National Energy Board

Reasons for Decision

TransCanada PipeLines Limited

RH-2-92

February 1993

Tolls

National Energy Board

Reasons for Decision

In the Matter of

TransCanada PipeLines Limited

Application dated 2 July 1992, as amended, for Tolls

RH-2-92

February 1993

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Recital and Appearances

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

IN THE MATTER OF an application by TransCanada PipeLines Limited for certain orders respecting tolls under Part IV of the Act; and

IN THE MATTER OF the National Energy Board Hearing Order No. RH-2-92;

HEARD at Calgary, Alberta on 13, 14, 15, 16, 19, 20, 21, 22, 23, 27, 28, 29, and 30 October and 2, 3, 4, 5, 6, 12, 13, 18, 19, 20 and 23 November 1992.

BEFORE:

R.B. Horner, Q.C.	Presiding Member
R. Priddle	Member
A. Côté-Verhaaf	Member

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K.J. Hadley	PanCanadian Petroleum Limited
M.A.K. Muir	ProGas Limited
N.J. Schultz	Tennessee Gas Pipeline Company
G. Cameron	Union Gas Limited
G.W. Toews	Western Gas Marketing Limited
W.M. Moreland	Alberta Petroleum Marketing Commission
V.J. Black	Minister of Energy for Ontario
J. Robitaille	Procureur général du Québec
J. Syme	National Energy Board

Abbreviations

ABP	Alberta border price
Act	the *National Energy Board Act*
Algoma	Algoma Steel Inc.
Algoma Steel	Algoma Steel Corporation, Limited
AFUDC	allowance for funds used during construction
Amoco	Amoco Canada Petroleum Company Ltd.
AO	Amending Order
ANR	ANR Pipeline Company
APMC	Alberta Petroleum Marketing Commission
ASL	average service life
base year	1 January to 31 December 1991
Bcf	billion cubic feet
Beaver Wood	Beaver Wood Fibre Company Limited
Board	National Energy Board
CanStates	CanStates Energy
CAPP	Canadian Association of Petroleum Producers
CAPP et al	Canadian Association of Petroleum Producers, Alberta Petroleum Marketing Commission, Industrial Gas Users Association, Minister of Energy for Ontario and Ministère de l'énergie et ressources du Québec
CBRS	Canadian Bond Rating Service
CCA	capital cost allowance
CCAA	Companies' Creditors Arrangement Act
Centra Ontario	Centra Gas Ontario Inc.

CEO	Chief Executive Officer
CICA	Canadian Institute of Chartered Accountants
CNG	CNG Transmission Corporation
the Company	TransCanada PipeLines Limited
Consumers Packaging	Consumers Packaging Inc.
Consumers'	The Consumers' Gas Company Ltd.
CPA	Canadian Petroleum Association
CSA	Canadian Standards Association
DBRS	Dominion Bond Rating Service
DCF	discounted cash flow
Direct Energy	Direct Energy Marketing Limited
Domtar	Domtar Inc.
ELG	equal life group
EM&R	Energy, Mines and Resources Canada
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Foothills	Foothills Pipe Lines Ltd.
FSC et al	FSC Resources Limited and Saranac Power Partners, L.P.
FS	Firm Service
FST	Firm Service Tendered
GDP	gross domestic product
G-7	group of seven economically advanced nations
GH	National Energy Board Gas Hearing, number and year (e.g. GH-2-87)
GJ	gigajoule

GMi	Gaz Métropolitain, inc.
GPIS	gas plant in service
GPUC	gas plant under construction
Great Lakes	Great Lakes Gas Transmission Company
IGUA	Industrial Gas Users Association
IPAC	Independent Petroleum Association of Canada
IPL	Interprovincial Pipe Line Company Limited
IR	information request
ISS	Interruptible Summer Service
ISW	Interruptible Winter Service
km	kilometre
kPa	kilopascal
LDC	local distribution company
long-Canada	long-term Government of Canada bond
Mcf/d	thousand cubic feet per day
MMcf/d	million cubic feet per day
Natural	Natural Gas Pipeline Company of America
NCO	North Canadian Oils Limited
NEB	National Energy Board
Northeast Group	Northeast Group (the)
Northland	Northland Power
NOVA	NOVA Corporation of Alberta
O&M	operating and maintenance
OEB	Ontario Energy Board
Ontario	Minister of Energy for Ontario

PAG	Pan-Alberta Gas Ltd.
Part IV	Part IV of the *National Energy Board Act*
PGT	Pacific Gas Transmission Company
ProGas	ProGas Limited
PS	Peaking Service
Quebec	Le procureur général du Québec
RH	National Energy Board Rate Hearing, number and year (e.g. RH-2-85)
STS	Storage Transportation Service
T-Service	Transportation Service
Task Force	joint industry Task Force initiated by TransCanada
TBO	transmission by others
TransCanada	TransCanada PipeLines Limited
Tennessee	Tennessee Gas Pipeline Company
test year	1 January to 31 December 1993
TGI-5-92	Interim Order for 1993 tolls for TransCanada
TQM	Trans Québec & Maritimes Pipeline Inc.
TransGas	TransGas Limited
TransMountain	TransMountain Pipe Line Company Ltd.
TWS	Temporary Winter Service
U.S.	United States of America
Union	Union Gas Limited
Westcoast	Westcoast Energy Inc.
WFS	Winter Firm Service
Western Gas	Western Gas Marketing Limited

10^3m^3	thousand cubic metres
$10^3m^3/d$	thousand cubic metres per day
10^6m^3	million cubic metres

Glossary of Terms

We provide here definitions for some terms used in these Reasons and which appear only infrequently in the Board's reports. Terms of art which are in common use in the area of NEB toll regulation are not defined.

ASL Depreciation	A group method of depreciation whereby the rate of annual depreciation is based on the average life or average remaining life of the group, and this rate is applied to the surviving balances of the asset group's costs.
CSA-Z184	Canadian Standards Association code for gas pipeline systems.
Double Leveraging	When a company having debt in its own capitalization makes an equity investment in another company which also has debt included in its capital structure, the investment is referred to as having “double leverage”.
ELG Depreciation	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) thus eliminating the need to base depreciation rates on the average service life of the assets.
G-7	Group of seven economically advanced nations (Canada, France, Germany, Italy, Japan, United Kingdom and United States).
GH-2-87	Hearing Order in respect of TransCanada's application for 1988 and 1989 facilities and approval of its toll methodology and related tariff matters.
GH-5-89	Hearing Order in respect of TransCanada's application for 1991-1992 facilities and various applications for natural gas export licences.
GH-4-92	Hearing Order in respect of TransCanada's application for 1993-1994 facilities.
Partial Assignment	This is an agreement between Consumers', as a firm shipper on the TransCanada system, and another party (i.e. the assignee) in accordance with which Consumers' assigns its capacity to the assignee. The assignee is the actual shipper on the TransCanada system and is treated as an FS shipper for nomination and billing purposes. Under the terms of the agreement, the assignee pays the NEB-approved tolls directly to TransCanada based on the delivery volumes specified in the

	partial assignment agreement, notwithstanding any rebate Consumers' might give the assignee.
RH-2-85	Hearing Order in respect of TransCanada's application for new tolls to be effective 1 August 1985.
RH-3-86	Hearing Order in respect of TransCanada's application for new tolls to be effective 1 January 1987.
RH-1-88	Hearing Orders (Phase I and II) in respect of TransCanada's application for new tolls to be effective 1 January 1988 and 1 January 1989.
RH-3-89	Hearing Order in respect of TransCanada's application for new tolls to be effective 1 January 1990.
RH-1-91	Hearing Order in respect of TransCanada's application for new tolls to be effective 1 January 1991.
Subshipper Agreement	An agreement between Consumers', as a firm shipper on the TransCanada system, and another party (i.e. the subshipper) in accordance with which Consumers' agrees to receive gas from the shipper at a designated receipt point and to use Consumers' firm service entitlement to ship the gas to the delivery point designated by the subshipper. Under the terms of the agreement the subshipper agrees to pay Consumers' a unit charge that may be less, but never more, than the NEB-approved tolls. Consumers' is the actual shipper on the TransCanada system and continues to pay the NEB-approved tolls to TransCanada, notwithstanding any discounts that Consumers' and the subshipper may have agreed upon.
Task Force	A joint industry Task Force initiated by TransCanada. Its membership is comprised of a wide cross-section of the natural gas industry, including representatives of the producing, marketing, brokering, pipeline, provincial government, local distribution and industrial end-user sectors.
TOPGAS charges	Sums paid to the TOPGAS and TOPGAS II bank consortia under agreements whereby they assumed TransCanada's take-or-pay liabilities. Also refers to sums paid under Alberta government policy, adopted subsequent to the recommendation of the NEB (see Reasons for Decision in the Matter of TransCanada PipeLines Limited Availability of Services, May 1986), that the financing costs be shared by non-system producers in Alberta.

Overview

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

The Application

On 2 July 1992, TransCanada applied to the Board for new tolls to be effective 1 January 1993. The application dealt with the issues of rate base, cost of service, rate of return, toll design and tariff matters.

The Hearing

The hearing, which lasted 24 days, opened in Calgary on 13 October 1992 and continued until 23 November 1992.

Effect of the Decision on Tolls

Effective 1 April 1993, the approved 100% load factor FS toll to the Eastern Zone will be 87.05 ¢/GJ. This toll can be compared to the toll of 86.86 ¢/GJ approved by the Board for 1992 and a toll of 89.01 ¢/GJ applied for by TransCanada for 1993.

Revenue Requirement

The approved 1993 revenue requirement, net of miscellaneous revenue, is $1,533,998,750 or $35,898,534 less than the 1993 revenue requirement applied for by TransCanada. The main factors contributing to this reduction are: a lower approved rate of return on common equity; a lower unfunded debt rate; lower associated income taxes; an allowed inflation factor for escalation of 2.3% (as opposed to the applied-for rate of 2.5%); the disallowance of 50% of the cost of the non-contributory employee savings plan and a reduction of the salary expense to reflect an allowed increase of 2.0% (versus the applied-for rate of 2.7%).

Rate Base

The Board has approved a rate base of $6,020,046,594 for 1993. This reflects the reduction of average gross plant by the amount of $16,282,050 to account for the projects which had not received Part III approval at the time of this Decision.

The Board has allowed in rate base the additional costs related to thick-wall pipe of $888,533 for 1991 but not the $1,878,909 in costs related to 1992. The Board estimates that this will reduce the revenue requirement for the 1993 test year by $297,469.

The Company has been directed by the Board to file financial cost/benefit analyses with its section 58 applications for all future projects having an estimated cost in excess of $500,000.

TransCanada has been requested to provide a description of its spare parts inventory control system accompanied by an examination of the methodology it utilizes to optimize the levels and locations of its inventory. It has also been directed to file in its next toll application a listing of all spare parts where the individual unit price exceeds $50,000. Furthermore, the Board has asked TransCanada for its comments regarding the feasibility of establishing a shared inventory management system with other parties.

The Board has denied TransCanada the affirmation it was seeking on negative salvage value but has approved its new depreciation rates.

Rate of Return

The Board has approved a rate of return on common equity of 12.25%, a decrease of one hundred basis points from the previously-approved rate of 13.25%.

TransCanada has been allowed to maintain its currently-approved common equity ratio of 30%.

The Board has also provided TransCanada some direction with respect to its proposed replacement of preferred shares by a mix of debt and equity.

Income Tax

The Board has approved the continued use by TransCanada of the flow-through method for calculating its income tax requirements. In addition, the Board is allowing TransCanada to drawdown its deferred income tax balance over the next three years, as applied for. This has the effect of reducing the revenue requirement by $43,131,666 for 1993.

Deferral Accounts

TransCanada has been denied a new deferral account for gas cooling costs but has been allowed to continue using the remaining deferral accounts. The Board has indicated that all deferral accounts will be reviewed on an ongoing basis but has highlighted the Transmission Plant in Service deferral account as one which will receive particular attention in the next toll proceeding. The Board also clarified that it has considered in the past, and will continue to consider in the future, materiality in its review of deferral accounts.

Toll Design and Tariff Matters

The Board has approved the continuation of TransCanada's existing cost allocation methodology for the test year.

The Board was not persuaded that it would be appropriate to direct TransCanada as to the level of financial assurances required for a particular group of shippers.

Loan of Transportation Capacity

The prudence of TransCanada's handling of a potential capacity shortfall in 1992 was the focus of much discussion during the proceedings. The Board has determined that TransCanada acted in a responsible and prudent manner in dealing with the problem and approved the associated tolling and cost consequences for the 1993, 1994 and 1995 test years.

Diversions

The question of diversions was not dealt with in the context of this proceeding. The issue has been deferred until a possible hearing in the Spring of 1993.

Subshipper Agreements

The Board has granted Consumers' the relief it sought with respect to the Board not giving leave under section 69(2) for prosecution of Consumers' under section 69(1) with respect to its subshipper agreements.

Interim Revenue Adjustment

The Board has estimated that the 1993 test-year revenue surplus is approximately $300,314 for the period 1 January 1993 to 31 March 1993 during which TransCanada was on interim tolls. An interim revenue adjustment of approximately $312,596, which includes the revenue surplus together with carrying charges, has been subtracted from the revenue requirement for the period 1 April 1993 to 31 December 1993.

Chapter 1

Background and Application

On 2 July 1992, TransCanada[1] filed an application pursuant to Part IV of the Act for new tolls for 1993. TransCanada revised this application on 16 September 1992 and on 6 November 1992. As part of its application, TransCanada filed a Task Force report containing various recommendations to the Board on issues considered by the Task Force. With respect to each issue, the recommendation indicated whether the Task Force had reached a unanimous or partial consensus or whether it considered that the issue required further study and should, therefore, be referred to a future tolls case.

On 31 July 1992, the Board issued Hearing Order RH-2-92 setting down the application for a public hearing to commence on 13 October 1992.

This order was amended by AO-1-RH-2-92 through AO-4-RH-2-92 to reflect additions to or deletions from the initial List Of Issues.

The public hearing pursuant to Order RH-2-92 commenced in Calgary on 13 October 1992 and continued for 24 hearing days, closing on 23 November 1992.

As set out in Order TGI-5-92, the Board established interim tolls for 1993 for TransCanada. This order remained in effect until the Board rendered its final decision on the application for 1993 tolls.

1.1 Observations on the Economic Environment for the Present Application

TransCanada's application for 1992 tolls was considered by the Board in RH-4-91, which was a four day hearing held in February 1992. The most recent TransCanada toll proceeding in which interested parties contested TransCanada's rate of return and other key elements of the Company's cost of service was RH-1-91. That proceeding was held in May, June and July of 1991 to consider TransCanada's application for 1991 tolls.

At the time of the RH-1-91 hearing, the general expectation, as reflected for example in the Spring 1991 forecasts of the Conference Board of Canada, was that a short-lived recession was nearly over and that strong economic growth was about to resume from mid-1991.

In the last eighteen months, the extent and persistence of what is now regarded as a prolonged recession have become apparent. Some economic analysts believe that the 1990s may be characterized by fierce competition in domestic and international markets and by widespread industrial restructuring. These circumstances, it is thought, will encourage and enforce an overall search for efficiencies in the use of human resources and physical capital.

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[1] The Board is only using abbreviations for many terms in the text of its decision. The long forms can be found in the Abbreviation section which starts on page (vii)

The western Canadian gas industry has experienced unfavourable business conditions for the past several years, reflected primarily in prices of gas which for nearly a decade through mid-1992 had been falling in money-of-the-day and even more in real terms.

As a result, the gas producing industry has been reducing expenditures and activity, cutting staff, taking substantial write-downs, and experiencing significant inter-corporate consolidations. The return on investment in the upstream oil and gas industry has, it is argued, been well below the industry's cost of capital for a decade or more.

Against this background, questions have arisen as to whether and, if so, to what extent, trends in the national economy generally and in the upstream gas industry particularly should find some reflection in the regulation of the tolls of companies such as TransCanada.

In the Board's view, there is a link between TransCanada and the upstream gas industry in terms of the business conditions under which both operate in western Canada. For example, the salary trends faced by TransCanada in a regional context should be very similar to those faced by the upstream gas industry. As well, a weak economy and poor conditions in the producing industries should find reflection in the pricing of at least some of TransCanada's inputs.

With respect to the return on capital invested, however, the Board recognizes that long-established and widely-accepted regulatory principles prevent TransCanada's shareholders from sharing in the “upside” should prosperity return to Canadian gas production. It therefore would be unjust, with regard to the return on equity, to force TransCanada to share the present “downside”. In addition, the Board recognizes the importance to the whole Canadian gas sector of maintaining TransCanada's ability to finance ongoing expansions. It is with these concerns in mind that the Board decided on the rate of return on common equity to be awarded to TransCanada for 1993.

Concerning the national economic context, the Board anticipates that TransCanada's management will seek to reflect changed economic expectations in terms of encouraging economy and efficiency in pipeline investment and operation. It expects TransCanada to continue to vigorously seek out and implement economies and efficiencies even though profit incentives associated with particular business decisions, such as capital projects, may point in the opposite direction.

In summary, the Board is of the view that TransCanada should always attempt to run the most efficient operation possible. In this regard, the Board has applied and will continue to apply rigorous scrutiny to all TransCanada's expenditures.

1.2 Line-by-Line Examination

Some of the parties to the hearing examined TransCanada's application in detail in areas such as transmission plant additions, operation and maintenance expenditures and spare parts inventory.

While this style of cross-examination took up considerable hearing time, the Board felt that it was a useful exercise because it did provide a necessary clarification of certain expenditures, identified estimating errors and revealed some possible weaknesses in TransCanada's record-keeping methodology.

The Board is certain that some of these clarifications could have been obtained and some of the errors corrected in the course of the Task Force's work. However, the Board has decided to follow up some of these areas, such as, the matter of inventory control.

On the one hand, the Board's basic philosophy is to allow and encourage TransCanada's management to run the regulated pipeline business within the parameters established by the Board without the Board in any sense seeking to usurp management's function in this regard. On the other hand, the Board also considers it is salutary for TransCanada's projected expenditures, whether of a capital or operating nature, to be subject to the possibility of periodic public examination such as that undertaken in the current hearing.

The Board anticipates that a line-by-line examination of items which were not satisfactorily clarified in the Task Force process will continue to be a feature of public hearings into TransCanada's toll applications.

1.3 Diversions

TransCanada gave notice to its customers that diversions would be curtailed effective 29 April 1992. TransCanada explained that the curtailments were necessary due to the continuing high, above-design load factors that FS shippers had been operating at during the 19 91-1992 gas year.

By letters dated 3 June and 18 June 1992, respectively, Consumers Packaging and W. Fruehauf Consulting Limited, on behalf of Beaver Wood, applied to the Board asking it to direct TransCanada to continue to allow them access to inter-Parkway Belt diversions. TransCanada had informed Consumers Packaging and Beaver Wood that inter-Parkway diversions would not be allowed beyond 30 June 1992, even though diversions with respect to other shippers elsewhere on the TransCanada system had been curtailed on 29 April 1992.

On 10 August 1992, the Board directed TransCanada to provide for inter-Parkway Belt diversions on an interim basis until the Board had considered this matter in the context of a Part IV proceeding and had rendered a final decision on it.

On 21 August 1992, the Board issued Hearing Order AO-1-RH-2-92 with respect to TransCanada's application for tolls effective 1 January 1993. Issue 13 was added to the List of Issues to specifically address the diversion issue.

On 11 September 1992, TransCanada advised the Board that it had been working with the Task Force Sub-Committee on Diversions with the aim of developing a new diversion policy. TransCanada indicated that the Sub-Committee wished to ensure itself sufficient time to fully consider the diversion issue. Accordingly, the Sub-Committee indicated its preference to review and examine the issue within the confines of the Task Force process and that it had passed an unopposed resolution that TransCanada request the Board to defer consideration of the diversion issue. As both Consumers Packaging and Beaver Wood, the two parties who had sought relief from the Board in respect of inter-Parkway Belt diversions, concurred with the resolution of the Sub-Committee, TransCanada requested that the Board amend the List of Issues so as to remove Issue 13 and to defer consideration of the diversion issue until a Phase II RH-2-92 hearing to be convened in the spring of 1993.

On 18 September 1992, the Board granted TransCanada's request to have Issue 13 removed from the subject portion of the RH-2-92 proceedings and to deal with this issue in a second phase of RH-2-92 to be held in spring of 1993. The Board indicated that, following receipt of the Task Force Sub-Committee report, it would determine the procedure to be followed with respect to Phase II of RH-2-92 and accordingly, would advise all interested parties.

Chapter 2

Revenue Requirement for 1993

The revenue requirement authorized by the Board for the 1993 test year is $1,533,998,750. A summary of this approved revenue requirement together with the Board's adjustments is shown in Table 2-1. In addition, the functional distribution and classification of the approved revenue requirement is set out in Appendix II to these Reasons for Decision.

Table 2-1
Transportation Revenue Requirement for the 1993 Test Year
($ millions)

	Application	**NEB Adjustments**	**Authorized by NEB**
Transmission by Others	353.0	(1.9)	351.1
Operation & Maintenance	209.4	(2.8)	206.6
Gas Cooling Charges	2.4	-	2.4
Depreciation	194.6	(0.5)	194.1
Municipal & Other Taxes	74.7	0.0	74.7
Income Taxes	67.4	(12.0)	55.4
Regulatory Deferrals & Amortizations	37.1[1]0.637 .7	Foreign Exchange Loss	
			0.2-0.2
Return on Rate Base	679.5	(20.3)	659.2
Gross Transportation Revenue Requirement	1,618.3	(36.9)	1,581.4
Miscellaneous Revenue	(48.4)	1.3	(47.1)
Interim Revenue Adjustment	-	(0.3)	(0.3)
Net Transportation Revenue Requirement	**1,569.9**	**(35.9)**	**1,534.0**

1 As revised by letter dated 22 January 1993.

Chapter 3

Rate Base and Depreciation

3.1 Gross Plant

The Board's adjustments to rate base for the 1993 test year are summarized in Table 3-1. The details of the adjustments are explained in the sections following the table.

Table 3-1
Rate Base for the 1993 Test Year
($ millions)

	Application	**NEB Adjustments**	**Authorized by NEB**
Utility Investment:			
Gross Plant	7,630.4	(18.7)	7,611.7
Accumulated Depreciation	(1,681.7)	0.1	(1,681.6)
Net Plant	5,948.7	(18.6)	5,930.1
Contributions in Aid of Construction	(1.5)	-	(1.5)
Total Plant	5,947.2	(18.6)	5,928.6
Working Capital	102.4	(1.7)	100.7
Deferred Costs:			
Average Accumulated Deferred Income Taxes	(63.2)	-	(63.2)
Miscellaneous Deferred Items	35.9	-	35.9
Operating & Debt Service Deferral	18.5	-	18.5
Other Deferred Items	(0.5)	-	(0.5)
Total Rate Base	**6,040.3**	**(20.3)**	**6,020.0**

3.1.1 Gross Plant Additions

TransCanada argued that its gross plant additions should be approved, based on the evidence presented, because it has adequately shown its proper and prudent control of capital expenditures in managing an extremely large construction program. These gross plant additions include costs related to section 52 and section 58 applications.

Decision

The Board approves all of TransCanada's applied-for gross plant additions except those identified in section 3.1.3 and section 3.1.5.

3.1.2 Review of Section 58 Applications

TransCanada stated that the section 58 process was used primarily for additions required to keep the system running and that the section 52 process was used for facilities expansions, although it had no formal policy which provided for such a differentiation. Also regarding section 58 applications, TransCanada noted that it performs financial cost/benefit analyses when warranted and would not be opposed to providing such analyses in future applications.

CAPP expressed concerns during the hearing regarding TransCanada's accountability with respect to section 58 applications, suggesting that TransCanada, and others, resorted unduly to the section 58 process with a view to avoiding full scrutiny at a public hearing. Referring to RH-3-89 and the Act, CAPP suggested that the section 58 procedure should be used primarily in circumstances involving pipeline integrity and safety, and for applications of limited cost. CAPP requested that TransCanada's 1993 annual section 58 application be entered as evidence and then questioned TransCanada on the cost and necessity of several items, arguing that the application contained elements which should bear the scrutiny of a full section 52 application.

APMC was concerned with TransCanada's accuracy in estimating the scope and costs in its section 58 applications and suggested that perhaps the applications should be subject to review by TransCanada's shippers through a Task Force subcommittee. APMC also suggested that overviews of section 58 applications should be provided to interested parties on an annual basis. TransCanada was questioned by APMC on its internal use of financial cost/benefit analyses, and whether it was opposed to providing such analyses in its applications.

IGUA stated that it relies on the Board to carefully scrutinize and resolve all of the issues that were raised concerning rate base during the hearing.

Views of the Board

The Board acknowledges the intervenors' concerns with regard to the section 58 process, but finds that a review of the process is beyond the scope of this hearing. A significant portion of the hearing was devoted to the detailed examination of transmission plant additions. Although an assessment of the merits of individual items would perhaps be more appropriate in a Part III hearing, the Board considers the exercise to have been useful in clarifying the brief and sometimes vague descriptions provided by TransCanada of these expenditure items, as well as in identifying some errors and redundancies.

The Board notes that section 58 of the Act is not limited by an expenditure ceiling or to facilities related to pipeline integrity or safety. It also notes that TransCanada currently sends copies of section 58 applications to some parties, and that the applications are available to any interested party on request. The Board is appreciative of the intervenors' *recommendations regarding improvements to the process. It notes, however, that the ultimate responsibility for reviewing and approving facilities applications rests with the Board.*

The Board is in agreement with the suggestion made by APMC that TransCanada be required to provide financial cost/benefit analyses for significant future facilities additions.

Decision

The Board finds that a review of the section 58 process is beyond the scope of this hearing, as are decisions regarding the merits of individual section 58 applications.

The Board directs TransCanada to submit a financial cost/benefit analysis with its section 58 applications for each future project having an estimated cost in excess of $500,000.

3.1.3 Unauthorized Capital Projects

TransCanada's revised Part V Requirements Table, submitted as part of its application, includes a number of projects which have not received Board approval under Part III of the Act. The costs related to these projects have been removed from TransCanada's applied-for rate base for the 1993 test year.

Decision

The Board has reduced TransCanada's average gross plant by $16,282,050 as a result of the removal of certain projects which had not received Board approval at the time of this Decision. These projects are set out in Appendix VII.

3.1.4 Spare Parts Inventory

TransCanada stated that it carries out an ongoing review of its spare parts inventory and that an assessment is made of the impact of not having parts in inventory when they are needed. TransCanada stated that its system is being run at 97% of its theoretical capability in the winter and that when a compressor unit is down the system is running well below that capacity.

CAPP expressed concern regarding the number of items included in TransCanada's 1993 section 58 application, such as compressor units and aero-assemblies, that were intended for inventory. It submitted that the number of units, and the associated carrying costs, appeared to be excessive. CAPP also questioned TransCanada regarding its requirements for additional warehouse space to house its inventory and the numerous references to cranes and crane upgrades in the 1993 annual section 58 application and Part V Requirements Table. CAPP recommended that TransCanada be required to provide a list of its inventory for items of significant cost, together with a detailed justification of its spare parts policy.

Views of the Board

The Board acknowledges the concern of CAPP regarding the management of inventory for a dynamic and geographically large system such as TransCanada's. The Board agrees that a *list of all major items in inventory would assist in monitoring TransCanada's efficiency in this regard, and is of the view that TransCanada should provide the Board and interested parties with a detailed description of its procedures for ensuring the optimization of the levels and locations of its inventory.*

In the event that TransCanada does not have a process in place which demonstrably optimizes the levels and locations of its inventory, the Board is of the view that an independent third party should provide advice to the Company in this area.

The Board also encourages TransCanada to discuss with other companies the possibility of developing a formal multi-company inventory management system whereby spare parts holdings, particularly for major components, could be shared.

Decision

The Board directs TransCanada to file with the Board and to serve on interested parties, within 30 days of the publication of this Decision, a description of its current spare parts inventory control system, together with a detailed explanation of the methodology it utilizes to optimize the levels and locations of its inventory. The Board will examine this description and explanation to determine whether it meets reasonable standards for proper inventory control. If the Board finds that such an inventory control system is not in place, TransCanada will be required to obtain independent third-party advice and to notify the Board of the advice received and of any subsequent implementation steps.

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

Finally, the Board directs TransCanada to file, with its next toll application, a listing of all spare parts in inventory where the individual unit price exceeds $50,000.

3.1.5 Thick-Walled Pipe

TransCanada has installed pipe of 12.1 mm wall thickness, rather than 11.7 mm, for certain sections of Line 100-6, thereby exceeding the design specifications approved by the Board in Certificates GC-78, GC-80, and Order XG-9-92. The increase in wall thickness was originally proposed in order to accommodate a planned increase in the maximum operating pressure. In its responses to information requests, TransCanada stated that 74.23 km of the thick-wall pipe was installed in 1991 at an incremental cost of $888,533 and that 228.30 km of the thick-wall pipe was installed in 1992 at an incremental cost of $1,878,909.

In a letter dated 10 October 1991, the Board approved TransCanada's request for variance of the 1991 sections, stating that the prudence of the design change and the associated cost of these sections would be subject to review under Part IV of the Act. This was after the 1991 sections were manufactured but before production of the 1992 sections had commenced. In a letter dated 6 March 1992, the Board denied the request for variance of the 1992 sections, directing TransCanada to design Line 100-6 for a pressure of 6895 kPa as per CSA Z184-M92 and stating that the costs would be subject to normal review pursuant to the Board's responsibilities. In its letter of 10 April 1992, TransCanada advised the Board that it had already taken delivery of the thick-wall pipe necessary to construct the 1992 sections. In its letter of 16 April 1992, the Board clarified its decision, stating that it would allow the installation, based on exigent circumstances, of the 12.1 mm pipe on the 1992 sections and reiterating its position with regard to costs.

In the current proceeding, TransCanada argued that it acted prudently with regard to the design changes for both the 1991 and 1992 sections and that the costs associated with the variances are appropriate for inclusion in rate base. TransCanada stated that it initially overlooked informing the Board of its intentions to vary the wall thickness, being more concerned with the GH-5-89 construction program as a whole, the management of which resulted in over-all savings to tollpayers. In its final argument, TransCanada requested that the Board allow it some latitude in order to carry out its affairs in an efficient manner.

In its written final argument, GMi supported TransCanada's position that the costs associated with the variance be included in rate base for both the 1991 and 1992 sections.

Ontario stated that this issue was an important one and went to the heart of the regulatory process. It requested that the Board disallow both the 1991 and 1992 costs plus carrying charges for 1991 and 1992, recognizing that TransCanada may have made a mistake for the 1991 sections, but questioning how the Board could allow the costs of the 1992 sections into rate base, having denied the variance.

Views of the Board

TransCanada's scheduling process resulted in the manufacture of pipe prior to receipt of the required approval. There was no apparent attempt on TransCanada's part to alert the Board to this situation. The Board is not convinced, particularly regarding the 1992 sections, that proper notification to the Board of the situation, and receipt of timely Board consideration, was not possible. In the light of the correspondence between TransCanada and the Board concerning the design variance of the 1991 sections, the Board is of the view that TransCanada was imprudent in failing to recognize that the Board had concerns regarding the efficacy of installing thick-walled pipe on Line 100-6 and in allowing the manufacture of the pipe for the 1992 sections to proceed. In the Board's view, it was this imprudence that gave rise to the exigent circumstances which led the Board to authorize TransCanada to install thick-walled pipe on the 1992 sections.

Decision

The Board allows the inclusion in rate base of the costs incurred as a result of the variance in wall thickness for the 1991 sections.

The Board denies the inclusion in rate base of the costs incurred as a result of the variance in wall thickness for the 1992 sections. An amount of $1,878,909, plus the estimated capitalized benefits and AFUDC of $46,503 has been removed from the applied-for average gross plant.

3.1.6 Forecast of Test-Year AFUDC

Decision

The calculation of AFUDC related to capital additions for the 1993 test year has been adjusted to reflect the approved rate of return on rate base (see section 4.6) as well as the removal of certain capital projects which had not received Board approval at the time of this decision (see section 3.1.3). The Board has reduced the test-year AFUDC by $488,011.

3.2 Working Capital

3.2.1 Cash Working Capital

In its original application, TransCanada proposed the continuation of a cash working capital requirement of 1/12th of its cash operating expenses for the 1993 test year. This request was based on the Company's time-lag study filed in TransCanada's RH-1-91 application. In its September revision, TransCanada filed the results of its most recent time-lag study which analyzed actual 1991 data and included an update to the mail-lag study. On the basis of the results of its new time-lag study, TransCanada requested that the Board approve an increase in the allowance from 1/12th to 1/11th of its annual cash operating expenses. The approval of this change would increase the cash working capital allowance in 1993 from $16,198,511 to $17,671,103.

CAPP argued that there are a number of reasons why TransCanada's cash working capital allowance should not be increased. These reasons included: CAPP's assertion that TransCanada's study methodology is flawed and not consistent with conventional lead-lag studies; CAPP's belief that TransCanada is generous with the timing of its monthly payment of its head office rent, which suggests that TransCanada is not as efficient as it could or should be with respect to its cash requirements; and the fact that TransCanada's forecast indicates the Company will be in a negative working capital position at the end of 1993 and therefore may not require an allowance for working capital at all.

With respect to its belief that TransCanada's methodology is not consistent with conventional lead-lag studies, CAPP suggested that TransCanada's methodology ignores the time between TransCanada's receipt of a service and its payment for that service. In addition, CAPP suggested that TransCanada assumes, in its study, an inordinately long lapse between the time it makes a payment and the time it is reimbursed through revenues.

As a result, CAPP suggested that at a minimum, TransCanada should remain on the present 1/12th arrangement.

Views of the Board

With respect to CAPP's assertion that TransCanada is “generous” in its payment of rent because the Company does not use post-dated cheques or hand deliver the cheque to the *landlord who is in the same building, the Board agrees with TransCanada that its banking department would not have to cover any funds associated with the rental payment prior to the first day of the month. This is because the cheque would require from one to two days for mail delivery and another day for the transfer between the landlord's account and TransCanada's account.*

The Board notes that CAPP's assertion that TransCanada may not require an allowance for working capital at all in 1993 was based on information contained in a Pro Forma Consolidated Balance Sheet as at 31 December 1993 which was filed by TransCanada as part of its Financial Evidence. The Pro Forma Balance Sheet indicates a negative working capital balance of $86,100,000 as at 31 December 1993. This negative working capital position appears to be due to an unusually low level of cash and short-term investments when compared to prior years. The Board notes that the 1993 figure supplied by the Company is only an estimate and that the date of 31 December 1993 is only a one-day snapshot of the Company's 1993 financial position. Given that there was no evidence to indicate how long this negative working capital situation may persist in 1993, it is very difficult for the Board to judge whether or not it is likely to be of a short-term or long-term nature. In addition, the Board notes that other evidence in the Company's application indicates that the corresponding actual/estimated year-end figure for each of the years from 1987 to 1992, shows TransCanada's utility working capital to be positive and approximates the level of working capital sought by TransCanada in this application. Therefore, the Board finds it very difficult to conclude that the Company's forecast negative working capital position at the end of 1993 is anything but a temporary situation.

The Board agrees with CAPP that TransCanada's study methodology is not consistent with conventional lead-lag studies. In a conventional lead-lag study, TransCanada would have to assess the length of time it requires funds to finance its short-term cash requirements from the time it provides a service to the time it receives payment in the form of toll revenue. In addition, the Company would be required to offset this funding requirement for the time it has the use of supplier funds from the time when it receives goods and services to the length of time it makes the corresponding payments for them. TransCanada's current study methodology focuses only on the lag between the time TransCanada writes a cheque and the time it is reimbursed through revenues as adjusted for mail lag.

The Board is of the view that, had TransCanada taken CAPP's concerns into consideration, as it would have in a conventional lead-lag study procedure, the resultant cash working capital allowance would be somewhat lower than that calculated in TransCanada's most recent study. The Board notes that TransCanada did not provide comments in its argument or reply as to whether or not CAPP's concerns were legitimate. As a result, the Board is not persuaded that an increase in the allowance for cash working capital is required.

Decision

The Board denies TransCanada's request for an increase in its cash working capital allowance from 1/12th to 1/11th of its annual cash operating expenses. Using an allowance of 1/12th of the Company's annual cash operating expenses, as adjusted

elsewhere in these Reasons (see Chapter 5), the Board has determined the cash working capital allowance for the 1993 test year to be $15,968,010 and the total working capital to be $100,659,791. In addition, with respect to the determination of an allowance for cash working capital, the Board directs TransCanada to file a lead-lag study procedure in its next application which would address the concerns expressed by CAPP and shared by the Board.

3.3 Depreciation

3.3.1 Depreciation Study

In its RH-1-91 Decision, the Board noted that TransCanada's last Depreciation Study was filed with the Board in December 1983 and as a result, the Board directed TransCanada to undertake and file a Depreciation Study by 30 June 1992.

The new Depreciation Study, carried out in conjunction with Gannett Fleming Valuation and Rate Consultants, Inc., was filed as part of TransCanada's 1993 tolls application.

Pursuant to this new Depreciation Study, TransCanada sought to obtain the following:

(a) approval of the depreciation rates set out in the Depreciation Study;

(b) approval for the continuation of the Average Service Life method of depreciation; and

(c) affirmation from the Board that negative salvage costs will be recoverable in future tolls when the Company presents a proposal, acceptable to the Board, for recovery of such costs.

3.3.1.1 Depreciation Rates

Based on the results of the Depreciation Study filed as part of its application, TransCanada proposed to reduce its composite depreciation rates from 2.83% to 2.56%. TransCanada noted that no aspect of the Depreciation Study, save TransCanada's request in respect of negative salvage costs, was opposed by any member of the Task Force. Therefore, in TransCanada's view, the evidence on the record in this proceeding overwhelmingly supports the Board's approval of TransCanada's proposed revised depreciation rates.

CAPP and Union stated that they were in agreement with the proposed revised depreciation rates sought by TransCanada.

GMi indicated that it had examined the Depreciation Study and found the rates requested to be just and reasonable.

Decision

The Board accepts the depreciation rates for the 1993 test year set out in TransCanada's Depreciation Study.

3.3.1.2 Average Service Life versus Equal Life Group Depreciation

With the Board's approval, TransCanada uses the ASL method of depreciation for toll-making purposes. In its RH-3-86 Decision, the Board directed TransCanada to evaluate the appropriateness of adopting the ELG method of depreciation in its next depreciation study. In the RH-3-89 hearing, TransCanada stated that it had engaged a firm of consultants to conduct both the depreciation study and a review of the ELG method of depreciation. TransCanada expected the study would be completed by the end of 1990. In the RH-1-91 hearing, TransCanada indicated that no substantive work had been done to evaluate ELG and that they did not have an expected date for the filing of the depreciation study.

TransCanada provided its evaluation of the ELG method of depreciation as part of its new Depreciation Study undertaken in conjunction with Gannett Fleming Valuation and Rate Consultants, Inc. In TransCanada's view, the ASL method of depreciation does not impose an unfair burden upon future tollpayers. In support of this claim, TransCanada noted that if the ELG method were implemented in the test year, there would only be 12/100ths of a percentage point difference in depreciation rates for the test year.

TransCanada provided the following reasons for supporting the continued use of the ASL method:

(a) the ASL method is the most widely used method in the pipeline industry. Therefore, from both an equity and a competitive point of view, it is the most appropriate;

(b) the ASL method is the one TransCanada has used in the past and with which it is therefore most familiar. It also most properly accords with TransCanada's existing systems and accounts;

(c) the ASL method is reasonable for TransCanada according to Gannett Fleming Valuation and Rate Consultants, Inc.; and

(d) retention of the ASL method was supported by a consensus of the Task Force.

CAPP stated that it was somewhat reassured by TransCanada's position as to why it should be permitted to continue to use the ASL method. CAPP also pointed out that the Task Force agreed with TransCanada's conclusion to stay with the ASL method.

GMi was of the view that the ASL method is appropriate. In this regard, GMi noted that, with the approval of the Régie du gaz naturel du Québec, GMi uses this method to calculate depreciation for its own rate-making.

Views of the Board

Since it was the Board's directive in RH-3-86, which required TransCanada to evaluate the appropriateness of adopting the ELG method of depreciation, the Board considered it fitting to explore the Company's views on the impact of the ELG method of depreciation. Based on the Company's responses, as well as arguments put forth by parties during the proceedings, the Board is satisfied that the continuation of the ASL method of depreciation is appropriate.

Decision

The Board approves the continued use of the ASL method of depreciation for TransCanada.

3.3.1.3 Negative Salvage

TransCanada noted in its Depreciation Study that "While the Company is not seeking recovery of negative salvage in its cost of service, it requires affirmation from the Board that negative salvage is a recoverable cost of owning a pipeline and that such costs, after appropriate review, will be recoverable as part of its future cost of service."

TransCanada maintained that its request is simply that the Board declare or affirm that negative salvage costs will be recoverable in future tolls. TransCanada claimed that the driving force behind its request is the CICA Handbook requirement (section 3060, Capital Assets) that negative salvage costs not be classified with accumulated depreciation but should be booked as a liability.

TransCanada stated that it cannot accurately ascertain what site restoration costs it might incur in the future, nor even when they might be incurred. As a result, TransCanada suggested that it is premature for the Company to book site restoration costs as a liability when no reasonable basis for determining them exists with the requisite degree of certainty. Yet, TransCanada noted that the CICA Handbook requires that such costs be booked. This therefore presents a dilemma for the Company. TransCanada recognized that it is in effect seeking a justification, acceptable to its auditors, for not making provision for negative salvage in 1993.

TransCanada claimed that it would gain no benefit from the assurance requested from the Board and that it will simply result in TransCanada being properly justified in not booking any provision for negative salvage costs in its accounts for the 1993 test year. TransCanada stated that neither the Board's letter of 19 February 1986 nor the Board's earlier paper[1] regarding negative salvage provides the Company with the level of assurance required. TransCanada also noted the heightened concern over the costs of restoring the Canadian environment to its pre-industrial state and the fact that legislation in this area continues to develop almost daily.

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1 A study of negative salvage value was commissioned by the Board in 1985, which was released for public comment under the title "Background Paper on Negative Salvage Value". Following receipt of input from interested parties, the Board, by letter dated 19 February 1986, issued a summary of its expectations of how the matter would be treated in the future. This action predated the CICA Handbook's recognition of the subject.

CAPP argued that it does not believe that TransCanada's requested confirmation should be granted by the Board. CAPP maintained that the request is both premature and unnecessary and noted the following facts which emerged in questioning:

(a) through the CAPP organization, a study is presently underway dealing with the entire negative salvage issue on a generic industry-wide basis. A TransCanada employee chairs the committee;

(b) Westcoast has put off dealing with the negative salvage issue and is not making provision for negative salvage in its accounts for the 1993 test year;

(c) no other Canadian pipeline appears to be making provision for negative salvage in its accounts for the 1993 test year at this time;

(d) TransCanada itself has only done preliminary work on its preferred method of abandonment. It is not at this time undertaking any sort of study;

(e) at present, there is no provision in the *Income Tax Act* or its *Regulations* which allows negative salvage recoveries to be treated as a deduction from income for tax purposes; and

(f) TransCanada effectively collects negative salvage on the retirements it makes now.

CAPP maintained that TransCanada's requested confirmation is unnecessary, for several reasons. First, and most importantly, there are significant gas reserves remaining in the Western Canada Sedimentary Basin. Second, TransCanada is, at this time, looking for the highest level of assurance (i.e the Board's), although TransCanada concedes that this is not needed to justify TransCanada deferring the costs of negative salvage from the test year. Third, TransCanada's use of a U.S. guideline, specifically FASB Statement No. 71, is of little value since it is a 1982 document which is decidedly generic in nature. Although this guideline has been in existence for a decade there are no U.S. onshore pipelines, except for PGT, which are recording negative salvage. CAPP also noted that despite the reference to this FASB document, TransCanada failed to provide any evidence whatsoever that assurances such as the one it is seeking are commonly requested by U.S. pipelines of their regulator.

CAPP suggested that there cannot be particular urgency to this matter because the CICA Handbook was, on the evidence, changed in order to deal with financial years after December 1990, yet TransCanada failed to bring this issue up in the tolls case for the 1992 test year.

Based on the arguments noted above, CAPP is concerned that should the Board grant the affirmation that TransCanada is seeking in its application, it will be regarded as a form of moral obligation on the Board to recognize and allow the collection of negative salvage in the future.

IGUA maintained that the narrow issue to be resolved is whether the Board should make what it characterizes as “advance rulings”, declaring TransCanada to be entitled to recover negative salvage claims with respect to pipeline assets in a future case.

IGUA also submitted that the negative salvage issue for the 1993 test year is purely hypothetical. IGUA noted that the courts have traditionally refused to consider and decide hypothetical issues. IGUA therefore suggested that the NEB, as a quasi-judicial tribunal, ought to do likewise and recommended that the Board should refrain from making any findings with respect to the negative salvage issue in this particular case.

GMi argued that negative salvage is a cost which must be addressed in order to assure intergenerational equity. GMi stated that this is reflected in the fact that provision for negative salvage is now recognized by the CICA as a generally accepted accounting principle. However, GMi argued that there does not seem to be a general industry consensus on how negative salvage is to be treated for transmission companies under the Board's jurisdiction. For example, GMi noted that IPL, NOVA[1], TransMountain and Westcoast do not now include it in their respective rates. In addition, GMi noted that this matter is actively under study within the CAPP. GMi therefore concluded that it would be appropriate for the Board to direct TransCanada to address the matter in its next tolls application, putting forth a more definitive proposal.

APMC stated that it is hardpressed to understand why, given that TransCanada has not yet examined the best way to complete the abandonment of its system, and given that the future recovery of negative salvage costs does not seem to be a significant issue for other NEB-regulated pipelines, TransCanada believes there is some urgency to deal with this matter now. To the APMC, this question is premature and should not be dealt with by the Board until TransCanada has completed its analysis and the CAPP study on negative salvage costs is released.

APMC also noted that there are currently unresolved tax issues concerning the treatment of negative salvage recoveries which, if dispensed with in a manner which would provide the appropriate relief, may very well mitigate TransCanada's concerns with respect to this issue.

Views of the Board

Given the arguments put forth by intervenors that other companies have not found it necessary to apply for the level of assurance that TransCanada is seeking, and that TransCanada itself admits that it would not be seriously affected without this assurance being given, the Board is not persuaded that the Company will be adversely affected should the Board not grant the affirmation sought. Moreover, the Board is reluctant to give what would amount to an "advance ruling" in the absence of a factual record on which to base such a ruling.

The Board is therefore of the view that it would be inappropriate for it to consider this issue until the Company files more substantive information.

Decision

The Board is not prepared to address the question of whether negative salvage will be recoverable in future tolls until such time as the Company submits an application containing more detailed information as outlined in the Board's letter of 19 February 1986.

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1 NOVA is not under the Board's jurisdiction.

3.3.2 Depreciation Expense

Decision

The Board has reduced the test-year depreciation expense by $529,652 and the accumulated depreciation by $135,287 to reflect the adjustment to the AFUDC rate (see section 3.1.6) and the disallowance of costs associated with certain capital projects (see sections 3.1.3 and 3.1.5).

Chapter 4

Cost of Capital

TransCanada, in its final revision, applied for a rate of return on rate base of 11.25% for the 1993 test year, as compared to the currently-approved rate of 11.56% for 1992. The applied-for rate of return on common equity for the 1993 test year was 13.25%, on a deemed common equity component of 30.0%, unchanged from that approved for 1992.

Details of the applied-for capital structure and requested rates of return, as revised, are shown in Table 4.1 and discussed in detail in sections 4.1 to 4.5.

Table 4-1
Applied-for Deemed Average Capital Structure and Rates of Return for the 1993 Test Year

	Amount ($000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Debt - Funded	3,475,577	55.19	10.92	6.03
- Unfunded	316,538	5.03	8.91	0.45
Total Debt Capital	3,792,115	60.22		6.48
Preferred Shares	616,176	9.78	8.08	0.79
Common Equity	1,889,268	30.00	13.25	3.98
Total Capitalization	**6,297,559**	**100.00**		
Rate of Return on Rate Base				**11.25**

4.1 Funded Debt

In its initial application, TransCanada applied for a capitalization which included a funded debt component of $3,476,125,000 (55.8% of total capitalization), costed at a rate of 10.84%. During the hearing this amount and the associated cost rate were revised to $3,475,577,000 (55.19% of total capitalization) and 10.92% respectively. The funded debt amount and the associated cost rate were determined using the gross proceeds approach approved by the Board in its RH-2-85 TransCanada Reasons for Decision.

No intervenor took issue with either the applied-for amount of the funded debt or the cost rate of 10.92%.

Decision

The Board approves the Company's funded debt amount of $3,475,577,000 for the 1993 test year at an embedded cost rate of 10.92%.

4.2 Unfunded Debt

Unfunded debt represents that portion of TransCanada's long-term debt which remains to be raised by the issuance of long-term debt. This figure is derived by subtracting the funded debt, preferred share capital and common equity capital from the total capitalization.

Initially, the Company applied for an unfunded debt rate for the test year of 8.74%, which was later revised upwards by 17 basis points to 8.91%. The Company argued that the currently-approved methodology, which uses a blend of short-term and long-term interest rates, for the calculation of an unfunded debt rate results in somewhat higher risk for TransCanada. The recent volatility in short-term borrowing rates and the risks associated with this volatility continuing into 1993 prompted TransCanada to revise its unfunded debt rate upwards.

CAPP in its filed evidence stated that, given current financial market conditions, the applied-for rate of 8.74% for TransCanada's unfunded debt for the 1993 test year is excessive. In final argument, CAPP argued that the 8.75% long Canada rate utilized by TransCanada for the calculation of its unfunded debt rate for the test year is too high. Furthermore, the requested increase of 17 basis points from the initially applied-for rate of 8.74% to 8.91% is caused, CAPP argued, by TransCanada rearranging its financing plans by projecting higher expenditures in the early part of 1993. CAPP suggested that this may have no relationship to reality.

CAPP's witness on capital structure stated in his filed evidence that, with the exception of 1987, TransCanada's actual cost for unfunded debt has been lower than the rate approved by the Board and TransCanada has been able to earn extra money by managing its unfunded debt position more effectively. TransCanada, however, disagreed with this witness' calculation and denied the suggestion that it overearned on the unfunded debt component of its capital structure. In final argument CAPP suggested that TransCanada's actual financing plan for its unfunded debt should be monitored on an ongoing basis to ensure that TransCanada does not overearn by rearranging the timing of its debt issues.

IGUA supported CAPP's position on unfunded debt.

Ontario opposed TransCanada's request to increase its applied-for unfunded debt rate from 8.74% to 8.91%. Ontario suggested that some benefit of the overearned interest on TransCanada's 1992 unfunded debt should be passed on to the tollpayers.

Views of the Board

Having reviewed the evidence presented on this issue, the Board is of the view that the forecast rates used by TransCanada for three-month Treasury Bills, ten-year and long-term Canada bonds to arrive at a rate for unfunded debt are at the high end of the range of reasonableness. Also, given the current and prospective economic environment and capital *market conditions, the Board is not persuaded that an unfunded debt rate higher than 8.74% is warranted for the test year. The Board notes that the reason given by TransCanada for the requested increase for the unfunded debt rate was the increase in the short-term interest rates. That trend has since reversed itself. The Board finds 8.74% to be a reasonable rate for unfunded debt in the test year.*

Decision

The Board approves an unfunded debt amount of $330,045,916 for the 1993 test year and an associated cost rate of 8.74%. The applied-for unfunded debt amount has been increased by $27,692,000 to reflect the Board's decision on the $60,000,000 proposed preferred share issue for the 1993 test year (see section 4.3).

4.3 Preferred Shares

TransCanada's applied-for capital structure for the test year includes a preferred share component of $616,176,000 (this represents 9.78% of the applied-for capital structure) with an associated weighted average cost rate of 8.08%. This applied-for amount includes the $60,000,000 preferred share issue which the Company proposes to issue in July 1993. As a result of changes to the income tax treatment for dividend income in the last few years, companies are no longer able to issue preferred shares at rates as attractive as those existing in previous years.

In RH-1-91, TransCanada addressed the possibility of issuing subordinated debentures in limited amounts as an alternative to preferred-share financing. While noting that the issuance of subordinated debt would be a cost-efficient alternative to preferred shares, the Company stated that there would be a limit as to how much of this type of debt could be raised without an increase in TransCanada's deemed common equity ratio. In RH-1-91, the Company viewed as reasonable an eventual replacement of the preferred share component of TransCanada's deemed capital structure, 75% by debt and 25% by common equity. There was a preliminary discussion of this in RH-1-91 and the Board in its Reasons for Decision acknowledged that the preferred share replacement concept may have some merit and encouraged all parties to further explore this issue in a future TransCanada tolls proceeding.

In the current proceeding, TransCanada's witness on capital structure maintained his view that preferred-share financing is not a cost-efficient method and that, given the term of preferred shares and the retractable and convertible features, he did not feel that this capital is equity in real terms but is more related to debt. TransCanada's expert witnesses therefore proposed gradually eliminating this expensive form of financing starting in 1993, 50% by debt and 50% by common equity.

The witness for CAPP et al agreed with TransCanada and its witnesses that preferred-share financing is not cost-efficient and that these instruments presently included in TransCanada's deemed capital structure should gradually be eliminated as they mature. In final argument, CAPP agreed with TransCanada's witness on capital structure that preferred shares should be eliminated gradually over a period of time, but disagreed with TransCanada's proposal to replace them with a 50/50 mix of debt and equity. CAPP argued that in the current proceeding TransCanada changed its proposal to a 50/50 split rather than the

75/25 proposed in RH-1-91. CAPP took the position that the preferred shares should be replaced over time with 100% debt.

IGUA supported the position taken by the witness for CAPP et al and argued that the existing preferred share component of TransCanada's deemed capital structure should gradually be replaced with debt only, and not with a combination of debt and common equity as suggested by TransCanada's capital structure witness.

APMC agreed with the views of the witness for CAPP et al on preferred shares, namely, that for all practical purposes investors consider preferred shares as debt and that non-payment of dividends on preferred shares essentially has the same adverse effect on investor views regarding the financial health of the utility as would the non-payment of interest on debt when due. APMC concurred with the CAPP et al witness that existing preferred shares should gradually be replaced with debt only.

Views of the Board

The Board agrees with TransCanada and the intervenors that preferred shares no longer represent a cost-efficient form of financing for TransCanada's utility operations.

Various alternatives were suggested by parties as to how the preferred share component of TransCanada's deemed capital structure should be progressively replaced. The alternatives only relate to the appropriate ratio of debt and equity to replace the preferred shares.

In considering the gradual replacement of TransCanada's preferred-share component of its deemed capital structure, the Board was cognizant of two issues: the first issue was the immediate and appropriate treatment of TransCanada's proposed $60,000,000 issuance of new preferred shares in 1993; and the second was the manner in which the remaining preferred shares currently included in the deemed capital structure of TransCanada, as well as any future new issuances of preferred shares, should be handled.

With respect to the proposed $60,000,000 issuance of preferred shares in 1993, given its finding that preferred shares no longer represent a cost-efficient form of financing, the Board has concluded that it would be inappropriate to allow TransCanada, for tollmaking purposes, to reflect the $60,000,000 ($27,692,000 on a paid-up equivalent basis) as preferred share capital in its 1993 deemed capital structure. Therefore, for tollmaking purposes, the $60,000,000 of preferred shares should be considered as wholly replaced with debt in the 1993 test year. As a result, the applied-for preferred share balance of $616,176,000 is reduced by $27,692,000, leaving a balance of $588,484,000.

With respect to the treatment of the remaining preferred shares which are currently included in TransCanada's deemed capital structure and which must be renewed or replaced, and the treatment of any proposed new issues of preferred shares, the Board is of the view that the costs and the tollmaking consequences of any such transactions should be dealt with in the context of the toll proceedings for the test years in which they are projected to occur.

Finally, the Board is of the view that, unless circumstances change so as to render preferred shares an efficient way of raising capital, the prudence of TransCanada's future use of preferred-share financing, for whatever purposes, will be examined in the relevant toll proceeding.

Decision

With respect to TransCanada's proposed issuance of $60,000,000 of preferred shares in 1993, the Board believes that this form of financing is not cost efficient. It has therefore decided that it would not be prudent for TransCanada to issue additional preferred shares in 1993. In this light, and having regard to the Board's decision that a 30% common equity ratio is appropriate for TransCanada for 1993, the Board, for tollmaking purposes, has deemed the proposed $60,000,000 to have been financed solely by debt and the unfunded debt balance has been increased to reflect this decision. For 1993, TransCanada's capitalization, for tollmaking purposes, will therefore show a preferred-share balance of $588,484,000 and an associated cost rate of 8.11%.

With respect to the existing preferred-share financing which will need to be renewed or replaced and to any future new preferred-share financing, the Board has decided that the costs and tollmaking consequences of these transactions should be examined in the toll proceedings for the test years in which the transactions are proposed to occur.

Further, unless circumstances change so as to render preferred shares a cost-efficient means of financing, the Board will examine, for tollmaking purposes, the prudence of any further use of preferred-share financing by TransCanada.

4.4 Common Equity Ratio

TransCanada applied for a deemed common equity ratio of 30% for the 1993 test year, unchanged from the currently-approved level.

All TransCanada's expert witnesses stated that there is no basis to reduce the utility's deemed common equity ratio because its business risks have remained unchanged since RH-1-91. TransCanada's witness on capital structure was of the view that a 30% common equity ratio is the minimum required to successfully complete TransCanada's upcoming massive financing program. All of TransCanada's expert witnesses were of the view that the intervenor's proposal of a 28% common equity ratio and an 11.5% rate of return on common equity, if accepted by the Board, would definitely be perceived by investors and the debt rating agencies as a shift in regulatory ground rules. The risk would therefore arise of TransCanada's debt being downgraded from its current rating of A to, for example, BBB (high). If this happened, TransCanada's borrowing cost at the margin may increase by 25 to 50 basis points and the Company may have to rely more heavily on the U.S. market to issue debt, as the Canadian debt market may not have the capacity to absorb large BBB debt issues. During cross-examination, however, TransCanada's witness on capital structure did acknowledge that, in the past, the Company has been very successful in raising capital at reasonable rates with a 30% deemed common equity ratio.

The issue of the appropriate interest coverage ratio for TransCanada was discussed during the hearing. The Company and its expert witnesses stressed the need to have an interest coverage ratio of 2.0 times, or at worst marginally below that figure to maintain the confidence of the debt rating agencies. When questioned about the importance given to the interest coverage ratio by investors and the debt rating agencies in determining the creditworthiness of a company, TransCanada's witness on capital structure substantially agreed with the rate of return witness for CAPP et al that the interest coverage ratio is only one of many risk factors that affect the creditworthiness of a borrower. He also agreed that the difference between his views and the views of CAPP et al's rate of return witness is a matter of degree only.

TransCanada's witness on capital structure acknowledged, in his filed evidence, that the common equity ratio for TransCanada's non-jurisdictional operations is at the lower end of the desired level. Under cross-examination, he also agreed that some of TransCanada's non-jurisdictional operations may be of a marginally higher risk than its utility operations. However, he denied the suggestion that cross-subsidization exists.

The rate of return witness for CAPP et al agreed with TransCanada's capital structure witness that the Company's business risks have not changed materially since RH-1-91. However, keeping in mind TransCanada's business risks, he was of the view that a 30% common equity ratio is too high. Furthermore, in his evidence he stated that a 30% common equity ratio allocation for the utility operations would leave less than 30% common equity for TransCanada's non-regulated investments. As well, some of these involve “double leveraging” and are therefore of higher risk than TransCanada's utility operations. CAPP's expert witness on capital structure shared the view of the rate of return witness for CAPP et al that TransCanada's non-regulated investments are of higher risk than its regulated operations, and do not have sufficient common equity underpinning them.

In discussing the issue of the appropriate common equity ratio for TransCanada's utility operations, CAPP argued that under certain circumstances the common equity ratio could be lowered, even though the Company's business risks have remained unchanged. TransCanada's rate of return witness shared this view, provided those circumstances resulted from changes in the capital market conditions and no such change, in his view, has taken place in this case. CAPP argued that the change has taken place in terms of lower economic expectations in the marketplace.

During cross-examination, while discussing TransCanada's debt rating, CAPP's financial panel took the view that the likelihood of TransCanada being downgraded from its current debt rating of A to the BBB category is remote, and that it is not in the best interest of CAPP's members to see TransCanada's debt rating lowered. CAPP's capital structure witness acknowledged that if TransCanada's debt rating were to be lowered to the BBB category, its borrowing cost at the margin could go up by 40-50 basis points.

In final argument, IGUA took the view that, given the number of deferral accounts that TransCanada has, its business risks are minimal and that a 28% deemed common equity ratio is appropriate.

APMC argued that, along with the evidence provided by the expert witnesses on capital structure and rate of return issues, the Board should give weight to the evidence provided by CAPP's financial panel. APMC and the Province of Quebec also supported CAPP et al's rate of return witness' recommendation of a 28% deemed common equity ratio for TransCanada's utility operations.

Views of the Board

There was much discussion about the conditions needed for TransCanada to maintain its present A credit rating, including interest coverage. The Board notes that there is general support for the desirability of TransCanada maintaining its present rating and that the interest coverage ratio is but one factor considered by rating agencies in their assessment of a company's creditworthiness. The Board also notes that TransCanada's own evidence is that its A rating by Standard & Poor's is essentially based on continuation of a consistent regulatory approach to capital structure and equity return. The Board does not believe that it should adopt a specific criterion regarding interest coverage ratios for TransCanada. Rather, the Board expects that fair regulatory treatment, particularly as to TransCanada's capital structure and equity return, will continue to send positive signals to rating agencies.

The Board finds some merit in the views expressed by the witnesses for CAPP and CAPP et al that the common equity ratio underpinning TransCanada's non-jurisdictional investments may be at the lower end of the desired level. However, the Board is also aware of the fact that TransCanada's non-jurisdictional assets now comprise a much smaller portion of the Company's asset base than in previous years.

The Board agrees with the Company's witnesses that there has not been any significant change in the TransCanada's business risk since RH-1-91.

Decision

The Board approves a deemed common equity ratio of 30% for the 1993 test year.

4.5 Rate of Return on Common Equity

TransCanada applied for a 13.25% rate of return on its 30% deemed common equity ratio, unchanged from the currently-approved level. In requesting this rate, the Company relied on the advice of its expert witnesses on rate of return, who based their 13.25% rate of return recommendation on consideration of the results of the comparable earnings, DCF and equity risk premium techniques for estimating the cost of common equity capital. The rate of return witness for CAPP et al applied the DCF and the equity risk premium tests to arrive at his 11.5% recommended rate of return on common equity for TransCanada. The results of the various tests applied by the witnesses are summarized in the following tables.

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

	Investors' Required Rate of Return	Adjustment for Lower Risk of Utilities	Adjustment for Market to Book Ratio	Required Rate of Return for Low Risk Utilities

Test:	(%)	(%)	(%)	(%)
Comparable Earnings	13.5	(.30)	N/A	13.2
Discounted Cash Flow	12.1	(.30)	1.10	12.9
Equity Risk Premium	12.25-12.50	-	1.00-1.25	13.5
Recommended ROE for TransCanada				**13.25**

Table 4-3
CAPP et al's Rate of Return Witness' Evidence

Test:	**Investors' Required Rate of Return (%)**	**Adjustment to Reflect Lower Risk of Pure Utilities (%)**	**Adjusted Test Results (%)**	**Required Rate of Return for Low-Risk Utilities (%)**
Comparable Earnings	N/A	N/A	N/A	N/A
Discounted Cash Flow	11.0	(.60-.80)	10.20-10.40	10.25-10.50[1]
Equity Risk Premium	10.25-11.00	N/A	10.25-11.0	10.25-11.0
Adjustment for "cushion"				0.50
Recommended ROE for TransCanada				**11.50**[2]

Notes:

1. Rounded
2. Final recommendation placed reliance on the high end of the range of the Equity Risk Premium Test results to which the witness added 50 basis points as a cushion to reflect prevailing financial conditions.

TransCanada's rate of return witnesses applied the comparable earnings technique to a sample of 28 low-risk industrial companies chosen from the consumer sector of the Canadian economy, and based their findings on the achieved returns of these companies for the time period 1983-1991. The sample companies' earned returns averaged 13.5% over this time period. This rate was adjusted downwards by 30 basis points in order to reflect the witnesses' finding that a high grade utility such as TransCanada is of lower risk than the companies included in their sample. The witnesses found no evidence to suggest that rates of return of some companies in the sample have been excessive as a result of monopolistic elements inherent in their operations. They therefore made no downward adjustment for this factor.

The witnesses' final rate of return recommendation based on the comparable earnings technique was 13.2%. The rate of return witnesses for TransCanada gave 50% weight to the results of this test which, in their view, is a reflection of the “fairness” standard.

During this proceeding, TransCanada's rate of return witnesses took the view that the time period 1983-1991 represented a full business cycle. However, they did acknowledge that the 1992 partial year average achieved returns for the sample companies appear to be lower than 13.5%. Therefore, if one were to include the achieved returns of the low-risk industrials for 1992, then the average achieved returns over the time period 1983-1992 would be less than 13.5%.

TransCanada's rate of return witnesses also applied the DCF technique to their sample of 28 low-risk industrial companies. The witnesses acknowledged that the application of the DCF test is highly subjective, because it is difficult to measure investor growth expectations with a high degree of precision and reliability. Their analysis suggested that investors' growth expectations for these companies was 9.5%. This growth rate, combined with a dividend yield of 2.6%, produced a “bare bones” cost of common equity of 12.1%. This rate was also reduced by 30 basis points for the lower risk of TransCanada relative to the sample companies. The resultant rate of 11.8% was adjusted upwards to 12.9% in order to allow for a market-to-book ratio of 1.15. Keeping in mind the difficulties associated with the application of the DCF technique, the witnesses only gave a weight of 10% to the results of this test.

TransCanada's rate of return witnesses, using the DCF-based risk premium study over the last two business cycles (1976-1991), arrived at an equity risk premium for a high grade utility in the range of 3.3-4.0%. The studies, based on achieved returns over a long period of time, suggested an average equity risk premium of 4.5% for the market as a whole. This 4.5% market risk premium was discounted by 30% to allow for the lower risk of utilities relative to the market as a whole. The estimated equity risk premium of 3.50-3.75%, when added to a projected long Canada rate of 8.75%, produced a “bare bones” common equity cost in the range of 12.25-12.50%. Adjusting this rate for market-to-book ratio considerations led the witnesses to conclude that the required return for low-risk utilities, as measured by the equity risk premium approach, is 13.5%. This result was given a 40% weight by the witnesses in reaching their final rate of return recommendations. During cross-examination, TransCanada's rate of return witnesses agreed that amongst all the tests discussed in this proceeding, in terms of attracting capital, the equity risk premium is the most relevant.

In their evidence, TransCanada's rate of return witnesses stated that their forecast long-Canada rate of 8.75% for 1993 is slightly higher than the “consensus” forecast since they believe that, amongst other things, the need to finance the rising government deficits in the U.S. and Canada will keep upwards pressure on interest rates in North America. The witnesses acknowledged that, should the GDP grow by 2.0% rather than the projected 3.5% for 1993, the long-Canada rate of 8.0% may be more appropriate.

During cross-examination, when discussing the fair rate of return for TransCanada, and the market perception of the “regulatory ground rules”, TransCanada's capital structure witness took the view that a rate of return below 12.5% may be perceived as a shift in those rules. The rate of return witnesses for the Company viewed 12.75% as the minimum rate of return for TransCanada.

With respect to the DCF approach, the rate of return witness for CAPP et al determined the investors' required rate of return for a sample of 20 low-risk non-utilities to be currently no more than 11.0%. To arrive at this conclusion, he added the indicated dividend yield of 2.9% to be the historical growth rate estimates of 6.8-8.2%. The resultant range of 9.7-11.1% would the investors' required rate of return. The witness put more weight on the high end of this range as the indicated dividend yield of 2.9% when combined with the mean growth rate of 8.2% for individual companies in his primary sample also indicated the investors' required rate of return to be in the 11.0% range. This rate was adjusted downwards by 60-80 basis points to reflect the lower risk of pure utilities relative to his sample of 20 low-risk non-utility companies, resulting in an investors' required rate of return of 10.25-10.50%.

The second market-based test employed by this witness was the equity risk premium approach. His analysis led him to the conclusion that the market risk premium over long-Canada's was in the range of 4.0-4.5%. In the light of his view that the risk exposure of low-risk utilities is no more than one-half of the equity market as a whole, this range was adjusted downwards to 2.0-2.25%. To this range the witness added a forecast long-Canada rate of 8.25-8.75%; the resultant investors' required rate of return range for low-risk utilities based on the equity risk premium test was 10.25-11.0%. Keeping in mind the recent fluctuations in long-term interest rates, the witness put more weight on the upper end of this range.

Although, the rate of return witness for CAPP et al used the DCF test, he essentially relied on the equity risk premium test results, citing concerns with the results he observed from his DCF analysis. He placed greater weight on the risk premium test because of the unsettled conditions currently prevailing in financial markets and his contention that this test reflects current market conditions to a greater degree than does the DCF approach. He concluded that the investors' required rate of return for TransCanada was in the range of 10.25-11.0% with emphasis on the upper end of this range. To this range he added a cushion of 50 basis points in order to allow for the high degree of uncertainty currently prevailing in the financial markets and for the unlikely possibility of a dilution effect.

In his evidence, the rate of return witness for CAPP et al pointed out that, relative to the long-term bond holders, TransCanada's common equity shareholders are protected from purchasing power risk because the Company's allowed rate of return is reviewed on a regular basis and adjusted to reflect the current and prospective financial conditions. TransCanada's witnesses did not share this view.

In final argument, TransCanada took the view that the witness for CAPP et al when making a downward adjustment for the lower risk of utilities relative to the market as a whole did so twice: first by applying a geometric mean to historical data, which produced a lower market risk premium compared to the results obtained by using an arithmetic mean; and second, by adjusting the market risk premium by 50% for the low-risk of utilities relative to the market as a whole. The rate of return witness for CAPP et al acknowledged TransCanada's argument but took the view that both adjustments were appropriate.

Views of the Board

Both the comparable earnings and equity risk premium techniques provided the Board with useful information in its determination of the appropriate rate of return to be allowed on TransCanada's deemed common equity component. However, the Board remains of the view that the results of the risk premium method should be given more weight than those of the comparable earnings method. The Board shares the concerns expressed by all rate of return witnesses as to the usefulness of the DCF test results in this case and has therefore given these little weight.

With respect to the comparable earnings evidence presented during the hearing, the Board notes that TransCanada's rate of return witnesses made an adjustment of 30 basis points to the results of the comparable earnings test in order to allow for the lower risk of the Company relative to the companies included in their sample of 28 low-risk Canadian industrials. The Board continues to believe that an adjustment of this nature is warranted. However, in the Board's view, bearing in mind TransCanada's risk relative to the sample companies, the magnitude of this downward adjustment should be more than 30 basis points. The Board also notes the evidence presented during the hearing that the addition of 1992 financial data for the low-risk industrials to the 1983-1991 series would lower the results of the comparable earnings test.

The evidence presented by the TransCanada witnesses on inflation indicated an average achieved inflation level as measured by the consumer price index and the GDP deflator was 4.67% and 4.05% respectively for 1983-1991. Furthermore, all parties agreed that the rate of inflation for 1993 is likely to be much lower than that experienced during 1983-1991. TransCanada's witnesses, however, stated that the inflation rate over the next complete business cycle is likely to be no different from the previous business cycle. Having reviewed the vital signs of the Canadian economy such as unemployment, the current and forecast rate of economic growth, long-term interest rates and inflation, the Board is of the view that inflation in Canada is likely to stay at low levels in the foreseeable future. The factors identified above indicate the need for a further downward adjustment to the results of the comparable earnings test.

With respect to the application of the equity risk premium test, the Board notes the arguments advanced by TransCanada's rate of return witnesses in support of their reliance on a long-Canada rate 25 basis points higher than the rate relied upon by the rate of return witness for CAPP et al. The Board considers that an 8.75% long-Canada rate for the test year is at the high end of the range of reasonableness. Having made an adjustment for the lower risk of utilities relative to the market as a whole, TransCanada's rate of return witnesses concluded an appropriate equity risk premium for low-risk utilities to be in the range of 3.50 -3.75%. On the other hand, the rate of return witness for CAPP et al, having made a similar adjustment but of a different magnitude to his market risk premium, arrived at an approximate equity risk premium range of 2.0 - 2.25% for low-risk utilities. The Board finds some merit in the argument put forward by the Company that the adjustments made by the rate of return witness for CAPP et al to arrive at an appropriate risk premium for low-risk utilities were excessive. The Board also finds the equity risk premium for low-risk utilities is not as high as suggested by the Company witnesses. The Board is of the view that the reasonable range lies somewhere between the ranges suggested by the Company and intervenors' witnesses.

The Board was persuaded by the argument put forward by the rate of return witness for CAPP et al that, relative to long-term bond holders, TransCanada's common equity shareholders are protected from the purchasing power risk. This is because the return on TransCanada's equity can be, and has been, adjusted periodically to reflect the changing financial environment, whereas the return on bonds with a fixed maturity date remains unchanged.

The Board agrees that an adjustment is necessary to raise the "bare bones" return so that the Company is able to attract new capital without dilution to existing equity. However, the Board is not persuaded that the magnitude of this adjustment should be to the degree suggested by the Company witnesses.

Having weighed all the evidence presented and giving particular consideration to the current and prospective interest rates and inflation levels, the Board finds 12.25% to be a fair rate of return on TransCanada's deemed common equity of 30% for the 1993 test year.

Decision

The Board approves a rate of return on common equity of 12.25% for the 1993 test year.

4.6 Rate of Return on Rate Base

Decision

The Board approves a rate of return on rate base of 10.95% for the 1993 test year. The approved capital structure and overall rate of return are shown in Table 4-4.

Table 4-4
Approved Deemed Average Capital Structure and Rates of Return for the 1993 Test Year

	Amount ($000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Debt - Funded	3,475,577	55.37	10.92	6.05
- Unfunded	330,046	5.26	8.74	0.46
Total Debt Capital	3,805,623	60.63		6.51
Preferred Shares	588,484	9.37	8.11	0.76
Common Equity	1,883,189	30.00	12.25	3.68
Total Capitalization	**6,277,296**	**100.00**		
Rate of Return on Rate Base				**10.95**

4.7 Income Taxes

4.7.1 Flow-Through Tax Calculation

Decision

The Board has adjusted the 1993 flow-through income tax provision from $67,364,000 to $55,409,649, a decrease of $11,954,351 as a consequence of the Board's decisions in

Chapter 3 and this Chapter in respect of rate base and rate of return on rate base (see Table 4-5).

Table 4-5
Approved Utility Income Tax Allowance for the 1993 Test Year
($000)

	Application	**NEB Adjustments**	**Authorized by NEB**
Return Related to Equity	288,123	(20,833)	267,290
Depreciation	194,592	(530)	194,062
Large Corporation Tax - 1993	13,306	(130)	13,176
Tax Rate Deferral	724	-	724
Preferred Share Dividend Tax	297	-	297
Non-allowed Amortization of Debt Discount & Expense and Foreign Exchange Costs	3,018	-	3,018
Non-allowed Expenses	191	-	191
Drawdown of Deferred Taxes	(25,290)		(25,290)
Capital Cost Allowance	(340,868)	5,934	(334,934)
Benefits Capitalized	(4,268)	-	(4,268)
Eligible Capital Expenses	(38)	-	(38)
Interest AFUDC	(17,690)	360	(17,330)
Interest Component of Income Tax Reassessment Deferral Account Carrying Charges:			
1993	(2,124)	(10)	(2,134)
1992 Adjustment	(664)		(664)
1991 Adjustment	(326)	-	(326)
Issue Costs	(7,370)	-	(7,370)
Taxable Income	**101,613**	**(15,209)**	**86,404**
Taxes at 0.43741/(1-0.43741) x Taxable Income	79,003	(11,824)	67,179
Ontario CCA Difference	48		48
Recovery of Large Corporation Tax	13,306	(130)	13,176
Income Tax on Preferred Share Dividends	297		297
Deferred Income Tax Drawdown	(25,290)	-	(25,290)
Utility Income Tax Allowance	**67,364**	**(11,954)**	**55,410**

4.7.2 Deferred Income Taxes

In its application, TransCanada proposed to amortize its deferred income tax balance of $75,868,922 to the cost of service over the three-year period commencing 1 January 1993.

This deferred income tax balance was accumulated between the years 1978 and 1982 when TransCanada, pursuant to Board direction, calculated its income tax revenue requirement based on the normalized rather than the flow-through method. Since 1983, the provision for income tax has been calculated on the flow-through basis, and the balance of deferred income taxes has remained on the Company's books. On a number of previous occasions, TransCanada has applied to the Board for permission to drawdown the deferred income tax balance to reduce the cost of service. On the most recent of those occasions, in RH-3-86, the Board ruled:

> “The Board was not persuaded that the Company's current proposal is materially different from its proposals in previous years. The Board therefore continues to believe that the Applicant's proposal is a departure from cost-based tolls and that the use of accumulated deferred income taxes in this manner is contrary to sound accounting principles. Accordingly, TransCanada's proposal is denied. The Board does not anticipate circumstances in the foreseeable future that would justify the use of accumulated deferred income taxes in this manner.”

In evidence, the Company provided reasons why circumstances had changed since the Board's last decision on this matter. While referring to the precedent of the Board's Decision in RH-1-92, wherein the Board approved a drawdown of accumulated deferred taxes for Westcoast, TransCanada presented evidence that the assets which gave rise to the deferred income taxes in the period 1978 to 1982 reached cross-over in 1988. The book depreciation on those assets now exceeds the available capital cost allowance. It was also noted that, as the accumulated deferred income tax balance reflected an over-recovery of costs to date, it seems to TransCanada to be appropriate to achieve a reduction in the cost of service and accordingly in tolls at this time. The Company had the support of the Task Force in making this application.

Views of the Board

The Board is persuaded that there has been sufficient change in circumstance since its decision in RH-3-86 to overcome its earlier concerns.

Decision

The Board approves TransCanada's proposal to drawdown the accumulated deferred income tax balance of approximately $75,900,000. TransCanada shall amortize this amount to the cost of service over the three-year period commencing 1 January 1993.

Chapter 5

Operating Costs

5.1 Transmission by Others

In its forecast for TBO, TransCanada included an amount of $74,580,000 for TQM tolls, representing the amount of TQM's requested revenue requirement for the 1993 test year. In its RH-4-92 Reasons for Decision dated December 1992, the Board approved a revenue requirement of $72,692,000 for TQM for 1993. The difference between the two amounts is $1,888,000.

Decision

The Board has reduced the applied-for amount for TBO by $1,888,000 to reflect the Board's recent decision on TQM tolls.

5.2 Operation and Maintenance

The Board's adjustments to the applied-for operation and maintenance expenses are summarized in Table 5-1 below.

Table 5-1
NEB Adjustments to Operation and Maintenance Expenses
for the 1993 Test Year
($)

	Application	NEB Adjustments	Authorized by NEB
Transmission Salaries	39,694,314	(270,556)	39,423,758
Other Transmission Expenses	56,973,445	(102,954)	56,870,491
Departmental Salaries	44,798,170	(305,343)	44,492,827
Other Departmental Expenses	13,571,827	(16,874)	13,554,953
General Expenses	32,484,990	(2,070,290)	30,414,700
NEB Cost Recovery	9,639,319	-	9,639,319
Operating Uses & Fuel Taxes	12,240,009	-	12,240,009
Total	**209,402,074**	**(2,766,017)**	**206,636,057**

5.2.1 Salaries

TransCanada's estimated total net salary expense of $84,492,484 for the 1993 test year is comprised of regular salaries, temporary salaries and overtime. The applied-for amount provided for year-over-year escalation of salary ranges, in-range progression, promotion and other changes including an amount for the Management Incentive Program, changes in permanent and temporary person-years, and overtime.

TransCanada introduced an Employee Assistance Program in July 1992. The program provides employees and their families with a voluntary and confidential counselling and referral service to help deal with personal or work-related problems, pressures and stress. The program is available to all permanent employees and the 1993 costs are estimated to be $62,158.

TransCanada is also planning to introduce a flexible benefits program in the 1993 test year. This program will be designed to provide the employees with certain choices regarding benefit program coverage which will serve as replacements for TransCanada's current employee benefit program coverage. The overall cost of this program will be the same as the existing one.

5.2.1.1 Number of Employees

For the 1993 test year, TransCanada applied for a regular staff complement of 1,466 positions thus increasing its 1991 staff level by 32 employees (29 field employees and 3 engineers). The Company stated that, due to its system expansion to meet market demands, construction, operation and maintenance will inevitably increase. It follows that such increased activity levels can lead, and in TransCanada's case has led, to the need for a larger staff.

CAPP stated that it was unconvinced that 29 new field employees are required for the test year. CAPP suggested that, even with the benefit of TransCanada's explanation, it could not understand why so many new employees would be required in the field, despite the new facilities being added.

TransCanada also applied for 178 temporary employees for 1993. This is an increase of 23 over the base-year level, the largest increase relating to the transmission group. The Company justified these increases by referring to its busy construction schedule for 1993.

Ontario noted that 1991 was the beginning of a major construction program and 1992 was the peak period of that program. Ontario argued that the number of temporary transmission employees needed should not be higher when a major construction program is near completion than it was at the peak of that program. Ontario also argued that the need for temporary employees should not increase when vacancies decrease, since temporary employees fill in for vacancies. Therefore, Ontario suggested that the Board should disallow TransCanada's request for an increase in temporary transmission employees in 1993 and hold the Company to the 1991 level of 155 total temporary employees.

Views of the Board

In the Board's view, the need for the full regular and temporary staff complement estimated by TransCanada for 1993 was adequately supported by the evidence. TransCanada is still in an expansion phase and the Board believes that the need for additional field staff is a normal outcome of system expansion.

Decision

The Board finds TransCanada's applied-for regular and temporary staff complement for the 1993 test year to be reasonable.

5.2.1.2 Annual Rate of Increase

TransCanada applied for a year-over-year increase of 2.7% in its salary levels on a company-wide basis. This increase is an average made up of two parts. The first part applies to the fixed-rate salaried employees, namely the field transmission staff responsible for the daily operation and maintenance of the pipeline. The Company is forecasting it will increase the ranges of the fixed-rate employees by 2%. The second part applies to the management, professional and support staff eligible for an annual merit review. TransCanada is forecasting that it will increase the ranges of these employees by 2% with an additional 1% available to permit progression within the salary ranges for those whose performance levels so merit. The two parts of the program are forecast to result in the requested 2.7% increase.

For its 1993 application, TransCanada based its estimates on a national survey by Towers and Perrin which was conducted in 1992 and published in September 1992. One of the reasons given by the Company for using the national survey in arriving at its annual rate of increase for salaries was that it views itself as a national company which has to compete in a national market for staff, not just in the oil and gas sector. The national survey was projecting an average increase for salaries of 3.3% for the economy as a whole but only 2.6% for the oil and gas sector.

TransCanada also based its requested annual rate of increase for the 1993 test year on the fact that, in the past, the level of its pay scales had in some ways prevented it from recruiting the number one candidates in the market.

CAPP suggested that a 2% year-over-year increase would be sufficient for the 1993 test year. CAPP based its argument on three factors: first, TransCanada draws a significant number of its staff from the oil and gas sector, and this sector projects the lowest salary increases in 1993; second, TransCanada does in reality draw a good deal of its staff from the Prairie provinces for which an overall salary increase of 2.4% is forecast; and, third, according to the Compensation Planning Outlook 1993 survey, the highest projected salary increases of 3% are going to occur in the Province of British Columbia.

CAPP also suggested that TransCanada employees enjoy job security which is virtually unparalleled in the private sector because while many other enterprises are reducing their staff levels TransCanada is continuing to expand its staff levels. CAPP therefore had difficulty accepting that an overall 2.7% increase was necessary to attract appropriate staff and recommended a 2% increase.

IGUA opposed the applied-for increase and asked the Board to approve an increase of 2%.

Ontario said that given the projections that the oil and gas sector will average pay increases of approximately 1.65%, and that employees in the Prairie provinces will average pay increases of 2.4%, the Board should hold TransCanada to an overall pay increase of 2.25%.

Views of the Board

The Board considers that the applied-for overall salary increase of 2.7% is excessive. The Board is of this view having regard for the salary increase expectations in the oil and gas sector and in the Prairie provinces where most of TransCanada's employees work. As well, the Board considers that the security of employment which the Company affords its staff should find reflection in the 1993 allowed increase.

Decision

The Board approves an escalation of 2% for TransCanada's 1993 test-year total salary expense, inclusive of general increases as well as increases for merit, promotion and progression.

5.2.2 Vacancy Rates

TransCanada estimated its vacancy rate for 1993 to be 30 positions: 20 positions for employees in head office and 10 positions for employees in the transmission department.

The only intervenor to comment on this subject was Ontario who argued that the vacancy rate for 1993 was too low given TransCanada's own expert witness' forecast of 3 to 3.5% economic growth for 1993. Ontario suggested that it would be appropriate to calculate the 1993 vacancy rate by averaging the 1991 actual rate with the 1992 forecast rate instead of averaging the actual vacancy rates over several years as was done in the past. Ontario asked that the vacancy rate for regular positions in head office be set at 23 positions instead of the applied-for 20 positions for 1993. This would imply a total vacancy of 33 positions for 1993.

Views of the Board

The Board is not convinced by Ontario's argument and finds TransCanada's applied-for vacancy rate to be reasonable.

Decision

The Board approves the applied-for level of vacancies for the 1993 test year of 30 positions.

5.2.3 Benefits

In its application, TransCanada submitted that its benefit levels are reasonable when compared to three different samples: the first comprised of 366 companies across Canada; the second, a subset of 15 companies operating in the petrochemical industry and located primarily in the Calgary area; and the third, a broad industrial sample of 156 establishments representative of the sectoral and geographical composition of Canadian industry.

In making its salary comparison, TransCanada used the Pay Research Bureau, which covers 18 occupational categories, and the Canadian Data Bank, which includes 500 national organizations within which companies with annual revenues exceeding $1 billion can be selected for comparison purposes. TransCanada said that, in determining the competitiveness of its compensation package, all comparable sectors from which it draws employees were examined.

Ontario made some comments on the samples used by TransCanada for its annual surveys. It took issue with the fact that TransCanada used different "population sets" of companies for its comparison of salaries and for its comparison of benefits.

Ontario requested that the same population set be used to permit a direct comparison of the total compensation and benefits package offered by TransCanada with the total packages of other comparable employers.

TransCanada had also requested approval of a total employee benefits cost of $25,787,216 for 1993. Part of this benefits package includes a non-contributory savings plan at a total cost of $4,140,581. TransCanada's contribution to that plan is set at 5% of the employee's base earnings with no corresponding requirement from the employee. A review of the evidence of TransCanada's expert witness indicates that comparable plans of other companies in his samples involve a contribution by the employee which is matched by the employer.

Ontario was concerned that TransCanada is requesting a level of compensation and employee benefits which is beyond that required to attract and retain good employees. More specifically, Ontario stated that the tollpayers should not have to pay for a non-contributory savings plan where there is also a non-contributory pension plan. Therefore, Ontario requested that the Board disallow half of this plan cost and so reduce TransCanada's revenue requirement by $2,070,290.

No other party commented on this issue.

Views of the Board

TransCanada's non-contributory employee savings plan has the effect that, in respect of a portion of the Company's equity, the tollpayers provide both the equity and the return on it. In the Board's view, the cost of the plan should be shared equally between the employees and the tollpayers.

In regard to TransCanada's total salary and benefits package, the Board is uncomfortable with an approach which uses different samples of companies for the evaluation of salaries than for the evaluation of benefits.

Decision

The Board approves 50% of the costs related to the savings plan contribution. This results in the Board removing $2,070,290 from TransCanada's 1993 revenue requirement.

The Board directs TransCanada to use, to the greatest extent possible, the same population sample for its salaries and benefits surveys when making future salary and benefit comparisons.

5.3 Test-Year Departmental and General Expenses

TransCanada requested approval of departmental and general expenses forecast to be $90,854,987, as revised, for the 1993 test year.

IGUA suggested that the Board should consider making its decision based on the memorandum dated 27 March 1992 from TransCanada's CEO (Mr. Maier), in which he set a goal to manage the O&M expenses at the 1992 allowed levels.

IGUA pointed out that the 1992 approved departmental and general expenses were $88,761,000 and suggested that for 1993 these expenses should stay at that level. IGUA also pointed out that TransCanada, in its initial application, applied for a 1993 level of departmental and general expenses of $90,601,000 which is a difference of $1,840,000.

IGUA argued that if TransCanada's CEO was of the view that the Company's departmental and general expenses should be budgeted and managed to the levels allowed by the Board for the 1992 test year then surely the Board should not hesitate to adopt these guidelines as the basis for determining the reasonableness of the claims made for these items of expenditure in the tolls case.

IGUA also noted that a “bottom line” management approach should be used in order to determine the level of expenses, and referred to a TransCanada witness who said that TransCanada manages its costs in total. IGUA believes that if this approach is adopted then the time-consuming and, more often than not, futile exercise of conducting a line-by-line examination of these expenditures will in large measure be eliminated from future tolls cases.

TransCanada replied by saying that this “bottom line” management is completely arbitrary and would not result in just and reasonable tolls. TransCanada was of the view that this was especially so when it is remembered that Mr. Maier's memo set very tough targets.

No other party commented on departmental and general expenses.

Views of the Board

The Board disagrees with IGUA's proposal of a “bottom line” management approach because it does not take into account that the various components included in departmental and general expenses can evolve differently from each other and because it is not consistent with the current established cost of service approach used to set TransCanada's toll.

Decision

The Board approves 1993 departmental and general expenses of $88,462,480 (i.e. departmental - $58,047,780 and general - $30,414,700), an amount which has been adjusted to reflect the Board's decisions made in sections 5.2.1.2, 5.2.3 and 5.5.

5.3.1 Departmental Training

TransCanada applied for approval of departmental training costs of $765,670. This is $163,165 more than the 1991 base-year amount and is caused essentially by an increase in training costs in the administrative and engineering departments. TransCanada also indicated it had incurred lower costs in 1991 in terms of training because of the move from Toronto to Calgary.

CAPP agreed in principle that an increasingly technical workplace requires training and education for employees on an ongoing basis. However, CAPP was concerned at the amount by which this item is increasing for TransCanada. CAPP is also concerned about whether TransCanada has adequately justified the need for the large increase.

Ontario submitted that it was somewhat surprised to see TransCanada requesting a large increase, given the economic constraints of the times and given Mr. Maier's own memorandum urging staff to hold overall departmental expenses to the 1992 budget levels. Ontario submitted that this increase is unacceptable and requested that the Board reduce training allowances for the departmental expense by holding TransCanada to its 1992 forecast level of $633,434.

Views of the Board

The Board is of the view that in a world of rapid technical change, the Company has to maintain a high level of expertise in new technologies. This requires among other things appropriate investment in training. The Board believes that the level of training applied for by TransCanada for 1993 is reasonable.

Decision

The Board approves TransCanada's 1993 forecast expense for departmental training.

5.3.2 Toronto Office Cost Allocation

The question of TransCanada's current practice of allocating common costs was raised at this hearing in the context of the appropriate allocation to the Toronto office.

TransCanada stated that it has 29 employees located in its Toronto office, five of whom are directly involved in transportation activities and 16 who are part of the investments and projects group. The other eight people are involved in information systems activities, working with the power generation group and the Toronto pipeline region and are also engaged in administrative functions.

TransCanada explained that the Toronto office costs are allocated between utility and non-utility activities in accordance with the Company's current policy for such allocation (that is, 85% to utility and 15% to non-utility).

In response to a comment by CAPP, TransCanada stated that, while the activities of employees at any given office may not exactly reflect the 85/15 split, when that split is consistently applied to all such costs across all offices, there is no cross-subsidy of the non-utility activities by the utility activities or vice versa.

CAPP was the only intervenor to comment on this issue. It suggested that the vast majority of employees at the Toronto office are not engaged in pipeline-related activities. Nevertheless, substantial expenditures were made for furniture and fixtures, computer hardware and software and communication equipment at that location. CAPP said that the Toronto office situation points out the danger of applying a general formula across the board. CAPP therefore suggested that the general allocation factor should be discarded and a specific allocation factor employed.

Views of the Board

The Board is of the view that TransCanada's current practice of allocating common costs in the ratio of 85% to utility activities and 15% to non-utility activities is carried out consistently across activities and locations and continues to be appropriate.

Decision

The Board considers that TransCanada's application of the company-wide 85/15 ratio for allocation of costs between the Company's utility and non-utility functions is appropriate.

5.4 Transmission Expense

TransCanada applied for approval of a transmission expense forecast of $96,667,759 for the 1993 test year.

IGUA suggested two different approaches to arrive at this expense. First, it suggested that the Board should reduce the salary component of the transmission expenses increase to reflect a 2.25% year-over-year adjustment, as opposed to the 2.7% increase TransCanada applied for. This would result in a reduction of approximately $270,000 from this particular category of expense. Second, IGUA suggested the Board adopt the “bottom line” approach previously discussed in section 5.3.

IGUA suggested that a reasonable allowance for the transmission expense would be the 1992 amount plus 2% for inflation.

No other party commented on this subject.

Views of the Board

The Board does not agree with IGUA with respect to the “bottom line” approach for the reasons set out in section 5.3 above.

Decision

The Board approves a 1993 transmission expense of $96,294,249, which has been adjusted to reflect the Board's decisions made in sections 5.2.1.2 and 5.5.

5.4.1 Electric Power Costs

In its initial filing, TransCanada requested a 10% increase in the electric power cost for compressor stations on the Montreal Line. In September 1992, Ontario Hydro revised its previous forecast downwards. TransCanada therefore updated its application during the hearing to reflect this revision and applied for an increase of 7.9%.

CAPP, being the only intervenor to comment, accepted this revision as being reasonable.

Decision

The Board finds the average increase for electric power costs of 7.9% to be acceptable for the 1993 test year.

5.5 Inflation Rate

In its application, TransCanada used an inflation rate of 2.5% for 1993 and 2.3% for 1992. To generate the 1993 estimate, TransCanada drew on four different sources: the Canadian Macroeconomic Short-Term Forecast and Analysis which had an inflation rate projection of 3%; the Canadian Forecast Summary which was projecting inflation for 1993 at 2.2%; the Conference Board of Canada which had a forecast for 1993 inflation of 2.5%; and the Consensus Forecast for inflation established in August 1992 at 2.4%.

A rate of 2.5%, while lower than inflation estimates made in March 1992 for the year 1993, was used because TransCanada was of the view that the March 1992 forecasts were too high based on expectations that economic recovery in Canada would be weak. TransCanada also felt the 2.5% estimate was still in line with the most recent forecasts in the sources mentioned above.

Transmission expenses and departmental expenses were therefore adjusted by TransCanada to reflect an inflation factor forecast of 2.5% for 1993.

IGUA was the only intervenor to comment on this issue and suggested that a 2% inflation rate should be adopted based on the low rates of inflation that have prevailed in 1992 and based on the Bank of Canada's policy to continue to wrestle inflation to the ground.

Views of the Board

The Board concludes that the appropriate inflation rate to be used for the test year is 2.3%.

Decision

The Board approves an inflation rate of 2.3% for those costs in the 1993 test year which have been adjusted for inflation. This adjustment represents a reduction of $102,954 for transmission expenses and $16,874 for departmental expenses.

Chapter 6

Deferral Accounts

6.1 Deferral Accounts - Generic

TransCanada now has 20 deferral accounts which cover approximately 85% of its cost of service. The amount of revenue or costs which exceed or fall short of approved amounts are recorded in these accounts for disposition in a subsequent toll proceeding. Participants in the Task Force had challenged the appropriateness of continuing several of these accounts. The Board therefore identified the effect of deferral accounts as an issue to be addressed in this proceeding.

TransCanada contends that deferral accounts enable tolls to be cost-based by ensuring that tollpayers are neither under- nor over-charged. In the case of many cost items, TransCanada is unable to make accurate estimates for the test year because of uncontrollable variations in the price and/or level of activity. Deferral accounts allow the Company to be more flexible in responding to the demands imposed on it in a deregulated market environment. For example, TransCanada suggested that the Company might be less willing to accommodate changing shipper demands for service without the ability to defer the associated transportation costs. TransCanada was concerned that the Board had decided to include this matter as an issue in this hearing, despite the fact that both the Company and the Task Force had sought to have it deleted. TransCanada noted that the Board has historically granted deferral accounts where expenditures are beyond the Company's ability to control or forecast with confidence and asked that the Board reaffirm its established policy in this decision.

CAPP stressed the fact that TransCanada is not a cost-of-service pipeline. CAPP stated that, with deferral accounts, TransCanada maintains the ability to exceed its allowed return. CAPP was particularly concerned about the misuse of deferral accounts to recover costs beyond the scope of the original approval. It requested greater precision in delineating what may be properly included in a deferral account. CAPP explained that it was not fully prepared to address deferral accounts in a generic sense in this proceeding but, in the meantime, it recommended the Board deny TransCanada's request for any kind of assurance concerning its deferral accounts.

GMi expressed its view that deferral accounts should be monitored closely by the Board and Task Force to ensure that items covered by them remain unforecastable, uncontrollable and material.

Views of the Board

The effect of deferral accounts is to transfer the risk of a variance in approved costs or revenues from the shareholders to tollpayers. The Board recognizes that the number and scope of TransCanada's deferral accounts have tended to grow over time, admittedly with the Board's approval. The Board believes that the need for each deferral account should be subject to ongoing reviews and that appropriate alternatives should be considered in each instance. In this context, the Board notes that, in conjunction with the Board's inquiry into incentive regulation alternatives, TransCanada has undertaken to propose a mechanism by which shareholders would participate in a portion of the risk associated with the Debt Service *deferral account. The Board looks forward to further innovation from TransCanada in the general area of deferral accounts.*

Decision

The Board is not prepared to grant TransCanada's request for a re-affirmation of established Board policy with respect to deferral accounts. Each deferral account will continue to be subject to ongoing scrutiny by the Board. TransCanada is expected to provide a justification for the continuance of each deferral account with every toll application and the Board will decide on the need for each account on a case-by-case basis.

6.2 Deferral Accounts - Materiality Criterion

TransCanada applied for deferral account treatment for variances in items which could be considered insignificant when compared to the total cost of service or earnings. TransCanada considered the materiality of a potential variance to be irrelevant. It noted that the Board has not identified materiality as a criterion in previous decisions with respect to deferral accounts. TransCanada asserted that small variances in costs could have a significant impact on the revenues of producers if, as a result of the lack of a deferral account, TransCanada chose not to incur such costs.

IGUA was of the view that TransCanada should be denied deferral account treatment if the impact of a cost variance is insignificant. This view was also espoused by both GMi and Union. In the main, all three supported the concept that materiality should be a stated criterion to be considered when deciding whether a particular deferral account should be approved.

Views of the Board

It is correct that the Board has not explicitly declared materiality to be one of the factors it considers in deciding on the appropriateness of deferral accounts. Nevertheless, in practice, the Board has considered the materiality of the potential variance in relation to TransCanada's earnings. The Board therefore expects that any request for a deferral account will include information concerning the magnitude of the potential impact on earnings.

Decision

The Board will take materiality into account in dealing with requests for new deferral accounts.

6.3 Carrying Charges

TransCanada calculates carrying charges each month on the average of the opening and closing balances in an operating deferral account for the month at a rate equal to one-twelfth the allowed rate of return on rate base. TransCanada considered the rate of return on rate base to be appropriate on the grounds that, if it must finance a deferred balance, it will presumably do so with a mix of debt and equity funds, since it does not trace its financing dollars.

Views of the Board

The matter of carrying charges on deferral accounts has been examined by the Board in previous proceedings. In RH-3-86, the Board stated that, with respect to operating deferral accounts, the debit and credit balances should offset each other and the net balances should not be significant over time. Based on this expectation, the Board envisioned that TransCanada and the tollpayers would, on balance, neither gain nor lose on carrying charges. The Board notes however that, over the three years 1990-1992, TransCanada has in fact accumulated large debit balances on which it has earned substantial carrying charges. The Board is concerned that TransCanada may be profiting unduly from this situation.

Decision

The Board has decided that TransCanada should continue to compute carrying charges on a monthly basis at one-twelfth the approved rate of return on rate base. Should TransCanada continue to have a net gain on carrying charges from its operating deferral accounts, the Board will re-examine this matter in a future proceeding.

6.4 Transmission Plant in Service Deferral Account

This deferral account records the notional variance in the cost of service which results from actual rate base additions differing by date and cost from those approved for the test year. It captures the consequent variations from the approved amounts of depreciation expense, return and income taxes. This deferral account was first established for the 1990 test year when TransCanada was in the midst of a major expansion program.

CAPP expressed the view that there may be inadequate after-the-fact examination of variances in the cost of additions. It considered the 1992 variances to be significant and deserving of further examination.

IGUA was concerned that TransCanada may be adding to its capacity and rate base without proper design parameters. It noted that this deferral account allows TransCanada to accelerate its construction program at will.

Views of the Board

The Board established this deferral account on a temporary basis to accommodate variances in approved versus actual rate base additions during a period of heavy construction. The Board contemplated that this account would be used for variances associated with additions that had been included in the determination of the test-year rate base. The Board did not expect TransCanada to also include additions associated with construction projects approved *after the setting of tolls. Valid comparisons between the approved and actual rate base can only be made by considering the same set of projects. The Board is concerned that TransCanada is using this account to incorporate, in rate base, new projects which had not been scrutinized in setting test-year tolls. This is contrary to the Board's intention to provide for a full review of additions before they are considered for inclusion in rate base.*

Decision

The Board is satisfied that this deferral account should continue for the 1993 test year. However, the variances eligible for inclusion in this account shall only relate to the depreciation, return and income taxes on rate base additions included in the test-year rate base. Items disallowed in Chapter 3 of this decision and any other subsequent additions approved for 1993 under Part III after this Decision shall not be included in the calculation of the monthly balance of this deferral account. In the next toll proceeding, the Board intends to consider whether TransCanada has completed its period of heavy construction and whether this account should be terminated.

6.5 Deferral Account for CCA Variances on Compressors

In December 1991, the Department of Finance indicated its intention to consider the reclassification of compressors into a class with a CCA rate of 4% versus 20% in the current class. In RH-4-91, the Board approved the establishment of a deferral account to record the income tax costs associated with this potential change. This matter may or may not be decided in 1993. The Department of Finance has now indicated its intention to expand its review to include the CCA classification of mainline pipe. TransCanada therefore requested that this deferral account be expanded to include the tax costs associated with a potential variance in the CCA rate for mainline pipe.

CAPP suggested that this deferral account may be redundant in view of the existence of a deferral account for Future Legislative Changes to Various Taxes. It noted that this latter account is broadly defined enough to incorporate the possible CCA variance for mainline pipe.

TransCanada stated that it was proposing to maintain this item in a separate deferral account for the sake of clarity.

Views of the Board

The Board appreciates that the outcome of the Department of Finance's review of the CCA rates is beyond TransCanada's ability to forecast or control. Moreover, a change in the CCA rate for mainline pipe could have a significant impact on TransCanada's costs and earnings. The Board therefore considers it reasonable to segregate the effects of a possible variation in CCA rates from other deferral accounts and to include in this account the related variance for mainline pipe.

Decision

The Board accepts TransCanada's proposals to maintain a separate deferral account for the effects of a possible variation in CCA rates and to include in this deferral account the variance in income taxes resulting from a change in the CCA rate for mainline pipe.

6.6 Deferral Account for Gas Cooling Costs

TransCanada requested a deferral account to capture the variance in actual costs from its $2.4 million estimate for billings by Amoco for gas cooling service at Empress, Alberta. TransCanada stated that this service was necessary to offset the effect of higher gas temperatures resulting from NOVA's increased use of its Red Deer River compressors. Gas cooling will increase capacity and reduce the risk of damage to its pipeline coatings. TransCanada indicated that the actual cost of this service will depend upon TransCanada's need for it in terms of time and temperature, Amoco's ability to provide this service, and throughput. None of these factors can be accurately forecast and TransCanada asserted that the actual cost could vary by up to 50% from the forecast. TransCanada contended that its shareholders were not compensated for this risk and should not be penalized just because the amount involved may be relatively small. In any event, this deferral account would only be required until TransCanada constructs its own coolers at the Burstall station.

CAPP was of the view that TransCanada precipitated the need for this cooling by not building facilities consistent with the receipt temperature of 50 degrees Celsius specified in its tariff. CAPP was not convinced that the most efficient solution to this problem over the long term would be the construction of new coolers by TransCanada. CAPP was concerned that the construction of coolers at the Burstall station may be the harbinger of substantial additions of cooling facilities across the system. As for the current request for a new deferral account, CAPP asked the Board to deny TransCanada's request. It contended that the potential variance was insignificant and that TransCanada had exaggerated its lack of control over this cost.

Views of the Board

A variance in this item in the order of 50% approximates $1,000,000 and will not have a material impact on TransCanada's earnings or the risk borne by shareholders.

Decision

The Board is not persuaded of the need to defer the potential variance in gas cooling costs and denies TransCanada's request for this deferral account.

6.7 Compressor Fuel

TransCanada estimates the ABP of shipper-supplied compressor fuel in order to derive its estimate of Saskatchewan and Manitoba sales tax on compressor fuel included in the cost of service. Any variance in the actual amount of these taxes is recorded in the deferral account for compressor fuel. In its application, TransCanada used an ABP of $1.60 per GJ.

CAPP and IGUA objected that TransCanada's estimate is too high. CAPP asked that this estimate be reduced to minimize any potential deferral account balance. CAPP stated that shippers would prefer lower tolls in the test year to a future roll-back in tolls for the subsequent year. IGUA recommended that the Board use a value between $1.45 and $1.50 per GJ to adjust TransCanada's estimate of provincial taxes on compressor fuel.

TransCanada replied that $1.60 per GJ is its best estimate. It was based upon the aggregation of plant gate prices, NOVA's tolls and the cost of fuel, and the TOPGAS charge. (The TOPGAS charge has been discontinued by the Alberta government effective 1 January 1993). TransCanada said that it uses this value for more than compressor fuel. It asserted that its estimate was reasonable in relation to the proposed alternatives.

Views of the Board

The Board considers that TransCanada's estimate of $1.60 per GJ is consistent with market expectations. Moreover, it notes that any variance in the actual versus forecast provincial fuel tax paid will be captured in a deferral account to be disposed of in a future proceeding. Tollpayers are thereby protected from the effect of an inaccurate estimate by TransCanada.

Decision

The Board accepts TransCanada's estimate of $1.60 per GJ for the ABP used to calculate the Saskatchewan and Manitoba sales tax on compressor fuel.

6.8 Other Deferral Accounts

TransCanada sought the continuation of several other deferral accounts on which intervenors declined to comment during the hearing. The continuation of these accounts for the test year was accepted by the Task Force. In addition, TransCanada requested a deferral account to record the variance which might be caused by a need to charge tolls on an interim basis pending the determination of final tolls for the test year.

Decision

The Board approves the continuation of the following deferral accounts without change for the test year:

Great Lakes Rates
Great Lakes Demand
Great Lakes Exchange
Great Lakes Refund
Fixed Costs in the Great Lakes Commodity Charge
Union Demand Volume
Union Commodity Volume
Union Rates
Trans Québec & Maritimes Pipeline Inc. Toll

Debt Service
Future Legislative Changes to Various Taxes
Income Tax Reassessment
Compressor Fuel
Demand Revenue
Municipal Taxes
Gas-Related Costs and Purchase Price

6.9 Test-year Revenue Surplus

The Board has determined that the interim tolls will result in a revenue surplus for the period 1 January 1993 to 31 March 1993. The Board has reflected this estimate in the 1993 test-year revenue requirement to be allocated in the nine-month period 1 April 1993 to 31 December 1993.

Since the actual revenue surplus cannot be determined until the actual volumes for the period 1 January 1993 to 31 March 1993 are known, it is reasonable to defer any variances from the Board's estimate. This is consistent with the Board's past practice.

Decision

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

Chapter 7

Interim Revenue Adjustment

7.1 1993 Revenue Surplus

The estimated 1993 test-year revenue surplus is $300,314 for the period 1 January 1993 to 31 March 1993. This amount represents the difference between the projected transportation revenue from the interim tolls and the approved test-year revenue requirement, as shown in Table 7-1. The Board's decision with respect to a deferral account for the 1993 interim period revenue variance is provided in section 6.9.

Table 7-1
NEB Determination of the Revenue Surplus for the 1993 Test Year
($000)

Transportation Revenue Under Interim Tolls	1,585,200
Miscellaneous Revenue Under Interim Tolls	(49,687)
Adjusted Transportation Revenue Under Interim Tolls	1,535,513
Approved 1993 Revenue Requirement (net of Miscellaneous Revenue)	1,534,311
Revenue Surplus for 1993	1,202
Revenue Surplus for the Period 1 January 1993 to 31 March 1993	**300**

7.2 Carrying Charges

The Board is of the view that the test-year Revenue Surplus deferral account is a special deferral account and hence carrying charges should be calculated at the rate that approximates the Company's probable cost of financing the deferred balance. The Board considers a short-term rate of 8% to be appropriate for this purpose.

Decision

The Board approves the use of a short-term rate of 8% for the determination of carrying charges with respect to the test-year Revenue Surplus deferral account.

7.3 Allocation of Interim Revenue Adjustment

Carrying charges of $12,282 have been added to the revenue surplus to arrive at the interim revenue adjustment of $312,596. As the new tolls will be in effect for only nine months (or three-quarters) of the test year, the amount of the adjustment should be multiplied by four-thirds to permit the full amount of the adjustment to be reflected in the tolls.

Decision

The tolls, effective 1 April 1993 have been set based on the allocation of the interim revenue adjustment over the last nine months of the 1993 test year. For the purposes of calculating tolls, the interim revenue adjustment of $312,596 has been multiplied by four-thirds to reflect the allocation over nine months of the test period.

Chapter 8

Toll Design

8.1 Throughput Forecast

TransCanada's throughput forecast for the 1993 test year, as updated in its "Final Revision" dated 6 November 1992, is 58 285 10^6m^3 (2 058 Bcf), of which 30 366 10^6m^3 (1 072 Bcf) is forecast for the domestic market and 27 919 10^6m^3 (986 Bcf) is forecast for the export market.

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

Decision

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

8.2 Algoma Demand Volume

For toll design purposes, TransCanada applied to exclude the 1993 test-year allocation units of 150.0 $10^3m^3/d$ (5.3 MMcf/d)[1] associated with Algoma. Algoma is the successor to Algoma Steel.

Specifically, TransCanada proposed to exclude the Algoma fixed volume, variable volume, fixed volume/distance and variable volume/distance allocation units for the 1993 test year, even though it expects to provide service to Algoma. TransCanada noted that its decision to exclude the Algoma volumes was based upon its obligation to base tolls on a volume forecast that is reasonable. TransCanada explained that if it recovers the applicable demand charges for service in 1993, the charges recovered would be credited to its Demand Revenue deferral account[2] and be included in the subsequent test year. TransCanada noted that the Algoma volume had similarly been excluded from the 1992 test-year allocation units.

On 18 February 1991, Algoma Steel sought protection under the CCAA, under which TransCanada was ordered to continue to provide service to Algoma Steel. TransCanada noted that, at the time of the court order, Algoma Steel owed TransCanada for service provided during the period December 1990 to mid-February 1991, and that Algoma Steel had a service agreement with TransCanada which was later

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1 In addition, Algoma has access to 850 $10^3m^3/d$ (30.0 MMcf/d) of gas under a buy/sell arrangement with Centra Ontario in accordance with which Centra Ontario is the shipper on the TransCanada system.

2 This account is used to record, among other things, the difference between the forecast demand revenues associated with transporting gas under any FS or FST contracts and the actual revenues received.

extended to expire on 31 May 1992. As a result of the Algoma Steel situation, TransCanada applied to the Board on 28 February 1991 to include in the 1991 test-year revenue requirement a provision for doubtful accounts totalling $1,000,000 and to establish a deferral account for doubtful accounts which would be used to defer, to a subsequent test year, any variance between TransCanada's actual bad debt expense and the $1,000,000 million forecasted[1]. In its RH-1-91 Reasons for Decision, the Board noted that TransCanada has the right to require financial assurances of any shipper and to terminate service. The Board therefore concluded that TransCanada already had the necessary power to control its doubtful accounts. The Board denied TransCanada's request for both an allowance for doubtful accounts and a deferral account.

TransCanada indicated that on 31 May 1992, when Algoma Steel ceased to be under the protection of the CCAA, TransCanada entered into a one-year FS contract with Algoma which will expire on 31 May 1993. The new FS contract was entered into upon the successful restructuring of Algoma and the completion of an agreement for the payment of the outstanding transportation service balances. TransCanada noted that, since Algoma had refused to provide the necessary financial assurances, TransCanada could have refused to agree to a new service agreement.

TransCanada submitted that the alternative would have been to deny Algoma further service, thereby shutting down the Algoma plant and idling the associated TransCanada capacity to the detriment of the other shippers since tolls would have increased as a consequence of fewer allocation units. TransCanada pointed out that, given the Algoma delivery point in the Sault Ste. Marie Delivery Area and the amount of capacity involved, there were no other shippers in its queue which could have assumed the vacated capacity. TransCanada acknowledged, however, that it could have either added downstream capacity to its system to get the gas beyond the Algoma delivery point or offered the upstream capacity to another shipper. TransCanada noted that under either scenario, there would have been delays caused by the construction and the finalizing of contractual arrangements which would have led to reduced allocation units and higher tolls for the other shippers.

TransCanada indicated that, under an agreement to pay the outstanding balance of $265,560 relating to services provided during the period December 1990 to mid-February 1991, Algoma has already paid an initial instalment of $78,160, with the final instalment $156,320 being due on 1 June 1993.

TransCanada argued that it believes that its proposal not to include the Algoma allocation units in the 1993 test year is appropriate and is a viable alternative to the non-renewal or to the termination of the Algoma service agreement, given the following:

(a) the establishment of a deferral account has been denied by the Board on previous occasions;
(b) financial assurances cannot be obtained from Algoma;
(c) termination of the Algoma service agreement is not a practical solution;
(d) despite the recent agreement with Algoma to pay back the outstanding balance, there are no assurances that TransCanada will continue to be paid, in which case there is no means for TransCanada to collect any outstanding balances;
(e) there is no assurance as to the long-term viability of Algoma;

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[1] Refer to the NEB's Reasons for Decision, RH-1-91, section 5.3 “Allowance for Doubtful Accounts”, pages 26 and 27.

(f) Algoma continues to owe TransCanada $156,320 which is due on 1 June 1993 in accordance with the previously-agreed-to payment plan; however, TransCanada will continue to be at risk since there are no assurances that this amount will be paid by Algoma;

(g) TransCanada has already written off $109,240, plus accrued interest of approximately $65,000, as uncollectible; and

(h) the existing service agreement with Algoma expires on 31 May 1993 and there is no assurance that that agreement will be renewed.

TransCanada argued that it had acted properly when it excluded the Algoma Steel volume from the allocation units used to establish the 1992 test-year tolls. TransCanada noted that at the time of its February 1992 RH-4-91 "Final Revision", the service agreement between TransCanada and Algoma Steel had already expired because Algoma Steel had been unable to satisfy TransCanada's renewal requirements. The service agreement with Algoma Steel had expired on 31 October 1991. TransCanada submitted that although it had not specifically used the words "Algoma Steel" in its Final Revision, it had advised all interested parties in the accompanying "Statement of Changes" and in certain responses to information requests filed in RH-4-91, of a change to the Sault Ste. Marie Delivery Area volumes. TransCanada argued that it has been forthright in its handling of the Algoma issue.

CAPP argued that TransCanada's requested treatment of the Algoma allocation units should be rejected. It submitted that TransCanada's proposal violates the Board's previous decision to deny TransCanada an allowance for doubtful accounts and a deferral account, as set out in the Board's RH-1-91 Reasons for Decision. CAPP noted that, despite the Board's RH-1-91 Decision, TransCanada excluded the Algoma allocation units from the final revisions to its 1992 Tolls Application, without specific mention of Algoma. CAPP expressed its distress at the actions taken by TransCanada in this regard and argued that the Board should censure TransCanada for its unacceptable conduct.

CAPP submitted that there was no evidence presented that Algoma could not have secured its gas supply by some means other than having to enter into a service agreement with TransCanada.

CAPP argued that TransCanada has the means to enforce its financial assurance requirements and that if it decides to provide service to Algoma for the good of the Sault Ste. Marie area in the absence of financial assurances, then TransCanada, not the producers and the other TransCanada shippers, should bear the consequences.

IGUA argued that all the contracted-for volumes, including the Algoma volumes, should be included in setting the 1993 test-year tolls and therefore recommended that TransCanada's proposal to exclude the Algoma units be denied so long as there is a service agreement in effect with Algoma. IGUA similarly argued that TransCanada's past actions in arriving at its 1992 tolls are deserving of censure.

APMC argued that TransCanada's proposed removal of the Algoma-related allocation units is an indirect attempt by TransCanada to achieve exactly what the Board denied TransCanada in its RH-1-91 Reasons for Decision. The APMC therefore submitted, that TransCanada should be directed to include the Algoma-related volumes in the allocation units for the purpose of calculating its 1993 tolls.

Views of the Board

While the Board acknowledges TransCanada's initiative to maintain service to Algoma, thereby possibly preventing the shutdown of the Algoma Sault Ste. Marie facility, the Board believes that the risk associated with such an initiative should not be taken at the possible expense of other TransCanada shippers but should be borne by TransCanada's shareholders.

The Board is concerned that TransCanada, by not including the Algoma volumes in the 1993 test-year allocation units, is attempting to accomplish exactly what the Board denied the Company in its RH-1-91 Reasons for Decision. Similarly, with respect to the 1992 test-year tolls, the Board is concerned that TransCanada failed in its RH-4-91 "Final Revision" to clearly identify Algoma as the cause of the change to the Sault Ste. Marie Delivery Area volumes. The Board believes that as long as there is an FS agreement in effect between TransCanada and Algoma, TransCanada should include the Algoma volumes in the allocation units for the purpose of determining the 1993 test-year tolls.

Decision

For the period 1 January to 31 May 1993, the Board has included the Algoma volumes in the allocation units for the purpose of determining the 1993 test-year tolls. In the event TransCanada enters into a FS agreement with Algoma for the period commencing 1 June 1993, TransCanada is directed to record any revenues collected in the Demand Revenue deferral account.

8.3 Delivery Pressure Tolls

In GH-2-87, the Board decided that those shippers using and benefiting from the provision of incremental delivery pressure should pay a separate delivery pressure toll based on the incremental costs of providing the service. In the light of the Board's decision, TransCanada implemented the Board-approved methodology in the RH-1-88 Phase II proceeding. In the decision stemming from that proceeding, the Board stated that, except for a minor modification requested, TransCanada had correctly implemented the delivery pressure toll design methodology approved by the Board in GH-2-87.

The calculation of delivery pressure tolls was raised as an issue with the 1993 Task Force. A number of interested parties raised questions regarding the methodology both in the Task Force and during the hearing. The main concern of interested parties was the determination of the facilities costs attributable to the additional pressure that is provided in excess of TransCanada's standard delivery pressure of 4000 kPa.

TransCanada, CAPP, IGUA, Centra Ontario, and GMi supported the continuation of the existing methodology for 1993. TransCanada noted that no party presented an alternative methodology for calculating delivery pressure tolls.

During the hearing, the Northeast Group proposed that any additional delivery pressure revenues resulting from IS, TWS or diversions, be credited to the firm service delivery pressure shippers. The

Northeast Group argued that its proposal should be implemented in 1993 for any additional delivery pressure revenues received in 1992.

TransCanada agreed in principle with the proposal of the Northeast Group but submitted that the appropriate time to implement the proposal is in the 1994 test year for any unforecast revenues received in 1993. For the additional revenues received in the 1992 test year, TransCanada proposed to continue to defer such incremental revenues in the Demand Revenue deferral account, to the benefit of all shippers.

Views of the Board

Based on the evidence before it, the Board sees no reason to depart from the currently-approved methodology for calculating delivery pressure tolls.

The Board agrees that, given that the delivery pressure charges are based on an incremental tolling methodology, it is just and reasonable to credit any unforecast delivery pressure revenues to those tollpayers at each delivery pressure point who are notionally paying for the incremental facilities to provide the higher pressure. Also, the Board agrees with the Northeast Group that any delay in the implementation of this change in methodology would be arbitrary and without factual justification.

Decision

The Board approves the continuation of the currently-approved methodology for calculating delivery pressure tolls for the 1993 test year. The Board also approves the proposal of the Northeast Group to credit any additional delivery pressure revenues to FS delivery pressure shippers. The Board has implemented this proposal in the 1993 test year by crediting the unforecast 1992 delivery pressure revenue to the applicable delivery points as follows:

Dawn	**$75,214**
Emerson 1	**3,430**
Emerson 2	**108,049**
Iroquois	**319,964**
Niagara Falls	**60,286**
Total	**$566,943**

8.4 Cost Allocation Methodology

TransCanada begins its cost allocation process by determining the distance of haul to its various delivery points via the historic northern Ontario route. This distance is then adjusted to account for any applicable shortcuts that the commingled gas stream may have followed to its final destination; for example, through the Thunder Bay Bypass, the Great Lakes/Union route, or the North Bay Shortcut.

As it did in the RH-1-91 proceeding, Tennessee made a major issue of TransCanada's cost allocation methodology. Tennessee was of the view that the FS toll for deliveries from Empress, Alberta to

Niagara Falls, Ontario is not just and reasonable because too much of the system's costs are allocated to Niagara Falls deliveries relative to other deliveries on the system. Tennessee submitted that TransCanada assigns too great a distance to the Niagara Falls export point because its approach to the calculation of distance of haul is flawed.

Tennessee requested that the Board require TransCanada to take into account the contractual and operational realities of its system in its allocation of costs to the Niagara Falls export point. Tennessee submitted that TransCanada only need adjust its approach to deliveries off the Kirkwall/new Niagara Line in the same manner as it did for deliveries off the Ottawa Extension by taking into account the new operational characteristics of the service rendered. According to Tennessee, the distance used for deliveries to Niagara Falls should be as measured along the Great Lakes/Union route through the Kirkwall line to Niagara (i.e. 2913.34 km compared to 3012.40 km per TransCanada's toll design).

An alternative approach advanced by Tennessee was to allocate costs to all delivery points based on the shortest or most direct route. Tennessee submitted that the shortest route approach would replace the practice of allocating shortcut “credits” among delivery points with a procedure by which all delivery points are allocated fixed costs based solely on contracted volumes and simple measured distances.

Tennessee submitted that this method would ensure that the process for determining the distance used for cost allocation purposes would be simple and clearly objective and that the result would remain constant from year to year.

TransCanada submitted that its currently-approved cost allocation methodology should continue for the 1993 test year because it reflects most closely the actual distance of haul on the pipeline as well as recognizing the actual configuration of the system and the actual flows of gas.

TransCanada argued that Tennessee's first alternative, namely, to use the shortest route distance for Niagara Falls and Chippawa, Ontario only, while not changing the distance calculations for all other points, is clearly discriminatory and should not be approved.

With respect to Tennessee's shortest route method, TransCanada argued that it is not appropriate for application to TransCanada's system because it does not take into consideration the fact that multiple routes do exist for most of the delivery points on the system; the fact that it is not physically possible for all gas to be delivered via the shortest route; and the fact that tolls would not recover the embedded costs of multiple routes from those shippers using the multiple routes. TransCanada also stated that, under the shortest route method, the principle of cost causation would be ignored since shippers may use multiple routes but would only be charged for the use of one route.

A number of intervenors, including Centra Ontario, Consumers', and Union, supported TransCanada's position while no party supported Tennessee's position. Union noted that TransCanada had taken a point of principle on this issue even though it is revenue neutral and Consumers' submitted that Tennessee had failed to meet its burden of proof for change on both proposals.

Views of the Board

The Board considers that the issue of TransCanada's cost allocation methodology has received a careful and thorough examination in this proceeding. The Board and interested parties were *able to explore the applicable principles of toll design and cost allocation and the cost implications of TransCanada's existing methodology and of the two alternatives proposed by Tennessee.*

The Board agrees that two fundamental toll design principles which should be adhered to are: tolls should be proportional to the distance gas is transported in the pipeline; and tolls should reflect cost causation or cost responsibility. Much of the disagreement on this issue focused on the meaning of the words "distance gas is transported". During cross-examination, Tennessee stated that it is the "contractual" distance that should be used for cost allocation and toll design purposes. Tennessee pointed to TransCanada's M-12 contract with Union, which has a receipt point at Dawn and delivery points at Kirkwall and Parkway, to justify that the Great Lakes/Union route should be used to measure the distance to Niagara Falls. TransCanada's existing methodology utilizes gas flow simulations as the basis to measure distances over the various routes on the pipeline.

In the Board's view, a cost allocation methodology which utilizes actual or forecast distances of haul over multiple pipeline routes, rather than contractual distances, leads to tolls which better reflect cost causation or cost responsibility. The evidence in this proceeding clearly showed that gas delivered at the Niagara Falls export point travels via the southern Great Lakes/Union route during the five winter months and via the northern Ontario route during the seven summer months. This results in approximately 60% of the gas delivered at Niagara Falls flowing via the northern route and 40% flowing via the southern route. Since the Niagara Falls export point will receive approximately 41% of the Union shortcut adjustment, the Board is satisfied that, under the existing cost allocation methodology, the Niagara Falls toll is just and reasonable.

The Board rejects both of Tennessee's proposals. The first proposal, to only change the distance to Niagara Falls by measuring it via the shorter Great Lakes/Union route, is rejected because, as explained above, 60% of the gas delivered to Niagara Falls flows via the northern Ontario route. To measure the distance only via the southern route would be contrary to the facts. The second proposal, the shortest route method, is rejected because it breaches the principle of cost causation by ignoring operational realities, pipeline capacity constraints and physical flows of gas. Shippers which use multiple routes should share in the costs of those multiple routes through an appropriate allocation of costs.

Decision

The Board approves the continuation of the existing cost allocation methodology for the 1993 test year.

8.5 WFS Tolls

As more fully described in section 9.3, TransCanada proposed to offer WFS commencing 1 November 1993. The proposed toll design for WFS was based on 131 days of TWS and 20 days of PS.

No party to the hearing challenged the proposed toll design.

Decision

The Board approves the proposed toll design for WFS for the 1993 test year.

8.6 Distance of Haul for Intrazonal Services

The existing method for determining distance was developed at a time when virtually all receipts of gas into the TransCanada system took place at Empress and/or in Saskatchewan. The first step under the existing methodology is a calculation of a distributor's delivery area load centre based on receipts of gas at Empress. The load centre calculation results in a weighted-average distance from Empress to all points within a delivery area.

Early in 1992, TransCanada began receiving requests from customers for point-to-delivery area services such as IS and FS, primarily from St. Clair and Parkway. In researching the distances applicable to these requests, TransCanada realized that the current methodology of basing distances on receipts at Empress was not reasonable if the gas was originating at places such as St. Clair or Parkway.

TransCanada therefore proposed that for all point-to-point distance calculations, or point-to-delivery area distance calculations, except for STS, the distance to be used for toll design purposes should be the volume-weighted distance from the particular receipt point to the particular delivery point or to all points within a particular distributor's delivery area.

Consumers' supported TransCanada's proposal, including the continuation of the existing methodology for STS.

Views of the Board

The Board finds TransCanada's proposal to change the method for calculating the distance of haul for all intrazonal services, except STS, to be reasonable because it will more accurately reflect the distance gas actually travels on the system.

Decision

The Board approves the proposed change for calculating intrazonal point-to-point or point-to-delivery area distances.

8.7 Tolls Procedure

In RH-1-91, the Board approved a procedure for determining tolls arising out of requests for new transportation services between specific points or zones on its system. TransCanada proposed to continue this tolls procedure for 1993, since TransCanada and its shippers have found the methodology beneficial because it results in new tolls for transportation between specific points or zones being approved in an expeditious manner.

TransCanada proposed to amend the tolls procedure by including a table showing the distances for all short-haul point-to-point ISS and ISW services that shippers may be interested in requesting. TransCanada stated that the amendment to the procedure would involve the Board approving the 1993 system average unit costs and the distances for ISS and ISW, upon which TransCanada would calculate and publish in its Transportation Tariff the corresponding tolls for ISS and ISW for the 1993 test year.

Views of the Board

TransCanada's proposal to amend the tolls procedure will help simplify and streamline the tolls approval process. The Board has included tables showing the approved 1993 system average unit costs in Appendix III and the distances for ISS and ISW in Appendix V.

Decision

The Board finds TransCanada's proposal to amend this aspect of its tolls procedure to be reasonable.

8.8 Backhaul Tolls

The Task Force recommended that TransCanada should continue the existing backhaul toll design for 1993 that has been in place since late 1990. The existing toll design is as follows:

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

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

Decision

The Board approves the continuation of the existing backhaul toll design for 1993.

8.9 IS Tolls

The Task Force recommended that, for the 1993 test year, IS toll design should be dealt with according to the provisions of the RH-4-91 Decision. The Task Force also agreed that this issue would be brought forward to the 1994 Task Force in accordance with the Board's directive to review the IS toll design after its use in one summer and one winter season.

Decision

The Board approves the continuation of the existing IS toll design for 1993.

Chapter 9

Tariff Matters

9.1 Financial Assurances and the Option to Terminate

TransCanada proposed that section XXIII of its General Terms and Conditions be amended to clarify TransCanada's right to terminate service if satisfactory financial assurances are either not provided or not maintained. The amended section provides for a 30-day period in which the shipper is required to provide the necessary financial assurances, failing which, the shipper is deemed to be in default under its transportation contract with TransCanada. TransCanada then has the option to terminate the shipper's contract. Before TransCanada can terminate the contract, it must give the shipper 10-days' notice of its intent to terminate. The amended section states that nothing contained therein shall limit the shipper's right to apply to the NEB for relief pursuant to subsection 71(2) of the Act.

ProGas stated that it generally supports the concept behind TransCanada's proposed tariff provision. However, ProGas proposed that the tariff provision be further amended to preclude TransCanada from terminating a shipper's contract prior to the Board's decision on that shipper's request for relief pursuant to subsection 71(2) of the Act. ProGas submitted that, in the absence of the amendment, a subsection 71(2) order could be irrelevant because the Board could order TransCanada to provide transportation to the affected shipper, only to find that the transportation is no longer available because TransCanada has released the corresponding capacity to another shipper.

TransCanada argued that section XXIII of the General Terms and Conditions should be amended as proposed. In TransCanada's view, the additional wording proposed by ProGas exposes TransCanada to additional financial risk. TransCanada noted that there are no provisions in the existing tariff limiting TransCanada's ability to ask for financial assurances to be provided immediately. In the spirit of compromise, TransCanada stated that it agreed to allow shippers 30 days in which to provide the necessary financial assurances. TransCanada maintained that allowing shippers an undefined period of time, as suggested by ProGas, emasculates the provision by removing a compelling mechanism to provide satisfactory financial assurances.

IGUA, Centra Ontario and GMi supported TransCanada's position.

Centra Ontario argued that there should not be an automatic stay of termination pending a decision of the Board on any subsection 71(2) application by a shipper facing possible termination. Rather, Centra Ontario submitted that any shipper facing termination could include, in its subsection 71(2) application, a request for interim relief, namely, a stay of termination pending the Board's decision.

Views of the Board

The Board finds the proposed amendments, to set a 30-day time period for compliance with a request for financial assurances and to deem failure to meet the 30-day deadline as a contract default, to be improvements over the existing tariff provisions. These amendments should aid in limiting the exposure of TransCanada and its tollpayers to financial risk.

With respect to the additional wording proposed by ProGas that would preclude TransCanada from terminating a shipper's contract prior to the Board's decision on that shipper's subsection 71(2) application, the Board agrees with Centra Ontario that there should not be an "automatic stay" provided through a tariff provision. Rather, any shipper facing termination could include, as part of its subsection 71(2) application, a request for a stay of termination.

Decision

The Board approves the amendment to section XXIII of the General Terms and Conditions as proposed by TransCanada.

9.2 Level of Financial Assurances from Shippers

Currently, TransCanada may, at its discretion, request a Letter of Credit from shippers seeking service that requires new facilities for an amount of up to twelve months of demand charges. Through the Task Force and in this proceeding, Northland expressed its concerns with respect to TransCanada's current approach to assessing the appropriate level of financial assurances requested from prospective shippers, particularly cogeneration shippers.

Northland stated that it was not its intent to have the Board remove all of TransCanada's discretion, or to overturn the past Board decisions on financial assurances. Rather, Northland requested that TransCanada be required to exercise its discretion in a reasonable manner.

Northland voiced its concern that TransCanada, in its assessment process, places undue reliance on, and attributes excessive weight to, the current financial position of the prospective shipper and does not attribute appropriate value to other aspects of the shippers' operations or business, which may substantially mitigate any perceived risks associated with the absence of a large asset base. In the case of cogeneration projects, Northland stated that TransCanada fails to take into account such factors as the existence of turnkey contracts and business interruption insurance when doing its assessment. In Northland's view, TransCanada's approach focuses only on a shipper's inability to pay in the event of a default, and does not consider the risk of a default occurring.

Northland stated that, while cogeneration projects are relatively new to the Board and TransCanada, the risks associated with this new market must be assessed in a rational and logical fashion. Based on the evidence of its expert witness, it was Northland's position that cogeneration projects pose little risk to the system, certainly by the time TransCanada is required to commence construction of any facilities needed to provide the contracted transportation service.

Northland stated that its submissions on this issue apply to cogeneration projects in general. Northland requested that the Board:

(a) explicitly find that, in its assessment of the appropriate level of financial assurances required from cogeneration projects, TransCanada has failed to take into account, and give proper weight to, other relevant factors aside from the project's ability to pay;

(b) direct TransCanada to take these other relevant factors into account when assessing financial assurances for cogeneration projects;

(c) direct TransCanada to compile, in a general sense, a listing of the matters that it considers in its deliberations; and

(d) find that a financial assurances package equivalent to three months of demand charges is more appropriate in the circumstances of this case.

TransCanada argued that its financial assessments are both thorough and comprehensive and do look at the risk of a default occurring. TransCanada stated that it considers a variety of factors in addition to financial factors when analyzing the requirement for financial assurances including: the time required to remarket capacity should there be a default; where the capacity is located on the system; the credit history of the shipper with TransCanada; and the nature of the shipper's business. TransCanada did acknowledge that a shipper's possible inability to pay is of greater concern and is given greater weight than is the risk of a default occurring. However, TransCanada stated that it faces the business risks, and should therefore not be unduly restricted in its manner of managing those risks. TransCanada stated that, even though the risk of default may be low, such risk does exist. TransCanada requested that it be given the opportunity to require an appropriate level of financial assurances to ensure it is paid if there is a default. TransCanada requested that no change be made to the tariff regarding this matter.

Direct Energy and Natural supported Northland's position while IGUA, Centra Ontario, GMi, Union and the APMC supported TransCanada's position.

Views of the Board

In past decisions, the Board has stated that TransCanada is in the best position to assess the risks associated with the individual projects underpinning its facilities expansions and, in particular, to determine the risk of non-recovery of demand charges. The Board has also stated that, in the event that a shipper defaults on its demand charge obligations and TransCanada applies to the Board for the recovery of those unrecovered demand charges, the question of prudence with respect to TransCanada's decision on the level of financial assurances would be reviewed. Moreover, the Board has denied TransCanada's requests for an allowance for bad debts and a bad debts deferral account.

By these decisions, TransCanada has been given the discretion to exercise its own judgment in assessing the level and nature of financial assurances it requires from its shippers. Failure to assess the risks correctly could result in TransCanada bearing any adverse financial consequences.

Having given TransCanada the discretion to manage the risk of non-recovery of demand charges, the Board is reluctant to interfere with TransCanada's exercise of this discretion, unless it can be established that the Company is acting improperly or unreasonably. In the case at hand, the Board was not persuaded that TransCanada has acted improperly or unreasonably in the exercise of its discretion.

TransCanada testified that it does look at a variety of factors other than purely financial ones. While TransCanada did acknowledge that it gives a shipper's ability to pay in the event of default greater weight than the risk of a default occurring at all, the Board does not find this unreasonable given that the risk of default, however low, does exist. The Board is not prepared to direct TransCanada as to the factors that it must consider or the weight to be applied to each.

The Board notes that TransCanada did state under cross-examination that, whenever it has discussions with new shippers, it makes them aware of what is initially required in terms of financial assurances. Also, numerous factors were discussed in this proceeding, which should give shippers an indication of those TransCanada may take into consideration when assessing the financial assurances it is going to require of a particular shipper. The Board sees no merit in having TransCanada provide a general listing of the matters it considers in such deliberations.

In view of the foregoing, the Board rejects Northland's request for a generic financial assurances package equivalent to three months of demand charges for all cogeneration projects.

Decision

The Board is not persuaded that it would be appropriate to direct TransCanada as to the level of financial assurances required for a particular group of shippers.

9.3 Winter Firm Service

TransCanada stated that it is expecting some excess capacity during the 1993-94 winter period. In order to effectively utilize this excess capacity, and to satisfy a perceived customer need, TransCanada proposed to offer a new service, WFS, under the following conditions:

(a) service will be offered from 1 November 1993 to 31 March 1994;
(b) no renewal rights;
(c) facilities will not be constructed for WFS;
(d) shippers may select one of four service periods - 75, 100, 125, or 151 days' service;
(e) there will be a minimum seasonal bill based on the number of days' service;
(f) assignments will not be allowed; and
(g) the toll will be based on 131 days of TWS plus 20 days of PS.

In concert with this new service, TransCanada filed a proposed WFS Toll Schedule, a WFS Pro-forma contract and amendments to sections XV and XVI of the General Terms and Conditions. TransCanada proposed that WFS have a curtailment priority equal to FS service.

Since the level of WFS volumes and the number of days of service are difficult to estimate at this time, TransCanada proposed that any differences between the forecast WFS revenue and the actual WFS revenue in 1993 be captured in the Demand Revenue deferral account.

TransCanada stated that its desire was to be proactive by having WFS on its menu of services. TransCanada submitted that WFS is an appropriate service offering over the long term, even though the available volumes may fluctuate from year to year.

ProGas expressed its concern about the priority of WFS. ProGas submitted that the proposed priority potentially places all FS shippers at risk of curtailment in the event that TransCanada inaccurately forecasts excess capacity, or if daily demand exceeds available capacity. ProGas requested that WFS have a lower priority, perhaps immediately below FS.

IGUA, Centra Ontario, Consumers' and GMi supported the proposal to implement WFS with an equal priority to FS. CAPP submitted that implementation of WFS should be postponed until the need for FST service is re-examined in the light of the way the TransCanada system is being designed.

Views of the Board

The introduction of WFS to TransCanada's menu of services will help effectively utilize any excess capacity that may materialize during the winter period and will give shippers a greater choice of services to meet their transportation needs.

The Board was not persuaded that giving WFS equal priority to FS will place FS shippers at risk of curtailment. Therefore, the Board accepts the priority provisions as proposed. In any event, the Board notes that tariff provisions are always subject to change. Should problems develop once TransCanada and shippers have gained experience with WFS, the priority provisions can be amended at a future proceeding.

Decision

The Board approves this new service, together with the proposed WFS Toll Schedule, the proposed WFS contract, and the amendments to sections XV and XVI of the General Terms and Conditions. The Board also approves the request to record any differences between the forecast WFS revenue and the actual WFS revenue in 1993 in the Demand Revenue deferral account.

9.4 Assignments

The Task Force unanimously agreed that section 7 of the FS Toll Schedule be amended to incorporate minor wording changes to clarify that assignments can be made at any time, not just when a company is succeeded by purchase, merger or consolidation.

Decision

The Board finds the proposal to amend section 7 of the FS Toll Schedule to clarify that assignments can be made at any time to be reasonable.

9.5 Receipt and Delivery Points

The Task Force unanimously agreed that the tariff should be amended to include for informational purposes a listing of the receipt and delivery points.

Decision

The Board approves the proposal to amend the tariff to include for informational purposes a listing of the receipt and delivery points.

9.6 Diversions from and to any Delivery Area or Point

The Task Force agreed that TransCanada should amend section 6 of the FS Toll Schedule to permit shippers to divert gas from any delivery area or point to any other delivery area or point.

Decision

The Board finds the proposal to amend section 6 of the FS Toll Schedule to permit diversions from any delivery area or point to any other delivery area or point to be reasonable.

9.7 Nomination of Volume, Date of Commencement

The Task Force unanimously agreed that section 2.2 of the FS Toll Schedule and the pro-forma contract with respect to the nomination of volume for the Date of Commencement should be amended to reflect the requirement that, for the start-up of a new contract, shippers are to provide the nomination for the Date of Commencement and six gas days following, at least five days prior to the Date of Commencement.

Decision

The Board approves the proposal to amend section 2.2 of the FS Toll Schedule and the pro-forma contract to reflect the requirement that, for the start-up of a new contract, shippers are to provide their nomination for the Date of Commencement and six gas days following, at least five days prior to the Date of Commencement.

9.8 Interest Rate Clarification

The Task Force unanimously agreed that TransCanada should amend section XI of the General Terms and Conditions to clarify that the interest rate used to determine the amount of interest payable, either by the shipper to TransCanada or by TransCanada to the shipper, may be varied from time to time.

Decision

The Board approves the proposal to amend section XI of the General Terms and Conditions to clarify that the interest rate used to determine the amount of interest payable, either by the shipper to TransCanada or by TransCanada to the shipper, may be varied from time to time.

9.9 Section 5 of the FS Toll Schedule

The Task Force unanimously agreed that section 5 of the FS Toll Schedule should be amended to reflect the approved practice, that FS is a daily service. TransCanada therefore proposed that section 5.1 and 5.2 be deleted.

Decision

The Board approves the proposal to delete sections 5.1 and 5.2 of the FS Toll Schedule.

Chapter 10

The Loan of Transportation Capacity

Issue 13 of Order AO-4-RH-2-92 reads as follows:

> "13. The cost consequences, for tollmaking purposes, of TransCanada's letter agreements with Western Gas Marketing Limited dated as of 18 May 1992 and CanStates Gas Marketing dated 6 July 1992 in respect of the "loan of transportation capacity" by each shipper to TransCanada, and the process used by TransCanada in order to select the shippers to approach in this regard."

TransCanada explained that it became necessary to borrow capacity from shippers in the summer of 1992 because of unforeseen increases in FS contract utilization. TransCanada noted that it designs a significant part of its system on the basis of average day usage of contracted volumes in order to minimize the facilities required and therefore the cost of service to all its shippers. The result is that TransCanada cannot deliver all of its shippers' firm service contractual entitlements each and every day of the year. TransCanada estimated that this design philosophy has reduced the amount of rate base by between $480,000,000 and $640,000,000 in each of the contract years 1987-88 through 1991-92, resulting in substantial savings to tollpayers. TransCanada added that the alternative would be to design its system on the basis of the maximum daily entitlement of contracted FS volumes.

TransCanada explained that it regularly canvasses shippers whose contract demand exceeds 50.0 $10^3m^3/d$ (1.8 MMcf/d) to determine seasonal and annual demands. TransCanada noted that the last survey, which requested seasonal load factor data for the 1991-92 contract year, was sent to its shippers in December 1991.

TransCanada stated that, mainly as a result of warmer than normal temperatures in the winter of 1991-92 and relatively low spot prices in January and February 1992, many of its shippers indicated that their original forecast requirements for the 1992 summer season might have to be revised downward. However, a colder than normal spring and early summer, coupled with below-normal gas storage inventories, resulted in some shippers revising their summer gas requirements upward. TransCanada noted that demand remained relatively high throughout the summer and that actual requirements and revisions to its forecasts reflected an anticipated utilization of 91% of contracted FS volumes, compared to the forecast rate of 83%. TransCanada indicated that this eight percentage point difference equated to 226.6 10^6m^3 (8.0 Bcf) of gas. TransCanada submitted that the annual load factor for the 1991-92 contract year is now forecast to be 92% of contracted FS volumes, compared to the earlier forecast rate of 88%.

In addition to the unforeseen increases in FS contract utilization, TransCanada noted the following factors which lowered system capacity in the summer of 1992 and also led to the need to borrow capacity:

(a) an increase in the temperature of the gas received off the NOVA system;

(b) actual ambient temperatures for the 1991-92 winter season were warmer than the assumed facilities design ambient temperatures causing a reduction in compression power availability;
(c) curtailments and under-deliveries of gas off the NOVA system which resulted in linepack reductions and sub-optimal system operations;
(d) greater than forecast construction-related flow restrictions;
(e) delay in the continuous operation of the new portable unit at Station 130 which restricted gas deliveries to Parkway; and
(f) failure on the Union system in December 1991 which forced TransCanada to draw down linepack to avoid reducing deliveries.

In addition to borrowing capacity, TransCanada indicated that it took other initiatives as follows:

(a) by mutual agreement with one of its shippers, TransCanada agreed to delay the start-up date for the new service to New England Power Company and Power City Partners, L.P. from the 1991-92 to the 1992-93 contract year;
(b) TransCanada delayed certain capital maintenance projects during the summer of 1992 in order to maximize available pipeline capacity;
(c) TransCanada curtailed discretionary deliveries, including diversions;
(d) maintenance was carried out around the clock to reduce pipeline capacity disruptions;
(e) expeditious release was sought from the NEB of previously-certificated facilities in order to maximize construction in the summer of 1992;
(f) where possible, TransCanada gave priority to those loops that provided the maximum capacity; and
(g) construction schedules for certain compressor unit additions were shortened by working double shifts.

TransCanada submitted that in addition to borrowing capacity as a means of alleviating its capacity problem, it considered curtailing firm service. TransCanada submitted that this was not desirable since it: could result in the permanent loss of sales for Canadian gas producers; would seriously degrade the quality of service to shippers; and would have a detrimental effect on the perceived reliability of Canada as a source of supply. TransCanada argued that, if service to the non-loaning shippers had been curtailed, the shippers would have had to incur significant workload and transaction costs, and higher energy costs, in arranging alternate gas supplies or alternate energy forms.

TransCanada also considered: borrowing gas from its shippers at the delivery point and replacing it in the future through advancing construction of capacity; purchasing gas to sell to its shippers to replace the gas it was unable to ship; and buying back capacity from existing shippers. These options were rejected, largely because they would have involved TransCanada in protracted contract negotiations and thus would not have allowed it to respond expeditiously to the capacity problem.

TransCanada submitted that it decided to borrow capacity in order to: maintain firm service to its shippers; maximize throughput for the benefit of Canadian gas producers and markets; maintain the image of reliability of the Canadian gas industry; and to minimize administrative efforts and associated costs. TransCanada noted that it was able to conclude loan arrangements quickly, which became an important consideration when the magnitude of the capacity shortfall became apparent.

TransCanada entered into capacity loan and capacity reduction agreements with five shippers. The agreements require TransCanada to pay back a total of 818.8 10^6m^3 (28.9 Bcf) of capacity during the period 1 November 1992 to 31 October 1995, exclusive of 56.7 10^6m^3 (2.0 Bcf) to be paid back to Western Gas on a reasonable efforts basis (Refer to Table 10-1).

Table 10-1
TransCanada Payback of Loaned Transportation Capacity[1]

SHIPPERS	1992-93 10^6m^3	1992-93 Bcf	1993-94 10^6m^3	1993-94 Bcf	1994-95 10^6m^3	1994-95 Bcf	TOTAL 10^6m^3	TOTAL Bcf
Consumers'/Union (FST)	56.7	2.0					56.7	2.0
Western Gas (FS)	255.0	9.0	170.0	6.0	85.0	3.0	510.0[2]	18.0[2]
Western Gas (FS)	42.5	1.5					42.5	1.5
Western Gas (FS)			113.3	4.0	62.3	2.2	175.6[3]	6.2[3]
CanStates (FS)	28.3	1.0					28.3	1.0
Domtar (FS)			5.7	0.2			5.7	0.2
TOTAL	**382.5**	**13.5**	**289.0**	**10.2**	**147.3**	**5.2**	**818.8[2][3]**	**28.9[2][3]**

Notes:

1. Source: TransCanada Exhibit B-56.
2. Exclusive of 56.7 10^6m^3 (2.0 Bcf) to be paid back to Western Gas on a reasonable-efforts basis (i.e. referred to as the capacity reduction volume).
3. Capacity loan agreement actually for 198.3 10^6m^3 (7.0 Bcf). Payback based upon Western Gas' projected requirements as of 18 September 1992.

TransCanada first approached the two FST shippers, Consumers' and Union, and was able to negotiate agreements to defer FST capacity from the 1991-92 contract year to November and December in the 1992-93 contract year. When it became apparent that these agreements would be inadequate to meet its forecasted requirements, TransCanada negotiated agreements with Western Gas and CanStates for the volumes which the Company, at the time, perceived to be its maximum requirements.

In September 1992, TransCanada requested tenders for offers of loans of capacity and as a result, entered into capacity loan agreements with Domtar and Western Gas. TransCanada noted that these two agreements will be the last as it now has sufficient loaned capacity to meet its system requirements.

TransCanada argued that, in the time available, it was not feasible to tender for the capacity, assess offers, and negotiate capacity loan agreements. Although discussions were held with other shippers willing to loan capacity, TransCanada found that, in each case, the terms and conditions of the proposed agreements were unsatisfactory. TransCanada submitted that Western Gas, Consumers' and Union were thought to have the ability and flexibility to manage a capacity loan program of the size required and to have the ability to respond to TransCanada's requests quickly.

TransCanada has agreed that, should the need arise for it to borrow additional capacity in the future, it will use the tendering process in order to secure the necessary loan capacity.

TransCanada submitted that under its proposal, there would be no “appreciable” fixed cost consequences for its shippers associated with the borrowing of the capacity and its subsequent payback. Under its proposal, the following would occur:

(a) In the year TransCanada borrows the capacity, the shipper loaning the capacity pays the full demand charge associated with the capacity loaned, even though the capacity is not being used. The effect is that all shippers who did not loan capacity will be able to use capacity to their full entitlement under the various service agreements.

(b) In the years TransCanada pays back the borrowed capacity, the fixed allocation units and the resulting demand tolls are approximately the same as they would have been had the loan of capacity not taken place and had the system been curtailed with a resultant demand revenue deferral and its future recovery. The effect is that other shippers on the system pay the fixed costs attributable to the payback volumes since the payback volumes are not included in the allocation units used for toll determination purposes.

TransCanada pointed out that any “intergenerational inequity” will be *de minimus* because: it is uncertain whether future tolls will be very different from the 1992 tolls; and, within the subject time frame, there is likely to be very little customer turnover from year to year.

At issue are the relevant costs in the 1993 test year arising from the capacity loan agreements. For the most part, these are the fixed costs associated with advancing facilities construction to accommodate the payback, in 1993 and beyond, of the capacity borrowed in 1992. The payback volumes will not share in the payment of those facilities costs in the 1993 test year since the corresponding fixed allocation units have been excluded for tollmaking purposes because those demand charges were prepaid in the 1992 test year.

With respect to the variable costs, the payback volumes will share in the payment of those costs since the corresponding variable allocation units have been included for tollmaking purposes. In addition, TransCanada will receive fuel gas to accommodate the payback volumes.

TransCanada submitted that the 1992 test-year cost of service and allocation units have already been approved by the Board and included in those allocation units, are those associated with the capacity borrowed by TransCanada. The effect is that no additional revenues over and above those already approved by the Board will be collected in the 1992 test year in connection with the borrowed capacity.

TransCanada submitted that the cost of the capacity loan agreements to the TransCanada system is the cost of advancing facility construction in order to allow for the payback of the loaned capacity. TransCanada submitted however, that it is moving the construction schedule forward not only to allow for the payback of capacity borrowed in the 1992 summer season, but also to accommodate the forecasted increases in shipper load factors. TransCanada estimated the cost of service impact, in 1992 dollars, of advancing construction to be: $15,500,000 in 1993; $8,000,000 in 1994; and, $2,900,000 in 1995 for a total of $26,400,000. The associated impact on the Eastern Zone toll was estimated to be 0.9 ¢/GJ in 1993; 0.5 ¢/GJ in 1994; and, 0.2 ¢/GJ in 1995. TransCanada noted that in comparison, if the 875.3 $10^6 m^3$ (30.9 Bcf) had been repurchased from its shippers, the associated cost would have been $26,500,000 (i.e. 30.9 Bcf x the 85.8 ¢/Mcf Eastern Zone toll).

During the hearing, the Board questioned TransCanada regarding section 62[1] of the Act as it related to the capacity loan agreements. In the light of the fact that the capacity loaners paid 1992 FS tolls for capacity they will use in the 1993 test year (or other future years), TransCanada was asked, to the extent that there is a difference between 1992 and 1993 FS tolls, would there not be a violation of section 62?

TransCanada submitted that section 62 must be read in conjunction with section 63 of the Act[2] and reviewed several previous court and Board decisions which dealt with the construction of those sections. Among the decisions it referred to were GH-2-87 and RH-1-88, Phase II. TransCanada argued that those decisions supported the proposition that, in assessing whether traffic had been carried under substantially similar circumstances and conditions, the Board could take into account the business motives of the parties, as well as any circumstances or conditions created by contract, or any other matter the Board considered relevant.

TransCanada went on to argue that the payback volumes for the loaned capacity would not be delivered under substantially similar circumstances and conditions as all other 1993 firm service volumes. In support of this position, TransCanada referred to the fact that shippers who had loaned capacity to TransCanada in 1992 would not necessarily have a daily contractual entitlement, for the payback volumes in 1993 which would be equal to their daily contractual entitlement to FS service in 1993. TransCanada submitted that the capacity loan agreements contemplated some of the loaned capacity being paid back as FS service; some of it being paid back as TWS service, with 15-day interruptions; and some of it being delivered back as IS service - in fact the lowest priority of IS service. On that basis, TransCanada argued that, even if there were a difference in the 1992 and 1993 FS tolls, there would be no violation of section 62.

In summary, TransCanada testified that its shippers were the beneficiaries of the following:

(a) a lower rate base and a lower cost of service resulting from its system design philosophy;

(b) TransCanada's ability to enter into capacity loan agreements with the effect that other shippers were not curtailed and no demand revenue was deferred to a subsequent test year; and

(c) the only additional costs of service in the 1993 test year are those associated with the costs of advancing facilities construction to accommodate the payback volumes.

In reply argument, TransCanada submitted that the interested parties had failed to demonstrate why the Board should not approve the capacity loan agreements and provide for the tolling of the payback volumes.

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[1] "62. All tolls shall be just and reasonable, and shall always, under substantially similar circumstances and conditions with respect to all traffic of the same description carried over the same route, be charged equally to all persons at the same rate."

[2] "63. The Board may determine, as questions of fact, whether or not traffic is or has been carried under substantially similar circumstances and conditions referred to in section 62, whether in any case a company has or has not complied with the provisions of that section, and whether there has, in any case, been unjust discrimination within the meaning of section 67. "

CAPP submitted that Western Gas had indicated its willingness to lend capacity to TransCanada, notwithstanding that it was Western Gas' revised forecast which was the dominant factor leading to the need for TransCanada to enter into the capacity loan agreements. CAPP argued that this was inconsistent with the actions taken by TransCanada and Western Gas. CAPP noted that based upon EM&R data, export sales by TransCanada, including Western Gas, in the first half of 1992 were below 1991 levels.

CAPP argued that it had insufficient information to properly assess whether TransCanada acted prudently and whether TransCanada should be allowed to recover the costs associated with the capacity loan arrangements. CAPP therefore recommended that the Board not approve any aspect of the agreements that affects the 1993 test year and that TransCanada be directed to defer all costs associated with the borrowed capacity and with its future repayment. CAPP also recommended that the entire matter be submitted to the Task Force for review.

CAPP noted that changes in TransCanada's annual load pattern had forced the Company to adopt a system design based on summer rather than winter requirements. CAPP recommended that TransCanada undertake a study of the FS and FST services focusing on the purpose and tolling of those services in light of the aforementioned changes in system utilization. CAPP proposed that the study be brought to the Task Force for consideration.

TransCanada argued that the capacity loan issue was examined in GH-4-92 and in the current proceedings and it therefore objected to CAPP's recommendation to defer the matter to the Task Force and thereafter to a future Part IV proceeding.

IGUA submitted that the Board should apply the following principles in considering the capacity loan issue:

(a) TransCanada should be permitted to recover costs incurred in connection with a transaction with its affiliate (i.e. Western Gas), or for that matter with any other third party, only to the extent that those costs are representative of the least cost alternative available to TransCanada to acquire the goods or services provided;

(b) where transactions with affiliates are concerned there should be a heavy onus on TransCanada to satisfy the Board that the incurred costs are no greater than the least-cost alternative available and that any costs in excess of the least cost alternative should be disallowed for tollmaking purposes; and

(c) all costs incurred in connection with the transactions that have taken place during the course of a test year for which tolls have already been set cannot, absent the establishment in advance of deferral accounts for protection, be recovered from tollpayers in future test periods. Such costs should be disallowed for the purposes of establishing tolls in the future test period as “out of period” costs.

IGUA expressed concern that TransCanada had failed to make complete disclosure to its “shipper constituency” of its need to enter into capacity loan arrangements. It argued that, if TransCanada had tendered to the secondary capacity market at the outset, then all market participants would have had an opportunity to offer capacity to TransCanada thereby allowing it to select the cheapest cost alternative.

IGUA was concerned that TransCanada did not tender for the capacity, but instead made a “private deal” with its affiliate, Western Gas.

IGUA questioned whether TransCanada has satisfactorily demonstrated that there was a real need for it to borrow capacity from Western Gas and in particular, whether Western Gas would have exercised its rights to use its full capacity entitlements, as TransCanada has claimed. IGUA pointed out that more than 50% of the increase in forecasted requirements which led to the need to borrow capacity, can be attributable to Western Gas.

IGUA argued that "... shippers play capacity forecasting games to position themselves to obtain demand charge relief through capacity assignments ...". IGUA believed that Western Gas was aware of the potential to obtain value for the costs of its unused capacity entitlements (i.e. the unabsorbed demand charges) by pressuring TransCanada to give value, at the expense of the other shippers, in return for Western Gas' agreement to refrain from using its full capacity entitlement. IGUA argued that a means for Western Gas to apply that pressure was to increase its requirement forecasts thus putting TransCanada in the position of having to act to ensure that there was sufficient capacity available to satisfy those new requirements.

IGUA questioned the credibility of Western Gas' higher forecast requirements in April and May 1992 which were a major contributing factor towards forcing TransCanada into the capacity loan agreements. Specifically, IGUA pointed out that, whereas Western Gas was forecasting increased requirements in April and May 1992, six months later it was able to relinquish capacity by entering into the capacity loan agreements with TransCanada.

IGUA argued that none of the capacity borrowed related to Western Gas' increased forecasts should be included in establishing the 1993 test-year tolls. IGUA added that, to the extent TransCanada has demonstrated a need to borrow capacity, the 1992 capacity borrowing transaction costs (i.e. the costs associated with advancing facilities construction in order to allow for the payback of the loaned capacity), not recoverable through a deferral account, should be excluded from the 1993 test-year tolls on the grounds that these are “out of period” transactions. IGUA did acknowledge that even if TransCanada were to have taken out the Western Gas forecasts as a contributing factor, there would still have been a need for TransCanada to borrow capacity.

IGUA submitted that there were alternatives available to TransCanada that would have obviated the need for TransCanada to borrow capacity. IGUA pointed out that TransCanada could have acquired the necessary capacity by entering into “Restraint of Use Agreements” with its shippers and offered those shippers a demand charge credit. IGUA submitted that, when compared to the TransCanada option of borrowing capacity and adding capacity in the future to pay it back, the least costly option would have been to borrow capacity without adding new capacity.

IGUA believed that Western Gas would have accepted the demand charge credit in 1992 rather than the capacity loan arrangements which will result in TransCanada having to add capacity to pay back the capacity borrowed. IGUA rejected TransCanada's contention that it did not go to the secondary market because there was no capacity available. IGUA pointed out that, at the time, there were shippers trying to secure upstream diversions to minimize the extent to which their reserved capacity would remain unutilized and there were shippers willing to enter into assignment arrangements.

IGUA submitted that directing TransCanada to the secondary market (i.e. by using demand charge relief rather than adding capacity): recognizes the existence of a dynamic secondary market in pipeline capacity; prevents the addition of facilities prior to it being established that they are required; reduces the risk of system underutilization; and recognizes the least-cost option for the benefit of the existing and future tollpayers.

IGUA argued that TransCanada was aware of the pending capacity constraints and that it could have applied to the Board for permission to establish a deferral account to capture any costs associated with the capacity loan agreements in the 1992 test year for recovery in 1993.

IGUA believed that the allocation units used for calculating the 1993 test-year tolls should include the payback volumes. It added that, to the extent tolls will be lower because TransCanada has to provide the payback free of charge, it will not recover any revenue from those shippers to whom it owes capacity.

TransCanada disputed IGUA's claim that TransCanada's shippers were playing “forecasting games” which led to the need to borrow capacity. TransCanada pointed out that its shippers were forecasting increased load factors in March 1992 and that actuals for 1992 to date reflect those expectations. With respect to IGUA's position regarding Western Gas, TransCanada submitted that Western Gas' contract reduction represented only 1.8% of its total contracted capacity of 40 665.0 $10^3m^3/d$ (1,435.5 MMcf/d) as of October 1992. TransCanada noted that although Western Gas was able to forego capacity, effective 1 November 1992, Western Gas has contracted for net capacity totalling 1 484.0 $10^3m^3/d$ (52.4 MMcf/d). TransCanada likewise pointed out that during those times when it was not fully using the capacity borrowed from Western Gas, Western Gas was using its capacity entitlements to the fullest. TransCanada similarly pointed out that under the Western Gas alternative arrangements (e.g. the short-haul volumes in Southern Ontario), Western Gas shipped a volume of gas approximately equivalent to the amount of capacity loaned out.

TransCanada rejected IGUA's assertion that it was unlikely that Western Gas would have used its full capacity rights. TransCanada argued that Western Gas would: not have simply incurred the associated demand charge obligations; not have given up its right to ship Canadian gas to market; and, not have incurred the additional expense of securing alternative gas supply to meet its contractual obligations.

TransCanada disputed IGUA's position that building additional facilities is not the least-cost alternative to the loan of capacity. TransCanada pointed out that advancing facilities construction would have cost $26,400,000, whereas the alternative of buying back capacity would cost $26,500,000. TransCanada added that advancing facilities construction allows for future additional flows of Canadian gas supply, whereas the buy-back option does not.

TransCanada pointed to IGUA's proposals for the cost treatment of the loan of capacity which would:

(a) disallow any Western Gas capacity loan costs triggered by their increased forecast;

(b) disallow recovery in 1993 of any costs from 1992 not covered by deferral accounts;

(c) disallow costs resulting from acceleration of in-service dates in 1993 unless there is convincing evidence that the load factors will continue at high levels; and,

(d) include the payback volumes in the 1993 allocation units.

TransCanada questioned the fairness of such a proposal, since it would result in all of the costs associated with the capacity loan arrangements and the subsequent payback volumes being denied and all of the allocation units for the payback volumes being included for 1993 test-year toll purposes.

Consumers' submitted that although the relevant costs are confined to the 1993 test year, the Board should extend its decision to similar costs relative to the payback volumes scheduled for delivery during 1994 and 1995. Consumers' argued that TransCanada should be permitted to recover the costs arising from the capacity loan agreements if those costs were prudently incurred. It noted that the determination of prudence can be made by answering the following two questions:

(a) Is it now reasonable to expect that TransCanada should have been able to foresee the capacity constraint problem soon enough to have been able to apply for and install the additional facilities that would have avoided the problem in the first place? and

(b) Under the circumstances, did TransCanada manage the capacity constraint problem in the most efficient and cost-effective manner?

Consumers' submitted that the answer to (a) is “no” since such an expectation is “patently unreasonable” because TransCanada relies heavily on shippers' forecasts to project its aggregate throughput requirements for facilities planning purposes and, while TransCanada must use judgment in assessing its shippers' forecasts, it is not in a position to second guess them. Consumers' also noted that the significant change in projected throughput requirements did not occur until well into the 1991-92 contract year, by which time it would have been far too late to file for and get approval of a facilities expansion to cover the capacity shortfall.

Consumers' argued that the answer to (b) is “yes” because TransCanada had only two practical alternatives, that is curtail service or borrow capacity to deal expeditiously with the capacity loan situation. Consumers' noted that the cost of these two alternatives on a present-value basis in 1992 dollars is roughly the same; namely $26,000,000 in lost demand revenue associated with the curtailment alternative and $26,400,000 for the capacity loan alternative. Based on the foregoing, Consumers' concurred with TransCanada that the capacity loan agreements were preferable to curtailing service.

Consumers' argued that the capacity loan agreements serve the interests of producers and consumers in an efficient and cost-effective manner. The associated costs, therefore, were prudently incurred and should be recovered as applied for by TransCanada.

Consumers' submitted that it would have been preferable if TransCanada had tendered for the initial 637.5 10^6m^3 (22.5 Bcf)[1] of required transportation capacity but it recognized the magnitude and the immediacy of the capacity constraint problem confronting TransCanada at the time. Consumers' submitted that the Board should direct TransCanada, except in unusual circumstances (e.g. severe time constraints), to use a tendering process in the future if borrowing capacity becomes necessary.

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[1] Comprised of Consumers' and Union FST of 56.7 10^6m^3, Western Gas FS of 552.5 10^6m^3 and CanStates FS of 28.3 10^6m^3.

Consumers' requested that the Board undertake to review TransCanada's current design philosophy because the capacity constraint problem was the result of that philosophy. Consumers' submitted that such a review should be carried out in the context of TransCanada's upcoming facilities application. To facilitate such a review, Consumers' recommended that the Board direct TransCanada to prepare and file an assessment of its current design philosophy.

Consumers' did not concur with the CAPP's recommendation that the capacity loan issue be deferred to a future NEB proceeding after consideration by the Task Force.

In response to Consumers' recommendation that TransCanada be directed to conduct a system design study, TransCanada argued that such a study is unnecessary since its own internal study forms an integral part of any facilities application filed with the Board.

GMi believed that the measures taken by TransCanada to assure that aggregate capacity was available to meet aggregate demand were appropriate. GMi commended TransCanada for its prompt action and took comfort from TransCanada's undertaking to use a tendering process so that in future, all shippers have an opportunity to loan capacity. GMi believed that the loan capacity costs should be included in TransCanada's 1993 tolls.

Natural argued that a gas supply aggregator, such as Western Gas, should not be permitted to trade away its firm capacity without its customers' approval. Natural recommended that the Board require that any capacity loan agreements entered into by TransCanada with a gas supply aggregator contain some form of assurance from the aggregator that it has secured its customers' consent to the loan. Natural argued that this would ensure that pipeline capacity was available for the aggregator's customers and provide an opportunity for customers to bid for any excess capacity held by the aggregator.

TransCanada objected to Natural's position as to such a representation from the capacity loaning agregator. TransCanada argued that this is not its concern but that of the aggregator who should be satisfied as to its ability to fulfil its contractual commitments before loaning capacity.

Union indicated that it was satisfied that, for tollmaking purposes, the methodology being proposed by TransCanada “adequately” allocates the costs during the payback period. Union concurred with TransCanada's commitment to tender for all such required capacity in the future.

Views of the Board

The Board has considered the circumstances that led to the need for TransCanada to borrow capacity and it is satisfied that TransCanada acted in a responsible and prudent manner. The Board believes that the capacity loan agreement option was the most appropriate one to pursue, given the urgency of the situation at the time and the substantial volumes involved.

The Board concurs with TransCanada that the circumstances at the outset of the capacity constraint problem were such that tendering for the required capacity was not a viable option. In this regard however, the Board notes TransCanada's undertaking to tender for such capacity in the future, should circumstances allow. While the Board recognizes that tendering may not always be feasible, especially when the situation is urgent and/or unforeseen, the Board expects TransCanada to pursue such a policy to the fullest extent possible.

With respect to the question the Board raised concerning section 62 of the Act, the Board concurs with TransCanada that because the FS capacity which is to be repaid in 1993 will not be "traffic of the same description carried under substantially similar circumstances and conditions" as TransCanada's other 1993 FS traffic, a divergence between the 1992 and 1993 FS tolls will not offend the stipulation in section 62 that tolls be charged equally with respect to traffic of the same description carried over the same route.

The Board believes that there is no evidence of impropriety on the part of either TransCanada or Western Gas in entering into capacity loan agreements. The Board is satisfied that all negotiations were conducted at arm's length and that there continues to be an arm's length relationship between TransCanada and Western Gas in this regard.

With respect to CAPP's recommendation that any decision on the capacity loan issue which impacts on the 1993 test year be deferred to the Task Force and thereafter to a future Part IV proceeding, the Board is satisfied that it has sufficient evidence to render a decision and will therefore not defer the matter. With respect to CAPP's recommendation that TransCanada undertake a study of the provisions of its current FS and FST services, the Board encourages CAPP to work with the Task Force to determine the need for, and the scope of, such a study.

The Board concurs with TransCanada that its internal facilities design study forms an integral part of any facilities application. Therefore, the Board does not believe that there is a need for TransCanada to be directed to prepare a study of its current design philosophy as part of its upcoming facilities application, as was recommended by Consumers'. In this connection, the Board notes that, if load factors continue to increase in the future, the application of TransCanada's design philosophy will result in aggregate capacity that more closely reflects the total contracted firm service volumes.

The Board concurs with Consumers' that it would be time and cost-effective for the Board to extend its tolling decision with respect to the capacity loan agreements to include the future payback periods in 1994 and 1995.

With respect to Natural's recommendation that TransCanada be directed to obtain a representation or a warranty from the aggregator that it has obtained its customers' consent with respect to the loaning of capacity, the Board concurs with TransCanada that this is the responsibility of the aggregator and not of TransCanada.

Decision

The Board finds reasonable both the process used by TransCanada in selecting shippers to loan capacity and the capacity loan arrangements themselves. The Board approves the tolling and cost consequences of the loan arrangements for the 1993, 1994 and 1995 test years.

Chapter 11

Subshipper Agreements

On 31 January 1992, Consumers' sought the Board's assurance that the Board would not give leave under subsection 69(2)[1] of the Act, for a prosecution of Consumers' under subsection 69(1)[1] of the Act, in connection with the subshipper agreements[2] when such agreements involve a discount from the Board-approved tolls.

Specifically, Consumers' requested that the Board treat the subshipper agreements in the same manner as FS and FST assignments, when such assignments involve a discount, in accordance with its RH-1-88 Phase II Reasons for Decision, "9.3.1 Brokering". In that decision, the Board found that, while it would not implement a capacity brokering scheme, it would permit assignments at a discount negotiated between assignors and assignees, provided that the approved toll continues to be paid to TransCanada. The Board added that in those circumstances, it would not give leave for a prosecution to be instituted pursuant to subsection 69(2) of the Act. The Board found that, by not interfering with assignments that are made at a discount, an even greater incentive is created to maximize system capacity utilization, thus benefiting all systems-users whether they be producers able to sell more gas, existing shippers able to obtain relief from demand charges on unused but contracted-for capacity, or potential shippers able to obtain firm capacity without necessarily having to "queue" for it, or having to rely on interruptible service.

On 13 May 1992, the Board directed Consumers' to serve a copy of its request on the interested parties to the RH-4-91 proceeding and invited those parties to file and serve their comments. Comments were received from APMC, Centra Ontario, GMi and IPAC, who all supported Consumers' request for a "no prosecution" assurance in respect of discounts from the Board-approved tolls under the subshipper agreements. Centra Ontario, GMi and IPAC recommended that the Board issue a generic "no prosecution" assurance to all FS shippers on the TransCanada system who elected to assign their capacity at a discount, on the condition that the full NEB-approved toll continues to be paid to TransCanada and that the negotiated per unit charge between the assignor and the assignee is not greater than the NEB-approved toll.

On 3 August 1992, the Board advised Consumers' that it had decided to defer consideration of Consumers' request to a future TransCanada Part IV proceeding to allow " ... a more thorough examination of the issue." On 2 September 1992, the Board issued Hearing Order AO-2-RH-2-92 which indicated that the Board would examine the following issues:

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[1] Section 69. (1) A company or shipper or an officer, employee or agent of the company or shipper who
a) offers, grants, gives, solicits, accepts or receives a rebate, concession or discrimination, or
b) knowingly is part or privy to a false billing, false classification, false report or other device,
whereby a person obtains transmission of hydrocarbons by a company at a less rate than that named in the tariffs then in force, is guilty of an offence punishable on summary conviction.

(2) No prosecution shall be instituted for an offence under this section without leave of the Board. R.S., c. N-6, s. 57.

[2] Refer to Glossary of Terms chapter.

"12. With respect to subshipper agreements and partial assignments:

(a) whether the Board should grant Consumers' request that the Board not give leave under subsection 69(2) of the Act, for the prosecution of Consumers' under subsection 69(1) of the Act, on the basis that pursuant to certain subshipper agreements it has entered into, parties are obtaining transportation on the TransCanada system at a less rate than that named in the TransCanada tariff in force from time to time;

(b) whether the Board should make a generic order that it will not give leave under subsection 69(2) of the Act, for the prosecution under subsection 69(1) of the Act, of parties who enter into subshipper agreements substantially similar to the Consumers' subshipper agreements, whereby parties obtain transportation on the TransCanada system at a less rate than that named in the TransCanada tariff then in force; and

(c) whether Consumers' practice of offering to enter into subshipper agreements or make partial assignments only with parties who wish to transport gas to locations outside Consumers' franchise area constitutes a violation of section 67 of the Act which provides, in part, that a company shall not make any unjust discrimination in its service against any person or locality."

On 5 October 1992, the Board issued AO-4-RH-2-92 removing issue 12(c) from the List of Issues. In removing issue 12(c), the Board noted that the applicability of section 67[1] of the Act to Consumers' is a threshold issue to a substantive inquiry on the possible existence of unjust discrimination by Consumers'. The Board indicated that it had decided that the word "company" in section 67 of the Act should not be construed so broadly so as to include shippers such as Consumers' who assign their excess transportation capacity to third parties.

Consumers' explained that the partial assignments and subshipper agreements are a means by which it brokers its excess capacity which becomes available when the total amount of available transportation capacity to its service area is in excess of the total demand in its service area. In this situation, Consumers' endeavours to reduce its unabsorbed demand charge exposure by using partial assignments and subshipper agreements to broker its excess capacity.

Consumers' submitted that, depending on demand in the secondary market, it may offer a discount from the NEB-approved tolls to assignees under the partial assignments and to subshippers under the subshipper agreements. Specifically, where excess FS capacity is used under partial assignments, Consumers' may reimburse the assignee for part of the NEB-approved tolls that the assignee pays to TransCanada. Similarly, where FS capacity is used under subshipper agreements, the subshipper pays Consumers' an agreed-upon unit charge that may be less, but never more than, the NEB-approved tolls. Consumers' noted that in both circumstances, therefore, discounting from the NEB-approved tolls occurs.

[1] "67 A company shall not make any unjust discrimination in tolls, service, or facilities against any person or locality. R.S., c. N-6, s. 55."

Consumers' explained that it would not offer discounts from the NEB-approved tolls for gas being shipped to in-franchise destinations under either partial assignments or subshipper agreements since it would make no sense to do so. Consumers' added that since an in-franchise arrangement is a means by which it facilitates direct purchases by contractual means, offering discounts would result in cross-subsidy of direct purchase customers since the cost associated with the discount would have to be borne by the other toll payers and/or its shareholders. Consumers' submitted that if it had excess capacity (i.e. capacity not required for its service area), discounts under the in-franchise arrangements would not create additional market demand in its service area and would therefore not help it to shed excess capacity since the discounted arrangements would merely replace the full-priced arrangements for deliveries to its service area.

Consumers' indicated that only in unusual circumstances, such as an unanticipated, temporary incremental market demand, would it offer a discount for gas to be shipped to in-franchise destinations. Consumers' cited the example of a coal-burning cement plant that might be persuaded to convert from coal to gas if it were offered a package of inducements, including a discount under a subshipper agreement.

Consumers' argued that the difference between a subshipper agreement and a partial assignment is a difference in legal form and substance, and not in practical effect since both are used to broker excess capacity. Consumers' therefore argued that subshipper agreements at a discount should be treated in the same way as assignments at a discount insofar as the “no prosecution” assurance is concerned.

Consumers' supported the issuance of a generic order that would apply to all subshipper agreements at a discount, conditional upon payment to TransCanada of the full NEB-approved toll. Similarly, Consumers' did not object to a condition that would proscribe a charge under the subshipper agreements that is greater than the associated NEB-approved TransCanada toll.

IGUA recommended that the Board approve Consumers' request, noting that shippers should have as many shipping alternatives as possible.

Centra Ontario believed that the Board should respond positively to the questions raised in issues 12(a) and 12(b). Centra Ontario argued that the RH-1-88 Phase II Reasons for Decision did not confine itself to a particular type of assignment and only stipulated that the NEB-approved toll continue to be paid to TransCanada. Centra Ontario further submitted that, in the event the Board is not satisfied that such assignments are not already allowed in accordance with its RH-1-88 Phase II Reasons for Decision, the Board “... should make a generic order or ruling that the Board will not grant leave for prosecution in circumstances where any shipper brokers excess firm capacity at a discount, so long as TransCanada continues to receive the Board-approved tolls”.

In supporting Consumers' request, Centra Ontario argued that it is inevitable for shippers to have excess firm capacity from time to time. It further argued that any means which permits shippers to mitigate the costs associated with that excess capacity and which encourages greater overall use of the pipeline system, is beneficial to all system users.

GMi argued that the reasons cited by the Board in its RH-1-88 Phase II Reasons for Decision in favour of permitting assignments at a discount and in support of its no prosecution assurance decision, remain valid. GMi believed that the ability to broker capacity is useful to all TransCanada shippers and to ensuring system capacity utilization. GMi noted that its support of the Consumers' request is conditional upon the Board issuing a generic order, or decision, that would apply to all shippers on the TransCanada system.

Views of the Board

As set out more fully in its RH-1-88 Phase II Reasons for Decision, the Board continues to believe that assignments, including those made at a discount, serve to maximize system capacity utilization to the benefit of all system users. The Board concurs with those parties who have argued that in a deregulated environment shippers will, from time to time, have excess capacity and that such shippers must be able to avail themselves of means to dispose of such excess capacity.

The Board believes that the subshipper agreements entered into by Consumers' are an appropriate means by which to dispose of excess capacity in order to minimize or eliminate the financial burden associated with underutilized or unutilized pipeline capacity. The Board believes that the subshipper agreements entered into by Consumers' are consistent with its findings in RH-1-88, Phase II.

The Board has been persuaded that its decision should be extended to include any party which enters into subshipper agreements, substantially similar to the Consumers' subshipper agreements, conditional upon:

(a) TransCanada receiving payment of the full NEB-approved toll for the service rendered; and,

(b) the charge under the subshipper agreements being no greater than the NEB-approved TransCanada toll for that service.

Decision

The Board will not give leave under subsection 69(2) of the Act for the prosecution of Consumers' under subsection 69(1) of the Act, on the basis that pursuant to certain subshipper agreements Consumers' has entered into, parties are obtaining transportation on the TransCanada system at a toll less than that named in the TransCanada tariff then in force.

This decision shall apply to any party which enters into a subshipper agreement substantially similar to the Consumers' subshipper agreements, and is conditional upon TransCanada receiving payment of the full NEB-approved tolls for the service rendered and upon the charge under the subshipper agreements being no greater than the NEB-approved TransCanada toll for that service.

Chapter 12

Task Force

In response to the suggestions of several parties, as noted below, that the Board could or should make various improvements to the Task Force process, TransCanada submitted that the Board should not get involved in the process. TransCanada was of the view that the Task Force participants should themselves deal with the suggestions. TransCanada further stressed that the procedures under which the Task Force operates were drafted and approved by the membership.

While all parties expressing a view on this area continue to be in favour and supportive of the Task Force process, several parties did make specific comments on the process itself.

IGUA was of the view that for the process to work all parties, especially TransCanada, must be able to make full, fair and complete disclosure of all relevant information pertaining to the issues. IGUA was also of the view that perhaps TransCanada's initial application figures, which are the precursor for the Task Force negotiations, border on the excessive and hinder the negotiation process. IGUA also suggested that the tolls filings would be enhanced if they included the bridge-year estimate as well as the base-year and test-year amounts.

Centra Ontario suggested that the use of the Task Force should be encouraged.

Northland indicated that it was of the understanding that participation in the Task Force was without prejudice to the participants and does not result in issues being won or lost based on a popularity contest. It objected to TransCanada's use, in argument, of the results of the Task Force vote on the issue it was contesting. Northland was of the view that if TransCanada was going to use the results of the vote from the Task Force as a basis to persuade the Board to agree to TransCanada's position then the results of the vote should not be disclosed.

ProGas was in agreement with Northland and shared the same concern that parties' positions should not be prejudiced by their participation in the Task Force. ProGas was of the view that the final vote of the Task Force should not impede a full and fair hearing before the Board.

Ontario strongly urged the Board to send a signal to TransCanada that will encourage TransCanada to settle issues in the future.

Views of the Board

The Board continues to believe that the Task Force provides an effective means of allowing TransCanada and parties to resolve issues on an informal basis, thereby reducing the number of issues to be litigated in hearings, hearing time and costs to all parties. Of course, nothwithstanding the existence of a settlement in any case, pursuant to the Act, the Board must always satisfy itself that the settlement results in tolls which are just and reasonable.

The Board supports the Task Force members' initiative in suggesting changes to refine and improve the Task Force process. The Board is of the view that the Task Force is the appropriate forum for discussion and implementation of such changes. For that reason, the Board is reluctant to impose its views on the manner in which the Task Force operates.

The Board is, however, sympathetic to the views expressed by several intervenors with respect to the inclusion, by TransCanada, of the final vote count on the issues in its Task Force Report. The Board does not see the results of the vote providing any meaningful information to the Board.

Decision

The Board does not consider it necessary to intervene to change the way the Task Force conducts its business. It is satisfied with the present arrangement whereby the Task Force membership itself decides the process to be followed. However, a party which does not feel that equitable consideration of an issue has been afforded at the Task Force can always bring its concern(s) to the Board for possible action.

The Board directs TransCanada to exclude the vote count, with respect to the issues considered by the Task Force, in future filings with the Board.

Chapter 13

Disposition

The foregoing chapters together with Order No. TG-1-93 constitute our Decision and Reasons for Decision on this matter.

R.B. Horner, Q.C.
Presiding Member

R. Priddle
Member

A. Côté-Verhaaf
Member

Calgary, Alberta
February, 1993

Appendix I

Order TG-1-93

ORDER TG-1-93

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

IN THE MATTER OF an application dated 2 July 1992, as amended, by TransCanada PipeLines Limited (“TransCanada”) pursuant to Part IV of the Act for certain orders respecting its tolls; filed with the National Energy Board (“the Board”) under File No. 4200-T001-7.

BEFORE the Board on 5 February 1993.

WHEREAS TransCanada filed an application dated 2 July 1992, as amended, for an order fixing just and reasonable tolls that it may charge for or in respect of transportation services rendered effective 1 January 1993;

AND WHEREAS the Board, expecting that its final decision on TransCanada's application would not be rendered until after 1 January 1993, issued Order TGI-5-92 on 17 December 1992, which authorized TransCanada to charge, on an interim basis, effective 1 January 1993, its existing tolls as authorized by the Board in its RH-4-91 Decision, pending the Board's final decision on the said application;

AND WHEREAS a public hearing was held pursuant to Hearing Order RH-2-92, as amended, in the City of Calgary, in the Province of Alberta, at which the Board heard the evidence and argument presented by TransCanada and all interested parties;

AND WHEREAS the Board's decisions on the application are set out in its Reasons for Decision dated February 1993, and in this Order;

IT IS ORDERED THAT:

1. TransCanada shall, for accounting, tollmaking and tariff purposes, implement the decisions outlined in the Reasons for Decision dated February 1993 and in this Order;

2. Order TGI-5-92, which authorized the tolls to be charged on an interim basis pending a final decision on the said application, is revoked and the tolls that were authorized to be charged thereunder are disallowed as of the end of the day on 31 March 1993;

3. The tolls which were in effect, on an interim basis, for the period 1 January 1993 to 31 March 1993 are final;

4. TransCanada shall, for service commencing 1 April 1993, charge the tolls set out in Appendix 1 of this Order;

5. TransCanada shall forthwith file with the Board, and serve on all parties to the hearing of this application, new tariffs, including general terms and conditions, and tolls conforming with the decisions outlined in the Reasons for Decision dated February 1993 and with this Order; and

6. Those provisions of TransCanada's tariffs and tolls, or any portion thereof, that are contrary to any provision of the Act, to the Board's Reasons for Decision dated February 1993, or to any Order of the Board including this Order, are hereby disallowed.

NATIONAL ENERGY BOARD

J.S. Richardson
Secretary

(Table A1-1)

(Table A1-2)

(Table A1-3)

(Table A1-4)

Appendix II

Functional Distribution and Classification of Revenue Requirement

(Table a2-1)

Appendix III

System Average Unit Cost of Transportation

(Table a3-1)

Appendix IV

Zone Differential Tolls - Applicable to Diversions

(Table a4-1)

Appendix V

Interruptible Service Distances

(Table a5-1)

Appendix VI

List of Previously Distributed Documents

(a) National Energy Board Hearing Order RH-2-92

(b) Amending Hearing Order AO-1-RH2-92

(c) Amending Hearing Order AO-2-RH2-92

(d) Amending Hearing Order AO-3-RH2-92

(e) Amending Hearing Order AO-4-RH2-92

(f) Interim Toll Order TGI-5-92

Copies of these documents are available on request from:

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

Appendix VII

Capital Projects Removed from Rate Base

(Table a7-1)