. Perlman	New York State Electric & Gas Corporation	M.L. Perlman
S. Schulli	Nexen Marketing	
K.F. Miller	Pittsfield Generating Company, L.P.	D.D. Jacques
K.F. Miller M.L. Perlman	Rochester Gas and Electric Corporation	M.L. Perlman
C. Chancellor	Rumford Power Associates, L.P.	
K.F. Miller	Selkirk Cogen Partners, L.P.	D.D. Jacques
N. Gretener	Simplot Canada Limited	D.H. Hawk
L.-A. Leclerc M. Imbleau L.-C. Ratelle	Société en commandite Gaz Métropolitain	W.G. Foster B.B. Henning L. Mercier M.D. Sloan
F.C. Basham	Talisman Energy Inc.	
G. Cameron	Union Gas Limited	W.G. Foster B.B. Henning M. Isherwood M.D. Sloan
K.F. Miller	USGen New England, Inc.	D.D. Jacques
G.M. Nettleton	Vector Pipeline L.P. and Vector Pipeline Limited Partnership	
L.-A. Leclerc	Vermont Gas Systems, Inc.	
B. Prenevost	Alberta Department of Energy	
J.C. Turchin J.J. Semenoff	Minister of Energy for the Province of Ontario	

Appearances	**Company**	**Witnesses**
J. Robitaille Y. Migué	Procureur Général du Québec	
A. Ross M. Yuzda	National Energy Board	

Glossary of Terms

Actual Year	A historical period (usually 12 consecutive months) between the Base Year and the Test Year. The 2002 Actual Year is the period from 1 January 2002 to 31 December 2002.
AECO	A North American gas marketing centre located in Alberta (i.e., AECO-C Hub).
Amortization Accounting	A depreciation procedure whereby the cost of an asset is distributed in equal amounts to each year of a fixed amortization period.
Average Service Life (ASL)	A group depreciation procedure whereby the rate of annual depreciation is based on the average service life of the group. This rate is applied to the surviving balances of the asset group's costs.
Base Year	A historical period (usually 12 consecutive months), for which actual data is available, used as the starting point in determining tolls for a future Test Year. The 2001 Base Year is the period from 1 January 2001 to 31 December 2001.
Commodity Charge	A charge applied to volumes actually transported in order to recover the variable costs of a pipeline.
Composite Depreciation Rate	A weighted average depreciation rate that, if applied to the total original cost balance of depreciable plant in service, would produce an annual accrual amount equivalent to applying the individual depreciation rates to each of the respective plant in service account balances.
Dawn	A North American gas marketing centre located in Southern Ontario (i.e., Dawn Hub).
Deferral Account	For regulatory purposes, generally, a type of account used to record revenues and expenses held in abeyance for future disposition by a regulator.
Delivery Area	A geographic area within a toll zone that is comprised of multiple delivery points where shippers receive delivery of their natural gas.
Demand Charge	A monthly charge which normally covers the fixed costs of a pipeline. The demand charge is based on the daily contracted volume and is payable regardless of volumes transported.

Depreciation	The process of charging the book cost of depreciable property to operations over its useful life.
Economic Planning Horizon	The Period over which it is expected that an asset will have a useful life. In the context of depreciation, the economic planning horizon is often used to establish a truncation period.
Equal Life Group (ELG)	A group method of depreciation whereby property groups are subdivided according to service life (i.e., each equal life group includes property with the same life span).
Fuel Curves	A graphical depiction of the variation of average daily fuel requirements with average daily deliveries.
GH-5-89	NEB Proceeding on a TransCanada facilities application.
GH-2-87	NEB Proceeding on a TransCanada facilities and tolls methodology application.
Interim Retirements	Retirements of plant assets that occur between the time of initial installation and final retirement of all plant assets.
Iowa Curve	Several families of curve shapes derived empirically from analysis of the mortality data for many different types of industrial property.
Load Factor	The ratio of the average use of the system to the maximum firm use of the system for the same period, usually expressed over a year and as a percentage.
Net Salvage	The gross salvage for a property being retired less the cost of its removal.
Rate Base	The amount of investment on which a return is authorized to be earned. It usually consists of plant in service, plus an allowance for working capital.
Remaining Life Technique	One of the techniques used to determine the depreciation rate to be applied to a utility's plant depreciation accounts. The remaining life technique seeks to recover the undepreciated original cost less future net salvage over its remaining life.
Return on Rate Base (Return)	The return which a regulated company earns on its approved Rate Base.
Revenue Requirement	The amount sought to be recovered in the tolls which will reimburse the company for its cost of service.

RH-R-1-2002	NEB Decision on TransCanada's Review Application.
RH-4-2001	NEB Proceeding on TransCanada's 2001-2002 Fair Return Application concerning cost of capital for the Mainline.
RH-2-2001	NEB Proceeding on a BC Gas Utility Ltd. Application for Review and Variance of the Board's RH-2-98 Decision.
RH-1-2001	NEB Proceeding on TransCanada's 2001-2002 Tolls and Tariff Application.
RH-1-99	NEB Proceeding on TransCanada's Application concerning Interruptible Transportation and Short Term Firm Transportation Tariff Amendments.
RH-2-98	NEB Proceeding on a BC Gas Utility Ltd. Application for orders requiring Westcoast Energy Inc. to receive, transport and deliver gas from Kingsvale to Huntingdon, British Columbia, and prescribing terms and conditions, including tolls, for the service.
RH-1-97	NEB Proceeding on TransCanada's 1997 Tolls Application and on TransCanada's FST Conversion Proposal.
RH-2-95	NEB Proceeding on TransCanada's 1996 Tolls Application.
RH-3-94	NEB Proceeding on TransCanada's 1995 Tolls Application.
RH-2-94	NEB Multi-Pipeline Cost of Capital Proceeding.
RH-4-93	NEB Proceeding on TransCanada's 1994 Tolls Application.
RH-2-92	NEB Proceeding on TransCanada's 1993 Tolls Application.
RH-1-91	NEB Proceeding on TransCanada's 1991 Tolls Application.
RH-3-86	NEB Proceeding on TransCanada's 1987 Tolls Application.
RH-6-85	NEB Proceeding on Westcoast's 1986 Tolls Application.
RH-2-85	NEB Proceeding on TransCanada's Application for new tolls effective 1 August 1985.

RH-1-72	Phase II of an NEB Proceeding on TransCanada's Application dated 14 August 1969 concerning Tolls and Tariff.
Service Life Estimates	An estimate of the probable life of an asset for the purpose of determining the time period over which the total purchase price of the asset will be depreciated.
Tariff	The terms and conditions under which the service of a pipeline are offered or provided, including the tolls, the rules and regulations, and the practices relating to specific services.
Terminal Development Rate	A variable used by GLJA which limits reserve additions in any one year to a percentage of the then remaining ultimate potential.
Test Year	A period (usually 12 consecutive months) used for ratemaking purposes. The 2003 Test Year is the period from 1 January 2003 to 31 December 2003.
Toll	The price charged by a pipeline company for the use of its facilities.
Toll Zone	For the purposes of setting tolls, long-haul domestic FT shippers pay tolls according to the toll zone to which gas deliveries are made. All deliveries within the same toll zone pay the same toll.
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 and pipeline segments of the industry, provincial governments and local distribution and industrial end-use customers.

Chapter 1

Introduction

1.1 Background

TransCanada PipeLines Limited (TransCanada) owns and operates the TransCanada Mainline Natural Gas Transmission System (Mainline), which is a high-pressure natural gas transmission system that extends from the Alberta border across Saskatchewan, Manitoba, Ontario, through a portion of Quebec and connects to various downstream Canadian and international pipelines. In addition, the Mainline integrated system includes contractual entitlements to transport natural gas on the Great Lakes Gas Transmission System (GLGT) from Emerson, Manitoba to St. Clair, Michigan; on the Union Gas System (Union) from Dawn, Ontario to Parkway, Ontario and to Kirkwall, Ontario; and on the Trans Quebec & Maritimes Pipeline (TQM). Figure 1-1 contains a map of the Mainline's integrated system.

During the 1972 to 1995 period, the tolls for the Mainline were generally established through annual, fully contested, tolls hearings.

For the four-year period from 1996 to 1999, the Mainline operated under the terms of the Incentive Cost Recovery and Revenue Sharing Settlement (1996-1999 Incentive Settlement), which was approved by the Board in the RH-2-95 Decision.

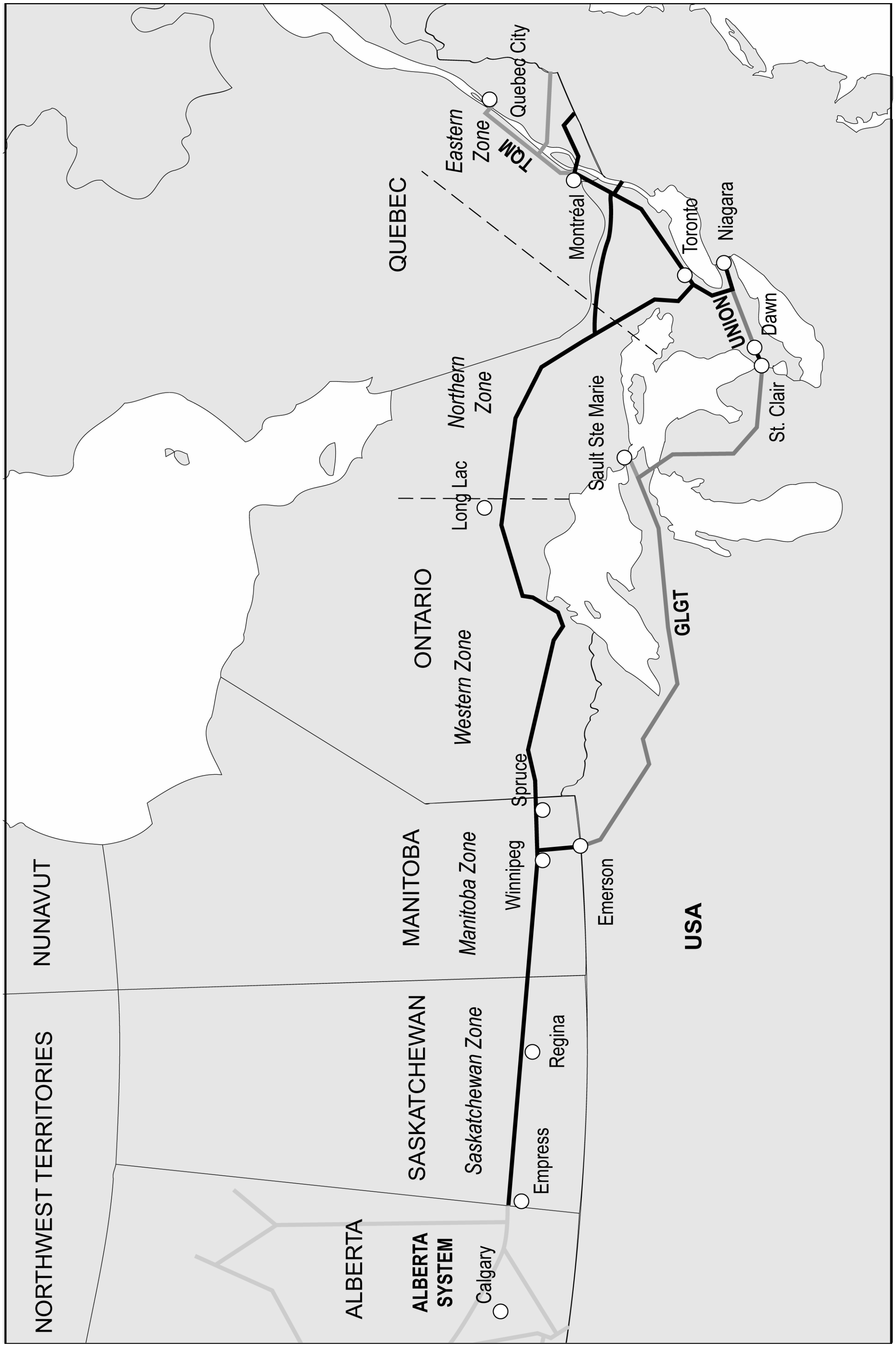
Negotiations to extend the term of the 1996-1999 Incentive Settlement for one year were unsuccessful. However, TransCanada and its stakeholders were able to negotiate a separate one year cost of service settlement in 2000.

In the RH-1-2001 Proceeding, the Board approved the terms of the 2001-2002 Mainline Service and Pricing Settlement (2001-2002 S&P Settlement). The 2001-2002 S&P Settlement prescribed the toll methodology to be utilized, applicable tariff provisions and the components of the Mainline's Revenue Requirement, with the exception of amounts relating to cost of capital. The Mainline's cost of capital for these years was addressed in the RH-4-2001 proceeding, which considered TransCanada's 2001 and 2002 Fair Return Application.

In the RH-1-2001 Decision, the Board expressed concern that the prospect of continued protracted negotiations could delay the timely filing of an application by TransCanada for the Mainline's 2003 tolls and tariff. TransCanada was directed to file a comprehensive tolls and tariff application for the 2003 Test Year (whether supported by a negotiated settlement or not) by 1 September 2002.

On 26 August 2002, TransCanada notified the Board that it was unable to reach a settlement with stakeholders on the elements of the Mainline 2003 tolls and tariff despite ongoing discussions and negotiations since November 2001. TransCanada requested an extension of time to 16 September 2002 to file the Mainline's 2003 Tolls and Tariff Application (2003 Tolls Application). This request was granted on 29 August 2002.

Figure 1-1
TransCanada Mainline



On 16 September 2002, TransCanada filed the 2003 Tolls Application. An overview of the 2003 Tolls Application appears in Section 1.2 of these Reasons for Decision.

Also on 16 September 2002, TransCanada filed an application with the Board for review and variance of the RH-4-2001 Decision and related orders (Review Application).

On 11 October 2002, the Board sought comments on six procedural questions and on an Initial List of Issues concerning TransCanada's 2003 Tolls Application.

On 5 November 2002, the Board issued the RH-1-2002 Hearing Order, indicating that it would convene an oral public hearing commencing 24 February 2003 to consider the 2003 Tolls Application. The commencement of the public hearing was eventually delayed to 26 February 2003. The hearing, which required 34 hearing days, was held in Calgary, Alberta and concluded on 16 May 2003. The RH-1-2002 proceeding was the first fully-contested cost of service tolls hearing for the Mainline since the tolls for the 1994 Test Year were established in RH-4-93.

1.2 Overview of the Application

The 2003 Tolls Application sought approval of tolls for the Mainline for the period 1 January 2003 to 31 December 2003 (2003 Test Year). The 2003 Tolls Application included information pertaining to the proposed Rate Base, Revenue Requirement, toll design and pricing changes. Information concerning return was presented by TransCanada on an illustrative basis only. The 2003 Tolls Application specifically requested that the 2003 return for the Mainline be determined by the Board in accordance with its disposition of the Review Application.

TransCanada updated its 2003 Tolls Application on numerous occasions, as follows:

- On 16 December 2002, the Application was updated to reflect new information that became available, including more recent forecasts;
- On 13 February 2003, the Application was updated to reflect 2002 actual results;
- On 7 March 2003, TransCanada indicated that there was an inconsistency in the positions taken by TransCanada in its filed evidence relating to depreciation. Specifically, the depreciation rates, Revenue Requirement and tolls for which approval was originally sought reflected an allowance for net salvage on terminal retirements. This is contrary to the policy position of TransCanada, which is not to include an amount for net salvage for terminal retirements at this point given competitive considerations. Between 7 and 13 March 2003, TransCanada updated selected pieces of evidence to reflect this change in relief sought concerning depreciation.
- On 5 May 2003, TransCanada updated its Application to reflect adjustments to the net Revenue Requirement arising from new or amended information provided by TransCanada during the evidentiary portion of the RH-1-2002 proceeding, and changes to firm volumes based on known contracts at 1 May 2003.

The information contained in these Reasons for Decision reflects the final revisions of 5 May 2003.

TransCanada proposed an average Rate Base for the 2003 Test Year of $8,569.5 million and a Net Revenue Requirement of $1,966.9 million. Components of the proposed Net Revenue Requirement are presented in Table 2-1 of Chapter 2.

The applied-for Revenue Requirement reflects TransCanada’s request for a composite depreciation rate of 3.65%. TransCanada supported the requested change to its composite depreciation rate with a depreciation study and a related throughput study.

The calculation of the illustrative return in the Revenue Requirement reflects the Board’s RH-4-2001 Decision and therefore includes a rate of return on equity of 9.79% (derived by applying the RH-2-94 formula methodology for 2003) and a deemed common equity ratio of 33%.

The proposed Revenue Requirement also reflects total Operations, Maintenance and Administrative (OM&A) cost of $246.2 million and a $69.1 million credit from actual 2002 flow-through and incentive-based deferral account balances.

TransCanada sought approval of two incentive programs: the Fuel Gas Incentive Program and the Revenue and Asset Management Program.

TransCanada proposed the creation of a Southwest Zone (SWZ), which would be located in Southwestern Ontario and would include the delivery points in the current Southwest Delivery Area. The delivery points at the Dawn market hub and storage sites would be included in the proposed SWZ.

TransCanada requested approval to raise the floor price for Interruptible Transportation (IT) Service from its current 80% minimum floor price to 110% of the 100% load factor Firm Transportation (FT) toll.

The proposed FT toll to the Eastern Zone is $1.232/GJ for 2003, which compares with the existing 2003 interim toll of $1.203/GJ and the 2002 toll of $1.153/GJ.

1.3 List of Issues

In its amended Hearing Order issued on 22 November 2002 (AO-1-RH-1-2002), the Board identified, but did not limit itself to, the following List of Issues.

All aspects of TransCanada’s 2003 Tolls Application, including the following issues:

1. The appropriateness of the proposed 2003 Rate Base, Revenue Requirement and components thereof;

2. The appropriateness of the proposed Incentive Programs;

3. The appropriateness of the proposed Southwest Zone;

4. The appropriate pricing of Interruptible Transportation Service;

5. The appropriateness of the proposed changes to depreciation expenses, including the reasonableness of the related throughput study and depreciation study;

6. The appropriateness of establishing the proposed deferral accounts; and

7. The appropriateness of resuming FT Make-Up Service.

Chapter 2

Revenue Requirement

TransCanada proposed to recover in its 2003 Tolls a Net Revenue Requirement of $1,966.9 million, which represents an increase of $75.0 million over the 2002 Net Revenue Requirement of $1,891.9 million. The components of the applied-for 2003 Revenue Requirement, along with a comparison to 2002 Actual Revenue Requirement, are presented in Table 2-1.

Table 2-1
Comparison of the Proposed 2003 Revenue Requirement with the 2002 Actual Year Revenue Requirement ($000)

	2002 Actual Year	Change	2003 Test Year
Transmission By Others	373,750	290	374,040
FST Replacement Costs	22,365	(124)	22,241
Pipeline Integrity and Insurance Deductible Costs	25,861	21,294	47,155
Merger Costs and Benefits Agreement Compliance Audit	4	(4)	-
NEB Cost Recovery	7,728	3,004	10,732
Return*	821,643	(27,251)	794,392
Income Taxes	153,765	55,052	208,817
Depreciation	362,274	88,326	450,600
Inventory Management Program	12,000	-	12,000
Gas Related and Electric Costs	53,427	370	53,797
Municipal & Other Taxes	115,848	1,685	117,533
Regulatory Amortizations	(100,107)	30,966	(69,141)
Gain on Sale of Storage Gas	(512)	(441)	(953)
Operations, Maintenance & Administrative	209,832	36,335	246,167
Pressure Charges	4,625	(769)	3,856
Gross Revenue Requirement	2,062,503	208,733	2,271,236
Miscellaneous Revenue			
Non-Discretionary Miscellaneous Revenue	(74,402)	8,894	(65,508)
Discretionary Miscellaneous Revenue	(96,216)	(142,598)	(238,814)
Total Miscellaneous Revenue	(170,618)	(133,704)	(304,322)
Net Revenue Requirement	**1,891,885**	**75,029**	**1,966,914**

* Information on Return provided by TransCanada for illustrative purposes.

The 2003 applied-for costs for Transmission by Others, NEB Cost Recovery, Inventory Management Program, Gas Related and Electric Costs, Regulatory Amortizations, Gain on Sale of Storage Gas, and Pressure Charges were not opposed by parties. Similarly, there was no objection to the forecasts of Non-Discretionary Miscellaneous Revenue and Discretionary Miscellaneous Revenue.

The justification for the other components of the proposed Revenue Requirement, along with the views of parties, views of the Board and Board Decisions are discussed in various Chapters of these Reasons for Decision, namely:

- Chapter 4 – Operating Costs;
- Chapter 5 – Depreciation; and
- Chapter 12 – Cost of Capital.

Decision

The Board approves the proposed amounts for Transmission by Others, NEB Cost Recovery, Inventory Management Program, Gas Related and Electric Costs, Regulatory Amortizations, Gain on Sale of Storage Gas, Pressure Charges, Non-Discretionary Miscellaneous Revenue, and Discretionary Miscellaneous Revenue for the 2003 Test Year.

Chapter 3

Rate Base

TransCanada requested approval of an average Rate Base amount of $8,569.5 million for the 2003 Test Year. No party raised concerns with respect to the Rate Base and its components. A summary of TransCanada's applied-for Rate Base is provided in Table 3-1.

Table 3-1
Comparison of the Proposed 2003 Average Rate Base with the 2002 Actual Year Average Rate Base ($000)

	2002 Actual Year	Change	2003 Test Year
Utility Investment			
Gross Plant	12,425,579	(30,118)	12,395,461
Accumulated Depreciation	(3,665,089)	(303,096)	(3,968,185)
Net Plant	8,760,490	(333,214)	8,427,276
Contributions in Aid of Construction	(19,880)	17	(19,863)
Total Plant	8,740,610	(333,197)	8,407,413
Working Capital			
Cash	19,771	5,730	25,501
Goods & Services Tax, Net	(4,820)	(14)	(4,834)
Materials and Supplies	35,273	(3,460)	31,813
Transmission Linepack	42,834	0	42,834
Storage Gas	22,232	(6,038)	16,194
Prepayments and Deposits	1,601	188	1,789
Total Working Capital	116,891	(3,594)	113,297
Deferred Costs			
Miscellaneous Deferred Items	51,457	(3,370)	48,087
Operating and Debt Service Deferrals	(48,252)	19,116	(29,136)
Surplus Pension/Post Employment Benefits	12,332	17,502	29,834
Total Deferred Costs	15,537	33,248	48,785
Total Rate Base	**8,873,038**	**(303,543)**	**8,569,495**

Decision

The Board approves TransCanada's applied-for Rate Base of $8,569.5 million for the 2003 Test Year.

Chapter 4

Operating Costs

This Chapter discusses the adequacy of financial cost information and various types of operating costs, namely: FST Replacement costs; pipeline integrity and insurance deductible costs; operations, maintenance and administrative (OM&A) costs; municipal and other taxes; and income taxes.

4.1 Adequacy of Financial Cost Information

During the hearing, a number of parties commented on TransCanada's inability to provide detailed cost information for the Mainline and suggested that TransCanada may be in contravention of the Board's *Gas Pipeline Uniform Accounting Regulations* (GPUAR). Reference was also made to the Board's 2000 audit report of TransCanada which found that TransCanada was not able to provide valid line-by-line reporting of Mainline costs.

CAPP argued that the necessary foundation for meaningful intervenor submissions on specific cost levels and for reasoned NEB adjudication was absent. In CAPP's view, line-by-line analysis of Mainline cost items is necessary to evaluate Mainline costs from year to year and within the same year. In accordance with the stand-alone concept, there should also be no cross-subsidies between the various business entities.

In CAPP's view, TransCanada is not maintaining its accounts in accordance with the GPUAR as TransCanada's bookkeeping does not meet the needs or the requirements of regulation of the Mainline as a stand-alone entity. Proper information becomes even more important as TransCanada evolves into a holding company structure. CAPP noted that when it asked for line-by-line cost information for the Mainline, the information was presented with cautionary notes. The Board's 2000 audit report observed that an issue of concern was the regulatory need for meaningful information to support informed decision making. In CAPP's view, the Board's focus in the audit report was entirely proper.

IGUA noted that the GPUAR stipulates that every Group 1 company shall keep separate books of account in Canada in a manner consistent with generally accepted accounting principles, unless otherwise authorized or instructed by the Board. In IGUA's view, it is unclear whether the manner in which TransCanada maintains its financial information and records complies with the Board's requirements. IGUA urged the Board to update its audit and to issue the directives that it considers to be necessary and appropriate to reduce and ideally eliminate the difficulty presented in this case.

FSG suggested that intervenors did not have the information necessary to make a reasoned judgment about the amount of OM&A costs that is prudent and reasonable and should be recovered in tolls.

Ontario expressed concern with the reporting capabilities of the Mainline. In Ontario's view, the absence of direct, detailed, clear financial information for the Mainline operation restricts both the Board and interested parties in their review of TransCanada's financial activities. Ontario submitted that TransCanada should be required to make all reasonable efforts to resolve, by the end of 2003, the shortcomings identified in the Board's 2000 audit report.

TransCanada claimed that it had complied with the Board's 2000 audit report in that it has the ability to produce the requested reports as evidenced by its response to a CAPP information request. TransCanada also argued that it has complied with the *Guidelines for Filing Requirements* (GFRs). In TransCanada's view, if the Board believes that a level of detail that exceeds the GFRs is required, then the Board should deliver that message.

With respect to its cost allocation policy, TransCanada indicated that CAPP and IGUA appear to take the view that its operation as one company with allocation of costs to the specific entities within that company is inappropriate. TransCanada's cost allocation policy was approved by the Board in RH-1-91. TransCanada indicated that, in accordance with this policy, it reflects its Operating, Maintenance and Administration (OM&A) costs on a Gross Expense basis under three major categories: Transmission, Departmental, and General. The amounts for Mainline activities are then shown as net after deducting amounts for non-mainline activities through an approved allocation process. TransCanada submitted that the current organizational structure leads to overall lower costs than separate lines of business.

TransCanada indicated that it would be possible for the Mainline to maintain its own separate departments for overlapping functions but it would result in higher costs for shippers.

Views of the Board

With respect to the financial cost information provided in RH-1-2002, the Board notes that the information initially filed by TransCanada as part of its 2003 Tolls Application was complemented by responses to numerous information requests and oral testimony, which in the Board's view, provides sufficient information for the Board to make its decisions. However, there is a need for TransCanada to provide more detailed Mainline cost information, as well as employee information, as part of future tolls applications in order to provide clarity, avoid numerous rounds of information requests, and reduce hearing time.

The Board intends to recommence its discussions with TransCanada's accounting staff and confirm TransCanada's ability to create financial reports that would show, for each department, as well as on a total system basis, TransCanada's actual results (by expense type) broken down for each fully-owned regulated entity and globally for non-regulated operations. In this regard, the Board expects that discussions with TransCanada will be completed in time for a TransCanada 2004 Tolls Application.

> TransCanada's capability to produce valid line-by-line cost information for the Mainline, coupled with its stated intention in the 2000 audit report to map NEB account codes to TransCanada's existing account codes, should be sufficient for TransCanada to meet the Board's expectation with respect to reporting its costs in accordance with the GPUAR.
>
> The Board is of the view that it is appropriate for TransCanada to operate as one company and allocate costs to its various entities using an allocation policy. To require the Mainline and each regulated entity to operate fully independently would result in higher Mainline costs and would not be in the best interest of tollpayers. Nonetheless, the information contained in a tolls application should be sufficient to justify the relief being sought. In certain circumstances, it may be necessary to supplement the result generated by the application of an allocation policy with additional evidence and rationale (see the Views of the Board in sub-section 4.4.2 for such an example).

4.2 FST Replacement Costs

TransCanada's Application sought approval of Firm Service Tendered (FST) Replacement costs of $22.2 million for the 2003 Test Year. The conversion of FST and associated cost components was first applied for and approved in the Board's RH-1-97 Decision. The FST Replacement costs include the costs of the following items: upstream storage or load balance arrangements; Union transportation; and annual owning and operating costs of additional facilities at the Dawn extension to accommodate storage withdrawals.

TransCanada submitted that it anticipated continuing to need to hold upstream storage capacity, including portions of a contract with EnCana Corporation (EnCana) for 8532 TJ expiring on 31 October 2003. Notice of extension of this contract was required by 1 February 2003. TransCanada renewed 6147 TJ, at a cost of approximately $3 million, for the 1 November 2003 to 31 March 2004 period.

TransCanada stated that its ability to manage linepack and system imbalances justified the cost of retaining upstream storage. In addition, TransCanada contended that retaining storage service would provide benefits to shippers in the order of $35 to $70 million in annual fuel cost savings. Storage service also provided the ability to continue the current fuel recovery mechanism and the ability to respond to changes in transportation demand in a timely manner, while delivering the fuel benefits.

FSG maintained that the FST Replacement assets are no longer required for the purpose of replacing FST storage capacity in Alberta.

IGUA argued that, given the Mainline's high volume of excess capacity, there was no longer a need for FST Replacement capacity and that the FST Replacement mechanism should be terminated. IGUA submitted that the existing excess capacity and associated linepack was more than sufficient to meet the Mainline's reasonable flexibility requirements to respond to throughput variances.

IGUA also submitted that the Board should disallow the recovery of any Alberta-based storage costs beyond 31 October 2003, the expiry date of the existing storage contract with EnCana. IGUA submitted that the FST Replacement account ought to be eliminated and that two FST-related contracts with Union Gas should be reclassified as TBO contracts and included in that cost of service account.

CAPP submitted that the potential savings from some reduction in storage-related costs were outweighed by the potential cost, if the ability to achieve maximum capacity was lost.

Views of the Board

The Board is satisfied that the benefits of retaining upstream storage outweigh the costs and therefore believes that the proposed FST Replacement costs are appropriate. Furthermore, the Board sees no reason to reclassify FST Replacement costs into a different account at this time.

Decision:

The Board approves the proposed FST Replacement costs of $22.2 million for the 2003 Test Year.

4.3 Pipeline Integrity and Insurance Deductible Costs

TransCanada forecast an amount of $47.2 million for pipeline integrity and insurance deductible costs for the 2003 Test Year. TransCanada noted that pipeline integrity and insurance deductible costs are subject to deferral account treatment.

While accepting the deferral account treatment of these costs, IGUA recommended that the amount to be included in the 2003 Revenue Requirement with respect to the existing pipeline integrity cost deferral account should be reduced by approximately $22 million from the budgeted amount of $47.2 million to reflect an amount more in line with actual expenditures for 2001 and 2002. IGUA's recommendation was based on the fact that in recent years, the levels of pipeline integrity costs incurred by the Mainline have been significantly lower than the amounts recovered in rates. IGUA submitted that a budget item subject to deferral account protection ought to be established at the low end of the range of reasonableness at a time when cost constraint and toll reductions are required.

TransCanada dismissed IGUA's suggestion and submitted that the operative premise for deferral accounts is that Test Year tolls should incorporate the best forecast so that any variance can be minimized.

Views of the Board

The Board is of the view that TransCanada's forecast amount of $47.2 million for pipeline integrity and insurance deductible costs for the 2003 Test Year represents an appropriate estimate of the costs expected to be incurred in 2003. Therefore, the Board believes that it would be appropriate to recover this forecast amount in 2003 tolls, subject to deferral account treatment.

Decision:

The Board approves the proposed Pipeline Integrity and Insurance Deductible costs of $47.2 million for inclusion in the 2003 Test Year Revenue Requirement, subject to deferral account treatment.

4.4 Operations, Maintenance & Administration Costs

This Section first discusses general OM&A matters. It then presents views on OM&A costs related to employee compensation, transmission expenses, departmental expenses, and general expenses. In addition, overall views on OM&A costs are presented at the end of the Section.

4.4.1 General OM&A Matters

Position of TransCanada

TransCanada applied for total Mainline OM&A costs of $246.2 million in 2003. This amount represents an increase of $36.3 million or 17.3% over the 2002 actual amount of $209.8 million. Table 4-1 presents the broad categories within OM&A that are commented on in the following sub-sections. Table 4-1 also contains a breakdown of the applied for OM&A costs and a comparison to 2002 Actual costs by broad expense category type. TransCanada established 2003 Test-Year expenses based on forecast activity levels and noted that forecast spending levels are not directly tied to prior year actual expenses.

TransCanada explained that the $36.3 million increase in 2003 Mainline OM&A costs, relative to 2002, was mainly due to increases in a number of specific items (see Table 4-2).

TransCanada stated that one of the principles it relied upon in support of its Application is the regulatory presumption of managerial good faith. TransCanada pointed out that the regulator is not the owner of the utility and that the regulator does not have the general power of management that is incumbent upon ownership. TransCanada further pointed out that the role of TransCanada's management is to set the level of expenses; the role of the regulator is to determine the expense to be recovered from ratepayers.

Table 4-1
Mainline OM&A Costs
Proposed 2003 Costs and Comparison to 2002 Actual Costs ($000)

	2002 Actual	Change	2003 Proposed
Transmission Expenses			
Field Transmission Expense	73,524	8,006	81,530
Aviation Patrol Expense	1,025	138	1,163
Total Transmission Expenses	**74,549**	**8,144**	**82,693**
Departmental Expenses			
Administration	26,375	478	26,853
Engineering	32,158	406	32,564
Transportation Aviation	1,041	(304)	737
Information Systems	20,479	3,297	23,776
Total Departmental Expenses	**80,053**	**3,877**	**83,930**
General Expenses			
Special Services	3,445	631	4,076
Insurance	4,504	766	5,270
Other General Expense	47,281	22,917	70,198
Total General Expenses	**55,230**	**24,314**	**79,544**
Total Mainline OM&A Costs	**209,832**	**36,335**	**246,167**

Table 4-2
Increase in Mainline OM&A
Proposed 2003 Costs Relative to Actual 2002 Costs ($ million)

Employee Compensation	18.4
Severance Program Adjustments Related to the 2001-2002 S&P Settlement	5.9
Severance Costs Related to 2003	2.0
Maintenance Parts and Lubricants/Maintenance Services	3.9
Line of Credit	0.6
Organizational Change Costs	0.4
Other Items	5.1
Total	**36.3**

Positions of Parties

CAPP stated that stakeholders had expected that the agreement that followed TransCanada's merger with Nova Gas Transmission Limited (NGTL) would lead to visible and permanent cost savings. However, in 2003, OM&A expenses are budgeted to be approximately 25% greater than what they were two years ago.

CAPP submitted that the Board does not have the foundation to make a proper finding as to an appropriate level of OM&A costs. CAPP submitted that it is imperative that TransCanada bring its accounting practices into line with NEB requirements forthwith. Further, CAPP requested that the Board issue appropriate directions in this regard for all years of non-compliance. CAPP recommended that a full investigation and audit be conducted, and that in the meantime, an OM&A costs deferral account be established.

IGUA advanced the position that the 2002 actual expense level was a reasonable target for 2003 OM&A expenses and that the Board should impose cost constraints. IGUA based its views, in part, on an internal memo from TransCanada's CEO to its managers that included the following directive: "At a minimum, the expectation is that process improvements will be in place to offset inflation, including salary inflation, such that the <u>2003 operating cost budgets should be no higher than 2002 actual costs are expected to be</u>. Variances from this standard will need to be explained in the budget presentation" [emphasis included in directive]. To arrive at its suggested level of 2003 OM&A costs, IGUA advanced views on specific items, including employee salaries and benefits, which could be reduced in order to maintain the 2003 budgeted OM&A expenses at the 2002 level. IGUA expressed strong opposition to CAPP's proposal to establish an OM&A deferral account.

FSG stated that a firm whose shareholders believe it is under genuine competitive pressure would not increase its OM&A by approximately 24% in two years. FSG adopted IGUA's position that 2003 OM&A costs should be set at the 2002 level.

Ontario also submitted that OM&A expenditures should be held consistent with 2002 actual costs.

Although it did not provide specific comments on OM&A costs, Brooklyn Navy Yard Cogeneration Partners, L.P. submitted a letter of comment in which it urged the Board to deny any increase in tolls above the level of the existing interim tolls.

Response of TransCanada to Parties' Positions

TransCanada indicated that its best estimate for total OM&A expense for the 2003 Test Year is the applied-for amount of $246.2 million. TransCanada maintained that it is not appropriate to reduce 2003 OM&A budgeted costs to the 2002 level, as it ignores the underlying cost drivers. TransCanada asserted that 2003 expenses are based on forecast activity levels. While accepting that the comparison of forecast 2003 expenses to 2002 actual levels is one factor for the Board to consider in assessing the reasonableness of 2003 expenses, TransCanada noted that the forecast levels for 2001 and 2002 were established as part of broader negotiated Revenue Requirements in those years and that there were gives and takes in the 2001-2002 S&P Settlement that affected those forecast levels. TransCanada maintained that the memo from its CEO was the starting point for 2003 budget deliberations and that variations from 2002 actuals were explained as required in that memo, resulting in the higher levels being found to be acceptable for budget purposes.

TransCanada also expressed strong opposition to CAPP's proposal to establish an OM&A deferral account.

Views of the Board

While the Board accepts the regulatory presumption of management good faith when utilities budget and make operating expenditures, it is of the view that an applicant must be prepared to thoroughly explain individual budget line items. The Applicant must also be prepared to justify increases in budgeted expenses from a Base Year to a Test Year, particularly when such increases are significant.

OM&A expenses for 2003 are budgeted to increase by $36.3 million to $246.2 million or 17.3% over 2002 actual expenditures of $209.8 million. The Board is of the view that TransCanada has not fully justified this increase.

The Board agrees with TransCanada that a budget which is set based on a level of activity for 2003 may not be directly comparable to a budget agreed to among parties in 2002, a settlement year, as those forecast levels were established as part of a broader settlement process. However it is entirely appropriate and instructive to compare the actual costs in a settlement year (2002) with the budgeted amounts for the 2003 Test Year. On reaching its conclusion as to the appropriate level of OM&A costs for 2003, the Board has taken note of those categories of OM&A costs where the budgeted amount for the 2003 Test Year has changed significantly from the 2002 actual costs.

While comparison to 2002 levels are useful, the Board does not accept the view expressed by certain parties that the 2003 OM&A budget should be set at the level approved for 2002 or at the 2002 actual expense level, as this approach would be unnecessarily arbitrary. Similarly, it would be arbitrary to establish the 2003 tolls at their current interim levels. CAPP's proposal for an OM&A costs deferral account for the 2003 Test Year is discussed in Chapter 11.

4.4.2 Employee Compensation

Included in transmission expenses, departmental expenses and general expenses are amounts related to employee compensation. The components of the Mainline's employee compensation include salaries, incentive compensation (IC), long-term incentive compensation (LTIC), benefits, and pension. Table 4-3 presents the 2003 applied-for amounts for each of these categories of compensation, along with a comparison to the 2002 actual costs. Table 4-3 also includes information on the number of employees allocated to the Mainline.

Table 4-3
Mainline Employee Compensation
Proposed 2003 Test Year Relative to 2002 Actual Year ($000)

	2002 Actual	Change	2003 Proposed
Direct Compensation			
Total Salaries	53,494	4,053	57,547
Incentive Compensation	9,060	1,626	10,686
Long-Term Incentive Compensation	8,247	4,092	12,339
Total Direct Compensation	**70,801**	**9,771**	**80,572**
Pension and Benefits			
Employee Benefits	14,439	1,103	15,542
Pension and Benefits Adjustments	1,721	7,559	9,280
Total Pension and Benefits	**16,160**	**8,662**	**24,822**
Total Compensation	**89,961**	**18,433**	**105,394**
Average Number of Employees Allocated to the Mainline	**814**	**23**	**837**

Position of TransCanada

Employee Compensation

TransCanada proposed that the salary levels for 2003 be escalated by 3.5% for field employees and 5.25% for non-field employees, relative to the 2002 levels.

For all types of compensation, TransCanada compared itself with Alberta-based energy companies of similar revenue, scope and size drawn from the oil and gas sector, the power merchant generation and utility sector, and the power marketing and trading sector. TransCanada stated that its compensation practices are market focused, competitive within the energy industry and aligned with organizations of similar size and scope. TransCanada provided the philosophy underpinning its compensation program and the steps taken to determine its competitiveness. The need for, and amount of, year-over-year increases are determined using market data, comparator data provided by consultants and TransCanada's own analysis.

Evidence prepared by TransCanada's compensation consultant, Towers Perrin, compared broad levels of TransCanada's employees against industry comparator groups in an aggregate format. Towers Perrin matched TransCanada's job families to positions within the industry comparator group and calculated the 50^{th} percentile Total Direct Compensation for each role. The variance between the comparator group and TransCanada roles (which covered 63% of the TransCanada non-field Canadian work force) showed that in 2002, the average TransCanada actual Total Direct Compensation was slightly below the 50^{th} percentile of its comparator group average.

TransCanada submitted that it adopts a pay-for-performance philosophy in establishing the level of compensation it provides to all employee levels. Consistent with this philosophy, TransCanada asserted that the incentive programs, as represented by IC and LTIC, are appropriate costs to be recovered from Mainline shippers. TransCanada further maintained that Mainline employees are encouraged by these programs to do things individually that align with the long-term direction of the company, including offering a reliable and efficient system that meets the needs of the shippers. TransCanada submitted that the 2003 amounts and increases are just and reasonable and are needed for it to be competitive in the market in which it competes for employees.

TransCanada stated that the primary cause of the $4.1 million increase in the LTIC program from 2002 to 2003 was the expansion of the Restricted Share Unit Program (RSUP) to a larger employee base and the introduction of an Executive Share Unit program. The RSUP is a broadly-based, company-paid program with the Mainline share being approximately $6.5 million in 2003. TransCanada made the point that the RSUP is just one item in a total compensation package, that it determines its compensation on a market-facing basis, and that absent incentives, the only option is to raise base salaries.

The proposed amount for LTIC also includes the cost of stock options, which TransCanada began to expense in 2002. TransCanada pointed out that originally there was no recognition of expense upon the granting of stock options. Previously, when stock options were exercised, the economic consequences of this portion of LTIC were borne by TransCanada's shareholders and not by shippers.

Employee Count

TransCanada noted that the total number of employees for the corporation was 2068 in 2002 and is estimated to be 2063 in 2003, while the average number of employees allocated to the Mainline was 814 in 2002 and is budgeted to be 837 for the 2003 Test Year. TransCanada was unable to provide the number of employees allocated to the Mainline in each of its job families for 2002, or any other year, as TransCanada does not track such information.

TransCanada submitted that the allocation of employees to the Mainline for the 2003 Test Year resulted from managers looking at employee activity levels and determining that their Mainline workload would require proportionately more time. TransCanada further pointed out that the extra 23 employees being allocated to the Mainline for the 2003 Test Year was not from one specific area but was the result of its various departments having determined where they will spend time in 2003.

TransCanada stated that the number of employees assigned to the Mainline is a result of direct assignment and allocation, as per TransCanada's allocation policy. TransCanada indicated that 265 employees in 2002 spent 100% of their time on Mainline activities.

Pension

TransCanada had three pension plans in 2002, a Defined Benefit Pension Plan (DB Plan), a Defined Contribution Pension Plan (DC Plan), and a Combination Pension Plan (Combination Plan), the latter two being introduced on 1 January 1997. The existence of three pension plans was a result of TransCanada employees being given the option, on 1 January 1997, to either retain the DB Plan or transfer to the DC Plan or Combination Plan. In 2002, it was decided to eliminate the DC Plan and Combination Plan and to move all existing participants to the DB Plan, effective 1 January 2003.

The Mainline's $9.3 million budgeted amount for pension and benefits adjustments for the 2003 Test Year is primarily related to an increase in the DB Plan expense as well as the consolidation of the former DC Plan and Combination Plan into the DB Plan. Of this amount, $3 million is directly related to the cost of the consolidation. TransCanada indicated that it had several reasons for consolidating the former DC Plan into a DB Plan. It was TransCanada's view that pension monies could be used more efficiently in a DB plan, due to market losses in the DC Plan compared with the DB Plan performance. Further the DC Plan contribution rate at 6% was no longer competitive and an increase to the 8% to 11% range would have been necessary for the plan to remain attractive to employees. Also, TransCanada asserted that DB plans still predominate in the Canadian market and that there is a trend away from defined contribution plans. TransCanada was concerned that it might be subject to class action litigation from employees should employees' poor investments in the DC Plan result in a shortfall in their pension funds.

Positions of Parties

CAPP, FSG and Ontario pointed out that the RSUP is tied to total shareholder return and due to its design, focuses on the enhancement of shareholder value. CAPP's position was that the cost of this program should be borne by shareholders, not by tollpayers, as the costs should follow the benefits. CAPP also sought clarification as to the type of employee behavior being rewarded by the RSUP. FSG suggested that TransCanada is trying to get shippers to assume responsibility for a cost that was previously borne by shareholders. Ontario further suggested that for a program such as the RSUP to be effective, there must be an alignment between those who pay for the program and those who receive the benefit.

CAPP contended that the trend is to DC plans and that they are less expensive than DB plans. CAPP maintained that the risk of litigation would be similar, regardless of the type of pension plan. CAPP submitted that the cost of keeping employees whole for past decisions is one more appropriately borne by shareholders than shippers. CAPP was further concerned with the magnitude of the pension plan funding deficiency and the rate at which it is growing. CAPP stated that the present pension expense and the current unfunded pension amount that is reflected in Rate Base have both current and future return and tax implications as the future liability is large and increasing rapidly. CAPP therefore suggested that not only the conversion cost of $3 million allocated to the Mainline be disallowed, but also that the income tax and Rate Base effect of the $7.9 million of pension plan funding allocated to the Mainline should be reversed.

IGUA aggregated all of TransCanada's salaries, wages, benefits and incentive compensation into an overall average total employee compensation for TransCanada and compared this average to that of Enbridge Gas Distribution Inc.'s (EGD). In IGUA's view, TransCanada's average total employee compensation is very high and should be reduced. In its filed evidence, IGUA suggested that a reduction of $37 million was appropriate, based in part on its comparison of similar amounts paid to EGD. Based on subsequent evidence and further analysis, IGUA, in final argument, advanced the position that $20 million of employee costs should be disallowed.

IGUA maintained that the number of employees allocated to the Mainline ought not to be increasing when the number for the corporation as a whole is decreasing. IGUA suggested that the increase in the number of employees allocated to the Mainline was purely as a result of the application of TransCanada's allocation policy. IGUA recommended that the number of employees allocated to the Mainline be reduced from 837 to 812, which represents a reduction of two employees from the 2002 level of 814. Such reduction would be commensurate with the overall reduction in TransCanada's number of employees from 2068 in 2002 to 2063 in 2003.

IGUA submitted that the total employee costs for the Mainline for 2003 should be no more than $100 million and that about $18 million of the total $118 million sought should be disallowed. In IGUA's view, this would represent a reasonable increase of 3.1% over 2002 actual levels for 812 employees.

FSG questioned whether Mainline shippers should pay for a compensation program (LTIC) based on share appreciation.

TransCanada's Response to Parties' Positions

With respect to total compensation, TransCanada noted that the evidence, including the expert evidence of Towers Perrin, showed that the totality of compensation is at or slightly under the median of the market. TransCanada asserted that it had made a reasonable and justified decision to determine compensation on a market competitive basis.

TransCanada pointed out that IGUA's analysis of employee compensation did not take into account the different organizational and cost structures of EGD and TransCanada. TransCanada noted that its review of public information filed by Enbridge Pipelines Inc. (Enbridge), the parent of EGD, showed that TransCanada's average direct compensation is less than that of Enbridge. TransCanada also noted that Enbridge, like TransCanada, operates a long-haul pipeline.

TransCanada submitted that it was not just the allocation policy which resulted in more people being allocated to the Mainline, but rather the result of managers assessing their planned activities and determining the amount of work to be done during the year.

In response to the suggestion of certain parties that pension conversion costs should be disallowed, TransCanada reiterated the reasons that led it to make the changes and submitted that the costs allocated to the Mainline are justified.

Views of the Board

The evidence provided suggests that the proposed per-employee total compensation (salaries, IC, LTIC, and benefits) for the Mainline is in line with the compensation provided by companies of similar size and scope. In the Board's view, TransCanada has provided evidence to warrant a salary escalation of 5.25% for non-field and 3.5% for field employees.

However, in the Board's view, TransCanada has not provided sufficient justification to support an increase of 23 employees to 837 for 2003 from the 2002 level of 814 on the basis of business need. While the forecast employee count results from the application of TransCanada's allocation policy, the application of this policy is not in and of itself sufficient to justify the proposed increase in employee count. While TransCanada submitted that forecast employee count also resulted from managers assessing their planned activities, insufficient evidence has been provided to lead the Board to conclude that increased activity level, relative to 2002, would justify an increase in the number of employees for 2003. Further, the proposed increase in Mainline employee count is counter-intuitive, since it occurs at a time when TransCanada's total employee count is decreasing and there is no evidence to suggest that this reduction is a result of reduced level of activity in other entities. In the face of what may be considered an unexpected result, or one imposing a significant cost variance without specific activity level justification, further supporting rationale or justification is required. TransCanada must demonstrate that the increase, in expenses or in number of employees, is required for the operation of the Mainline. In the Board's view, such justification has not been provided. Therefore, the Board believes that the level of salaries, IC, LTIC, and benefits recovered in 2003 tolls should reflect 814 employees, rather than the proposed 837. As presented in Table 4-5, this adjustment results in a disallowance of $2.6 million.

Further, with respect to LTIC, the Board is of the view that there is merit in the position of certain parties that the design of LTIC rewards behaviour that enhances shareholder value. Although the focus on shareholder value is not necessarily to the detriment of shipper interests, the Board's view is that part of the cost of LTIC should be borne by shareholders. A variable compensation program which is paid out on the basis of measuring the increase in value to shareholders could drive a different behaviour than one which focuses on areas of benefit to customers. The Board accepts that TransCanada, in order to be competitive in the marketplace for employees, must offer a suite of compensation components similar to its comparator group. However, in the case of LTIC which clearly rewards employees for aligning their interests with shareholders, it is the view of the Board that shareholders should bear a significant portion of the cost of LTIC. Therefore the Board is of the view that it would be appropriate for tollpayers to pay for only 50% of the cost of LTIC applicable to 814 employees. As shown in Table 4-5, this adjustment results in a disallowance of $6.0 million.

While the reasons for converting from a DC Plan back to a DB Plan are understandable, the Board does not believe the $3 million actual cost of conversion is a cost that should be borne by shippers. Based on the evidence, the Board is of the view that both DC and DB plans are appropriate and a reasonable company should be expected to decide on one type of plan and stay with that plan. As markets fluctuate and as conditions in the economy change, certain types of plans come into or go out of favour. At various times one or another of a DC Plan or a DB Plan may be preferred for a short period of time. For shippers to cover the cost of moving back and forth between plans sets an inappropriate precedent in the event the trend reverses at some point in the future.

As for CAPP's suggestion that the income tax and Rate Base effect of the $7.9 million of pension plan funding allocated to the Mainline should be reversed, the Board is of the view that such a disallowance is not justified.

4.4.3 Transmission Expenses

Transmission Expenses for the Mainline are proposed to be $82.7 million for the 2003 Test Year which is an increase of $8.1 million or 10.9% over the 2002 Actual amount of $74.5 million. TransCanada explained that the major factor responsible for this increase was an increase of $9.3 million in the Repair and Overhaul (R&O) program for the Mainline. TransCanada's R&O program was the only significant issue addressed under Transmission expenses other than employee compensation, which is covered in sub-section 4.4.2.

Repair & Overhaul Costs

Position of TransCanada

TransCanada indicated that its R&O program is intended to efficiently schedule maintenance on compressors. The timing of compressor overhauls is based on an analysis of usage, type of compressor and time since the last scheduled maintenance took place. TransCanada stated that in arriving at the Test Year's budgeted R&O costs it started with forecasts of system utilization for the remainder of the current year and for the Test Year. For each compressor, it added the time since the last overhaul and then predicted whether the next overhaul would be required in the Test Year.

Position of Parties

FSG suggested that TransCanada had an economic incentive to delay scheduling costly compressor overhauls in the years in which it was operating under a negotiated settlement (i.e., 2001 and 2002) as well as to plan and budget overhauls for 2003 that could be done in 2004 or 2005. FSG did not dispute that TransCanada should do whatever it needs to do to maintain the system and acknowledged that it is not expert in the way TransCanada schedules and performs its maintenance. FSG, however, maintained that TransCanada has considerable discretion in relation to the timing of overhauls, and that, through proper management, TransCanada ought to be able to distribute overhauls relatively smoothly over time.

IGUA noted that TransCanada had filed a number of revisions to its applied-for 2003 amount for Maintenance Parts and Maintenance Services accounts, which includes R&O costs. IGUA submitted that these changes suggest a certain level of confusion on TransCanada's part as to what expenditures should be charged to these accounts. While all transmission expenses are supposed to be direct assignments, the confusion over the categorization of expenditures raises doubts as to the accuracy of the allocation of total transmission costs between the three pipeline businesses which TransCanada owns and operates. IGUA further maintained that based on trends in actual expenditures from 1997 to 2002, the budgeted amount of $40.9 million for 2003 is excessive by an amount of about $10 million.

TransCanada's Response to Parties' Positions

TransCanada responded by indicating that it has only limited control over the overhaul program and reiterated that the program is driven mostly by the level of throughput on the system. As evidence of the lack of control or discretion over the overhaul program, TransCanada pointed to its history of budget versus actual expenses over the last six years and noted that in four of these years, expenditures exceeded budget.

> ***Views of the Board***
>
> The Board is of the view that TransCanada's approach to budgeting for R&O activities for the Mainline is reasonable. Further, sufficient reasons have been provided to justify the level of R&O activities planned in 2003. The Board does not believe that the evidence presented supported FSG's contention concerning the timing of R&O expenditures.

4.4.4 Departmental Expenses

TransCanada applied for a Total Departmental Expense amount of $83.9 million for the 2003 Test Year. This represented a $3.9 million or 4.9% increase over the 2002 actual amount of $80.1 million. A budgeted increase in information system costs of $3.3 million over the 2002 actual costs of $20.5 million accounts for most of the increase in this category of OM&A costs. TransCanada pointed out that due to the changing nature of information system costs, capital costs in this area are budgeted to decline by more that $4.7 million in 2003.

Except for issues related to employee compensation, no parties raised concerns specifically related to Departmental Expenses.

4.4.5 General Expenses

TransCanada applied for a Total General Expense amount of $79.5 million for the Mainline in 2003, an increase of $24.3 million or 44.0% over the 2002 actual expenses of $55.2 million. The $24.3 million increase was a result of increases in several items, some of which were found to be contentious during the proceeding (see Table 4-4).

Table 4-4
Increase in General Expenses
Proposed 2003 Costs Relative to Actual 2002 Costs ($ million)

Severance costs related to the 2001-2002 S&P Settlement	5.9
Incentive Compensation (IC)	1.6
Long Term Incentive Compensation (LTIC)	4.1
Line of Credit Standby Fees	0.6
Organizational Change Costs	0.4
Pension and Benefits Adjustments	7.6
Severance costs related to 2003	2.0
Changes to other items	2.1
Total General Expenses	**24.3**

The specific items that were in dispute included IC, LTIC, and Pension and Benefits Adjustments, which are discussed in sub-section 4.4.2. Also in dispute were costs related to line of credit standby fees, organizational change costs, severance costs, and regulatory and legal costs. These costs are discussed below.

Line of Credit Standby Fees

The obligation of the banks under TransCanada's line of credit expired in 2002. Proposals for 2003 and beyond were sought by TransCanada. As a result of the new line of credit facility TransCanada must incur two distinct costs, a one-time upfront fee for the establishment of the facility and annual fees during the duration of the facility. In 2003, TransCanada proposed to allocate $1.4 million to the Mainline for line of credit standby fees, an increase of $0.6 million over the $0.8 million cost incurred in 2002.

TransCanada stated that it funds substantially all of its short-term cash needs through its commercial paper program and that to get the lowest-cost financing possible, the line of credit is necessary to backstop the commercial paper program. TransCanada acknowledged that the Mainline is not currently forecast to require short-term funding and that the line of credit has never been drawn upon and is not intended to be drawn in the near future. Nonetheless, TransCanada maintained that prudently run ventures should maintain access to adequate short-term funds at all times.

CAPP noted that TransCanada has a mix of long-term embedded debt and lower-cost shorter-term debt. CAPP pointed out that the Mainline is allocated none of the benefit of this short-term debt. CAPP questioned the appropriateness of the Mainline covering the cost of standby fees for short-term debt when none of this debt is allocated to the Mainline.

CAPP stated that TransCanada is in a substantial pre-funded position (on average, about $83 million in 2003). The level of pre-funding is expected to increase, especially with any increase to the Mainline's depreciation rate. CAPP suggested that the level of pre-funded debt should be managed by TransCanada through debt reduction. CAPP further suggested that, since depreciation paid by the shippers is returning invested capital to TransCanada, any penalties for early retirement of debt should not be the responsibility of Mainline shippers.

IGUA proposed an overall reduction of $3 million in Net Stock and Debt Administration Expenses, of which Line of Credit Standby Fees represents approximately 35% of the total, on the basis that the Mainline is pre-funded and will be pre-funded for years to come.

TransCanada submitted that it would not be prudent to incur unnecessary costs to prematurely retire debt. It pointed out that shippers bear no cost for the existence of pre-funded debt, as the average cost of funded debt is credited to the Revenue Requirement. TransCanada further pointed out that the Mainline has a significant amount of high-coupon debt as a result of the system having needed funds for expansion when the cost of debt was higher than it is today. TransCanada also stated that since the debt was incurred for the benefit of shippers, it would be inappropriate for the costs of early retirement of debt to be borne by TransCanada shareholders.

With respect to IGUA's proposed overall reduction of $3 million to Net Stock and Debt Administration, TransCanada responded that these costs are allocated to the lines of business on the basis of the capital requirements for each of the lines of business. In TransCanada's view, there is a specific capital structure requirement and that over the life of the company, each of the lines of business should share in the costs of maintaining that structure.

Views of the Board

Given the substantial pre-funding position of the Mainline, the Board does not believe that it is reasonable for shippers to pay for a line of credit standby fee at this time. The Mainline is not currently forecast to require short-term funding. Should the Mainline require short-term funding, the evidence suggests that TransCanada would have no difficulty obtaining such funding for the Mainline. As shown in Table 4-5, this adjustment results in a disallowance of $1.4 million.

The Board rejects CAPP's position that TransCanada should redeem some of its pre-funded debt at its own cost at this time. However, the Board is of the view that TransCanada should consider cost effective redemption of debt in order to bring the Mainline's debt in line with its deemed capitalization.

With the exception of the portion related to the line of credit standby fee, the Board sees no basis for IGUA's proposed reduction of $3 million to Net Stock and Debt Administration costs.

Organizational Change Costs

TransCanada announced that a holding company above TransCanada is being created and will be named TransCanada Corporation. The common shareholders of TransCanada will become the common shareholders of TransCanada Corporation, which in turn will become the sole shareholder of TransCanada. The objective of the organizational change is to allow TransCanada Corporation to be able to make future investments that it otherwise might not have been able to make from within the existing corporate structure. Included in the Auditing, Legal and Common Stock expense budgeted for the Mainline for the 2003 Test Year is approximately

$450,000 of costs related to that organizational change, an allocation of approximately 53% of the $850,000 cost of this corporate change budgeted in 2003.

CAPP submitted that TransCanada's shareholders are the beneficiaries of the company being able to engage in the growth strategy that this reorganization will facilitate.

Ontario submitted that the investments under TransCanada Corporation would not be to the immediate benefit of the Mainline and that the Mainline does not require the establishment of a holding company.

TransCanada maintained that the amount being allocated to the Mainline is a small price to pay and would allow TransCanada to potentially influence decisions that would be beneficial to Mainline shippers (for example with respect to Northern gas development).

Views of the Board

The Board is of the view that TransCanada has not demonstrated that the expected benefit of the organizational change will accrue to the Mainline. Therefore the cost associated with the organizational change is not an appropriate cost for Mainline tollpayers to bear. As shown in Table 4-5, this adjustment results in a disallowance of $450,000.

Severance Costs

IGUA suggested that the $2 million in severance costs allocated to the Mainline for the 2003 Test Year was inconsistent with TransCanada's contention that the number of employees allocated to the Mainline will increase. IGUA recommended that this cost be disallowed.

TransCanada submitted that major organizations frequently face severance costs while they increase the size of their workforce. TransCanada noted that such a result is driven by differences in the skills of employees leaving and joining the organization. In addition, TransCanada stated that the majority of the severance budget had been spent in the first two months of 2003.

Views of the Board

The Board does not believe that IGUA's proposed disallowance of severance costs would be appropriate and accepts the submission of TransCanada on this matter.

Regulatory and Legal Costs

CAPP argued that a doctrine of compensating reasonable and necessary regulatory costs does not require compensating TransCanada for the costs related to mistakes in its Application and the correction thereof, especially in relation to issues with respect to TransCanada's depreciation analysis. Citing what it perceived as a lack of due diligence on TransCanada's part, CAPP requested a disallowance of regulatory costs of $2 million.

IGUA supported CAPP's position. Further, IGUA proposed a reduction in Legal costs of $1 million. IGUA questioned the various components of this category of costs and stated that it believes that there are excesses of at least $1 million with respect to litigation, tax issues, corporate secretary and regulatory.

TransCanada responded that there is no regulatory principle of a financial penalty for an honest mistake. TransCanada submitted that its management acted in good faith and the error in the depreciation analysis was revealed as soon as it was found.

In response to IGUA's proposed disallowance of Legal costs, TransCanada pointed out that these legal costs were external costs which were budgeted based on the effort required to support the issues identified.

Views of the Board

The Board does not accept CAPP's proposal that $2 million in regulatory costs be disallowed. The Board found no evidence that TransCanada was negligent in preparing its Application or in advising parties when it became aware of the inconsistency in its depreciation analysis.

The Board also rejects IGUA's proposed legal costs disallowance and notes that IGUA did not introduce any specific evidence to support a reduction of $1 million.

4.4.6 Overall Views on OM&A Costs

Table 4-5 presents the disallowances from TransCanada's applied-for OM&A costs that the Board views as appropriate for 2003.

Decision

The Board approves Total OM&A costs of $232.7 million for the 2003 Test Year.

Table 4-5
Summary of OM&A Costs Disallowances for 2003 Test Year ($000)

2003 Proposed OM&A			**246,167**
LESS:			
Compensation Reflecting 814 rather than 837 Employees			
Salaries	1,581		
IC	294		
LTIC	339		
Benefits	427		
Total: Compensation Reflecting 814 rather than 837 Employees		2,641	
50% of LTIC for 814 Employees		6,000	
Pension Conversion Costs		3,000	
Line of Credit Standby Fee		1,403	
Organizational Change Costs		450	
Total OM&A costs Disallowances			**13,494**
Approved Total OM&A costs for 2003 Test Year			**232,673**

4.5 Municipal and Other Taxes

Municipal and other taxes are budgeted at $117.5 million for 2003, an increase of $1.7 million over 2002 actual. TransCanada proposed deferral account treatment for this item of Revenue Requirement. In its pre-filed evidence, IGUA had concerns with the increase as originally estimated, but later accepted the $1.7 million increase as reasonable and supported deferral account treatment.

Decision

The Board approves the proposed amount of $117.5 million for municipal and other taxes for the 2003 Test Year, subject to deferral account treatment.

4.6 Income Taxes

TransCanada calculated the 2003 Test Year income taxes based on the Revenue Requirement as submitted in the Application. No comments were received from parties on the method of calculation.

Decision

TransCanada is directed to re-calculate and file as part of its compliance filing, the Mainline's Income Taxes for the 2003 Test Year to reflect the decisions contained in these Reasons for Decision.

Chapter 5

Depreciation

TransCanada sought approval of an increase in depreciation rates that it contends better reflect the risk of recovery of its investment in the Mainline. Based on a comprehensive depreciation study prepared by Gannett Fleming Inc. (GFI) and an updated Mainline throughput forecast, TransCanada's Application included: an economic planning horizon of 25 years; a proposed change in depreciation procedure from Average Service Life (ASL) to Equal Life Group (ELG); the introduction of amortization accounting for a number of accounts; inclusion of costs of ongoing retirements in the estimation of future net salvage; as well as new assumptions as to the timing of compressor retirements and other minor changes.

In its initial Application, TransCanada applied for a composite depreciation rate of 4.12% relative to the Mainline's approved rate of 2.89% for 2002. This represented an increase of $152.3 million in depreciation expense from $362.3 million in 2002 to $514.5 million in 2003. This increase was accompanied by an increase of approximately $87 million in related income taxes. However, on 7 March 2003, TransCanada indicated that the depreciation rates contained in the initial Application included a provision for net salvage on terminal retirements contrary to policy statements made in its evidence. As a result, TransCanada reduced its applied-for composite depreciation rate to 3.65%. This correction resulted in the 2003 applied-for depreciation expense being reduced by $63.9 million to $450.6 million, an increase of $88.3 million over the 2002 actual amount. Associated with this $88.3 million increase in depreciation expense is an increase of approximately $51 million in income tax expense.

TransCanada's last depreciation study filed with the Board was a 1992 study prepared by GFI, which was filed in the RH-2-92 Proceeding. In that proceeding, the Board approved a composite depreciation rate of 2.58% for the Mainline. Since that time, the only changes that have been approved to the Mainline's depreciation rates have occurred as a result of the 2001-2002 S&P Settlement. Under the terms of the 2001-2002 S&P Settlement, TransCanada's approved composite depreciation rate was increased to 2.74% in 2001 and to 2.89% in 2002.

TransCanada explained that had it applied the 1992 depreciation parameters (35 year planning horizon, ASL procedure, 1992 estimated net salvage rates, and 1992 survivor curve estimates) against the aged surviving balances as at 31 December 2001, the composite depreciation rate for 2002 would have been approximately 2.50%. A breakdown of the increase from 2.50% to 3.65% by components was provided by TransCanada and is presented in Table 5-1. In addition, Table 5-1 also shows the impact of the proposed changes on depreciation expenses, income taxes and the Eastern Zone Toll.

Table 5-2 presents similar information, but shows the impact of the proposed depreciation rate, relative to the rate of 2.89% approved for 2002.

Table 5-1
Breakdown of the Impact of Changes:
2003 Proposed Depreciation Rate Relative to the
Implied Rate Derived Using the Approved 1992 Depreciation Parameters

	Impact on Composite Depreciation Rate (%)	Depreciation Expense Impact ($000)	Income Tax Impact ($000)	Eastern Zone Toll Impact (¢/GJ)
Implied 2002 Composite depreciation rate derived using the 1992 Approved Depreciation Parameters:	2.50	-	-	-
Change due to new assumptions as to timing of compressor retirements:	0.04	4,956	2,841	0.47
Change due to the use of different survivor curves:	0.00	(89)	(51)	(0.01)
Change due to the use of amortization accounting:	0.12	14,869	8,524	1.41
Change due to revised interim net salvage value amounts:	0.08	9,914	5,682	0.95
Change due to shortening of economic planning horizon:	0.68	84,258	48,300	8.02
Change due to change to ELG from ASL:	0.23	28,498	16,337	2.71
Change due to other factors:	0.00	-	-	-
2003 proposed composite depreciation rate:	3.65	142,406	81,633	13.55

Table 5-2
Impact of Change:
2003 Proposed Depreciation Rate Relative to the
Approved 2002 Composite Depreciation Rate

	Impact on Composite Depreciation Rate (%)	Depreciation Expense Impact ($000)	Income Tax Impact ($000)	Eastern Zone Toll Impact (¢/GJ)
2003 proposed composite depreciation rate:	3.65	450,600	-	-
2002 approved composite depreciation rate:	2.89	362,274	-	-
Change from 2002 to 2003:	0.76	88,326	51,000*	8.6*

* estimates

The remainder of this Chapter describes TransCanada’s proposed depreciation changes in the following order: economic planning horizon, change from ASL to ELG, amortization accounting, net salvage, estimates of service life, and other matters and overall views on depreciation.

5.1 Economic Planning Horizon

Position of TransCanada

TransCanada adopted the recommendation from GFI to incorporate an economic planning horizon in its depreciation analysis. TransCanada indicated that significant retirements will occur on the Mainline, not only due to the physical forces of retirement, such as wear and tear and deterioration, but also due to economic forces, such as significant decline of gas supply and lower utilization of the Mainline. TransCanada suggested that the introduction of an economic planning horizon was a means of providing a reasonable assurance of the recovery of invested capital. TransCanada determined the year 2027 as the end of the planning horizon on the basis of the following three factors:

- the decline in throughput on the Mainline to 50% of system utilization;
- the mid-point of the period during which the majority of the Mainline's facilities will be retired; and
- industry practice.

TransCanada supported its proposed economic planning horizon with a throughput study, in which six cases were presented. The cases combined various scenarios with respect to five major variables:

- conventional and unconventional production from the Western Canada Sedimentary Basin (WCSB);
- Northern gas supply from the Mackenzie Delta and Alaska;
- Western Canada gas demand;
- allocation of total supply to ex-Alberta pipelines; and
- pipeline capacity additions out of the WCSB.

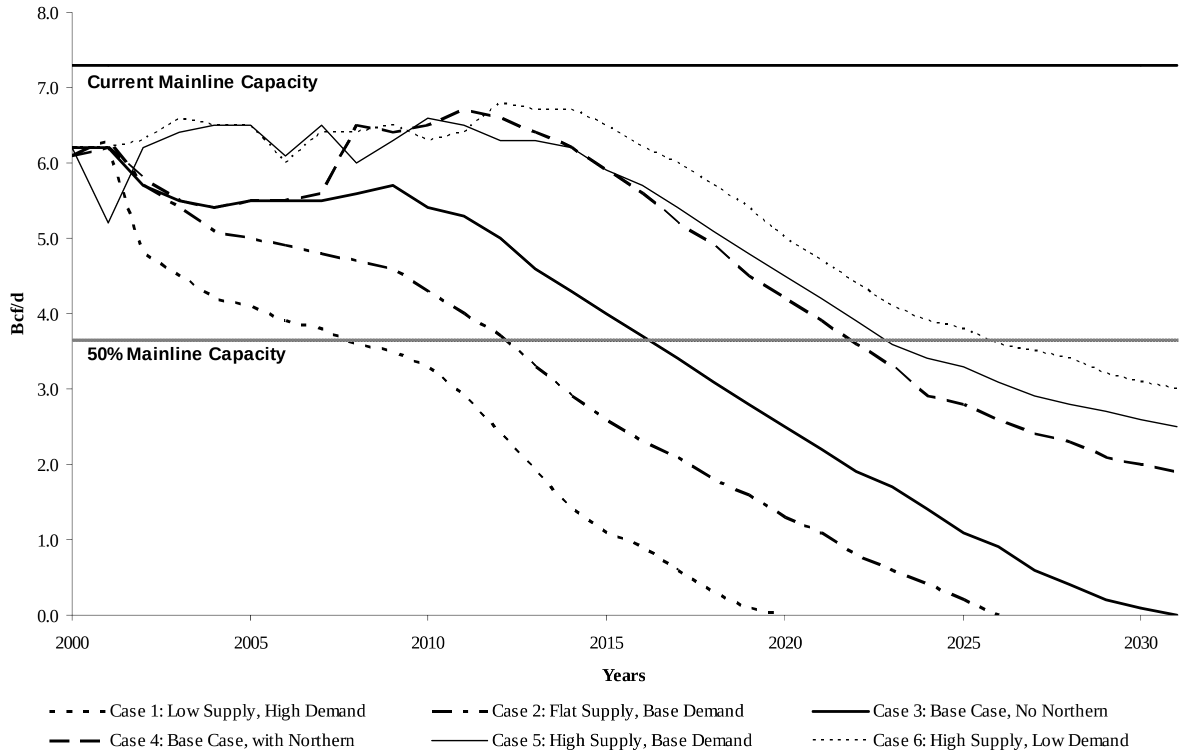
TransCanada's throughput study illustrated that the year when the Mainline utilization might be at 50% of its current capacity could be as early as 2009 and as late as 2027, with the base cases at either 2018 or 2023, depending on whether or not Northern gas supply was included. The throughput forecasts corresponding to each of TransCanada's six cases appear in Figure 5-1.

TransCanada expected throughput to peak around 2015 and anticipated that significant facilities would be retired due to reduced throughput thereafter. TransCanada suggested that the range of the majority of system retirements would support a truncation date of 2015 to 2027.

TransCanada also noted that most Board-regulated pipelines employ a 25-year economic life, and that industry practice suggested a truncation period of 12 to 40 years.

TransCanada submitted that it had to balance several factors in its selection of an economic life for the Mainline, and while it was of the view that a 15-year or 20-year economic life would be more appropriate, it proposed a 25-year economic life to address the desire to reduce the toll increase that would result from the use of a shorter economic life.

Figure 5-1
Mainline Throughput Forecasts



Position of Parties

CAPP submitted that TransCanada's analysis focused on scenarios that were at the very low end of potential results. CAPP maintained that TransCanada backed out continental US production rather than WCSB production to accommodate Northern gas flows, which led to TransCanada's model adding capacity for that gas, rather than assuming Northern gas would flow on existing pipelines.

CAPP's recommendation was for a 30-year economic planning horizon, and a truncation date of 2032. In support of this recommendation, CAPP relied on six sensitivities developed by Gilbert Laustsen Jung Associates Ltd. (GLJA). The six sensitivities used TransCanada's fourth case as a starting point (Base Case with Northern Gas) and progressively incorporated the impact of a change in terminal development rate to total remaining resources (conventional plus unconventional), displacement of WCSB supply when Northern Gas commences, lower and no increase in ex-WCSB capacity, and greater and delayed supply from Alaskan supply. Under these six cases, the Mainline achieved a 50% utilization rate between 2028 and 2040. CAPP concluded that a truncation date of 2032 was well within the range of reasonable outcomes and that it was a conservative estimate.

FSG submitted that TransCanada had carefully engineered its model to drive the results to the conclusion that, despite ample supply of gas, the Mainline would never be successful over the long term. Specifically, FSG expressed concerns with TransCanada's assumptions for capacity addition, supply allocation among pipelines, failure to account for demand-related factors, and the use of a 50% utilization assumption in determining a truncation date.

FSG developed a total of 32 cases by combining eight different combinations of TransCanada's supply and Western Canadian demand forecasts with four different assumptions on new capacity and allocation of flows on ex-WCSB pipelines. Results for the 32 cases were presented for 50%, 40% and 30% pipeline utilization rates. Overall, FSG submitted that its evidence supported a truncation date of 2037, implying a 35-year economic planning horizon.

Response of TransCanada to Parties' Position

TransCanada noted that neither FSG nor GLJA (for CAPP) conducted an independent assessment of the fundamentals of supply and demand. TransCanada indicated that it was the only party to present a throughput study that took into account the interaction of supply, demand and prices for each supply basin and demand region in North America. TransCanada argued that, in contrast, FSG and CAPP selected certain elements of the TransCanada analysis and manipulated data in an effort to extend the truncation date beyond 2027.

TransCanada noted that CAPP's model could be characterized as a set of calculations that produce a supply to match a given demand scenario. In addition, TransCanada expressed the view that applying a terminal development rate to total supply without regard to the different characteristics of conventional and unconventional supply leads to an aggressive and unreasonable unconventional production profile.

TransCanada noted that FSG's analysis of supply, demand and pipeline flows was limited to manipulation of the TransCanada data with three changes: rejecting the three TransCanada cases that did not include Northern Gas; re-allocating pipeline flows once the WCSB goes into decline; and positing a deferred development scenario in order to minimize infrastructure development.

TransCanada submitted that the use of a 2027 truncation date was optimistic given the result of its throughput study and that a 25-year economic life span was consistent with other pipelines in the WCSB. It also represents an increase of one year over the truncation date TransCanada used in the Mainline's 1992 depreciation study that was approved by the Board. TransCanada submitted that imposing a truncation date beyond 2027 would increase TransCanada's risk of complete capital recovery and would place it at a distinct competitive disadvantage compared with Alliance.

Views of the Board

In the Board's view, the Mainline's depreciation rate should provide TransCanada with a reasonable opportunity to recover its invested capital. Further, where feasible and practical, the Board should attempt to ensure that companies under its jurisdiction are treated on a similar basis

With respect to the first of these factors, the Board is of the view that the throughput study presented by TransCanada, in support of its proposed economic planning horizon, contained a comprehensive analysis of the fundamentals of supply, demand and gas prices. TransCanada developed a range of potential outcomes of Mainline throughput taking into account a reasonable range of conventional and unconventional WCSB supply, the development and timing of Northern gas, Western Canadian gas demand, the allocation of supply to ex-Alberta pipelines, and possible future ex-WCSB pipeline capacity additions. The analyses presented by CAPP and FSG were limited to a number of parameters, such as delaying the start-up of Northern gas, restricting ex-WCSB pipeline expansions or delaying the development of WCSB resources. In addition, the Board shares TransCanada's concern regarding GLJA's approach of jointly modeling conventional and unconventional supply.

The Board is of the view that the results of the TransCanada throughput study more appropriately reflect the full range of outcomes that may reasonably be expected to occur, including scenarios that would support planning horizons shorter than 25 years. Therefore, the Board is of the view that substantially more weight should be given to the analysis of TransCanada than to those of CAPP and FSG. The Board also notes that TransCanada will be required to file depreciation studies regularly in the future. This will provide an assurance that TransCanada's economic planning horizon reflects the latest developments.

With respect to the second factor, the Board is of the view that a 25-year economic planning horizon is more in line with the planning horizons used by competing pipelines. To require the Mainline to operate under a proposed 30-year (CAPP) or 35-year (FSG) planning horizon could be unfair to the Mainline, as it may place it at a competitive disadvantage should competing pipelines be fully depreciated sooner than the Mainline.

Both of the above factors support the adoption of an economic planning horizon of 25 years, as proposed by TransCanada.

5.2 Equal Life Group versus Average Service Life Procedures

Position of TransCanada

In its 1992 depreciation study prepared for TransCanada, GFI concluded that the ELG depreciation procedure is superior to the ASL depreciation procedure in that ELG better reflects actual consumption of service value. Despite this finding, TransCanada maintained that ASL continued to be more appropriate at that time. TransCanada explained that ASL remained appropriate because of the following factors:

- ASL was the most widely used depreciation procedure in the pipeline industry, and therefore, from both an equity and a competitive point of view, it was the most appropriate;

- ASL was the depreciation procedure TransCanada had used in the past and with which it was most familiar and which most properly accords with TransCanada's systems and accounts;
- ASL was reasonable for TransCanada according to GFI; and
- The retention of ASL was supported by a consensus of the Task Force.

TransCanada indicated that it now believes that ELG would be more appropriate in that it better reflects the consumption of service value. TransCanada also suggested that ELG would ensure long-term inter-generational equity among shippers in an increasingly competitive environment. In the long run, TransCanada's tolls would be lower using ELG than they otherwise would be if ASL continued to be used. This would result in lower, more competitive tolls as gas production declines. The adoption of ELG would also ensure that users of the system do not pay depreciation expense for service consumed by previous users of the system.

TransCanada suggested that the administrative requirements of the ELG procedure, when using the remaining life technique, are the same as the administrative requirements of the ASL procedure on the same basis. TransCanada also noted that although the implementation of ELG would result in a greater Revenue Requirement at this time than continuing ASL, it would result in lower capital charges, being the sum of depreciation and return, over the life of the assets. Furthermore, the decline in throughput later in life would result in the per unit costs of throughput increasing more under ASL than under ELG. TransCanada also noted that ELG has been accepted by several regulatory boards in Canada.

Position of Parties

CAPP noted that ASL is the most commonly used depreciation procedure in the gas pipeline industry and that GFI has no hesitation in using ASL. ASL meets the requirements of both depreciation theory and the accounting regulations. It is systematic and rational. There is no need to change to ELG, especially now in an environment where tolls have been increasing. ELG, although claimed to be theoretically more precise than ASL, requires more precision and more ongoing adjustment than ASL. As ELG brings depreciation collection forward in time relative to ASL, the depreciation expense to tollpayers is increased. CAPP noted that the Public Utilities Commission of the State of Colorado found that ELG demands complete and complex plant records and that low retirement levels jeopardize the accuracy of ELG. The data problems existing in TransCanada's historical property records, the fact that only 2% of TransCanada's pipeline facilities installed over the 46-year history of the pipeline have been retired, and the other factors noted above, led CAPP to conclude that the ELG approach should be rejected.

FSG conceded that it may be true that ELG is superior to ASL in matching the depreciation expense and the consumption of service value. However, FSG submitted that this does not necessarily answer the question of whether ELG is superior to ASL when it is applied in the market and regulatory circumstances of the Mainline. FSG expressed the view that ELG front loads depreciation expense relative to ASL. As a result, FSG suggested that the use of ELG is an attempt by TransCanada to load costs onto current captive customers, in an attempt to artificially reduce capital-related costs for future shippers. In FSG's view, TransCanada's evidence does not explain why it is fair for shippers to pay more now so that others can pay less in the future.

FSG noted that the issue of choosing between ELG and ASL appears to FSG to be one that does not have a right answer but is one that is really a matter of judgement. In FSG's view, TransCanada's need to compete will only occur in the outer years of the throughput forecast and, at that point, there is essentially no difference between tolls derived on the basis of ELG and ASL. FSG also noted that TransCanada appears to focus its comments in the area of inter-generational equity on the issue of when depreciation expense alone is recovered from shippers. In FSG's view, it is more relevant to consider in this context, the overall burden of capital-related costs on shippers at different time periods. Looking at the toll impact over the long haul, FSG suggested that the most noticeable impact is over the first few years or about 2003 to 2006, and that the differences lessen after that. As a result, shippers get a big hit initially for trivial future benefits. Although TransCanada would receive an increase in initial cash flow as a result of a change to ELG, FSG suggested that the resultant negative effect on shippers indicated that the ASL approach should be retained.

Views of the Board

In the Board's view, both the ASL and ELG depreciation procedures meet the requirements of depreciation theory and accounting regulations. In addition, the Board views each approach as being rational and systematic in its ability to fairly recover capital costs over time. ELG, although not as commonly used as ASL, has been approved by many regulatory tribunals in North America. Both procedures have their advantages and disadvantages. While both procedures are adequate, the Board is of the view that there is insufficient justification to warrant a policy change from ASL to ELG at this point, some 46 years into the life of the Mainline given the impact on current shippers' tolls for what the Board views as relatively minor toll reductions in the future.

Furthermore, the Board notes that very accurate and detailed retirement information must be available in order for the ELG depreciation procedure to be able to correctly subdivide each of the vintage groups into subgroups of assets with the same anticipated service life. Given the fact that there is an unquantified amount of historical retirement information missing from TransCanada's property plant accounting records and that only approximately 2% of the Mainline's pipeline facilities have been retired to date, the Board does not have confidence in TransCanada's ability to accurately forecast valid amounts to be placed in each equal life group.

5.3 Amortization Accounting

Position of TransCanada

Based on recommendations from GFI, TransCanada proposed to convert five of its general plant accounts from depreciation accounting to amortization accounting (see Table 5-3). Under amortization accounting, the cost of an asset is distributed in equal amounts to each year of a fixed amortization period. The amortization periods proposed by TransCanada were based on judgement which incorporated a consideration of the period during which the assets would render most of their service, the amortization periods and service lives used by other utilities, and the service life estimates previously used for the asset under depreciation accounting.

The five accounts proposed represent numerous units of property, but a very small portion of depreciable gas plant in service. TransCanada noted that within the last few years there has been a growing trend of regulated companies applying for and receiving approval from other regulators to change to amortization accounting for their general plant accounts. TransCanada explained that in seeking ways to operate more efficiently, it finds the detailed tracking of high volume, but individually small dollar assets to be burdensome. Additionally, the combined value of these assets represents a small percentage of gas plant in service (approximately 1.5% for the Mainline at present). TransCanada contended that retirement orders are often not prepared or are overlooked for the retirement of these general plant assets. The result is that assets are left on the books and the net plant balance does not reflect the actual balance. Accordingly, TransCanada claimed that amortization accounting provides a more appropriate matching of amortization expense to the physical consumption of the service value. Under its amortization accounting proposal, TransCanada would amortize the annual expenditures within each of the five accounts over the amortization periods shown in Table 5-3.

Table 5-3
Accounts for Which Amortization Accounting is Proposed

Account	Description	Proposed Amortization Period (Years)	Share of Total Plant (%)
483.1	Furniture and Equipment	15	0.1
483.2	Computer Equipment	5	1.1
486.1	Tools and Work Equipment	30	0.2
488.1	Communication Equipment - Office	20	0.1
468	Communication Equipment - Field	15	0.1

With respect to any net salvage that might be realized upon the retirement of these assets, TransCanada proposed that any expected salvage proceeds would be forecast within OM&A for a Test Year such that TransCanada would be at risk for any variance from the forecasted amounts. TransCanada indicated that it would not object to deducting any salvage proceeds from the additions in a particular vintage year and then applying amortization accounting to the net amount.

TransCanada contended that amortization accounting was particularly appropriate for computer equipment. TransCanada noted that computers are often upgraded in a number of small pieces (monitors, software, etc.) and that tracking of computer equipment in the plant accounting sub-ledgers is a time consuming and inaccurate procedure. Over time accounting records do not reflect reality. In TransCanada's view, the use of amortization accounting resolves these issues.

Further, TransCanada expressed the view that the use of a five-year amortization period for computer equipment was more than reasonable.

Position of Parties

There was little opposition to the use of amortization accounting for all proposed accounts except for account 483.2 Computer Equipment, for which TransCanada proposed a five-year amortization period.

CAPP conceded that amortization accounting is probably the simplest capital cost recovery mechanism to administer and will likely result in time and labour savings as suggested by TransCanada. Accordingly, CAPP recommended that the Board approve amortization accounting for all proposed accounts except 483.2. For this account, CAPP recommended that ASL should continue to be applied with the use of an average service life of nine years. CAPP indicated that the analysis provided by Technical Associates Inc. (TAI) showed that computer equipment is being retained for periods longer than that proposed by TransCanada and that a 5-year amortization period is too short for this account. CAPP argued that the change to amortization accounting for computers will result in an increase in annual depreciation expense of some $22.5 million which is more than 170% over the current expense level and should therefore be rejected.

CAPP recommended that net salvage continue to be deducted in the calculation of the depreciation rate, as is currently the case.

FSG also expressed concern with account 483.2 but did not provide further comment on this issue in Final Argument.

Views of the Board

In respect of amortization accounting, the Board accepts that this accounting method is a more effective means of accounting for the large number of small dollar assets typically found in general plant accounts. The Board also notes the growing trend toward amortization accounting for general plant accounts.

With respect to whether or not amortization accounting should be approved for Account 483.2 - Computer Equipment, the Board is satisfied that amortization accounting would be adequate and that an average service life of five years is reasonable. Accordingly, the Board is of the view that the use of amortization accounting for the accounts proposed by TransCanada, as well as the amortization periods proposed, would be appropriate.

The Board is of the view that TransCanada should deduct any salvage proceeds it may receive from the disposition of assets in these accounts from the additions in a particular vintage year and then apply amortization accounting to the net amount. The Board notes that TransCanada indicated that it would not object to such a procedure. In the Board's view, this procedure should be easy to administer and will ensure an appropriate disposition of net salvage revenue.

5.4 Net Salvage

Position of TransCanada

TransCanada indicated that it has proposed modest estimates of negative net salvage for its transmission plant accounts, which represent a weighting of reasonable levels of negative net salvage for interim retirements and zero net salvage for terminal retirements (see Table 5-4). The levels of negative net salvage for interim retirements were based on statistical analyses of cost of removal and gross salvage related to the original cost of retirements for the period 1977 through 2001. They were also based on discussions with operating management and comparisons with the estimates of net salvage used by other gas utilities.

TransCanada noted that it has experienced significant levels of removal cost during its recent pipeline integrity and compressor retirement programs and anticipates similar costs will be incurred in conjunction with future interim retirements. TransCanada also noted that the proposed cost estimates are within the range of estimates used by other gas utilities and that there is no reason to believe that future retirement costs of all current pipeline, compression, and metering assets will not at least equal the currently-witnessed cost of on-going retirements as a percent of original cost.

Table 5-4
Proposed Net Salvage Amounts

Account	Description	2003 Proposed (%)
461	Land Rights	0
462	Compressor Structures	-10
463	Measuring & Regulating Structures	-5
465	Mains	-15
466	Compressor Equipment - Reciprocal/Electric	-15
466.9	Compressor Equipment - Other	-10
467	Measuring & Regulating Equipment	-10

In GFI's view, zero net salvage is not an appropriate estimate for the costs that will be incurred when the system is abandoned. However, GFI accepted that TransCanada's management does not believe that incorporation of an allowance for such costs in the cost of service is appropriate at this time. TransCanada submitted that this issue will need to be addressed in the near future.

Position of Parties

In CAPP's view, there are significant problems with the accuracy and consistency of the data files that TransCanada uses for depreciation analysis. CAPP noted that TAI was not able to validate or determine alternate net salvage figures given the deficient nature of the data. Therefore, CAPP recommended that net salvage should remain as it was in TransCanada's 1992 depreciation study.

FSG submitted that shippers are entitled to a complete explanation as to why TransCanada's recent net negative salvage costs have increased by such a large extent and that TransCanada must be able to demonstrate that this reflects what is likely to happen over the remaining life of the system. In FSG's view, TransCanada has not adequately explained how the proposed salvage percents were derived from the data. FSG expressed the view that with so much confusion, it is best to leave the net salvage percents at the 1992 levels.

Response of TransCanada to Parties' Position

TransCanada argued that the Board should not revert back to the 1992 estimates of net salvage as recommended by TAI, as these estimates do not reflect recent experience. To use net salvage percentages developed and reviewed a decade ago would ignore recent retirement activity which has been the most intensive in the TransCanada's history.

With respect to concerns over problems encountered in obtaining proper salvage data, TransCanada explained that although the retirements in the salvage file are not in precise agreement with those in the actuarial file, they do not prevent its use for developing indications of net salvage percents. TransCanada submitted that compared with other companies, its estimates of negative net salvage on interim retirements are well within reason.

Views of the Board

In the Board's view, it is readily apparent that TransCanada has incurred significant net salvage costs in recent years as evidenced in GFI's depreciation study. The Board accepts TransCanada's claim that there is no reason to believe that future retirement costs of pipeline, compression, and metering assets will not at least equal the currently-witnessed cost of on-going retirements as a percent of original cost. Accordingly, to continue to use the 1992 rates as proposed by CAPP and FSG would not be appropriate.

The Board believes that the timely return of capital is a fundamental requirement for any approved depreciation methodology and accepts that TransCanada's estimates of net salvage are in line with those of other companies. Therefore, the Board is of the view that it would be appropriate to adopt TransCanada's proposed estimates of net salvage.

5.5 Estimates of Service Life

Position of TransCanada

GFI used the retirement rate method for the analysis of the retirement activity related to property groups, except for the five groups for which amortization accounting was proposed. Each retirement rate analysis resulted in a life table which, when plotted, formed an original curve. Inasmuch as the survivor pattern did not necessarily describe the life characteristics of the property group, GFI employed Iowa type curves in the interpretation of the original curves in order to use them as valid considerations in service life estimates. In addition, GFI noted that the final survivor curve estimates were based on current policies and outlook as determined during conversations with TransCanada operations and management personnel, as well as, survivor curve estimates from previous studies of TransCanada and other transmission companies. TransCanada contended that GFI's approach to service life estimation is consistent with authoritative texts on the subject of depreciation and with many depreciation experts.

TransCanada acknowledged that some of its depreciation files were incomplete. In this respect, TransCanada noted that the absence of both the addition and retirement of certain assets from the database used for the analysis of service life produces historical indications of life that are greater than they would be if such additions and retirements were included in the database. TransCanada noted that GFI tested the results of its analyses through discussions with TransCanada's management and comparisons with the estimates used by other gas transmission companies. As a result, TransCanada argued that GFI's proposed estimates of service life are reliable.

Position of Parties

In CAPP's view, based on TAI's analysis, TransCanada's depreciation files contain data problems which raise doubt as to the accuracy of TransCanada's estimates of service life. TAI noted that GFI used the retirement rate method to derive its survivor curves. TAI submitted that this method requires aged data from the continuing property records and noted that these records have been found to be discontinuous, since some data on retirements and installations has not been converted by TransCanada into its newer accounting software. TAI disagreed with GFI's suggestion that the inclusion of this information would lead to a shortening of the average service life. In CAPP's view, it is worth the time and effort to have TransCanada go back through the files and correct the accounts before approving revised service life estimates.

CAPP noted that TAI had to rely on mathematical techniques to reach its conclusions as TransCanada did not provide copies of any notes or working papers as requested, even though it was determined through cross-examination that such evidence exists.

CAPP noted that TAI's analysis of compressors shows a life very comparable to the current S_3-40 Iowa curve and not the proposed $R_{1.5}$-25 Iowa curve. TAI recommended the use of an S_3-46 Iowa curve.

Response of TransCanada to Parties' Position

TransCanada submitted that TAI's life analysis deserves no weight. In TransCanada's view, it is based on a method that is not in favour in the mainstream of depreciation practice and was developed solely through the use of statistical fitting without the Application of informed judgement. TransCanada suggested that TAI's methodology produced illogical results, which were particularly apparent in TAI's analysis of service life for account 466.9 Compressor Equipment - Reciprocating/Electrical. TransCanada noted that GFI's estimate for this account was within the range TAI considered reasonable in depreciation work related to a Northern Border Pipeline case while TAI's estimate was outside that range.

Views of the Board

With respect to the possible impact that any missing retirement information could have on TransCanada's service life estimates, the Board accepts as reasonable the view of TransCanada that it is likely that the inclusion of this data would lead to shorter estimates of service life. Nonetheless, the Board is of the view that TransCanada should undertake all reasonable efforts in order to assess the extent to which retirement data has been omitted from its depreciation records and to try to correct these records as soon as possible.

The Board found the service life evidence presented by TransCanada to be persuasive while the approach used by CAPP appeared to depart from what is used by a significant number of depreciation professionals. In addition, the Board notes that CAPP's results are based on a pure mathematical fit while TransCanada's results benefited from qualitative analysis and interaction between the depreciation consultant and experienced TransCanada personnel. As a result, the Board believes that adopting TransCanada's service life estimates would be appropriate.

5.6 Other Matters and Overall Views on Depreciation

Position of TransCanada

GFI recommended that the depreciation rates be reviewed annually to reflect the changes that result from plant and reserve account activity and that complete depreciation studies be performed every three to five years. TransCanada advised that its intention was to undertake a complete review of its depreciation rates and methods within the next three to five years and noted that it would not object to a direction from the Board concerning the timing of a future depreciation study.

Position of Parties

In Ontario's view, the evidence filed by TransCanada is not sufficient to support the depreciation changes requested. Ontario suggested, that even if the Board were to approve TransCanada's request, it would not settle the depreciation issue, even for the short term. The fundamental disagreement between TransCanada and GFI on net salvage on terminal retirements remains unresolved. In Ontario's view, there would be greater cost certainty if all elements of depreciation, including net salvage on terminal retirements, were dealt with at once in one proceeding. In addition, approving TransCanada's claim for depreciation will further reduce the cost competitiveness of the Mainline. For these reasons, Ontario submitted that TransCanada's claim related to depreciation should be denied.

Views of the Board

Other Matters

The Board notes the importance of performing depreciation studies on a timely basis and of ensuring that depreciation rates reflect up-to-date information. The Board notes TransCanada's expert witness recommended that depreciation studies be performed every three to five years and that TransCanada accepted this recommendation. Accordingly, the Board would expect the filing of TransCanada's next comprehensive depreciation study to be within this time frame.

The Board does not agree with Ontario's suggestion that the Board delay a decision on depreciation matters until all elements of depreciation, including net salvage on terminal retirements, could be dealt with in one proceeding. In the Board's view, denying all of TransCanada's depreciation proposals at this time would result in an improper recovery of depreciation expenses in 2003 and future shippers having to pay disproportionately large depreciation charges.

Overall Views on Depreciation

The Board is of the view that it would be appropriate to implement a composite depreciation rate that reflects all aspects of the TransCanada depreciation study, with the exception of the proposed change from ASL to ELG. Further, the Board is of the view that TransCanada should offset any salvage proceeds it may receive from the disposition of assets in accounts subject to amortization accounting against the additions in a particular vintage year and then apply amortization accounting to the net amount. Based on TransCanada's calculations, which are reproduced in Table 5-1, the Board expects that the resulting composite depreciation rate will be approximately 3.42% for 2003. The exact level of the composite depreciation rate will be confirmed once TransCanada files its compliance tolls filing.

Decisions

The Board denies TransCanada's proposed change from ASL to ELG.

The Board directs that TransCanada deduct any salvage proceeds it may receive from the disposition of assets in accounts subject to amortization accounting from the additions in a particular vintage year and then apply amortization accounting to the net amount.

The Board approves all other aspects of TransCanada's depreciation study.

The Board approves a composite depreciation rate reflecting the above three decisions. TransCanada is directed to file as part of its compliance tolls filing detailed calculations of the resulting composite depreciation rate for 2003, along with supporting schedules.

TransCanada is directed to file its next comprehensive depreciation study with the Board no later than as part of its 2008 Tolls Application.

Chapter 6

Incentives

A package of incentives was first implemented in respect of the Mainline in 1996 under the 1996-1999 Incentive Settlement. A number of incentives were also implemented as part of the 2001-2002 S&P Settlement. TransCanada proposed that two of the incentives contained in the 2001-2002 S&P Settlement be continued:

- The Revenue and Asset Management Program (RAMP), but with the removal of the $5 million cap on the commission that TransCanada could earn; and
- The Fuel Gas Incentive Program (FGIP).

Position of TransCanada

TransCanada stated that it believes incentives align the interests of TransCanada and its customers, which results in mutual benefits. According to TransCanada, incentives enhance prudent decision making, thus giving TransCanada's customers more confidence that decisions will be made to reflect the economic interests of shippers. TransCanada suggested that without incentives, TransCanada employee behaviours would be focused mainly on minimizing OM&A costs, primarily to the benefit of TransCanada. However, the two incentives TransCanada proposed retaining would align interests and provide the appropriate balance in decision making related to OM&A costs, revenue and fuel. In this regard, TransCanada noted that incentives may allow it to recover expenses incurred in providing services that may result in a lowering of transmission costs. Specifically, TransCanada provided an example where it had incurred overtime charges in order to perform repairs faster, which resulted in fuel costs savings for shippers.

Revenue and Asset Management Program

The proposed RAMP would have TransCanada earn commissions on a number of services, as follows:

- 2% on total revenue from IT service less its contribution to fixed costs;
- 7% of the total revenue in 2003 from various miscellaneous discretionary services;
- 6% on net new FT service contracts (if positive);
- 9% of the total revenue in 2003 from STFT service; and
- 20% of cost savings generated in 2003 from the management, assignment or disposition of Transportation by Others (TBO) assets, and FST Replacement assets.

TransCanada proposed that the total RAMP commission payable be recorded in an incentive-based deferral account with the amount to be included in the subsequent year's Net Revenue Requirement.

TransCanada suggested that major benefits to customers of continuing the RAMP would be toll reduction resulting from maximization of service availability and revenue generation from services and asset management. According to TransCanada, the RAMP would ensure that its operational capacity management decisions would not be made solely on the basis of cost, but would also consider additional revenue opportunities.

TransCanada proposed that the RAMP be continued at the same level of commissions that had been negotiated in the 2001-2002 S&P Settlement. The commission percentages were based on the level of influence and control TransCanada has over each service. TransCanada stated that the priorities established by the varying percentages are appropriate and reflect the priority shippers might expect relative to TransCanada's sales effort and capacity availability. Further, TransCanada stated that the incentive program previously in place resulted in innovative ways to reduce costs and generate incremental revenues for the benefit of customers.

TransCanada proposed removing the $5 million cap on commission that existed in the 2001-2002 S&P Settlement. TransCanada submitted that removal of the cap would be appropriate, noting that once it had earned up to the cap, the positive effect of the incentive would be lost, resulting in a misalignment of interests.

Fuel Gas Incentive Program

TransCanada proposed re-instating the FGIP that was part of the 2001-2002 S&P Settlement and to use for 2003 the same target equations and incentive schedule negotiated for 2001 and 2002. TransCanada submitted that the purpose of the proposed program was to provide TransCanada with an incentive to minimize total delivered costs while achieving an acceptable balance between cost savings and level of service.

Table 6-1 presents the calculation of the proposed annual incentive amount that TransCanada would be entitled to earn, as it relates to actual fuel volume savings. Scaling of the annual incentive amount would begin at a fuel savings of 100 10^3m^3/d and would be applied linearly between each of the defined increments shown in Table 6-1. The total incentive amount would be calculated at the end of each of the summer and winter gas seasons based on target equations defined for the Prairies and Northern Ontario sections of the Mainline to determine target fuel volumes. These sections were chosen as they consume up to 90% of the Mainline fuel. The equations relate fuel and throughput for these sections of the Mainline.

TransCanada stated that it initially developed equations representing the least fuel consumption that can theoretically be achieved, but cannot be maintained on a sustained basis. The equations were adjusted to conform more closely to actual operating data. TransCanada submitted that the target equations appropriately reflect the amount of fuel that would be consumed absent a fuel gas incentive and are appropriate targets for the 2003 calendar year.

TransCanada indicated that it can choose whether it runs electric compressor units or gas-driven units, and that without including both electric and gas compressors in the target equations, TransCanada would be motivated to maximize the use of the electric units in order to minimize fuel. This would not always result in the lowest delivered cost for shippers. TransCanada explained that the proposed FGIP, which would include both electric and gas compressors, would provide TransCanada with an incentive to minimize total delivered costs while achieving an acceptable balance between cost savings and level of service.

Table 6-1
Fuel Gas Incentive Schedule

Fuel Volume Savings ($10^3m^3/d$)	**Annual Incentive Amount ($ millions)**
0	0
100	1.5
200	3.5
300	6.0
400	9.0
500	12.0
600	15.0

TransCanada reported that under the FGIP, during the 2001-2002 winter season, it saved 249 10^3 m^3/d of fuel, or about a 5% reduction in overall fuel consumption from which shippers benefited. TransCanada pointed out that fuel is a significant cost to shippers on the TransCanada system. For example, in 2003, fuel costs are expected to be approximately $500 million. TransCanada noted that over 12 months, under the FGIP, shippers benefited by approximately $8.7 million, while TransCanada earned a commission of about $5.7 million.

TransCanada outlined a number of ways it is able to reduce fuel usage. These include: improved linepack management; improved outage coordination together with the appropriate balancing of OM&A expenditures; optimum compressor wheel deployment; and detailed efficiency analysis and performance monitoring.

Position of Parties

CAPP urged the Board to deny the proposed incentives, noting that TransCanada is already compensated to perform to high standards so that additional payments are not justified. CAPP explained that from its perspective, it is critical that incentives be negotiated and agreed to by stakeholders. CAPP's view was that incentive programs, such as those proposed by TransCanada, should remain under the umbrella of a negotiated settlement. CAPP argued that incentive proposals should not be brought selectively and unilaterally before the Board for approval, as this could undermine the without prejudice nature of the settlement process and allow TransCanada to garner one-sided benefits from what was previously a complete package. CAPP's position was that if the incentives were approved as proposed, there would be no negotiated or other balance of value and fairness, no symmetry of risk and reward, and no substantial, measurable increased performance above the normal performance that would be expected of TransCanada.

CAPP outlined specific concerns relating to the RAMP. CAPP noted that under the current toll design, FT shippers are responsible for the full fixed costs of the system through demand charges. As such, TransCanada is already fully compensated to make its capacity available and to provide service. In addition, as part of TransCanada's employee compensation, incentives are already provided by tollpayers to TransCanada employees to do their jobs well. Further, according to CAPP, the commission would be an unearned bonus as TransCanada would be rewarded for market swings that bring additional volumes to the system through no effort of its own. CAPP also expressed concerns relating to the interrelationship of several of the services TransCanada had identified, noting that changes in one would create automatic commission on another.

CAPP recommended that TransCanada's request for the FGIP also be denied. CAPP explained that the FGIP was to be for the period of the 2001-2002 S&P Settlement only, and that this settlement included commitments to conduct a full review, discussion and decision regarding the merits of the program after the initial period, but that this had not occurred.

CAPP noted that only TransCanada has the intimate knowledge necessary to develop the fuel targets for the Mainline and for this reason, CAPP did not have any comfort that TransCanada's fuel targets were reasonable. While CAPP agreed that fuel efficiency is important and that monitoring fuel efficiency in a more transparent way could be beneficial, it stated this activity did not warrant an incentive payment. CAPP suggested that TransCanada be directed to implement a fuel efficiency monitoring mechanism in addition to, or as an alternative to, a review of the FGIP mechanism, as contemplated in the 2001-2002 S&P Settlement.

IGUA adopted and supported the submissions of CAPP with respect to incentives. IGUA's view was that incentives are not a cost-based Revenue Requirement, should not play a part in the 2003 Revenue Requirement, and should be negotiated.

Centra Gas Manitoba Inc. (Centra) stated it is not opposed to the use of incentive mechanisms and programs when the use of such programs is reasonable, appropriate, and commensurate with the risks underlying the particular regulatory regime. Centra noted that under the proposed RAMP, TransCanada would continue to be insulated from the risk of under-recovering its costs while it would be guaranteed incremental revenue without innovation or creativity. Centra indicated that the RAMP is inconsistent with the cost-of-service regulatory regime under which TransCanada operates. Centra urged the Board to reject the RAMP or, alternatively, to limit the commissions payable to TransCanada to $5 million annually. Centra stated that it would support the continuation of the FGIP as it is reasonable and mutually beneficial to TransCanada and its customers.

FSG stated that the proposed incentives are inappropriate, as they would result in shippers paying the pipeline a higher than authorized return, with the pipeline assuming no incremental risk. FSG noted that it is not philosophically opposed to structuring tolls in a way that would give the pipeline a financial incentive to maximize its revenues so long as the pipeline accepts some reasonable risk, and the incentives are balanced, such that the pipeline and shippers both have equal chances of winning or losing.

With respect to the proceeds from disposition of excess TBO capacity, FSG also suggested that $22 million could be credited to the Revenue Requirement and that TransCanada should be put at risk for 25% of the variance between that figure and TransCanada's actual proceeds from sales of excess capacity. In view of the affiliate relationship between TransCanada and GLGT, FSG suggested that returning to a cost-of-service approach and relying on a retrospective prudence review to evaluate the reasonableness of TransCanada's dealings with its excess GLGT capacity may be appropriate. FSG explained that under a prudence review approach, TransCanada would not be automatically at risk for that amount. Instead, in the 2004 tolls case, the Board and parties would look at TransCanada's actual results in 2003 and consider whether they reflect a prudent approach to mitigating TBO costs. If found to having been prudent, TransCanada would be kept whole on any variance between the credited amount and its actual proceeds. If not, the deferral account balance would be adjusted to reflect the result that TransCanada should have been able to achieve.

FSG suggested that the FGIP could be adapted to meet its incentive criteria by leaving the FGIP in place and equalizing the distribution of risk associated with the program by crediting the Revenue Requirement with the expected amount of the incentive payment. The credit would be last year's actual incentive payment, plus some additional amount to reflect the fact that the pipeline would likely be able to improve its performance after a year of experience. For example, last year's actual payment was about $5.7 million, which could suggest an appropriate credit of approximately $8 million.

Gaz Métropolitain noted that, in general, incentive programs had been introduced as part of negotiated settlements between TransCanada and its users and that within a negotiation context, parties may be asked to approve some components that would normally be unacceptable to them in exchange for an advantageous compromise on some other issue, making the entire settlement acceptable to all participating parties. Gaz Métropolitain was of the view that what is considered acceptable within a negotiation process is not necessarily acceptable in a tolls hearing, because in a tolls hearing TransCanada would be required to justify the merits of the amount claimed for each cost of service component. Gaz Métropolitain submitted that in a tolls hearing, only programs likely to benefit all parties, including users, and not just TransCanada's shareholders, should be considered by the Board. Gaz Métropolitain also explained that TransCanada should not have the opportunity to receive, through an incentive, additional compensation for a task for which it would already be fully compensated through its approved Cost of Service. For these reasons, and because the proposed programs would not expose TransCanada to any risk, Gaz Métropolitain was opposed to extending the incentive programs proposed by TransCanada.

Regarding the FGIP, Gaz Métropolitain stated that because there is no benchmark for assessing TransCanada's actions, and it is not possible to effectively monitor its performance, the FGIP should be denied even though such a program may in theory benefit users and has generated significant cost savings in the past. However, Gaz Métropolitain noted that it would be willing to negotiate with TransCanada and other parties for a new FGIP that could be applied as of next year.

While it is open to future negotiation regarding incentives, Union recommended that the Board reject TransCanada's proposal on the incentive mechanisms outlined in the 2003 Tolls Application. Union stated that it believes incentives can work to align the interests of TransCanada and Mainline shippers when the incentives are appropriately structured and when they are the result of negotiations. Union expressed the view that the RAMP and FGIP were part of the 2001-2002 S&P Settlement in which shippers accepted the totality of the package without determining that any particular component was acceptable.

With respect to the RAMP, Union's view was that the appropriate commission percentages defined in the program could be entirely different today than when they were included in the 2001-2002 S&P Settlement.

Union noted that the intent of all parties was to undertake a review of the effectiveness of the operation of the FGIP following a trial period. This review was not undertaken and TransCanada nevertheless chose to include the FGIP in the 2003 Tolls Application. Union stated that it believes the FGIP has promise for incentive arrangements; however, to provide comfort with the proposal, a thorough review of how it operated in 2002 should be undertaken.

Ontario submitted that the RAMP and FGIP were specific to the 2001-2002 S&P Settlement that expired at the end of 2002, that there was no settlement in this proceeding and parties did not request that the two incentives be approved or modified to a more generous form, as proposed by TransCanada. For these reasons, Ontario urged the Board to deny the proposed RAMP and FGIP.

Views of the Board

In the Board's view, incentives can be appropriate mechanisms provided that they induce a company to behave in a way that improves the operation of the pipeline for its shippers, or if they provide mutual benefits to the shippers and the pipeline company. Incentives should also be carefully considered so as to avoid the potential of perverse or unintended outcomes. Generally, incentives should be developed such that there is symmetry between risk and reward, or that benefits derived by shippers be commensurate with payment of an incentive commission to the company. Another desired feature of incentives is that they should affect choices over which management has legitimate control. In general, such desired outcomes are unlikely to be achieved outside a negotiated settlement between the pipeline and its stakeholders, as the iterative process of negotiation is best suited to highlight possible concerns or perverse outcomes, which in turn ensures they have been appropriately considered in the development of incentives. Nonetheless, when parties cannot agree, and it is demonstrated to the Board that a particular incentive achieves the criteria outlined above, the Board may decide that the incentive should be approved.

In the case of the RAMP, the Board is not persuaded that the program meets the criteria set out above. In the Board's view, the RAMP commission percentages and services have not been adequately explained. Further, the commission would not necessarily result from actions taken by TransCanada to improve the operation of the pipeline. For example, under the RAMP, TransCanada's commission would increase significantly if a shipper decided to ship its gas under STFT service rather than IT service, although total throughput would not change. Similarly, ongoing weather conditions could result in major throughput fluctuation that would affect the level of the commission but would not be related to the actions of TransCanada. Finally, the RAMP guarantees incentive revenues to TransCanada without imposing any symmetrical risk. For these reasons, the Board does not view as appropriate the implementation of the RAMP at this time. However, the Board encourages parties to continue negotiations to arrive at an incentive package that meets the criteria outlined above.

Unlike the RAMP, the Board is satisfied that the proposed FGIP provides an appropriate balance between benefits to shippers and TransCanada. A fuel program is particularly important for the Mainline, due to that fact that the Mainline fuel ratio is generally higher than that of other pipelines and that fuel costs are expected to account for approximately $500 million in 2003. While the program may permit TransCanada to earn incremental revenues through a commission, the Board is of the view that TransCanada will only earn a commission where there are direct fuel savings for shippers. Further, the Board is of the view that the benefits of the program, in terms of fuel savings, outweigh its cost in terms of commission payable to TransCanada. For similar reasons, the Board does not believe the amendments proposed by FSG are necessary.

The Board is of the view that it would be appropriate to implement the FGIP. However, the Board is concerned that the review expected to take place at the completion of the 2001-2002 S&P Settlement has not taken place. The Board expects that such a review will take place by a date agreed upon by the Tolls Task Force (TTF), but no later than 31 December 2003, and that the result of the review be reported to the TTF, Mainline shippers, and to the Board so that future consideration of the FGIP can be undertaken with a better information base.

Decisions

The Board denies the proposed RAMP.

The Board approves the proposed FGIP for the 2003 Test Year.

The Board directs that a review of the FGIP, which was part of the 2001-2002 S&P Settlement, take place no later than 31 December 2003, and that the result of the review be reported to the TTF, Mainline shippers, and to the Board.

Chapter 7

Great Lakes Transportation by Others Capacity

TransCanada's integrated system (see Figure 1-1) consists of facilities owned by TransCanada and contractual entitlements to transport natural gas on pipeline systems owned by others (referred to as Transportation by Others or TBO). One of the contractual entitlements is TransCanada's right to transport natural gas on the Great Lakes Gas Transmission System (GLGT)[1] from Emerson, Manitoba to St. Clair, Michigan. From St. Clair, the natural gas is transported across the international border into Southwestern Ontario for further transportation on the Union Gas system and the Mainline to Eastern domestic and export markets.

TransCanada's principal entitlement on GLGT is derived from a contract for firm transportation of approximately 1305 million cubic feet per day (MMcf/d - 1370 TJ/d), which expires on 31 October 2005. TransCanada was required to give GLGT, on or before 30 April 2003, notice of its intentions with respect to the renewal or expiry of the GLGT contract.

In the past, when TransCanada had an operational requirement to increase its entitlement on GLGT, it applied to the Board for permission to contract with GLGT for the proposed increased capacity. In its RH-4-93 Decision, the Board stated that, from that point forward, it would not be necessary for TransCanada to obtain prior approval of the Board to contract on other pipelines. Instead, the Board would review the prudence of such matters retrospectively when TransCanada applied to recover in tolls the costs associated with such contracts.

When TransCanada filed its Application, it only sought recovery of GLGT TBO costs that will be incurred in 2003, the year for which TransCanada sought orders establishing tolls. TransCanada did not seek an order from the Board with respect to the impending renewal. As the RH-1-2002 hearing progressed, several parties suggested that it would be in the best interest of Mainline shippers for TransCanada to reduce TBO costs to the greatest extent possible. Specifically, CAPP stated that TransCanada should be turning back GLGT TBO capacity when the opportunity arises because, in its view, TransCanada has an obligation to minimize costs. IGUA, the Cogenerators Alliance (CA), and the Eastern Utilities submitted that reducing excess TBO capacity would lead to lower TransCanada tolls. IGUA and the CA also contended that if the Board were to approve TransCanada's Southwest Zone proposal (see Chapter 8) as part of this proceeding, it would in effect authorize and oblige TransCanada to continue to contract for excess capacity on GLGT.

1 TransCanada holds a 50% interest in GLGT

Position of TransCanada

In response to the intervenors' evidence, TransCanada filed reply evidence wherein it discussed the costs and benefits of renewal of the GLGT contract and announced its intention to renew the full 1305 MMcf/d of capacity. It stated that the best course of action would be to renew the full volume of GLGT TBO capacity on 30 April 2003 and continue to make short-term assignments of discrete portions of its GLGT and Union TBO capacity from time to time whenever that capacity is not otherwise needed for transportation of gas or efficient system operation.

From its analysis, TransCanada concluded that renewal of its TBO capacity on GLGT would be in the best interests of its shippers for the following reasons:

- Renewal of the full volume of GLGT TBO capacity would result in the lowest tolls to the Eastern Zone;
- TBO capacity on GLGT and Union provides operational flexibility for the TransCanada system which in turn contributes to the reliability of its transportation service; and
- By keeping Mainline tolls lower, renewal of the GLGT TBO will better position the system to attract Mackenzie Delta and Alaskan gas.

The key assumption in TransCanada's analysis is that, if it did not renew the full amount of its GLGT contracted capacity, the capacity that was not renewed would be picked up and contracted by shippers who would choose to ship on GLGT rather than through TransCanada's Northern Ontario Line. TransCanada concluded that 100% migration to GLGT would be likely given that GLGT is a part of the lowest-cost route to Dawn. TransCanada estimated that the total flow between the WCSB and Eastern markets would remain substantially unchanged. The only change would be the contracting behaviour on the Mainline. The result would be that TransCanada would transport less gas to the Eastern markets and instead deliver the gas only to Emerson.

Specifically, TransCanada stated that, upon expiry of their long-haul contracts, shippers to the Central Delivery Area, Niagara Falls and Chippawa would have an economic incentive to segment their transportation contracts by contracting for any available GLGT capacity. Other Eastern Delivery Area shippers would likely let their TransCanada long-haul contracts expire and instead would have an economic incentive to purchase their gas supply at Dawn, rather than further upstream.

According to TransCanada's analysis, renewing the full GLGT entitlement of 1305 MMcf/d (1370 TJ/d) would result in the lowest toll for all shippers. If TransCanada renewed 760 MMcf/d (798 TJ/d) of GLGT capacity (approximate minimum to serve firm contracts that can only be served by the GLGT route), the Eastern Zone toll in 2006 would be approximately \$0.04/GJ higher than if it renewed its full GLGT entitlement. The Eastern Zone toll in 2006 would be approximately \$0.07/GJ higher if TransCanada only renewed 60 MMcf/d (63 TJ/d) of GLGT capacity (minimum amount required to serve Sault Ste. Marie contracts). Therefore, TransCanada stated that it intends to renew the full amount.

TransCanada stated that the GLGT TBO capacity could be regarded as really a 'pipe within a pipe' which, since 1967, has been a key part of the integrated TransCanada system. According to TransCanada, this segment of the integrated system provides the most cost effective flow path for transporting Western Canadian gas from the terminus of the Prairies Line to markets in Southwest Ontario and the US Northeast through the Niagara and Chippawa export points. TransCanada asserted that for it to give up this TBO capacity would be effectively the same as retiring some of the most valuable and efficient assets on its system and then selling those assets to its competitors. The competitors could then bypass the Mainline by offering lower-cost service to Mainline customers.

During the proceeding, CAPP, IGUA, EGD, FSG and Union brought a motion to the Board asking for an order:

(a) Formally adding the issue of ‘The prudence and cost consequences for TransCanada’s tollpayers of renewal by TransCanada of its Great Lakes contracts’ to the List of Issues to be considered by the Board in the current proceeding; and

(b) Directing TransCanada to take no step that commits it irrevocably to renewal of any portion of the GLGT contract until the Board issues its decision on the GLGT issue, or until 120 days from 30 April 2003, whichever is earlier.

TransCanada responded that, given the inclusive nature of the Board’s List of Issues and the development of the evidentiary record to date, it would be unnecessary to formally add the GLGT issue to the List of Issues, although TransCanada would not contest such addition. Further, TransCanada undertook that it would take no step that commits it irrevocably to the renewal of any portion of the GLGT contract as requested in the motion. As a result of TransCanada’s undertaking, submissions on the second aspect of the motion were rendered moot. TransCanada noted that this course of action would eliminate one option that is presently available to TransCanada, being the automatic rollover of the GLGT contract for one year in the event that no notice is provided to GLGT by 30 April 2003.

In its argument, TransCanada responded to some of the broad themes raised by intervenors during the hearing. TransCanada stated that characterizations like ‘anti-competitive hoarding of capacity’ amounted to rhetoric and did not shed light on the real issue, which is: Is the decision to renew and the terms upon which that renewal takes place in the best interests of TransCanada’s tollpayers? On this point, TransCanada stated that avoiding the $0.07/GJ toll increase, which it forecast to occur if it did not renew the GLGT capacity, is what had driven it to make the decision to renew.

Concerning the alleged conflict of interest as both shipper on and part owner of GLGT, TransCanada submitted that intervenors, TransCanada and the Board have lived with these facts for decades. The perception of conflict is the reason why TransCanada was prepared to demonstrate, to the best of its ability, that the decision made on the renewal of GLGT capacity is a prudent one.

TransCanada submitted that it has the expertise and ability to assess its own operations, its markets, and do the necessary toll sensitivities to complete the analysis, which it placed before the Board and intervenors. Concerning arguments that its analysis is deficient, TransCanada stood by the assumptions underlying its analysis and stated that it did not take into account possible outcomes which TransCanada concluded were not reasonable. Additional sensitivities were performed during the hearing even though TransCanada considered that they involve highly improbable outcomes.

Lastly, in response to allegations that TransCanada's rationale for retaining GLGT capacity is based on speculation, the hoarding of capacity and is anti-competitive, TransCanada pointed out that it earns no revenue from the renewal of GLGT capacity and that it passes the benefits of that low-cost capacity to its shippers. It stated that there is nothing anti-competitive about attempting to retain cost-effective transportation to the benefit of its customers, rather than making that capacity available to competitors so that they can compete more effectively with TransCanada, thus causing Mainline throughput to decrease and tolls to increase.

TransCanada asked the Board to consider the prudence of and cost implications to shippers of its decision to renew the full GLGT capacity and find that pursuing that option is in the best interests of the shippers.

Position of Parties

CAPP stated that its perspective on this issue is consistent with its themes of letting the market work and focussing on cost competitiveness. CAPP argued that TransCanada should not hold leased GLGT capacity that the Mainline does not need, charge the costs of such unneeded capacity to tollpayers, or hold leased capacity that it does not need in order to preclude its open availability in the transportation market.

CAPP asserted that continuing to hold GLGT capacity which is not needed and results in higher average cost of transportation is not the right long-term decision. To do so masks the higher costs of the Northern Ontario Line and results in a less efficient use of the lower-cost GLGT path to market by pushing the cost up to the higher Mainline average cost.

As for the amount of GLGT capacity that does not need to be renewed, CAPP noted that TransCanada had said that it needs 703 MMcf/d (738 TJ/d) of the 1305 MMcf/d (1370 TJ/d) to meet its firm requirements in Southwestern Ontario and the Niagara and Chippawa export points. Therefore, CAPP submitted, about 600 MMcf/d (630 TJ/d) ought not to be renewed.

IGUA submitted that the Board should not authorize TransCanada to acquire and hold excess GLGT capacity under any circumstances. Alternatively, if the issuance of such an extraordinary order is to be considered, it ought not to be granted, except in the clearest of cases and upon a convincing demonstration of material and irreparable harm to the public interest.

IGUA urged the Board to find that the maximum GLGT capacity required by TransCanada to meet its GLGT dependent obligations after 31 October 2005 is 703 MMcf/d (738 TJ/d). It estimated that a renewal of about 703 MMcf/d (738 TJ/d) of GLGT capacity would lead to TBO savings of about $111 million per year. IGUA argued that the Board ought to find that the cost consequences of a renewal of capacity in excess of that amount will not be recoverable from Mainline shippers.

IGUA criticized TransCanada's analysis and urged the Board to ascribe little weight to the results of the study. It submitted that the analysis was one-sided and incomplete and provided insufficient evidence to support a finding that there would be 100% migration to available GLGT capacity.

EGD argued that TransCanada had failed to demonstrate a need for the renewal of its entire capacity rights with GLGT. In EGD's opinion, TransCanada had also failed to provide a complete analysis of the cost consequences of a partial renewal of its GLGT capacity.

In FSG's view, it would not be prudent for TransCanada to renew more GLGT capacity than it can demonstrate it needs to meet its existing contractual commitments. FSG stated that if TransCanada holds more capacity than it needs, it is effectively speculating on the value of GLGT capacity with shipper's money for the benefit of its affiliate.

For a variety of reasons, FSG disputed TransCanada's analysis that Mainline shippers would be better off financially if TransCanada renewed the full amount of GLGT capacity. However, FSG stated that, even if the toll increases that TransCanada predicts actually occur if it renews less than the full amount, the result would not necessarily be inappropriate. FSG expressed the belief that the market is more likely than TransCanada to sort everything out in an efficient way and if an efficient market outcome means that FSG members end up either worse off or better off, that is still an appropriate outcome.

Gaz Métropolitain stated that the evidence filed by TransCanada was insufficient for it to take a definitive position on this issue. It had hoped for more detailed and exhaustive evidence, including several renewal scenarios and an illustration of the impacts on its operations of the relinquishment or renewal of various levels of GLGT capacity.

Gaz Métropolitain submitted that, when evaluating this issue, it must take into account the fact that its system is located at the end of the Mainline's integrated system, and that, for all practical purposes, it is a captive customer of the Mainline. Gaz Métropolitain stated that it must therefore pay particular attention to any change that could increase or decrease TransCanada's efficiency and tolls.

Union objected to and considered anti-competitive the rationale that TransCanada advanced for the renewal of GLGT capacity in excess of firm requirements. Union submitted that it would object to TransCanada's recovery of the costs of this excess capacity in tolls, even if TransCanada had presented a sound analysis that established the likely avoidance of toll increases.

Union asserted that it is not reasonable for a regulated pipeline, operating in the current environment established by the Board, to recover from tollpayers the costs of removing a competitive option from those tollpayers. Further, Union stated that the Board has heard producers, marketers and end-users testify and argue that the governing principle is having TransCanada at the right size, even if it means a toll increase.

Union submitted that there is no place in the Board's regulation of TransCanada for an order permitting TransCanada to recover from tollpayers the costs of purposefully acquired excess capacity, especially when the purpose of that acquisition is to defeat the competitive option that would otherwise exist. Union cautioned that when the Board is considering the public interest in this matter, it should reject any rationale for renewal of GLGT capacity that is premised on preventing shippers from having access to a competitive option.

In Union's opinion, TransCanada had not presented a sound analysis of potential toll impacts. Union stated that TransCanada has presented a hastily assembled and one-dimensional analysis that establishes that under a number of scenarios, TransCanada is better off to retain throughput and pay the costs of an equivalent volume of GLGT TBO capacity than to lose that throughput and avoid incurring the charges.

It was Union's position that TransCanada should not be able to recover in tolls the costs of any more than approximately 700 MMcf/d (735 TJ/d) of GLGT firm capacity at market rates. Also, given the uncertainty of TransCanada's future long-haul throughput, Union stated that TransCanada needs maximum flexibility to further decrease its GLGT commitments in the future.

Noting that TransCanada had only provided the Board with an analysis for 2006, Union also requested that the Board caution TransCanada to preserve flexibility in any renewal arrangements that it makes and that the Board reserve the right to review the prudence of any commitment beyond 2006. Union suggested that any authorization to renew GLGT capacity should be subject to review and variance in the event of a future change in circumstances warranting different provisions.

Ontario submitted that the negotiations between the Mainline and GLGT raise the issue of a perceived conflict of interest and, potentially, an actual conflict of interest. Given that both parties are answerable to the same parent company, Ontario stated that it is reasonable to believe that both parties will attempt to arrive at a deal which will be in the best interests of their parent, not Mainline shippers.

Ontario also submitted that the conclusions that TransCanada drew from its GLGT TBO analysis are flawed, self-serving and should be discounted by the Board. It argued that the renewal quantity on GLGT should not exceed the 703 MMcf/d (738 TJ/d) required to serve its firm transportation requirements. Further, Ontario submitted that there is no public interest in permitting TransCanada to retain TBO capacity beyond Mainline requirements in order to prevent its use by others. That, Ontario submitted, would be an unnecessary interference in the market.

Quebec stated that it wants the Mainline integrated system as a whole to be competitive. As a result, Quebec did not oppose the renewal of a portion of the contracts on GLGT, provided that the level of recontracted volumes fosters use of the Northern Ontario route while minimizing transportation tolls across TransCanada's integrated system.

Androscoggin Energy, L.L.C. and Rumford Power Associates, L.P. opposed TransCanada's position because, in their view, TransCanada does not need all the capacity to meet its service obligations and the cost of GLGT capacity is borne by its shippers, without shippers receiving commensurate benefits.

Response of TransCanada to Parties' Position

TransCanada submitted that the quantity of GLGT capacity needed is not related only to FT commitments. It pointed out that, during January and February of 2003, all of TransCanada's GLGT and Northern Ontario Line capacity was needed to move the volumes nominated. It noted that since the RH-1-99 Decision, there has been a dramatic migration from FT to IT service and, in January and February 2003, about 30% of the system flows were as IT service.

TransCanada also referred to the Board's RH-2-98 and RH-2-2001 Decisions, wherein the Board found that an important factor in its consideration of competitive scenarios was the impact of allowing that competition on existing shippers on the pipeline. TransCanada argued that that impact should not be ignored, as suggested by Union.

Views of the Board

In its RH-4-93 Decision, the Board discussed the matter of approval of changes to TransCanada's long-term TBO related contractual obligations. In that Decision the Board stated:

> *"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." [emphasis added]*

The GLGT contract renewal will take effect on 1 November 2005. It is around that time that the prudence of the GLGT renewal can be assessed, because the actual terms and conditions of renewal, including the final volume, price and term will only be known at that time. Accordingly, the Board and interested parties will have an opportunity to review changes in GLGT costs pursuant to the renewal when tolls for the 2005 Test Year are considered. However, given the level of parties' interest in this issue and the significance of the financial decision facing TransCanada, the Board finds it worthwhile to provide some guidance to TransCanada and parties on the GLGT contract renewal issue.

On this issue, the Board considers that a sensible approach is to ask, "What would a reasonable person, acting in good faith, do in similar circumstances?" At the outset, the Board notes that TransCanada's stated objective in seeking to renew the full amount of GLGT capacity is to avoid toll increases on its system. TransCanada has a duty to protect the long-term viability of its system and its shippers, especially those who are captive to its system. The Board agrees that in considering renewal of the GLGT capacity, TransCanada should consider the impact of its decision on tolls.

Many parties suggested that TransCanada should only renew approximately 703 MMcf/d (738 TJ/d), or even some lesser amount of capacity, which would be required to serve TransCanada's FT commitments at this time. As the market evolves from relying primarily on one service, namely FT, to relying on a broader suite of services, including IT and STFT, it would be reasonable to consider the need for capacity for services in addition to FT. The Board agrees with TransCanada that the entire suite of services offered should be taken into account when determining the amount of GLGT capacity to renew.

Other secondary considerations that TransCanada may take into account on this issue include the fact that GLGT capacity may provide flexibility and security of supply to the system and that GLGT capacity not required from time to time may be assigned to others, with the miscellaneous revenue reducing tolls.

The Board will be required to consider broader public interest issues when deciding on the recovery of future GLGT charges. Such issues might include the expected use of the GLGT capacity, should some capacity currently held by TransCanada be relinquished, as well as the potential and the appropriateness of any relinquished capacity being concentrated in the hands of a few shippers, rather than being available to provide service to all Mainline shippers.

An eventual prudence review may also need to assess the extent to which TransCanada has obtained the best terms and conditions for its tollpayers, for any capacity it elects to renew.

Finally, the Board stresses that the above comments are to be considered as guidance and not a ruling on the prudence of renewing GLGT capacity or any specific terms of such renewal. The Board expects TransCanada to carefully consider all its options and their consequences when making its renewal decision, as well as the fact that the cost consequences of that decision may be subject to a future review.

Chapter 8

Southwest Zone

TransCanada proposed the establishment of a new toll zone in Southwestern Ontario, called the Southwest Zone (SWZ), which would include all points in the existing Southwestern Delivery Area (SWDA), i.e., any point on TransCanada's St. Clair to Dawn pipeline. Hence, the proposed zone would include the delivery points and storage sites at the Dawn market hub and SWDA (see Figure 8-1). Upon obtaining Board approval, TransCanada would, through an open season, offer to shippers available long-haul capacity from Western Canada to the SWZ and short-haul capacity from the SWZ to downstream points. FT service to the SWZ would commence 1 November 2003, with IT and STFT services available 30 days following the first day of the month after NEB approval.

No intervenors supported the SWZ proposal.

Discussion of the proposal focused on four major themes: development of the Dawn hub; competitiveness of the Mainline; zoning principles; and the future business model of the Mainline.

8.1 Development of the Dawn Hub

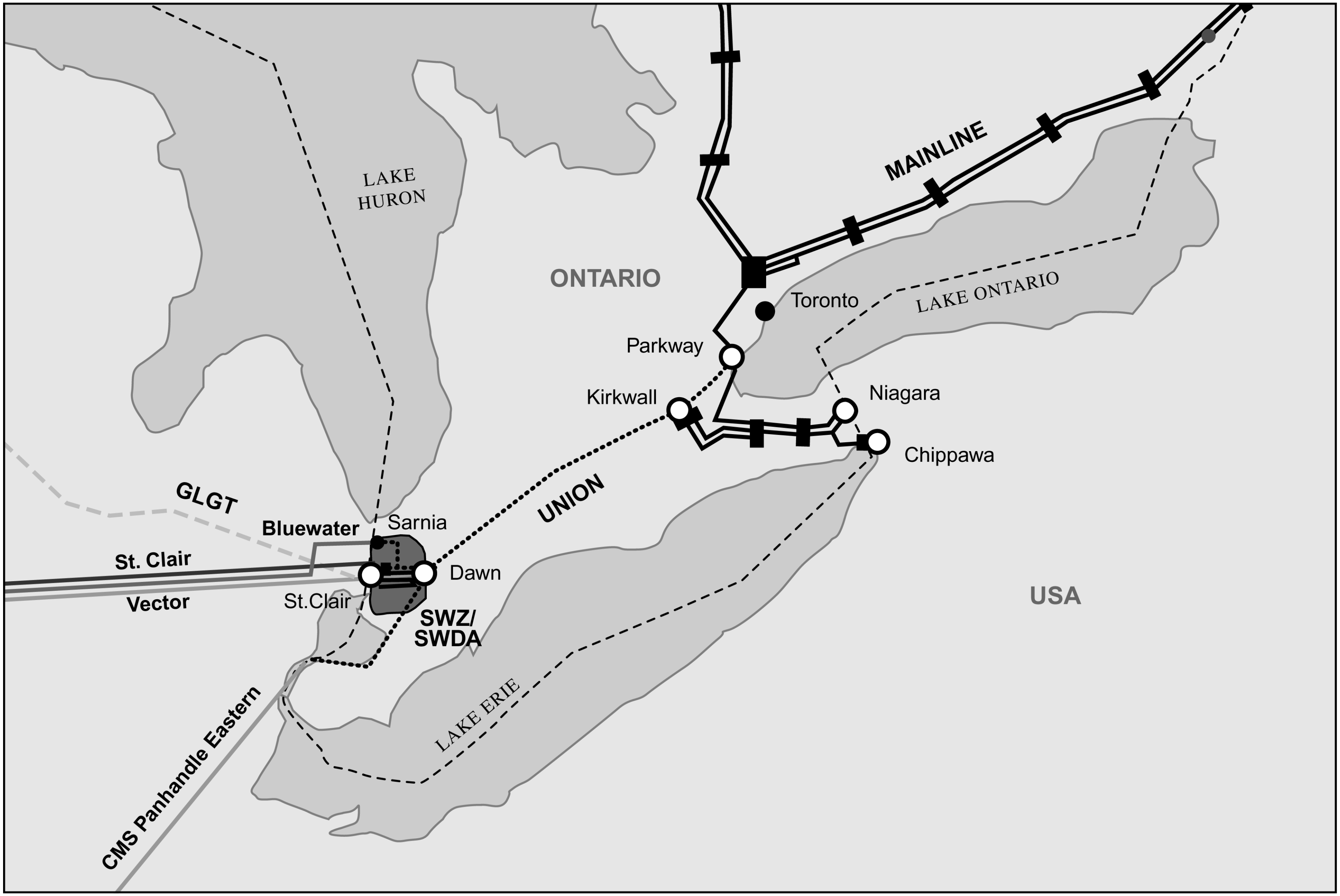
Position of TransCanada

TransCanada submitted that the natural gas market has changed dramatically since the mid-1990s and that market centres, such as the AECO and Dawn hubs, have emerged as key trading points. TransCanada submitted that it must be able to compete effectively with several other pipelines that also serve these hubs and that the need to have competitive tolls and market-responsive services becomes more important as the Mainline's contract profile changes.

TransCanada indicated that a key reason for proposing the SWZ is to respond to customer interest in further developing a large, accessible, liquid gas market in Eastern Canada and to reduce the Mainline's tolls to the Dawn hub in order to enhance the competitiveness of the Mainline as a source of supply to the hub.

TransCanada expressed the view that the SWZ proposal would promote a more liquid market hub at Dawn and would therefore benefit customers. The Dawn hub is located in Southwestern Ontario, where it is served by several pipelines, including the Mainline, Vector Pipeline, St. Clair Pipeline, CMS Panhandle Eastern Pipeline and Bluewater Pipeline. The Dawn hub also has access to the large Dawn/Tecumseh storage facilities. TransCanada indicated that between 1998 and 2001, the volume of gas traded at Dawn had increased more than 300% from 2.8 Bcf/d (2.9 PJ/d) to almost 12 Bcf/d (13 PJ/d).

Figure 8-1
Southwest Zone/Southwest Delivery Area



TransCanada submitted that customers served by the Mainline in both Canada and the US are seeking to purchase increasing quantities of gas at more local market centres, such as Dawn. By creating the SWZ, TransCanada could offer a lower-cost, more competitive, service direct from Alberta to Dawn as well as short-haul service from Dawn to customer delivery areas or delivery points.

TransCanada expressed the view that creating the SWZ would increase the liquidity and depth of the Dawn hub as well as provide greater access to that hub, which would create further benefits for customers. TransCanada defined market depth as a measure or indicator of the number of different parties that are buying and selling in a market, and indicated that market access represents the ability of all parties to transport gas to and from a market centre on non-discriminatory terms. Increased liquidity and depth would in turn reduce the risk of unabsorbed demand charges.

TransCanada submitted that by facilitating both deliveries to and from Dawn through the creation of the SWZ, it is anticipated that the physical volume available to be traded at Dawn will increase, which would increase the liquidity at the hub.

TransCanada submitted that there are benefits to both buyers and sellers associated with large liquid market hubs, such as: greater competition and reduced risk of any single party exercising market power; improved price discovery; reduced transaction costs and risks; increased supply and reliability; and greater flexibility and a wider range of options.

TransCanada suggested that customers' interest in a regional market centre and in short-haul transportation capacity was demonstrated by various factors: the increased liquidity at the Dawn hub; the substantial increase of over 500,000 GJ/d in short-haul capacity that Mainline customers acquired from Dawn in the last two years; the extent that customers have turned back long-haul capacity on the Mainline, often in order to purchase gas on a delivered basis from marketers; a survey result suggesting that customers plan to purchase their gas on a delivered basis or at Dawn; and meetings with end-users and their agents indicating that they were interested in accessing Dawn using short-haul capacity rather than sourcing their gas supplies in Alberta using long-haul capacity.

TransCanada submitted that its SWZ proposal was not promoting short-haul service over long-haul service. TransCanada considered that it is responding to customer interest in accessing a more local market through short-haul capacity, such as Dawn instead of AECO, while facilitating the ability of customers to deliver to the Dawn hub from Western Canada through lower-priced long-haul services on the Mainline.

TransCanada noted that capacity to the SWZ would increase market access by providing shippers access to the Dawn hub at a more competitive toll compared with the more distant Eastern Zone load centre. Depending on the level of uptake of service to the SWZ, the toll to the SWZ would be between $0.16/GJ and $0.19/GJ cheaper than the toll to the Eastern Zone. TransCanada noted that it could offer approximately 630 TJ/d of FT capacity from Empress to the Dawn hub. TransCanada submitted that continuing to include the SWDA in the Eastern Zone prevents the Mainline from competing effectively at Dawn and noted that the Mainline was the only pipeline that must include downstream costs in shipping to the Dawn hub.

TransCanada indicated that it is becoming increasingly important for pipelines to offer services that support market trading activity that occurs at market hubs. By creating the SWZ, TransCanada was of the view that it could offer flexible, more competitive services from Alberta to the Dawn hub than with the existing Eastern Zone.

Position of Parties

EGD, Gaz Métropolitain and Union (collectively the "Eastern Utilities") submitted that the proposed SWZ would not materially increase deliveries to Dawn, but even if it did, it would not improve the operation of Dawn as a market hub because sufficient liquidity already exists. The Eastern Utilities did not consider appropriate TransCanada's attempt to augment the operation of the Dawn market through a zoning change.

The Eastern Utilities submitted that Dawn had developed into an important trading location and that Dawn was a liquid point with a higher degree of liquidity than most other trading points used in Ontario, Quebec and the US Northeast; that the liquidity at Dawn was sufficient to meet the requirement of an efficient market; and that the physical characteristics of the Dawn Hub would not be changed by implementation of the SWZ.

Gaz Métropolitain expressed the view that the Dawn storage facilities were the operational lungs of the Eastern Zone and that any proposal that changed this or diminished its benefits would necessarily have a major negative impact on Mainline users, particularly those in the Eastern Zone.

FSG expressed the view that there was no basis to believe that the SWZ would have any meaningful impact on deliveries to Dawn or on the viability of Dawn as a hub.

Response of TransCanada to Parties' Position

TransCanada rejected the suggestion of the Eastern Utilities that the Dawn hub was big enough and liquid enough and indicated that there was no such thing as too much liquidity. Further, TransCanada noted that the Eastern Utilities expert witness agreed that there was no harm associated with increased liquidity. TransCanada also noted that EGD had recently expressed reservations with liquidity at Dawn, as had an industrial customer appearing for IGUA in this proceeding.

8.2 Competitiveness of the Mainline

Position of TransCanada

TransCanada identified three sources of risks from not creating the SWZ.

First, there was the risk that beginning in 2003, domestic customers that choose not to renew all their long-haul contracts could elect to rely on short-haul contracts from Dawn and buy gas supplied to the hub by other pipelines.

Second, there was the risk that the Eastern Canadian market centre will not continue to grow sufficiently over the next three years to make the market attractive to US Northeast buyers when their contracts to purchase Canadian gas begin to expire in 2006. TransCanada noted that should these buyers replace even part of their Alberta gas supplies from less distant sources, Mainline throughput could decline. On 31 October 2006, approximately 1220 TJ/d of contracted capacity to the US Northeast at Niagara and Iroquois will come up for renewal.

Third, there was the risk that if TransCanada loses throughput, Mainline tolls will increase, reducing producer netbacks and making it more difficult to compete with bypass pipelines out of the WCSB and to attract Northern gas to the Mainline.

TransCanada submitted that the SWZ would help the Mainline to either attract more or lose less throughput than would otherwise occur. TransCanada held the view that, in the short term, the Mainline's throughput would be principally determined by the volume of residual WCSB supply after the needs of the Western Canadian market are met. However, in the medium to longer term, TransCanada noted that infrastructure could be added, causing further throughput losses to the Mainline. It held the view that the SWZ proposal would effectively allow the Mainline to compete with capacity additions by competitors.

TransCanada noted that creating the SWZ would have no immediate impact on tolls to the Eastern Zone, as there were no contracts for delivery to the SWDA. The future impact of the SWZ on the Eastern Zone toll would depend on the take up of service to and from the Dawn hub. If all the capacity to Dawn were contracted, along with short-haul capacity to the Central Delivery Area (CDA), but there was no incremental throughput, there could be an increase to the Eastern Zone toll of approximately $0.02/GJ. This toll increase could be fully offset if the SWZ resulted in incremental throughput of greater than 83 TJ/d from Empress to the SWZ. This would benefit all shippers on the system.

Position of Parties

CAPP expressed doubt over the true impact of the SWZ on the Eastern Zone toll, pointing out assumptions made by TransCanada in allocating GLGT and Union distance credits to the Eastern Zone. CAPP noted that TransCanada did not expect to attract incremental load to the SWZ in the short term and that TransCanada's competitiveness concern was longer term.

CAPP, IGUA, the Eastern Utilities, FSG, and the CA suggested that the creation of the SWZ was premised on TransCanada's retention (locking-in) of capacity on GLGT. Several parties submitted that the retention of GLGT capacity had not been subjected to sufficient cost benefit analysis nor a prudence review of the future usefulness of TransCanada's physical and contractual assets by TransCanada and its stakeholders. IGUA added that the Board need not consider issues raised with the SWZ proposal should the Board agree that it would be imprudent for TransCanada to renew more than 703 MMcf/d (738 TJ/d) of GLGT capacity. EGD submitted that the SWZ proposal was based on speculation of possible expansion by other pipelines and that such speculation should not be used to justify renewal of GLGT capacity.

IGUA expressed the view that the SWZ offered little scope to improve the Mainline's competitive position and suggested that only a sharp reduction in tolls would achieve that objective.

IGUA submitted that TransCanada did not need the Board's approval of its SWZ proposal in order to offer transportation service to Dawn which is cheaper than the Eastern Zone toll. IGUA submitted that TransCanada could simply offer its excess GLGT capacity on the secondary market for terms greater than a few months.

The Eastern Utilities expressed the view that TransCanada had not justified the need for the proposed SWZ and that it would result in a negative toll impact for them and their customers, with no apparent offsetting benefit for them or for the Mainline.

The Eastern Utilities indicated that they would not contract for service to the SWZ and expressed doubt that an appreciable number of shippers in their franchise areas would do so. They noted that there currently exist more economical alternatives on other pipelines than the proposed SWZ on TransCanada for any shippers wishing service to Dawn. Specifically, they pointed out that the segmented option of utilizing the Mainline from Empress to Emerson, the GLGT system from Emerson to St. Clair and the Mainline from St. Clair to Dawn resulted in cost savings relative to the proposed SWZ toll. They also noted that the other pipelines serving the Dawn hub have excess capacity and have the ability to negotiate discounted tolls at a level below the proposed SWZ toll. Further, they submitted that cheaper capacity is available on the secondary market.

The Eastern Utilities expressed concern that the proposed SWZ would result in a reduction of GLGT distance credits available to Eastern Zone shippers and would also increase the cost of compressor fuel, as more Eastern Zone gas would have to be transported via the longer Northern Ontario route. They also noted that if the SWZ were created, the cost of segmented service to the SWZ and then from the SWZ would be significantly higher than the existing Eastern Zone toll.

The Eastern Utilities submitted that the implementation of a lower toll for the SWZ than the Eastern Zone would increase the Eastern Utilities commodity cost of gas at AECO by up to $0.19/GJ, because producer netbacks to the SWZ would be more attractive than to the Eastern Zone.

EGD expressed concern that with any contracting to the SWZ, TransCanada could elect to deliver gas under Storage and Transportation Service (STS) to Parkway instead of Dawn. This would require STS shippers to use their westerly FT service entitlement with Union to ship their STS gas to Dawn, and would result in incremental costs for these users.

Gaz Métropolitain considered that the SWZ implied real and tangible disadvantages with no immediate and obvious advantages to Mainline users. Gaz Métropolitain submitted that the Board should question the appropriateness of approving permanent, structural change, such as the SWZ, to resolve a conjectural problem, such as TransCanada's goal of preventing its competitors from adding new facilities. Gaz Métropolitain submitted that its recent purchase of additional short-haul capacity between Dawn and its franchise area should not be viewed as an expression of interest in the proposed SWZ. Vermont Gas System Inc. and Marketing d'Énergie HQ Inc. supported the position of Gaz Métropolitain.

Union submitted that the SWZ proposal was anti-competitive as it was being put in place to prevent the emergence of a competitive option to TransCanada transportation to Eastern Canada. Union also suggested that the SWZ proposal amounted, in essence, to predatory pricing as it represented a cost shift from a competitive market to a captive market.

FSG submitted that making the Mainline more competitive at Dawn did not by itself suggest anything about the reasonableness of the toll. FSG argued that TransCanada has no need to compete at Dawn because the market is not at Dawn but in Eastern Canada and the US Northeast. FSG suggested that the reason customers have sought to buy gas at Dawn is that it is cheaper than buying gas in Alberta and shipping it on the Mainline. FSG argued that the problem is the overall cost of the Mainline system from Empress to market areas and that this cost would go up if the SWZ is approved.

The CA submitted that the Board's primary consideration in evaluating the SWZ proposal should be whether the proposal would enable TransCanada to attract new or retain existing FT shippers. The CA held the view that the SWZ proposal should be rejected and that, at best, it would have a marginal impact on the Mainline's ability to attract and retain load.

In its opposition to the SWZ proposal, Ontario cited the lack of customer support for the proposal, the possible negative impact on the Eastern Zone toll, its view that the SWZ would not have a significant impact on the competitive risk facing the Mainline, and TransCanada's lack of quantitative evidence concerning incremental load. Ontario submitted that the overriding consideration that should guide the Board is the cost competitiveness of the Mainline. Ontario suggested that the SWZ proposal was created to offset the impact of the depreciation proposal contained in the 2003 Tolls Application.

Response of TransCanada to Parties' Position

TransCanada did not consider intervenors' suggestions that the SWZ would not allow the Mainline to be immediately competitive ('in the money') at the Dawn hub to be relevant. It considered that Mainline tolls needed to be restructured in order to become more competitive at Dawn in the future. It noted that there is a great deal of volatility in the gas marketplace and that the future was uncertain. In addition, TransCanada noted that in the event the SWZ failed to attract customers, there would be no impact on tolls and thus no harm.

TransCanada was not surprised by the lack of interest in shipping to the SWZ expressed by the Eastern Utilities and end users and noted that it expected that producers and marketers would be most interested in shipping to the SWZ. TransCanada suggested that producers or marketers with gas to sell would want to get that gas to a liquid hub, and would look at whether the netback from delivery to Dawn exceeded the alternative of shutting in the gas. TransCanada expressed the view that the SWZ would not compete with the price at which delivered gas could be purchased at Dawn, but stated that the SWZ was intended to provide a more competitive toll on the Mainline for delivery into the Dawn hub.

TransCanada held the view that the position of several intervenors that the SWZ proposal was intended to justify renewal of unneeded GLGT capacity was without merit. In its evidence concerning renewal of GLGT TBO capacity, TransCanada submitted that full GLGT entitlement was in the best interest of its shippers, whether or not the SWZ was approved. Therefore, the SWZ was not a consideration in TransCanada's decision on GLGT capacity renewal.

TransCanada submitted that the impact of creating the SWZ on the Eastern Zone fuel ratio would be an increase ranging from 0.01% to 0.06%, which would result in a small added cost of fuel in the range of $0.001/GJ to $0.003/GJ depending on the utilization of the system.

TransCanada considered the suggestion that the SWZ would raise the price of gas at AECO for Eastern Zone customers as a distortion of the evidence presented in the hearing. TransCanada noted that the Eastern Utilities had suggested that the decrease in toll to the SWZ would result in an equal increase in cost of gas to the Eastern Utilities. TransCanada specified that its evidence was that the only impact that the SWZ could have on AECO prices would be on the volumes that could flow to the SWZ and only if these were the marginal volumes out of the WCSB. TransCanada agreed that the creation of the SWZ would directionally have an upward impact on commodity prices that the Eastern Utilities paid at AECO, but disagreed that the impact would be a one-for-one increase coinciding with a reduced SWZ toll.

TransCanada rejected Union's suggestion that the proposal to create the SWZ was anti-competitive and amounted to predatory pricing. TransCanada noted that predatory pricing was, by definition, the reduction of prices by a party with market power for the purpose of driving a competitor out of business, then subsequently raising prices in the resulting less competitive environment. In TransCanada's view, tolls that are cost-based cannot be predatory.

8.3 Zoning Principles

Position of TransCanada

TransCanada indicated that it would continue to calculate its tolls on an integrated system basis using the existing Board-approved methodology. The only change that was proposed was the creation of a new SWZ with its own distance-based toll. TransCanada submitted that the SWZ toll would be cost-based, as it would be based on the Mainline's integrated system average unit costs and the distance to the zone load centre.

The SWDA would be removed from the Eastern Zone for toll design purposes and all points in the SWDA would become part of the new Southwest toll zone. The SWZ toll would be based on the weighted average distance of the contracted FT deliveries to the SWDA. The distance to the SWDA would be determined based on the distance from Empress to Emerson, the GLGT system distance and the distance from St. Clair to the Dawn and Sarnia meter stations. All other aspects of the current distance-based tolling methodology would remain unchanged. For the 2003 Test Year, the load centre of the SWZ would be 2608 km. The SWZ would be 20.5 km in length, and most of the gas delivered to the zone would be delivered to the Dawn delivery point.

TransCanada noted that under the Board-approved distance methodology, one of the factors that TransCanada takes into consideration is the short-cuts over which gas may travel, such as the GLGT/Union Route. TransCanada noted that it can only physically deliver gas to the SWDA using the GLGT route. TransCanada indicated that if the number of firm, short-haul contracts from Dawn increase to the point where TransCanada's M-12 capacity on the Union system is fully utilized, the GLGT/Union credits would decrease. This would result in a toll increase for all locations that receive distance credits from the GLGT/Union path. TransCanada expected that the number of GLGT/Union credits available for the Eastern Zone and Eastern Export Points would continue to decline, even in the absence of the SWZ, because of the increasing number of short-haul contracts from St. Clair and Dawn, but noted that creating the SWZ may cause the number of credits to decline more quickly. While proposing to retain the existing methodology for determining distance credits for the time being, TransCanada noted its intention to monitor and, if necessary, revise the methodology after the SWZ was created.

Position of Parties

CAPP was of the view that the proposed SWZ was neither consistent with the nature and operation of the integrated Mainline system nor consistent with the equitable and fair sharing of the costs and benefits of the integrated system. CAPP pointed out that TransCanada had previously opposed the creation of a SWZ and had suggested that such a zone would undermine the integrated system and call into question the reasonableness of the entire zoning system.

CAPP suggested that some of the gas delivered to the SWZ would actually flow on the Northern Ontario Line and arrive at Dawn through operational exchange on the Union system. Under this belief, CAPP questioned the appropriateness of assuming for toll design purposes, that all the SWZ gas would travel through the GLGT route.

CAPP indicated that not all the load within the geographic area of the proposed SWZ could access the SWZ toll, due to the requirement of the Union system for some of its customers to have their gas delivered at Parkway, which would not be part of the SWZ.

IGUA submitted that the SWZ is a proposal to shift costs from one group of tollpayers to another. IGUA argued that SWZ gas will move over the Northern Ontario Line because TransCanada has no remaining physical capacity to take SWZ gas away from Dawn. IGUA suggested that this was effectively an exchange service over the Northern Ontario Line under a combination of segmented tolls that were insufficient to cover the cost of carriage over the Northern Ontario Line. IGUA submitted this in effect amounts to a discounted long-haul toll and is a matter that needs to be reviewed by the Board.

The Eastern Utilities viewed the SWZ proposal as unfair and inconsistent with the tolling methodology and regulatory principles that have been applied to the Mainline by the Board. They considered the SWZ proposal to be inconsistent with past decisions of the Board that have always considered the contractual entitlements held by TransCanada on GLGT as an integrated part of the TransCanada Mainline. They viewed the SWZ as an unfair and arbitrary dedication of part of this capacity to a single zone at the expense of the others.

The Eastern Utilities expressed the view that TransCanada was proposing to change its system to create a microscopic toll zone, which would be out of character with the system’s other zones. They submitted that large zones were appropriate because of the uncertainties of cost measurements. They were concerned that, in effect, TransCanada was proposing to establish the SWZ on a point-to-point basis.

The Eastern Utilities noted that the proposed SWZ would be carved out of the Eastern Zone. They submitted that any shipper to the SWZ would pay a lower toll than other Eastern Zone shippers, even though they would be receiving the same service to the same geographical area.

Gaz Métropolitain submitted that there are differences between service to St. Clair and to Dawn which justified Dawn remaining part of the Eastern Zone.

FSG was of the view that the relevant inquiry for assessing the SWZ proposal was whether the proposed tolls properly reflect the cost of providing the service and are consistent with accepted principles related to distance sensitivity and the design of zones on an integrated system. FSG noted that TransCanada had in the past defended the integrity of the Eastern Zone on the basis that its operations in the area were integrated, and that there was no clear correlation between contractual flows and physical distances.

FSG suggested that TransCanada was not promoting lower tolls to Dawn because few shippers use Dawn as a final destination, but was rather promoting lower tolls to other points in the Eastern Zone by combining the new SWZ toll and the existing point-to-point short-haul tolls. FSG submitted that it was inappropriate to put in place a new tolling structure that would possibly have such an effect, without a complete examination of the appropriateness of the existing zone structure and of possible alternatives to it.

FSG submitted that it was not obvious that there was anything fundamentally wrong with the Eastern Zone as it currently exists, from a cost causation or competitive perspective.

FSG suggested that there was a potential discrimination and capacity allocation issue with the SWZ proposal, as TransCanada was essentially segregating the distance-related cost advantage associated with the GLGT route, such that a subset of Eastern Zone shippers would acquire all the benefits and the remaining Eastern Zone shippers would bear the costs. FSG noted that the Eastern Zone toll would be higher in some instances than the total of the segmented SWZ toll and short-haul toll and questioned whether this situation would be consistent with the non-discrimination provisions of the NEB Act.

The CA expressed the view that the SWZ proposal lacked comprehensive analysis, that it would involve a cost reallocation and that the establishment of the SWZ would give some shippers the benefit of the integrated system, while others would bear the burden.

Quebec submitted that any proposal that compromised the principles of homogeneity of the regions, the equitable distribution of cost of service, the integration of the transportation system and the national interest should be analysed carefully to ensure the survival of the system.

Quebec viewed the SWZ proposal as unfair and discriminatory because the GLGT route would be dedicated to the SWZ and that the service offered to the SWZ would be very similar to the service to the Eastern Zone, but the toll would be lower.

Quebec submitted that the SWZ proposal would promote short-haul contracts to the detriment of long-haul contracts and noted that TransCanada had not filed an appropriate impact study that would enable an assessment of all impacts related to the SWZ proposal.

Quebec suggested that the proposed SWZ was, in essence, midway between a domestic zone and an export point, because of the final destination of the gas. In that respect, Quebec was opposed to Eastern Zone consumers subsidizing the cost of transportation for volumes that would be consumed in the US.

In assessing the reasonableness of the proposed SWZ, Quebec submitted that the toll increases in the order of 30% experienced by Eastern Zone shippers in recent years had to be taken into account and not just the toll impact of the SWZ on Eastern Zone shippers.

Response of TransCanada to Parties' Position

TransCanada acknowledged at the outset that its position on the SWZ was different than when it opposed the SWZ proposals that were made in the RH-1-72 and RH-2-85 cases. However, it submitted that substantial changes had taken place since those cases. TransCanada submitted that the principles of tollmaking did not include consistency or the maintenance of the status quo. These principles were to create tolls that are fair and equitable, just and reasonable and not unduly discriminatory. TransCanada expressed the view that changes in circumstances warrant changes in position.

TransCanada disagreed with the suggestion of various parties that SWZ customers would receive essentially the same service as Eastern Zone customers and that a lower toll to the SWZ would result in cross subsidization, and undue and unjust discrimination. Rather, TransCanada expressed the view that it would be unjust and discriminatory to continue to charge shippers a toll to Dawn or the SWDA based on the Eastern Zone load centre 400 km further downstream. TransCanada submitted that the SWZ uses a Board-approved cost-based toll methodology to create a just and reasonable toll that responds to the Mainline's new competitive reality.

TransCanada considered that gas transported to the SWZ would not be transported under similar circumstances and conditions as gas transported to the Eastern Zone or other zones. Contracted service to the Eastern Zone entails service not to a specific point, but to several delivery points in a delivery area of a local distribution company (LDC) for the purpose of distribution. Further, the actual amount of gas delivered under a contract to each delivery point within a delivery area is controlled by the LDC, not by TransCanada. In contrast, virtually all gas delivered to the SWZ would be delivered to a single point, Dawn. With limited exceptions, the gas would not be delivered to an LDC in the SWZ for the purpose of distribution.

TransCanada also considered that the gas transported to the SWZ would not be traffic of the same description as gas transported to the Eastern Zone. Virtually all gas delivered to the Eastern Zone is delivered to an LDC for the purpose of distribution to end users for consumption (final destination). In comparison, almost all gas delivered to the SWZ would be delivered to Dawn, which would not be the final destination of the gas, as Dawn is akin to a staging point where gas can be readily traded, exchanged or injected into storage before it is ultimately delivered at additional cost to a downstream pipeline.

In response to parties who suggested that the SWZ would not benefit end users in the Sarnia area due to the obligation imposed by Union that gas volumes need to be delivered at Parkway, TransCanada expressed the view that a rule imposed by Union on its customers should not preclude TransCanada from pursuing changes to enhance the competitiveness of the Mainline.

TransCanada rejected the suggestions of several parties that some of the deliveries to the SWZ would flow on the Northern Ontario Line and specified that it neither has the physical nor the contractual ability to deliver gas to Dawn, the SWZ or St. Clair over the Northern Ontario Line.

TransCanada disagreed with the Eastern Utilities' view that the SWZ was inconsistent with the integrated nature of the Mainline or that the SWZ was an arbitrary dedication of GLGT capacity to a single zone. TransCanada was of the view that the service it would provide to the SWZ was different from the service it provides to the Eastern Zone and that the service differences warrant separate tolls, determined on the basis of TransCanada's traditional distance-based toll design. TransCanada indicated that the proposed SWZ adheres to the principles that tolls should be proportional to the distance that gas is transported in the pipeline.

TransCanada indicated that it does not dedicate the lower cost of the GLGT system to any delivery point, as the Mainline's total costs, including GLGT TBO, are rolled-in and all tolls are based on the integrated cost of service. TransCanada noted that the Southern Route (GLGT) is the only route over which gas can travel to reach the SWZ, and that the distance to the SWZ is consistent with the methodology used to determine the distance to the current SWDA and other delivery points and zones on the Mainline, such as St. Clair, the Dawn export point and the Western Zone.

TransCanada saw no basis for the Eastern Utilities' suggestion that the distance measurement for the SWZ was effectively calculated on a point-to-point basis similar to the methodology used to calculate the distance to export points. TransCanada considered that the size of a zone by itself should not be a factor to determine a zone boundary, and that a further consideration is whether the character and condition of service provided to all delivery points within a zone is similar. TransCanada submitted that the SWZ proposal fully satisfies all of the zone criteria of distance, load factor, load density and load diversity.

TransCanada rejected FSG's suggestion that the SWZ would create a "confused mixture of long-haul and short-haul services and tolls" and noted that it has offered its shippers a wide assortment of long-haul and short-haul services for many years. TransCanada also noted that shippers are already arranging transportation to Dawn via long-haul contracts to St. Clair and short-haul contracts to the SWDA (Dawn) and the proposed SWZ would simplify access to the Dawn hub via the Mainline.

TransCanada viewed FSG's suggestion that the SWZ was not consistent with the principles of fairness and rationality in the design of tolls, as being premised on the unsubstantiated assumption that the SWZ would cause a subset of shippers located in the CDA to segment existing Eastern Zone contracts into long-haul contracts to Dawn and short-haul contracts from Dawn.

TransCanada did not share the view of FSG that the proposed SWZ would raise the Eastern Zone toll and ultimately cause the Eastern Zone to "collapse." TransCanada did not believe that the SWZ itself would cause shippers to segment their contracts, and noted that shippers had shown in the last three years a growing interest in sourcing their gas supplies at more local points such as Dawn. TransCanada pointed out that in the absence of the SWZ, the long-haul toll to the Eastern Zone would increase as shippers shift to short-haul from Dawn and that by creating the SWZ, the Mainline will be in a more competitive position to attract and retain existing long-haul load.

8.4 Future Business Model of the Mainline

Position of TransCanada

TransCanada indicated that it expects that further changes to its rates and services will be required as the market and customer demand continue to evolve, including possible further modifications to the existing rate structure to respond to increasing competitive pressures and realities. TransCanada noted that future changes would focus on the continued expansion and enhancement of the connectivity of the Mainline to and from an Eastern Canadian market hub or hubs. TransCanada identified a series of new services which are contemplated and for which it has initiated discussion with its stakeholders through the TTF. TransCanada was not proposing these additional changes as part of its Application as it considered that discussion with stakeholders was required to refine the services to meet industry needs and determine the potential implications for existing transportation services and commercial arrangements. TransCanada indicated that it would continue to work with stakeholders to pursue the development of further changes on an ongoing basis.

Position of Parties

CAPP noted that TransCanada had portrayed the SWZ proposal as a first step towards more regulatory reform. CAPP expressed the view that parties should have a greater knowledge of the destination of such reform, prior to contemplating a change like the SWZ. CAPP was concerned that approval of the SWZ could preclude or complicate other possible changes that could emerge later.

CAPP submitted that it would not be wise to adopt a possible solution without considering all the consequences, for example, if the SWZ lead to other toll design issues such as the incentive to bypass the Eastern Zone through contract splitting. The SWZ also highlights a disconnect between the growing demand for short-haul FT in the East and the physical means by which it is provided.

The Eastern Utilities noted that TransCanada had advanced the SWZ as a first step towards an Eastern market centre, but that TransCanada had not articulated that goal in the context of the RH-1-2002 proceeding. The Eastern Utilities expressed the view that it was not possible to assess whether the SWZ was an advisable first step in any plan without knowing what that plan was or whether any steps should be taken towards a plan that is not before the Board for consideration. The Eastern Utilities indicated that it would be preferable and more prudent to review and analyse all of TransCanada’s proposed changes to Eastern market services, together with their potential consequences, within a comprehensive proceeding.

Union wondered why TransCanada had yet to file an application with the Board for comprehensive reforms of the Mainline's Tariff or business and regulatory model. Union submitted that the fact that TransCanada failed to obtain a consensus on its White Paper did not justify a piecemeal regulatory approach.

The CA requested that the Board direct TransCanada to produce as soon as possible, and no later than its next tolls case, a comprehensive regulatory suite of new services that would establish a model capable of enabling TransCanada to participate in the current pipeline environment.

Quebec suggested that if a review of the methods used to set transportation tolls for the Mainline is needed, that review cannot be piecemeal, but must factor in the entire system, as a whole, and respect the basic principles that enabled the development of the existing system.

Response of TransCanada to Parties' Position

TransCanada was of the view that the SWZ is a considered and justified step toward a new business and regulatory model for the Mainline that will enhance TransCanada's ability to compete effectively for future market demand and gas supply. TransCanada stated that the SWZ advances its vision of a business model that allows it to offer more competitive, long-haul services to a hub and short-haul services out of the hub.

TransCanada submitted that the SWZ was included in the 2003 Tolls Application not only on the basis of its intrinsic merit, but on TransCanada's expectation and understanding that it was responsive to shipper interests and would receive some stakeholder support. TransCanada expressed the view that given the diversity and conflicting interests across TransCanada's system, it is not practical to expect to achieve consensus on fundamental changes to the business model, particularly if any redistribution of costs is involved.

TransCanada commented on the suggestions of intervenors that it would be premature to approve the proposed SWZ without finalizing the Mainline's future business model and undertaking a comprehensive review of toll design. It noted that it tried a comprehensive review through its White Paper and received widespread opposition from its stakeholders. TransCanada submitted that it needs to compete at Dawn now or risk long-term throughput loss to existing and potential bypass pipelines, and could, therefore, not afford to wait until after a lengthy toll hearing on comprehensive reform.

Views of the Board

In its RH-1-2001 Decision, the Board recognized that the landscape in which TransCanada operates has changed and that there may be a need for the framework in which it operates to evolve. In its RH-4-2001 Decision, the Board noted that one of the most significant changes to take place since 1994 has been an increase in competition for customers among pipelines, both out of the Mainline's supply basin and into its market areas. The combination of competitive pressures means that TransCanada must look for new and innovative ways to compete. TransCanada has advanced its SWZ proposal as a means to respond to competition at the market end of its system, particularly at Dawn.

TransCanada indicated that the creation of the SWZ would allow it to offer a direct and competitively priced service to Dawn while responding to customer interest in further developing a large, accessible, liquid gas market in Eastern Canada. In addition, TransCanada indicated that the creation of the SWZ would have minimal impacts on existing customers. If total available capacity to and from the Dawn hub is utilized, with no incremental throughput, the impact on the Eastern Zone toll is anticipated to be approximately $0.02/GJ, while there would be no impact if no customer chooses to use the SWZ. Further, TransCanada submitted that all shippers benefit if the SWZ allows the Mainline to attract or retain long-haul load. Finally, TransCanada has stated that the proposal respects the existing cost allocation and toll design methodology and would be simple and easy to administer.

Parties opposed to the creation of the zone argued, in part, that the toll resulting from the creation of the SWZ would be unfair because it dedicates the benefits of GLGT to the SWZ, subsidizes one group of shippers at the expense of others, charges a different rate for the same service to different customers, and is anti-competitive (constitutes predatory pricing). In addition, they argued that creation of the SWZ would increase natural gas prices at AECO, leading to adverse impacts on consumers. As well, they suggested that there is no customer support for the proposal, that it continues to be 'out of the money', and that it is unnecessary because the Dawn hub already has sufficient liquidity. Finally, they argued that it is inconsistent with previous positions taken by TransCanada and that it is premature and piecemeal.

In assessing this proposal, the Board has had regard to certain factors. First, as a matter of law and of principle, tolls must be just and reasonable and not unduly discriminatory. Second, the Mainline and its TBO entitlements were designed as an integrated system and the integrated nature of the system should continue to be respected.

Although these factors continue to guide the Board, the manner in which they are applied and the tolls that arise from them must reflect current circumstances. In particular, TransCanada should not be subject to restrictions that place it at an unfair disadvantage to other pipelines with which it competes. In addition, in considering Tariff changes, the Board needs to be mindful of, and attempt to minimize, potential adverse effects. In the Board's view, the creation of the SWZ is responsive to current competitive realities and does not offend the factors and principles articulated above.

With respect to the issue of fairness, the Board recognizes that, to the extent the SWZ is taken up by customers, the effects of the proposal will be unevenly distributed. However, the Board does not find that this would result in discriminatory or unfair tolls. The Board accepts that customers are switching to local markets and short-haul capacity and that Dawn has emerged as a market hub at which these transactions are occurring. The inclusion of costs downstream of Dawn puts TransCanada at a substantial competitive disadvantage relative to competing pipelines in serving this hub. If the Mainline is unable to compete effectively for market share, so that there is further loss of long-haul volumes, the negative impacts on all shippers are likely to be substantially greater than the potential negative impacts on the Eastern Zone toll resulting from the SWZ.

With respect to the potential impact on natural gas prices, the Board accepts that the creation of the SWZ may indeed put some upward pressure on gas prices at AECO. However, the Board notes that there are several factors that influence gas prices and the evidence presented suggests that the impact of the SWZ on gas prices is unlikely to be determinative.

Similarly, the Board considered the suggestion that the SWZ proposal was anti-competitive and amounted to predatory pricing as being without foundation. In the Board's view, attempts to respond to competition should not, in most cases, be characterized as being anti-competitive in the absence of specific evidence in that regard.

The Board does recognize that the removal of the SWZ from the Eastern Zone is a significant change to TransCanada's toll methodology; however, the Board notes that the creation of the SWZ does not fundamentally change the way in which tolls are calculated. Although the proposal acts to move the load centre for the SWZ approximately 400 km closer to Western Canada than the load centre of the Eastern Zone, the method used to calculate tolls is otherwise unchanged. As a result, although the distance units used to allocate total system costs are changed, and to the extent the SWZ is used, the distance credits available to points further East may decline, the Board finds that the calculation of tolls continues to respect the integrated nature of TransCanada's system. The Board does not accept that the effect of the SWZ is to dedicate the benefits of GLGT to the proposed zone.

The Board gave little weight to the argument that the SWZ proposal would increase liquidity at the Dawn Hub. While the Board is of the view that a lower toll could attract additional volumes to Dawn, it does not believe that the potential for increased liquidity is a particularly relevant factor in the current assessment of appropriate zoning for the Mainline.

The Board recognizes that, at this time, there is no expressed shipper support for the creation of the SWZ, that the proposed toll may be 'out of the money' relative to certain alternatives, and that the SWZ is primarily intended to compete with new infrastructure. The Board would have preferred to see some demonstration of shipper support for the SWZ proposal, but notes that if these objections to the SWZ prove true, they simply suggest that the zone will not be used and there will be no impact on the Eastern Zone toll.

Similarly, the Board would have preferred to assess the merits of the SWZ as part of a comprehensive business plan by TransCanada to address its competitive challenges. Such a plan would have helped all parties to more fully determine whether the SWZ is likely to accomplish the results sought by TransCanada.

In the absence of such a plan, the Board is of the view that TransCanada should file a report with the Board on the operation of the SWZ within two years from the implementation of the SWZ. A period of two years should be sufficient for the level of interest in the SWZ and its impacts to be further identified. The report should present information on the use of the SWZ by customers, any impacts on other services, any other issues that have arisen from the implementation of the SWZ, possible strategies for dealing with these issues, and an assessment as to the continued desirability of the SWZ. TransCanada is encouraged to work with the TTF in developing the terms of reference for the report.

The Board is of the view that it would not be appropriate to offer IT or STFT service to the SWZ in advance of the offering of FT service, as proposed by TransCanada. Such an approach would mean that the IT and STFT toll to the SWDA would be lower than the corresponding FT toll during a transition period, which would be contrary to the intent of the Board's decision concerning IT pricing (see Chapter 9).

The Board believes that it would be appropriate to implement the SWZ and to offer FT, STFT and IT services to the new zone effective 1 November 2003.

Decisions

The Board approves the creation of the SWZ, the corresponding changes to the Mainline's Tariff, and the offering of FT, STFT and IT services to the SWZ effective 1 November 2003.

TransCanada is directed to file a report with the Board on the operations of the SWZ on or before 1 November 2005.

Chapter 9

Interruptible Transportation Service

Concerned about the relative value of Interruptible Transportation (IT) Service to Firm Transportation (FT) Service, and perceived migration from FT to IT service, TransCanada requested that the Board approve an increase in the IT service bid floor price from 80% to 110% of the 100% load factor FT toll. CAPP, Simplot and the CA offered alternate proposals to TransCanada's proposal. CAPP's Overrun Interuptible Service (OIS) proposal took the form of an entirely new way to manage IT service, while the Simplot IT Quality Factor proposal offered a different way of calculating the price and allocation of IT service. The CA suggested that the minimum bid for IT service should be set at 120% of the 100% load factor FT service toll.

Position and Proposal of TransCanada

TransCanada proposed that the IT service bid floor price be increased from 80% to 110% of the 100% load factor FT toll. TransCanada noted that, at this time, there exists significant excess capacity on its system resulting from non-renewal of FT service. As a result, IT service is now able to provide shippers with flexibility and value that is superior to FT service and a level of reliability that is comparable to FT service, at a 20% discount to FT service. This situation, TransCanada stated, is unjust and unreasonable.

TransCanada explained that, on most parts of the Mainline, IT service is virtually as reliable as FT service. Excess capacity is available on most parts of the system due to non-renewal of FT service contracts that took place in recent years. For the 2003 Test Year, TransCanada expected over 2 200 TJ/d and 800 TJ/d of excess FT service capacity to be available for IT service on the Prairie Line and Northern Ontario Line, respectively. The average price paid for IT service in 2001 of 82.2% of the 100% load factor FT toll provided evidence that excess capacity is generally available to meet IT service demand. Under its Tariff, TransCanada cannot arbitrarily curtail or interrupt IT service.

TransCanada noted that FT shippers must make a minimum of a one-year commitment to pay demand charges for the full daily contract quantity regardless of whether service is actually required each day, whereas IT shippers need only nominate and pay for service on the days and for quantities and paths that are actually required. This implies that IT service has a high level of flexibility.

Between 1999 and 2001, a period during which FT service contracted volume declined significantly, the quantity of IT service being used increased by about 800%, or 700 TJ/d. In 2002, IT service accounted for about 42% of the total gas quantity transported on the system. TransCanada also pointed out that a significant shift from FT to IT service was observed in 2002 as a result of the Authorized Overrun Service (AOS) and FT Make-up programs. TransCanada also noted that 480 TJ/d of FT service contracted capacity expired on 31 October 2002 and that 2100 TJ/d of FT service may expire between 31 March and 31 December 2003, unless renewed by shippers. TransCanada stated that renewal rights, an advantage attached to FT service, have little value on paths where excess capacity is readily available.

TransCanada stated that, since the RH-1-99 Proceeding, it has become apparent that underutilization of the system is a long-term issue, as TransCanada anticipated that the excess capacity situation is likely to persist for at least the next several years. Further, TransCanada stated that it views the significant increase in the use of IT service and the fact that large quantities of FT service have not been renewed as evidence of migration from FT to IT service. TransCanada noted that FT shippers will have a strong financial incentive to migrate to IT service if the floor price remains at a discount to FT tolls.

TransCanada acknowledged that increasing the IT service floor price may not significantly alleviate migration, but it would reflect a fair value for the service and make a positive contribution to the system Revenue Requirement; hence, lowering FT tolls. As market circumstances continue to change, TransCanada indicated that it would review the Mainline's IT service pricing to ensure that it remains appropriate.

It was TransCanada's view that the reliability of IT service and its flexibility, when taken together, elevate the value of IT service to a level above the value of FT service in the current excess capacity environment. TransCanada proposed that the IT service bid floor price be established at a level in excess of the FT service toll to reflect the higher value of IT service and to discourage migration from FT to IT service. However, the IT service price should not be set at so high a level that it would completely discourage use of IT service to meet legitimate interruptible operating requirements. TransCanada proposed 110% of the 100% load factor FT toll as an appropriate level that would balance TransCanada's concerns.

TransCanada cited examples of IT service tolls being established at levels higher than FT service tolls. These included the RH-6-85 Decision for Westcoast Transmission Energy Inc. (Westcoast), a 1996 Decision of the Alberta Energy and Utilities Board for NGTL, and the IT tolls established in the RH-3-86 Reasons for Decision for the Mainline.

Position and Proposal of CAPP

CAPP opposed TransCanada's proposal to increase the IT service bid floor price to 110% of the 100% load factor FT toll. CAPP's view was that increasing the IT service bid floor price to 110% of the FT service toll would result in a major distortion of the North American gas commodity market and a widening of the price differential between AECO and markets. This would result in artificially lower prices for Western Canadian gas relative to other supplies and a wealth transfer to marketers and other gas buyers that would be contrary to economic efficiency. CAPP stated that if the IT service price was increased, FT shippers would receive the double benefit of an artificially increased transportation value and access to gas at artificially lower prices than would otherwise be the case. In addition, CAPP stated that increasing the IT service price would be contrary to TransCanada's stated concern regarding pipeline-on-pipeline competition and that increasing the IT service price would further marginalize the Mainline.

CAPP's view was that maintaining the marginal cost pricing principle for IT service is important. CAPP also stated that FT shippers have a higher priority of service, that IT service is not as reliable as FT service, and that when capacity is tight, bidding for IT service takes the IT service price above the FT service toll. CAPP made the point that although migration appeared to be the major driver for changing the IT service floor price at the outset of the proceeding, TransCanada later acknowledged that higher IT service prices may not affect migration. CAPP's position was that higher IT service prices would not effectively discourage migration. CAPP noted that in spite of increased IT service prices on NGTL in 1996, FT service levels have declined while IT service levels have increased, although total volumes on NGTL have remained relatively constant.

CAPP suggested that TransCanada's concerns regarding IT service pricing would be better addressed by replacing IT service with a new service, Overrun Interruptible Service (OIS). CAPP explained that under its proposed OIS, access to all excess capacity available on the TransCanada system would be through OIS and that entitlement rights to OIS would be allocated on a GJ-km basis to all FT shippers. Entitlement rights would be fully assignable to third parties. Nominations for OIS would be made through the four nomination cycles presently in place for each gas day. The OIS bid floor would move up and down in accordance with marginal cost and there would be no ceiling on bid price.

Position and Proposal of Simplot

Simplot's view was that the level of migration, as described by TransCanada, is exaggerated and that most of the decreased use of FT service and increased use of IT service can be explained by factors other than migration. Simplot stated that if migration were responsible for the decrease in FT service, a one-to-one relationship between loss of FT service and increase of IT service should be observed over a number of months, but that this was not the case. Simplot suggested that in 2002, FT shippers were using FT Make-up and AOS because there was a financial incentive to do so, but that they would have their FT service contracts to fall back on. For January of 2003, the large increase in IT service usage was attributed to market circumstances that resulted in the system operating at full capacity during that period. Simplot stated that LDC decontracting in 2003 was due primarily to market loss, not migration.

Simplot disagreed with TransCanada's argument that in the present excess capacity environment, IT service would be virtually interruption-free and that given its increased flexibility compared with FT service, it should be priced at a premium to FT service. Simplot stated that this approach fails to recognize that the risk of IT service being curtailed, along with the risk of IT service not being allocated in the first place, make IT service inherently inferior to FT service.

Simplot acknowledged that availability and reliability, or quality and value of IT service may be enhanced during periods of excess system capacity. As such, Simplot suggested that in certain circumstances it would be appropriate to increase the current IT service bid floor price from 80% to 100% of the 100% load factor FT toll. Simplot stated that during periods of tighter system capacity, the quality and value of IT service are diminished and that when this occurs, IT service should be priced at a discount to FT service, with the discount reflecting the quality of IT service over a preceding period. To accomplish this pricing strategy, Simplot put forward its IT Quality Factor Proposal.

Under Simplot’s IT Quality Factor Proposal, IT service would be priced according to its reliability as measured over a prior period. Simplot stated that its proposal is innovative, would avoid potential migration by allowing the IT service toll to rise to the level of the FT toll during times when migration might be an issue, is fair as it recognizes higher quality IT service by pricing it higher, would encourage maximum IT service use by keeping the toll more competitive than it would be under the TransCanada proposal, and would operate appropriately in times of both excess and tight system capacity.

Under Simplot’s Proposal, and subject to a minimum of 80% of the FT toll, the IT service price would be calculated using an ‘IT Quality Factor.’ This would be calculated, using specific path data from a previous period, as the ratio of the amount of IT service actually supplied to the amount of IT service actually supplied plus IT service requested but either curtailed or not authorized. Application of the IT Quality Factor Proposal would ensure higher reliability IT service would be priced close to or at the 100% load factor FT toll, while lower reliability service would be priced at a discount. The current bidding mechanism would be abandoned and allocation of IT service would be proportional, based on nominations. Simplot also stated that any added value of IT service derived from flexibility is at least offset by the always present risk of interruption; hence, the price of IT service would never exceed 100% of the FT service toll.

Position and Proposal of the Cogenerators Alliance

The CA supported TransCanada's proposal to raise the IT service bid floor price from 80% to 110% of the applicable 100% load factor FT toll. The CA agreed that TransCanada's shippers have been shifting from FT to IT service in significant numbers and that an IT service bid price that is higher than the FT service toll was required to help stop migration. The CA also agreed with TransCanada’s position that, in the present excess capacity environment, IT service is of a higher quality because IT service reliability is comparable to that of FT service and IT service is more flexible than FT service. In addition, according to the CA, by turning back their FT service entitlements, certain shippers have burdened the Mainline with a substantial amount of stranded costs.

The CA suggested that the IT service bid floor price be increased to 120% of the applicable 100% load factor FT toll. The CA explained that this bid floor price, although higher than that recommended by TransCanada, is justified in that a shipper operating at a 90% load factor would be indifferent to FT service as opposed to IT service at 110% of the 100% load factor FT toll and that only an IT service floor price that is higher than 110% would discourage such a shipper from migrating from FT to IT service.

The CA also suggested that if the Board concurred with TransCanada by setting the bid floor price at 110%, then TransCanada should be directed to conduct a study on the actual impact of the 110% figure on migration from the date of implementation to the end of 2003.

TransCanada's Position on Proposals of Intervenors

TransCanada submitted that CAPP's OIS proposal would result in higher FT service tolls and encourage further migration from FT service. TransCanada also stated that OIS would be inconsistent with open access and would be overly complex. TransCanada explained that CAPP's proposal rested on the proposition that short-run marginal cost pricing is required for the allocation of excess Mainline capacity, but that would result in the future mispricing of FT service on the Mainline and would distort the true long-run marginal cost of pipeline service out of the WCSB. Therefore, according to TransCanada, the CAPP proposal would result in a wealth transfer from existing FT shippers to producers, which would not be appropriate.

TransCanada noted that Simplot agreed that the IT service price should increase to reflect the higher availability and reliability of IT service as a consequence of excess capacity on the system and that the disagreement between TransCanada and Simplot relates to the quality of IT service. TransCanada stated that while IT service has a lower priority that FT service in the Mainline Tariff, neither IT nor FT service would be curtailed so long as there is excess capacity. In the unlikely event of a catastrophic failure, both IT and FT service would likely be curtailed. In addition, according to TransCanada, the elimination of the price bidding mechanism for IT service which has been proposed by Simplot is not appropriate as there are problems with the proportional allocation methodology proposed by Simplot.

TransCanada stated that there had been no empirical evidence presented that would support the CA proposal that the IT service bid floor price should be raised to 120% of the FT service toll and acknowledged that TransCanada's decision to request the 110% IT service bid floor was based on judgment, rather than quantitative analysis. TransCanada nonetheless expressed the view that its proposal most appropriately balanced its stated objectives concerning the pricing of IT service.

Position of Other Parties

IGUA agreed with TransCanada that the current IT service pricing mechanism has encouraged migration from FT to IT service and agreed that the IT service pricing mechanism should be changed in an effort to correct the identified imbalances. As such, IGUA recommended that the Board approve a new pricing mechanism that sets the IT service minimum floor bid price at a minimum of the 100% load factor FT toll. IGUA supported the proposal of Simplot and noted that it did not oppose TransCanada's proposal.

IGUA expressed opposition to CAPP's OIS proposal, stating CAPP's plan would create significant complexities and offer little benefit for industrial end-users holding transportation on the Mainline. For industrials relying on third-party transportation arrangements, IGUA stated that the CAPP plan would not necessarily result in a pass-through to the end-user of any benefits the FT service holder might generate through the resale of the assigned excess capacity.

Centra stated that it believed that TransCanada's pricing proposal for IT service is appropriate in the current circumstances of underutilization faced by the Mainline and that anything less than the minimum bid floor price of 110% of the 100% load factor FT Toll for IT service would continue to exacerbate migration from FT service to IT service and increase the FT service toll of the Mainline. Centra noted that STFT is also available as an option for shippers to meet their short-term requirements.

EGD's view was that the TransCanada proposal would best address IT service related concerns. EGD noted that TransCanada's proposal retained the bidding process and that it would make IT service less attractive to FT shippers. EGD also noted that the TransCanada proposal would retain regulatory oversight and that it would be consistent with the rationale outlined by the Board in the RH-3-86 Reasons for Decision.

In the view of EGD, neither the CAPP nor Simplot proposals were satisfactory. EGD stated that neither proposal would make IT service a less attractive alternative than FT service. EGD expressed the belief that CAPP's proposal would remove regulatory oversight and that it could have the effect of inflating supply area prices. EGD was sceptical that using the experience from past period to establish future IT tolls, as proposed by Simplot, would be wise.

FSG supported TransCanada's proposal to increase the bid floor for IT service to 110% of the 100% load factor FT toll. FSG recognized that the TransCanada proposal may not have a significant effect on curtailing migration; however, it stated that FT service needs to be made more attractive in order to be a desirable option for shippers and that a premium of at least 10% for IT service would be appropriate. In addition, FSG's view was that an IT service floor price of 110% would help to equalize the annual fixed cost responsibility of IT and FT shippers and that, under certain circumstances, a premium greater than 10% would be suitable. FSG also noted that in the current market conditions, the flexibility benefits of IT service outweigh the costs associated with the risk that IT service would be unavailable or interrupted in the current market conditions.

FSG did not support CAPP's OIS proposal or Simplot's IT Quality Factor Proposal. FSG outlined the following concerns about the proposed implementation of CAPP's proposal: gas commodity costs would go up; FT service tolls would also go up; and the OIS entitlements that the proposal would give FT shippers would be essentially worthless. FSG also stated that the Simplot proposal underestimates the flexibility value of IT service.

Gaz Métropolitain accepted TransCanada's evidence that migration from FT service to IT service had been occurring, resulting in lost revenues for TransCanada and an increase in the tolls charged on the Mainline. Gaz Métropolitain acknowledged that in the current context of excess capacity, the quality of IT service is virtually the same as FT service, because even though the service could be interrupted, it is very unlikely that it would be. Hence, IT service users have the advantage of having access to a service that is essentially FT service, but with no exposure to higher demand charges resulting from underutilization of the system. Further, by setting the price of IT service lower than the price of FT service, IT service users do not contribute to fixed system costs to the same extent, even though they enjoy essentially the same service as FT service users, who do pay their fair share of those costs.

Gaz Métropolitain commented that some of the other proposals could, in principle, address migration but concluded that TransCanada's proposal is the best solution possible as it has the benefit of simplicity, and the merit of having been used successfully in the past. Gaz

Métropolitain suggested that the Board approve TransCanada's proposal, subject to reviewing this issue again when the migration and excess capacity problems have been mitigated.

Union agreed that the condition of surplus capacity on the Mainline may persist for some unknown period of time and that shippers would continue to be financially motivated to acquire cheaper IT service that provides similar levels of reliability to FT service without exposure to demand charges or the risk associated with holding long-term FT service capacity. For Mainline shippers holding significant quantities of FT service capacity, the relative market value of their investment in that capacity is at risk. Union also stated it believed that FT service is the backbone service of the Mainline while IT service is a by-product service whose availability under historic Mainline utilization levels was largely determined by factors such as Mainline existing conditions, or capacity made available by virtue of lower load factor shippers. As such, Union submitted that TransCanada's proposal to increase the IT service floor price to 110% of the 100% load factor FT toll would appropriately manage the price and availability of IT service to the primary benefit of the Mainline's FT shippers. Union stated that it would support a process through which the success of the 10% premium can be evaluated and modifications considered if, after a suitable trial period, it could be demonstrated that the increase could be further optimized by either raising or lowering the IT service floor price from the 110% level.

Ontario agreed with TransCanada's evidence that migration from FT to IT service was occurring. It stated that TransCanada's proposal to increase the cost of IT service above FT service would more accurately reflect the lower risk and higher flexibility of IT service and may discourage further migration from FT to IT service. Ontario further submitted that the experience with the IT service pricing proposal should be reviewed as part of the 2005 Tolls Application to allow TransCanada and interested parties an opportunity to gain experience with the proposed IT service bid floor price.

Quebec supported TransCanada's proposal to increase the IT service floor price from 80% to 110% of the FT service toll, stating the increase is needed to offset the use of IT service contracts as replacements for FT service. Quebec noted that during a period of excess capacity, IT service is of the same or better quality than FT service because it allows the consumer to terminate shipments at will, at a fraction of the price of FT service contracts. Quebec based its support of TransCanada's proposal on the notion that in the present situation of excess capacity, IT users are not paying their fair share of the cost of transportation. As such, Quebec stated that in the interest of fair distribution of service costs, it was in favour of TransCanada's proposal.

Views of the Board

The Board is of the view that preserving the value of FT service is the primary factor that should determine IT service pricing in the current environment and that the pricing of IT service at a price reflecting its value relative to FT service is an important consideration. In making its decision regarding IT service pricing in this proceeding, the Board was mindful of the guidelines it outlined in its RH-6-85 Reasons for Decision:

> *“The Board accepts incremental cost as a lower limit for an interruptible toll and value of service as a conceptual upper limit for pricing purposes.”*

In the Board’s view, all of the IT service pricing proposals presented in the proceeding fall within the range of incremental cost and value of service. It is in the context of the current environment of excess capacity on the Mainline that the Board must decide where the appropriate IT service price level should fall within that range.

In addition, the Board believes that the statement made in its RH-3-86 Reasons for Decision is also appropriate in this instance:

> *“The Board believes that a toll design that allows a firm service customer to nominate for interruptible service and receive that service virtually interruption-free at a toll lower than the firm service toll is not just and reasonable. Also, the Board is of the view that interruptible tolls should be high enough to discourage customers from contracting for high quality interruptible service to meet their firm operating requirements while low enough to promote the use of interruptible service to meet legitimate interruptible operating requirements.”*

The Board accepts that the level of FT service contracts on the Mainline has declined significantly in recent years, creating an environment of excess capacity on the Mainline, and that under the present circumstances of excess capacity, IT service is virtually as reliable as FT service under normal operating conditions. The Board also understands that IT service is more flexible, and in a certain respect less financially risky, than FT service. Specifically, IT users are able to make decisions daily, implying a high degree of flexibility and virtually no long-term risk, while FT shippers must pay demand charges and are at risk for any unabsorbed demand charges. The Board also accepts that migration from FT to IT service has been occurring on the system, although the decline in FT contracts likely reflects other factors as well.

In the current environment of excess capacity, the Board’s view is that pricing IT service higher than the 100% load factor FT toll would appropriately reflect the value of IT service relative to FT service and assist in preserving the value of FT service. In the Board’s view, migration is a lesser concern than ensuring that the price paid by IT shippers is reflective of the value derived from the service in the present environment. So while the Board acknowledges that migration from FT to IT service is a concern, it is also aware that increasing the IT service floor price may not significantly prevent migration.

The Board is of the view that TransCanada's proposal to increase the floor price for IT service from 80% to 110% of the 100% load factor FT service toll would be appropriate, as this would more appropriately reflect the value of IT service relative to FT service. As previously noted, the Board is of the view that interruptible tolls should be high enough to discourage customers from contracting for high quality interruptible service to meet their firm operating requirements while low enough to promote the use of interruptible service to meet interruptible operating requirements.

The Board also believes that retaining a bidding mechanism is desirable, from an economic efficiency perspective. When and where capacity is tight, a bidding mechanism helps ensure that available IT service capacity is used by those shippers that place the highest value on the capacity and that the price paid for IT service reflects the value of this service to each shipper. The proposals of TransCanada and of the CA were superior to those of CAPP and Simplot in this respect.

In choosing between a floor price of 110% and 120%, the Board accepts that the specific choice of 110% is based on judgment. Nonetheless, the Board is of the view that a floor of 110% will appropriately meet the criteria outlined previously and notes that such a level has been used in the past. In addition, the Board agrees with parties that the information resulting from a study of the impact of changes to IT service pricing would be useful and notes that TransCanada also agrees that it should implement such a review. This study should monitor the impact of changes to IT service pricing, particularly relative to changes in market circumstances, and its results should be provided to the Board no later than as part of the Mainline's Tolls Application.

Simplot's Proposal

The Board appreciates the effort of Simplot in developing its IT Quality Factor Proposal. However, while the Board accepts that the Simplot proposal would be a step in the right direction, the pricing level suggested by Simplot would likely be insufficient to curb opportunistic migration and does not allow IT service to make as great a contribution to fixed costs as the TransCanada proposal.

The Board also notes that it is possible that some gaming could occur if this proposal was implemented and should shippers attempt to influence the IT Quality Factor applicable to a specific path. In addition, the Board does not accept the use of data from a previous period to pre-determine present reliability. The market environment can change unpredictably with the result that the IT Quality Factor may not be an accurate measure of system reliability at a particular point in time.

CAPP's Proposal

The Board is not persuaded of the merits of CAPP's OIS proposal. In the Board's view, implementing the OIS proposal could lead to destabilization of the Mainline by encouraging shippers to reduce their use of FT service and rely more on OIS. In addition, the proposal could result in the concentration of FT service and OIS in the hands of a few large shippers.

The Board also accepts that OIS would result in transportation prices that reflect the short-run marginal cost of capacity out of the WCSB and is therefore concerned that the OIS proposal could result in transportation costs well below the full cost of providing transportation and potentially below the value derived by the user of the service. The Board is also of the view that OIS would be administratively cumbersome without commensurate benefits.

Although not accepting the intervenors' proposals, the Board is pleased that parties made the effort to critically, and in some cases creatively, evaluate the IT service pricing concern. The Board encourages parties to continue to offer such suggestions in the future. Discussions of various proposals help support the evolution of the regulatory framework by encouraging innovation in a positive and inclusive manner.

Decisions

The Board approves an IT service floor price, effective 1 September 2003, equal to 1.10 times the 100% load factor FT Toll for service over the applicable path.

The Board directs TransCanada to perform a study on the impact of changes to IT service pricing, particularly relative to changes in market circumstances, and to provide the results of the study to the Board no later than as part of the Mainline's 2005 Tolls Application.

Chapter 10

Other Tolls and Tariff Matters

In its evidence, FSG made a number of proposals that it stated were designed, in one way or another, to enhance the flexibility that Mainline firm shippers have in using the services that they have contracted with TransCanada. The general principle that the FSG believes should be applied is that shippers who have contracted for a specified amount of capacity on the system should be able to use that entitlement in whatever way that suits their business needs, subject to operational constraints and the rights of other shippers. FSG proposed six changes to the Mainline's toll design, Tariff, and service offerings, namely:

- Roll-in of Export Points;
- Roll-in of Delivery Pressure Charges;
- Pooling Points;
- FT Make-Up;
- Contract Path Flexibility; and
- Capacity Segmentation.

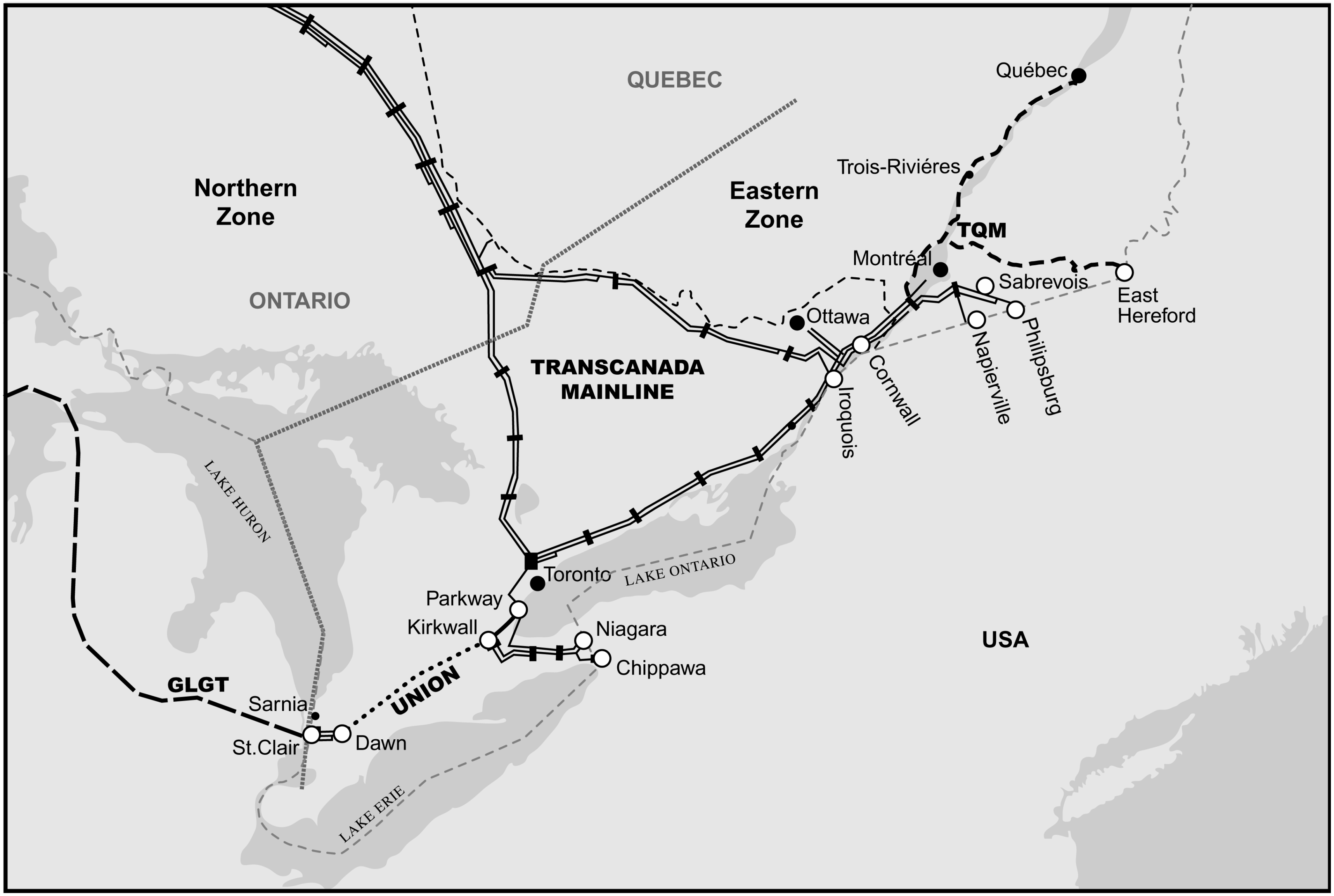
10.1 Roll-in of Export Points

Under TransCanada's current toll design, all long-haul domestic deliveries are tolled on a zonal basis and all long-haul export deliveries are tolled on a point-to-point basis.

FSG stated that the current structure of FT tolls could be made simpler, fairer and more efficient by eliminating the current distinction between domestic and export services. To that end, FSG proposed rolling the export points into the adjacent domestic zones for toll design purposes. The result would be that the load centre calculation for each domestic zone would include the volumes and distances associated with the adjacent export points, with uniform tolls for all points within the zone. The proposal would therefore incorporate the St. Clair, Chippawa, Niagara Falls, Iroquois, Cornwall, Napierville, Philipsburg, and East Hereford export points into the Eastern Zone (see Figure 10-1) and the Emerson and Spruce export points into the Manitoba Zone (see Figure 1-1).

FSG's position was that there is no basis in the modern era for different treatment of export and domestic transportation. FSG stated that the distinction results in anomalous and seemingly discriminatory treatment between shippers that are similarly situated. In FSG's view, the physical facilities of the Mainline form a single integrated set of facilities that is used to provide service to both the export and domestic markets. It stated that the only facilities that could conceivably be considered to be dedicated to export service are short laterals that connect the main system to the export points at the border.

Figure 10-1
Eastern Zone and Eastern Export Points



FSG stated that circumstances have changed since the GH-5-89 Decision was released some 12 years ago when this proposal was last rejected. FSG asserted that there has been significant evolution of the gas and transportation markets, and of the Mainline system, since the 1990s. Today, direct and indirect interactions between export and domestic shippers and customers are not only possible, but also very common. The market is in reality an integrated whole in which the distinction between export and domestic is largely irrelevant.

During the hearing, TransCanada stated that it was not advocating any change to the current methodology because, in its view, the facts and circumstances that were relevant at the time the Board last addressed this issue are still relevant today. It noted in its comments on FSG's pooling point proposal that the mechanism appears to be designed in such a manner as to justify roll-in of export tolls and pressure charges into the adjacent domestic zones.

In CAPP's view, the proposal to roll in the export points appears to be a move in the wrong direction. It would involve more averaging of costs in what is becoming a more competitive environment. CAPP argued that the current point-to-point methodology is the appropriate cost-based toll design approach for exports.

The CA opposed the roll-in of export points and noted that the roll-in shifts costs away from the FSG in the order of approximately $7.4 million per year and makes these costs the responsibility of other shippers.

EGD disagreed with FSG's proposal and argued that the market or market area served by each export point today is dissimilar to the adjacent Canadian market, as it was in 1989.

Centra urged the Board to reject FSG's proposal to roll in the export points. In Centra's view, the alleged benefits enumerated by FSG for the proposal would not be commensurate with the 7% increase in the Manitoba Zone toll and the corresponding impact to Manitoba consumers.

Androscoggin Energy, L.L.C. and Rumford Power Associates, L.P. supported FSG's proposal. They argued that it is a fairer approach than the current system and it would also help facilitate the development of a pooling mechanism on the TransCanada system that would be available to all long-haul shippers.

10.2 Roll-in of Delivery Pressure Charges

At various points on its system, TransCanada has delivery pressure charges to recover, on an incremental basis, costs associated with delivering gas at pressures higher than the system minimum. These charges were first approved in the GH-2-87 Decision wherein the Board stated that 'the provision of additional delivery pressure is a separate and distinct transportation service' and found that providing for an incremental charge is consistent with the principles of cost causation and user-pay. TransCanada charges for higher delivery pressure at Emerson, Dawn, Niagara Falls, Iroquois, Chippawa, and East Hereford.

In FSG's view, the incremental delivery pressure charges have outlived their usefulness and it is no longer appropriate to impose them. FSG stated that it is unusual in the modern era to pick out, from amongst all the potential cost factors that could be used to distinguish between different transportation services, the single factor of delivery pressure costs as requiring a rigidly incremental toll treatment. A more consistent and fair approach would be to treat differences in available delivery pressure as another minor locational service variation, and recover the associated costs on an averaged basis from all shippers through the integrated cost of service and toll design. For example, FSG noted that customers in Toronto pay a portion of the costs of the TQM system, which is part of the integrated Mainline system, even though the gas that they receive never uses the TQM facilities.

FSG believes that it is inconsistent, and therefore discriminatory, for the Mainline toll design to ignore all of the very significant facilities-related cost differences and then to pick out one minor factor of delivery pressure as attracting incremental toll treatment.

FSG asserted that the key difference since 1987 is that the nature of the market has changed. The gas market has fully evolved from a system sales model to an open access model such that all customers that are connected to the system benefit at least indirectly from the availability of incremental pressure at the affected points. Those benefits include operational and economic flexibility, market options, and pricing transparency.

TransCanada did not express an opinion on this proposal directly, but noted in its comments on FSG's pooling point proposal that the mechanism appears to be designed in such a manner as to justify roll-in of export tolls and pressure charges into the adjacent domestic zones.

The CA opposed the roll-in of delivery pressure charges.

EGD opposed FSG's proposal because, in its view, there is no justification for changing the present toll treatment for pressure charges. EGD stated that FSG's rationale – the change from a system sales model to an open access model – is flawed. It noted that when delivery pressure charges were first authorized in the GH-2-87 Decision, the customers in question were transportation shippers rather than system gas buyers. Further, in the GH-2-87 Decision, TransCanada was directed to adopt an open access tariff.

10.3 Pooling Point Proposal

FSG proposed that TransCanada implement a pooling point mechanism on the Mainline for long-haul shippers. The proposal would entail creating a paper or notional delivery point in each zone, to which FT shippers could nominate on a firm basis as an alternative to their contracted or primary delivery point. FSG explained that this would create a common transaction point at which all shippers and customers could notionally meet and transact.

Further details on the proposal were described as follows:

- For each zone, TransCanada would create a pooling point, which would be available as a firm alternate delivery point to all long-haul shippers contracted to delivery points within that zone. This proposal is dependent on the export points being rolled into the adjacent zone, so that there is a uniform long-haul toll into or to the border of each zone;
- Long-haul shippers who wish to sell their gas at the pooling point would be entitled to nominate that point as a firm delivery;

- Receiving shippers who purchase gas at a pooling point would be entitled to nominate the transportation of that gas from the pooling point to any delivery point or delivery area in the zone, at no incremental charge;
- A receiving shipper who wanted to purchase gas at a pooling point in one zone and deliver it at a delivery point or delivery area in a downstream zone would pay the toll differential between the two zones;
- Scheduling priority of such a transaction would be below firm nominations at those points and diversions, but higher than IT nominations; and
- Shippers would be required to balance their gas volumes daily at pooling points.

FSG explained that implementing this mechanism requires uniform tolls within a zone. With a uniform zone tolling structure, the toll paid by the delivering shipper will be designed such that it will recover the deemed cost to deliver to any point in or adjacent to the zone. This proposal also assumes that the delivery pressure charges are rolled into the zone tolls. Alternatively, they could be recovered through the commodity tolls.

TransCanada stated that it agrees with FSG on the need to develop hubs, pooling points and market centres to enhance liquidity and flexibility for shippers and to improve competitiveness of the system as a whole. However, TransCanada identified several issues and concerns with respect to the specifics of FSG's pooling point proposal. It expressed concern that the proposed mechanism is complicated, may be of limited value and appears to be designed to justify roll-in of export tolls and pressure charges into the adjacent domestic zones. As an alternative, TransCanada suggested two simpler means of developing flexible and liquid hubs. One is the creation of the SWZ to foster growth of the existing Dawn Hub. Second, TransCanada noted that its existing domestic delivery areas are already pooling points with full access to hub services, such as title transfer and parking and loans. While not proposing such a change, TransCanada stated that liquidity and flexibility at these existing pooling points could be enhanced by providing receipt and delivery transactions at all locations on the system. At the present time, receipt and delivery transactions are only allowed at certain locations, primarily export points.

In response to TransCanada's reaction to the proposal, FSG stated that the Mainline should be trying to figure out a way to compete with Dawn in the market areas rather than try to compete at Dawn. In FSG's opinion, its pooling point proposal would give TransCanada its own service tool with which to compete with Dawn. It would also give customers access to a market centre on the Mainline that accessed the whole of the Mainline's long-haul capacity and that was not dependent on Dawn or Union.

CAPP advocated deferring the concept of pooling points to a later date, noting that TransCanada also has attempted to enhance or develop trading points on its system, for example, in its White Paper. CAPP stated that TransCanada should be given another opportunity to bring forward a coherent proposal for pooling points.

10.4 FT Make-Up

FT Make-up crediting began on 1 January 2002 and expired on 31 December 2002. It was part of the 2001-2002 S&P Settlement, and the goal of FT Make-up was to enhance the value of FT service for FT shippers. Under FT Make-up, a credit equivalent to a shipper's total unused demand charges, could be applied toward the shipper's IT invoice. Credit were calculated monthly and could not be carried forward from one month to the next.

FSG proposed that the FT Make-up provision be reinstated, but recommended that the crediting mechanism be amended. Under the proposed amendment, shippers would be credited an amount equal to the minimum IT toll for their FT path less the applicable FT commodity toll plus the unit cost of any applicable delivery pressure charges. Under FSG's proposal, if the IT price were 110% of the FT toll, a credit of 110% of the FT demand toll would be appropriate. In addition, shippers utilizing this service feature would be subject to a minimum bill for their IT service equal to the FT commodity tolls that they would have been liable for if their volumes had flowed under their FT contracts. FSG stated that this crediting arrangement would enable FT shippers to utilize the number of GJ-km of capacity for which they contracted, with the net cost to them remaining the same as it would have been had they used their FT entitlements in the traditional way. FSG stated that its proposal would eliminate gaming and cost avoidance, which had occurred in the previous program.

At Union's request, the Board added the issue of the appropriateness of resuming FT Make-up Service to the Revised List of Issues. The basis for Union's request was that FT Make-up was considered to be a valuable enhancement arising out of the 2001-2002 S&P Settlement and Union wanted the issue to be dealt with earlier than it anticipated the TTF discussions could be concluded with subsequent outcomes approved by the Board.

Union acknowledged that while IT was priced at 80% of the 100% load factor FT toll, shippers had abused the FT Make-up provision. However, Union suggested that if the Board were to approve an IT toll of 110% of the 100% load factor FT toll, as proposed by TransCanada, it would also be appropriate to reinstate FT Make-up. At the time of its request, Union noted it was optimistic that FT shippers would support the resumption of FT Make-up in combination with the higher IT toll.

Union submitted that in an environment of excess capacity, such as presently exists on the Mainline, FT Make-up would enhance the value of FT service, which may have the effect of retaining existing shippers and attracting new FT shippers. Union explained that FT shippers pay for nearly all the Revenue Requirement and should therefore be accorded the opportunity to access some of the flexibility resulting from the excess capacity. This would in turn help mitigate the burden of FT tolls and optimize the utility of capacity entitlements for which FT shippers pay.

During final argument, Union stated that while it still supports FT Make-up as a valuable enhancement to FT service, it had asked that the reinstatement of FT Make-up be included in the List of Issues under the assumption that other parties would not contest the service proposal. However, during the proceeding, it became evident to Union that both TransCanada and CAPP had reservations about reinstating FT Make-up. As such, Union withdrew its request that

FT Make-up be reinstated by the Board at this time, considering it more appropriate to defer the issue to continued TTF negotiations.

TransCanada noted that in 2002, shippers could earn FT Make-up credits on FT capacity that was not nominated. Shippers could also earn FT Make-up credits on any amount of FT capacity that was initially nominated but not authorized and confirmed.

In 2002, a shipper could reduce its net transportation costs by shutting in its FT contracts and then using the resulting FT Make-up credits to nominate for IT service over the same path. In order to substitute IT for FT, as a backup in the event that TransCanada did not allocate the required IT quantity, the shipper would initially nominate both IT and FT for the same quantity and the same path at the same time. To the extent that the shipper was allocated IT service, the shipper would reduce its FT nomination in the confirmation process in order to balance to its downstream market or take away requirements.

TransCanada provided examples to illustrate how, using FT Make-up credits, a hypothetical shipper could ship an amount of gas equivalent to its FT contract, but for a reduced cost, or ship more than its contracted amount for an equivalent cost. In the case where less than its contracted amount was shipped, it was possible that the shipper could use its FT Make-up credits to pay off its FT commodity charge. In 2002, this occurred and resulted in a shortfall of approximately $38 million to be recovered through a deferral account in 2003.

TransCanada stated that a higher IT floor price is necessary to eliminate the financial incentive for FT shippers to use FT Make-up credits to convert to a larger quantity of IT service over the same path. To address the under-recovery of FT commodity revenue, should the FT Make-up program be reinstated, TransCanada suggested that shippers not be able to use FT Make-up credits to reduce net IT costs below the FT commodity charge.

TransCanada initially did not offer a position on the reinstatement of FT Make-up; however, after assessing the positions of intervenors, TransCanada's view was that FT Make-up would be an inappropriate service. It described the FT Make-up proposal as similar to FSG's contract path flexibility proposal, but on an interruptible basis. TransCanada suggested that, if the Board were to approve FT Make-up, the approval should be kept short-term to allow for reassessment. TransCanada also recommended that FT Make-up only be reinstituted if:

- The IT floor price is set at 110% of the FT toll;
- There is a one-to-one unit credit similar to the 2002 program, not the 1.1 unit credit proposed by FSG; and
- There is an adjustment for any FT commodity shortfall.

FSG did not accept that credit should only be given for the FT demand charge, nor did it accept that a sunset clause would be appropriate, should the program be approved by the Board. Such a clause, in FSG's view, would provide TransCanada and other parties with leverage for any future points of negotiation.

CAPP stated that FT Make-up is not appropriate. CAPP noted that FT shippers already have a variety of rights to use the system in flexible ways such as diversions, implying that FT Make-up would be somewhat redundant. CAPP was of the opinion that the proposals amounted to the provision of free IT, which it opposed.

Androscoggin Energy, L.L.C. and Rumford Power Associates, L.P. urged the Board to approve FSG's FT Make-up proposal.

10.5 Contract Path Flexibility

FSG proposed that TransCanada implement tariff provisions that would allow FT shippers to change their primary contracted receipt and delivery points, subject to the availability of capacity along the new path. To the extent that toll revenues for new paths differed from toll revenues under their original paths, shippers would be obligated to adjust their contract volumes so as to ensure that TransCanada's demand revenue is held constant.

FSG stated that, in principle, it would be appropriate to permit such contract path adjustments at any time, on a first come, first served basis. As a practical matter, however, it may be desirable to permit path changes only at the beginning of a month, or even at longer intervals. As a general principle, shifts of primary receipt and delivery points should have priority over both IT and STFT services. Where TransCanada cannot accommodate a proposed shift because capacity is temporarily taken up at the proposed new point by one or more STFT contracts, those STFT contracts would be honoured. Unless otherwise agreed by TransCanada, all such contract path adjustments would be permanent and the shipper would have no guarantee of being able to revert to its original path.

FSG stated that neither TransCanada nor other firm shippers should have any objection to shippers adjusting their paths as proposed, provided that capacity is available on the new path and the pipeline remains revenue neutral. FSG acknowledged that the right to shift primary paths should be subject to TransCanada's ability to object if the shift might truly strand transmission capacity. In FSG's opinion, the circumstances in which that might happen would be rare.

FSG submitted that its proposal is consistent with the US Federal Energy Regulatory Commission's (FERC) determination in Order 637 that the pipelines it regulates must allow FT shippers to shift primary receipt and delivery points subject to availability of capacity and keeping the pipeline revenue neutral. FSG explained that its proposal goes further than the FERC policy since it would oblige the pipeline to accept shifts to upstream zones under most circumstances. However, FSG was of the view that by requiring shippers to keep the pipeline whole through contracted volume adjustments, its proposal achieves the objective of keeping the pipeline revenue neutral while affording shippers flexibility.

TransCanada opposed contract path flexibility because of the potential for significant revenue and toll impacts on all shippers (e.g., IT revenues could be reduced). Other concerns raised by TransCanada included erosion of accountability for new facilities and an increased risk of overbuilding, excess capacity and higher tolls for all shippers in the future. Also, TransCanada stated that there is a potential risk that the proposal could result in stranded capacity and shifts could erode the availability of diversion capacity for all other shippers.

TransCanada also noted that shifts are already possible under its existing Tariff. It has sole discretion to approve, or not, requests for shifts, subject to complaint by shippers and oversight by the Board.

CAPP argued that this proposal would significantly alter the rights of FT shippers on the system with potentially undesirable impacts on system design, capacity and utilization. CAPP stated that, as presently framed, contract path flexibility is not desirable and should be deferred to a later date.

10.6 Capacity Segmentation

FSG proposed that TransCanada allow FT shippers to ‘segment’ their contracted capacity paths. In this context, segmentation means dividing a contracted path into one or more smaller, discrete, non-overlapping segments, each of which the shipper is entitled to use to ship its contracted quantity.

For example, a shipper who has a contract for service from Empress to the Iroquois export point could divide its path into an Empress to Winnipeg segment and an Emerson to Iroquois segment. It could then buy gas at Empress and deliver that volume to a customer in Winnipeg using the first segment. At the same time, it could buy gas at Emerson and ship that volume on the second segment of its capacity to a customer at the Iroquois export point.

FSG explained that FERC-regulated pipelines in the US are required to afford their shippers the opportunity to segment capacity, subject to the operational requirements of the system. This option first arose out of the service restructuring initiatives that followed from implementation of Order 636. In Canada, the Enhanced Capacity Release mechanism in place on the TransCanada Mainline is essentially a limited form of capacity segmentation.

FSG acknowledged that it would be necessary to work out the details of capacity segmentation through a compliance filing and consultative process, but suggested that this was not a reason for rejecting the idea in principle.

TransCanada stated that it was not opposed to capacity segmentation in principle, but submitted that insufficient details have been provided in this proceeding to properly assess the proposal. In its evidence, TransCanada expressed a general concern related to the complexity of its system. It explained that while the contractual path of a FT contract might be a relatively simple matter on a linear system, such is not the case with the Mainline. TransCanada also had concerns with the aspect of the proposal that would enable shippers to double deliveries at a single location along the path of their FT contract. TransCanada stated that it might not have sufficient lateral or metering facilities in place to accommodate a doubling of firm deliveries at all points on the system. TransCanada submitted that it and its shippers need to thoroughly consider the potential impact on design and operations of the system as a consequence of such a proposal.

CAPP did not support FSG’s proposal, stating that it should be deferred to a later date.

Views of the Board

The Board appreciates the efforts of the FSG in advancing proposals that have the objective of enhancing the flexibility of FT shippers in utilizing their contracted capacity and, hence, providing value to at least some FT shippers. In the Board's view, consideration of changes to TransCanada's toll design and service offerings that improve the operation and value of the system is a worthwhile exercise.

The Board notes that many concerns that were raised about FSG's proposals related to impacts on revenues, tolls, design and operation of the system. It is evident that further testing and discussion of all of the proposals needs to take place so that these concerns can be addressed. The Board is not satisfied that the specific proposals ought to be approved, even in principle, until the basic operational and financial concerns are worked out. Further, sufficient information should be provided to assess whether a proposal will benefit shippers as a whole or identify the subset of shippers likely to benefit or be harmed by the proposal and the potential magnitude of the impact. Ideally, this should occur as part of a comprehensive proposal for service enhancements.

With respect to the specific proposals to roll the export points and delivery pressure charges into the adjacent domestic zones, the Board is of the view that the facts and circumstances have not changed sufficiently to justify a change from the current toll treatment. The Board continues to find that, for the Mainline, the circumstances surrounding the zoning of domestic volumes do not apply to volumes destined for export. Further, the Board continues to find that the application of the existing point-to-point methodology for export deliveries does not result in tolls that are unjust or unduly discriminatory. With respect to the provision of higher delivery pressure, the Board continues to find that shippers using and benefiting from this service should bear the incremental costs in order to ensure that no undue cross-subsidization occurs.

While the concept of a pooling point mechanism may have merit for the TransCanada system, the Board believes that FSG's evidence raises many unanswered questions on how the concept would work in practice. For example, issues related to access, priority and contractual matters need to be addressed.

The Board accepts that the 2002 experience with FT Make-up has shown that the FT Make-up credit program resulted in increased use of IT and decreased use of FT service on the Mainline and in a significant FT commodity shortfall to be recovered in 2003 through a deferral account. These are results that are not desirable. Given this experience, the Board believes that a program, such as the FT Make-up credit program, which links unused FT to IT invoicing, and encourages shippers to nominate volumes in excess of their intended shipments is not appropriate. While a change to the IT floor price would attenuate this concern, it would not eliminate it.

With respect to contract path flexibility, given the potential for impacts on revenues, tolls and operation of the system, the Board considers it appropriate for TransCanada to retain the discretion provided in the Mainline's Tariff to approve, or not, requests for changes to shippers' contracted receipt and delivery points. Should any party be dissatisfied with the manner in which TransCanada exercises its discretion, it would be open to the party to bring a request to the Board under section 59 of the NEB Act for the Board to investigate and issue orders as appropriate.

The Board agrees with TransCanada that insufficient details have been provided in this proceeding on how capacity segmentation would be implemented in practice, especially on a system as complex as the Mainline.

Finally, the Board is of the view that FSG has not demonstrated that there is any urgency that would require implementation of its proposals at this time. Therefore, the Board believes that the TTF remains an appropriate forum for initial consideration of the impacts on design and operation of proposals such as those put forward by FSG.

Decision

The Board rejects FSG's proposals for changes to the Mainline's toll design, Tariff, and service offerings, namely: Roll-in of Export Points; Roll-in of Delivery Pressure Charges; Pooling Points; FT Make-Up; Contract Path Flexibility; and Capacity Segmentation.

Chapter 11

Deferral Accounts

In addition to the continuation of existing deferral accounts, TransCanada proposed a new deferral account for regulatory proceeding costs. CAPP in turn proposed a deferral account for OM&A costs.

Regulatory Proceeding Costs

TransCanada indicated that significant aspects of regulatory costs are beyond its control and, accordingly, the costs are very difficult to forecast. For instance, TransCanada noted that with regard to regulatory proceedings in 2003, there is uncertainty as to what the requirements will be for 2004 applications, what the timing of a possible hearing might be, and what negotiations might take place.

FSG objected to the proposed deferral account for regulatory expenses. FSG stated that it does not consider it fair to expect shippers to provide the Mainline with a blank cheque to pay for whatever new regulatory initiatives TransCanada may want to embark upon for the Mainline by establishing a deferral account.

IGUA recognized that some flexibility with respect to regulatory costs is appropriate, but supported the view expressed by FSG that a blank cheque is inappropriate.

OM&A Costs

CAPP submitted that a temporary deferral account for OM&A expenses should be established until such time as TransCanada is able to bring its accounts into compliance with NEB directives. In CAPP's view, an OM&A deferral account would also address the system utilization concerns around the R&O costs which are not under TransCanada's control. This deferral account could also assist in the development of a fuel economy performance measure. TransCanada would be expected to demonstrate prudence under an approach which would not penalize the company for spending necessary capacity maintenance dollars. CAPP, for its part, indicated that it is especially concerned about maintaining the availability of capacity and does not want TransCanada to have an excuse to reduce its available capacity. An OM&A deferral account would also be fair given the concerns about intervenors' ability to sufficiently test TransCanada's OM&A budget, the duration of the proceeding, and the timing of a decision.

IGUA opposed an OM&A deferral account. In IGUA's view, OM&A costs are controllable costs and thus should not qualify for deferral account treatment. The onus should be on TransCanada to prove its OM&A budget is reasonable. Furthermore, it is generally not in the public interest to keep a company's books open for a significant component of Revenue Requirement for a prospective test year.

TransCanada argued that there was absolutely no evidence offered by CAPP with respect to its proposed OM&A deferral account. TransCanada stated that if CAPP had put this proposal into its evidence, CAPP's witnesses would have been cross-examined on it. In TransCanada's view, it was improper for CAPP to first raise such a substantive proposal in argument.

Views of the Board

In its RH-4-93 Decision, the Board set out three criteria that it generally considers in approving deferral accounts; 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.

The Board is of the view that TransCanada may have a certain degree of control over how it spends its regulatory dollars but appreciates that at present, it is difficult to forecast such costs, given the uncertainty related to the timing of regulatory proceedings. The Board notes that a deferral account should not be viewed as giving TransCanada blanket approval to spend in this area, as the disposition of deferral account balances will be subject to prudence review in the following year. Therefore, the Board believes that it would be appropriate to establish a deferral account for regulatory proceeding costs for 2003.

With respect to CAPP's proposal for a deferral account for OM&A costs, the Board is of the view that sufficient information has been placed on the public record to assess the reasonableness of TransCanada's OM&A costs. Furthermore, such an account may reduce TransCanada's incentive to control OM&A costs in 2003. As a result, the Board is of the view that such a deferral account is not warranted.

Decisions

The Board approves the establishment of the proposed deferral account for regulatory proceeding costs for the 2003 Test Year.

The Board denies the establishment of an OM&A deferral account for the 2003 Test Year.

The Board also approves the continuation of the existing deferral accounts, as proposed by TransCanada.

Chapter 12

Cost of Capital

The cost of capital for the Mainline was considered by the Board in its RH-4-2001 Decision of June 2002, concerning TransCanada's 2001 and 2002 Fair Return Application. In that Decision, the Board approved, among other things, the following in respect of the Mainline's Cost of Capital:

- a rate of return on common equity based on the RH-2-94 formula methodology; and
- an increase in the Mainline's deemed common equity ratio from 30% to 33%.

On 16 September 2002, TransCanada filed its 2003 Tolls Application and, separately, filed an application with the Board for review and variance of the RH-4-2001 Decision and related orders (Review Application).

The 2003 Tolls Application specifically requested that the 2003 return for the Mainline be determined by the Board in accordance with its disposition of the Review Application.

In its RH-R-1-2002 Decision, dated 20 February 2003, the Board dismissed the Review Application on the basis that TransCanada had not raised a doubt as to the correctness of the Board's RH-4-2001 Decision.

By application to the Federal Court of Appeal on 21 March 2003, TransCanada sought leave to appeal the Board's RH-R-1-2002 Decision. Leave to appeal was sought on questions concerning the legal test applied by the Board in establishing TransCanada's return and whether the Board fettered its discretion in setting the Mainline's rate of return on common equity based on the RH-2-94 formula methodology.

On 21 May 2003 the Court granted TransCanada's application for leave to appeal the Board's RH-R-1-2002 Decision.[2]

While the 2003 Tolls Application requested that the 2003 return for the Mainline be determined by the Board in accordance with its disposition of the Review Application, it also included, for illustrative purposes, return information based on the Board's RH-4-2001 Decision. Based on the continued application of the Board's RH-4-2001 Decision, the Mainline's rate of return on equity for 2003 would be 9.79% return on a deemed common equity ratio of 33%.

No significant evidence was placed on the record by TransCanada or other Parties regarding an appropriate return for the Mainline for 2003 other than by reference to the Board's RH-4-2001 Decision and the outcome of the Review Application.

2 Federal Court of Appeal Docket No. 03-A-16, Order Dated 23 May 2003.

Position of TransCanada

In argument, TransCanada suggested that the result of the Review Application remains to be determined given its then outstanding application to the Federal Court of Appeal for leave to appeal the Board's RH-R-1-2002 Decision. Accordingly, TransCanada requested that the Board leave tolls interim in respect of return until the disposition of its court action.

Position of Parties

Intervenors that addressed this issue argued that tolls ought not to be left interim pending disposition of TransCanada's court action.

IGUA argued that it would not be in the public interest to have toll payers exposed to TransCanada's claim for increased return for 2003 pending the disposition of TransCanada's court action. In IGUA's view, leaving tolls interim for 2003 would impair the forward test-year toll setting regime.

FSG noted that the 2003 Tolls Application sought a return based on the result of the Review Application. FSG contested TransCanada's assertion that the result of the Review Application was not known, submitting that the result was determined when the Board dismissed the Review Application in its RH-R-1-2002 Decision. FSG also asserted that the 2003 Tolls Application did not indicate that TransCanada would seek to have the Mainline's 2003 return subject to appeal of any Board decision in relation to the Review Application.

CAPP also submitted that the result of the Review Application was determined in the Board's RH-R-1-2002 Decision. CAPP further argued that the 2003 Tolls Application created an expectation of parties that the return would be based upon the Board's consideration of the Review Application and that it would be unreasonable for tolls to remain in a state of uncertainly pending the outcome of TransCanada's court action. Finally, CAPP questioned the jurisdiction of the Board to leave tolls interim on the grounds that no substantive evidence had been filed as to the appropriateness of any return other than that established by reference to the RH-4-2001 Decision, that 2001 and 2002 tolls are themselves final and that the RH-4-2001 Decision was not appealed by TransCanada.

Views of the Board

The Board notes that TransCanada requested that the Mainline's return for 2003 reflect the result of the Board's consideration of the Review Application. Neither TransCanada nor any other party filed significant evidence regarding an appropriate return for 2003 other than in reference to the Board's RH-4-2001 Decision and the outcome of the Review Application.

While the Board determined in its RH-R-1-2002 Decision that TransCanada had not raised a doubt as to the correctness of the RH-4-2001 Decision, the Federal Court of Appeal has subsequently granted TransCanada's application for leave to appeal the RH-R-1-2002 Decision.

The Board recognizes the interest of parties in achieving toll certainty and is concerned with tolls remaining interim pending the outcome of court action over which the Board has little or no control as to timing and in respect of a revenue component as significant as cost of capital. However, in light of the outstanding court action in relation to the Board's RH-R-1-2002 Decision, and the absence of evidence regarding an appropriate return other than that established by the RH-2-94 formula methodology, the legal reality is that the Mainline's approved return and tolls for 2003 may remain subject to uncertainty regardless of any decision of the Board to approve final or interim tolls at this time.

It is the nature of interim tolls that any discrepancy between the interim and final tolls may be charged to the account of shippers in respect of services held and used during the period in which interim tolls were in place. In the Board's view, maintaining this option in respect of the financial consequences of the outcome of the TransCanada court action would be appropriate in this case.

In respect of the CAPP submissions regarding jurisdiction, the Board notes the broad authority provided in sub-section 19(2) and section 64 of the NEB Act regarding interim orders.[3] In the circumstances of this case, the Board does not believe that it lacks the jurisdiction to leave tolls interim pending the outcome of the TransCanada court action.

Accordingly, the Board is of the view that tolls should remain interim pending the disposition of the TransCanada appeal of the Board's RH-R-1-2002 Decision. The Board notes that leaving tolls interim will preserve the Board's ability, in the event the result of the Board's RH-4-2001 Decision is varied, to determine at that time how any necessary adjustment to 2003 cost of capital should be effected.

The Board is also of the view that it would be appropriate to change the level of the interim tolls such that they reflect the decisions of the Board in these Reasons for Decision; the illustrative return contained in the

---

3 19(2) The Board may, instead of making an order final in the first instance, make an interim order, and may reserve its decision pending further proceedings in connection with any matter.

64. Where the Board has made an interim order authorizing a company to charge tolls until a specified time or the happening of a specified event, the Board may, in any subsequent order, direct the company

(a) to refund, in a manner satisfactory to the Board, such part of the tolls charged by the company under the interim order as is in excess of the tolls determined by the Board to be just and reasonable, together with interest on the amount so refunded; or
(b) to recover in its tolls, in a manner satisfactory to the Board, the amount by which the tolls determined by the Board to be just and reasonable exceed the tolls charged by the company under the interim order, together with interest on the amount so recovered.

2003 Tolls Application; and recovery or refund of any difference between these interim tolls and the interim tolls approved by Order TGI-2-2002 to be made over the remainder of the 2003 Test Year, along with applicable carrying charges calculated using TransCanada's estimated short-term borrowing rate of 3.6% for 2003. This approach will ensure that the interim tolls will be at the level of the eventual final tolls, should the Federal Court of Appeal uphold the Board's RH-R-1-2002 Decision or the result of the Board's RH-4-2001 Decision otherwise remain unchanged.

Decisions

The Mainline's tolls shall remain interim pending the disposition of the TransCanada appeal of the Board's RH-R-1-2002 Decision.

TransCanada shall file on or before 15 August 2003, for Board approval, revised interim toll schedules to be effective 1 September 2003 that reflect the Decisions of the Board in these Reasons for Decision; the illustrative return contained in the 2003 Tolls Application; and recovery or refund of any difference between these interim tolls and the interim tolls approved by Order TGI-2-2002 to be made over the remainder of the 2003 Test Year, along with applicable carrying charges.

Chapter 13

Disposition

The foregoing chapters together with Order AO-1-TGI-2-2002 constitute our Reasons for Decision in respect of the 2003 Tolls Application heard by the Board in the RH-1-2002 proceeding.

J.S. Bulger
Presiding Member

Deborah Emes

D.W. Emes
Member

C.L. Dybwad
Member

Calgary, Alberta
July 2003

Appendix I

Toll Order AO-1-TGI-2-2002

ORDER AO-1-TGI-2-2002

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

IN THE MATTER OF an application filed by TransCanada PipeLines Limited (TransCanada) pursuant to Part IV of the NEB Act for orders fixing and approving tolls that TransCanada shall charge for transportation services provided on its Mainline Natural Gas Transmission System (Mainline) between 1 January 2003 and 31 December 2003 (2003 Tolls Application); and

IN THE MATTER OF Hearing Order RH-1-2002

BEFORE the Board on 22 July 2003

WHEREAS TransCanada filed an application dated 16 September 2002, as amended, for an order fixing just and reasonable tolls that it may charge for or in respect of transportation services provided on the Mainline between 1 January 2003 and 31 December 2003 (2003 Test Year);

AND WHEREAS the Board issued Order TGI-2-2002 on 6 December 2003, which authorized TransCanada to charge, on an interim basis effective 1 January 2003, tolls as filed with the Board on 13 November 2002, pending the Board's final Decision on the 2003 Tolls Application;

AND WHEREAS the Board issued Hearing Order RH-1-2002 Directions on Procedure on 5 November 2002, Amended Hearing Order AO-1-RH-1-2002 on 22 November 2002, and Amended Hearing Order AO-2-RH-1-2002 on 31 January 2003;

AND WHEREAS an oral public hearing was held in Calgary, Alberta between 26 February 2003 and 16 May 2003 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 2003 Tolls Application are set out in its RH-1-2002 Reasons for Decision dated July 2003, and in this Order;

THEREFORE, IT IS ORDERED, pursuant to Parts I and IV of the NEB Act, that:

1. TransCanada shall, for accounting, tollmaking and tariff purposes, implement the decisions outlined in the RH-1-2002 Reasons for Decision dated July 2003 and in this Order;

2. TransCanada shall forthwith, and no later than 15 August 2003, prepare and file with the Board, for approval, revised Tariff pages, revised schedules and revised toll calculations for the 2003 Test Year based on the RH-1-2002 Decision; and

3. The Mainline's tolls shall remain interim pending the disposition of the TransCanada appeal of the Board's RH-R-1-2002 Decision.

NATIONAL ENERGY BOARD

Michel L. Mantha
Secretary