

NATIONAL ENERGY BOARD

IN THE MATTER OF the *National Energy Board Act*,
R.S.C. 1985, c. N-7, as amended, and the Regulations
made thereunder; and

IN THE MATTER OF an Application by TransCanada
PipeLines Limited for approval of a negotiated
Settlement of 2007 Mainline tolls pursuant to Part IV of
the *National Energy Board Act* and the National Energy
Board *Revised Guidelines for Negotiated Settlements of
Traffic, Tolls and Tariffs*.

TRANSCANADA PIPELINES LIMITED

APPLICATION FOR APPROVAL OF A MAINLINE NEGOTIATED
SETTLEMENT AND 2007 MAINLINE TOLLS

March 2007

Régie de l'énergie
DOSSIER: R-3630-2007
DÉPOSÉE EN AUDIENCE par l'ACIG
Date: 29/08/07
Pièces n°: C-8.22-ACIG

To: The Secretary
National Energy Board
444 Seventh Avenue S.W.
Calgary, Alberta
T2P 0X8

Background and Summary

1. TransCanada PipeLines Limited (“TransCanada”) is a federally incorporated Canadian corporation and a “company” as that term is defined in the *National Energy Board Act* (“Act”).
2. TransCanada owns and operates a high-pressure natural gas transmission system that extends from the Alberta border across Saskatchewan, Manitoba, and Ontario, through a portion of Québec, and connects to various downstream Canadian and international pipelines (“Mainline” or “Mainline System”).
3. The Mainline is subject to regulation by the National Energy Board (“Board”).
4. TransCanada is currently charging interim tolls for 2007 for transportation on the Mainline pursuant to Board Order TGI-01-2006 effective January 1, 2007 pending approval of final 2007 tolls.
5. The Tolls Task Force (“TTF”) is a joint TransCanada and industry task force whose membership is comprised of a wide cross-section of the natural gas industry, including representatives of the producing, marketing, brokering and pipeline segments of the industry, provincial governments and local distribution and industrial end-use customers. The TTF is a forum for the resolution of issues related to the tolls, tariffs and operations of the Mainline without resorting to a hearing process.
6. The negotiated tolls settlement (“Settlement”), dated February 23, 2007, reflects an agreement for a five-year term commencing January 1, 2007 and ending December 31, 2011 (“Term”). The Settlement addresses all elements of the Mainline’s revenue requirement and tolls for the Term.

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7. This Application seeks approval from the Board of the Settlement and resulting 2007 Mainline transportation tolls (“2007 Mainline Tolls”).

Application

8. TransCanada hereby applies to the Board pursuant to Part IV of the Act and the National Energy Board *Revised Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs*, dated June 12, 2002 (“Guidelines”) for approval of the Settlement and 2007 Mainline Tolls (“Application” or “Settlement Application”).
9. In support of its Application, TransCanada provides and relies on the information contained in this Application including the Settlement (Tab A), the schedules supporting the 2007 Mainline net revenue requirement and rate of return (Tabs B and C respectively) and toll design calculations (Tab D).
10. TransCanada also relies on the unopposed TTF Resolution 04.2007 in support of the Application. The Settlement and the supporting TTF Resolution are provided in Tab A.
11. TransCanada further provides, for information purposes only, illustrative tolls for the years 2008-2011 based on the terms and conditions pursuant to the Settlement. Although the illustrative tolls will vary from the tolls to be determined during each year of the Term in accordance with the provisions of the Settlement, TransCanada is providing this additional information to enable the Board to adduce the reasonableness of the Settlement and impacts of the Settlement on TransCanada’s tolls. Details of the illustrative tolls are provided in Tab E.

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12. TransCanada has filed, under separate cover and concurrent with the Settlement Application, an application for interim tolls to be effective April 1, 2007. The proposed interim tolls are supported by TTF Resolution 06.2007. The proposed April 1 interim tolls were calculated based on the 2007 Settlement net revenue requirement and include a forecast of the interim revenue adjustment for the period January 1 to March 31, 2007. TransCanada is requesting that the proposed interim tolls, upon approval of the Settlement by the Board, be made final for the 2007 test year. The interim revenue adjustment results in a deficiency of \$12.7 million. In order to permit full recovery of the adjustment from April 1 to December 31, 2007, the deficiency amount, for toll design purposes, is \$16.9 million.

Details supporting the toll calculations for 2007 are provided in Tab D, Toll Design.

The Settlement

13. The Settlement represents a revenue requirement and tolls agreement for five years commencing January 1, 2007 and terminating December 31, 2011.
14. The Settlement requires that a forecast of the net revenue requirement and firm allocation units be made for each test year during the Term for determining annual tolls. In accordance with paragraph 4 of the Settlement, TransCanada will file, subsequent to the November TTF meeting in each year prior to the test year, an application for interim tolls to be effective January 1 of each test year. An application for final tolls will be made subsequent to the March TTF meeting in each test year and include an estimate of the interim revenue adjustment reflecting the variance between interim and final tolls.

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15. The Settlement is the result of broad industry negotiations since September 2006 and represents a balance of interests and compromises among the TTF members. The Settlement is an agreement for determining the cost and miscellaneous revenue components included in the net revenue requirement to calculate test year tolls for each year of the Term.
 16. The Settlement establishes the Mainline's cost of debt and equity capital, depreciation expense allocated on a segmented basis, annual Operations, Maintenance and Administrative ("OM&A") expense for each year of the Term and the implementation of certain performance-based incentive programs. No single component of the Settlement can be said to be acceptable to any TTF member independent of the entire Settlement. It is a specific provision of the Settlement that the Settlement must be approved in its entirety by the Board.
 17. The Settlement net revenue requirement in each year of the Term incorporates a cost of capital that reflects the rate of return on equity ("ROE") based on the NEB RH-2-94 formula (8.46 percent for 2007) and applied to a deemed equity component of 40 percent of the Mainline's capital structure. The debt component of the Mainline's capital structure reflects the redemption of the U.S. 8.25% Junior Subordinated Debentures ("JSD") in 2007.
 18. The Settlement reflects the disposition of the foreign exchange gain resulting from the redemption of the JSDs in 2007. The foreign exchange gain, including associated income tax impacts, will be amortized on an annual basis to the Mainline's net revenue requirement over the Term commencing in 2007. Any variance between the 2007 estimated and actual foreign exchange gain will be included in the determination of the amortization amounts, including the

associated income tax impacts, for the period 2008 to 2011. The unamortized JSD issue costs in the amount of \$20.2 million will be amortized annually to the Mainline's net revenue requirement over a 20 year period commencing in 2007.

19. The Settlement reflects an agreement that, during the Term, TransCanada will not pursue litigation of the NEB RH-2-94 ROE formula on behalf of its B.C. System, the Foothills Pipe Lines Ltd. Systems and its Mainline System and will not rely on the Mainline System's increased equity thickness from 36 percent to 40 percent achieved in this Settlement as a basis for seeking increases in the equity thickness for its Alberta System (NOVA Gas Transmission Ltd.), B.C. System and the Foothills Pipeline Systems.
20. The Settlement includes a fixed amount for OM&A expense for each year during the Term as follows:

<u>Year</u>	<u>Amount (\$000)</u>
2007	178,100
2008	187,896
2009	198,230
2010	212,341
2011	221,907

Any variances between actual OM&A costs incurred and the amounts established for toll making purposes for the years 2007, 2008 and 2009 will be for the account of TransCanada. Any variances between actual OM&A costs incurred and the amounts established for toll making purposes for the years 2010 and 2011 will be shared equally (50/50) between Shippers and TransCanada.

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21. The Settlement establishes flow through based deferral accounts for all costs and revenues during the Term excluding OM&A cost variances for the years 2007 to 2009 inclusive. Variances in flow through costs and revenues, both positive and negative, will be brought forward for disposition and included in the following test year's tolls. A comprehensive list of the deferral accounts, including incentive based deferral accounts, is provided in paragraph 3 of the Settlement.
22. The Settlement provides for the allocation of the Mainline's annual depreciation expense of its transmission plant assets on a segmented basis during each year of the Term reflecting the economic lives of the three main segments of the Mainline system. The segments include the Prairies line (Empress to Station 41 including the Emerson extension), the Northern Ontario line (Station 41 to Station 116 including the Sault St. Marie line) and the Eastern Triangle (east of Station 116 including the St. Clair to Dawn and Niagara to Kirkwall lines). The transmission plant segmented depreciation rates and the general plant depreciation rates to be employed during the term are provided in Appendix B of the Settlement. The Settlement also requests that the NEB will move into abeyance, until the end of the Settlement, TransCanada's current requirement to file a depreciation study no later than the 2008 Mainline tolls application.¹
23. The Settlement provides for a one-time independent compliance audit of the Settlement Term to be conducted prior to December 31, 2012. Details with respect to the audit are described in paragraph 7 of the Settlement.

¹ National Energy Board, Reasons for Decision, RH-1-2002, pg. 44.

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24. The Settlement includes a dispute resolution process, described in paragraph 8 of the Settlement, whereby parties will attempt in good faith to resolve disputes within 45 days and, pending no resolution within this time frame, may apply to the Board to adjudicate the disputed matter.

Settlement Incentive Programs

25. The Settlement provides for the implementation of a Performance Incentive Envelope ("PIE") for the Term that includes incentive payments to TransCanada should certain cost savings and performance targets be achieved. The 2007 gross revenue requirement includes a fixed amount of \$15.9 million related to all PIE programs. Any variance between the actual incentive amounts achieved under each program and the fixed amount of \$15.9 million shall be recorded in the appropriate PIE deferral account and brought forward for disposition in the following test year. The fixed amount for the PIE program for subsequent years during the Term will be forecast and included the Mainline's annual revenue requirement.

Programs contained in the PIE include the following:

- 1) Fuel Gas Incentive Program ("FGIP")

The FGIP is an eighteen month incentive program effective for the 2006/07 gas year with the continued purpose, as in previous FGIP programs, to provide TransCanada with an incentive to reduce fuel consumption while not affecting transportation services or compromising throughput. The FGIP will commence November 1, 2006 and terminate March 31, 2008 unless an extension is agreed to by TransCanada and the

TTF. Details of the program, along with the incentive payment schedule, are found in Tab A, Settlement, Appendix C-1.

2) Leak Detection and Repair (“LDAR”) Incentive Program

The purpose of this program is to mitigate gas costs, including fuel, and provide TransCanada with an incentive to reduce natural gas leaks and emissions. Incentive payments to TransCanada are based on defined ranges of energy emissions savings.

Details of the program, along with the incentive payment determination, are provided in Tab A, Settlement, Appendix C-2.

3) Municipal and Capital Tax Savings Incentive Program

The purpose of this program is to provide TransCanada with an incentive to minimize the municipal and capital tax cost for each year in the Term of the Settlement. TransCanada will receive an incentive payment equal to 50 percent of any municipal and capital tax cost savings.

Details of the program, along with the incentive payment determination, are provided in Tab A, Settlement, Appendix C-3.

4) Great Lakes Gas Transmission (“GLGT”) - Long Term Releases Incentive Program

The purpose of this program is to mitigate GLGT Transmission by others (“TBO”) costs and provide TransCanada with an incentive to release portions of its GLGT TBO contracts dependent on certain

conditions. Long term releases under this program are capacity releases of two or more days. TransCanada will receive an incentive payment equal to 40 percent of the long term net TBO cost savings.

Details of the program, along with the incentive payment determination, are provided in Tab A, Settlement, Appendix C-4.

5) Great Lakes Gas Transmission - Short Term Releases Incentive Program

The purpose of this program is to mitigate GLGT TBO costs and provide TransCanada with an incentive to release all or portions of the un-nominated GLGT TBO contract capacity on the day ahead or intra-day nomination cycles dependent on certain conditions. Capacity releases under this program may require negotiations between TransCanada and GLGT pursuant to the GLGT tariff. TransCanada will receive an incentive payment equal to 50 percent of the short term net TBO cost savings.

Details of the program, along with the incentive payment determination, are provided in Tab A, Settlement, Appendix C-4.

6) Fuel Ratio Accuracy and Timeliness Incentive Program ("FRATI")

The purpose of the FRATI program is to provide shippers with greater certainty with respect to their fuel requirements while providing TransCanada with incentives to improve on the timeliness of fuel ratio postings and the accuracy of projected fuel ratios. The FRATI program provides for two benchmarks to be achieved through a two-step process contained within each benchmark.

The first benchmark, Consumed Fuel Forecast, provides TransCanada with incentive payments for (a) the timely posting of forecast monthly fuel ratios by a specified date and (b) within defined ranges, for fuel ratio accuracy determined by the difference between the monthly forecast and actual Eastern Zone fuel ratios. The date specific posting of the monthly forecast fuel ratios must be met in order for any incentive amount to be paid with respect to fuel ratio accuracy.

The second benchmark, Posted Fuel Forecasts, provides TransCanada with incentive payments (a) for the timely posting of forecast summer (April – October) and winter (November – March) seasonal fuel ratios by specified dates and (b) within defined ranges, for fuel ratio accuracy determined by the difference between the forecast posted seasonal Eastern Zone fuel ratio in a given seasonal month and the forecast Eastern Zone fuel ratio for the same month. The date specific posting of the forecast seasonal fuel ratios must be met in order for any incentive amount to be paid with respect to fuel ratio accuracy.

Details of the program, along with the incentive payment determinations including bonus payments where applicable, are provided in Tab A, Settlement, Appendix C-5.

2007 Test Year

26. The 2007 Settlement net revenue requirement is \$1,601.6 million. The net revenue requirement, including the interim revenue adjustment, is \$1,618.5 million.
27. Total miscellaneous revenues, including discretionary and non-discretionary revenues, are fixed at \$342.6 million for 2007.
28. Average rate base is fixed at \$7,297.5 million for 2007.
29. In accordance with the Settlement, all costs and revenues, with the exception of OM&A costs, will be treated on flow-through basis.
30. Regulatory amortizations, representing a forecast of the 2006 deferral account balances brought forward in 2007 for disposition, are fixed at a credit amount of \$36.3 million. Variances between the forecast and actual 2006 balances will be brought forward for disposition in the 2008 test year.
31. TBO costs for 2007 are fixed at \$308.9 million. This amount includes the costs associated with the GLGT contract renewals effective November 1, 2007.
32. Income taxes for 2007 are fixed at \$178.5 million and reflect the tax impact associated with the 2007 amortization of the estimated net gain on the JSD redemption.
33. TransCanada is providing detailed schedules supporting the 2007 cost components of the net revenue requirement and toll design.

Other

34. The Settlement was achieved in accordance with the Board's criteria for an acceptable settlement process as set out in the Guidelines.

More specifically:

- (a) All TTF members having an interest in the Mainline's traffic, tolls and tariffs were provided with a fair opportunity to participate and to have their interests recognized and appropriately weighed;
- (b) The settlement process was open and all TTF members were invited to participate in the actual settlement negotiations.
- (c) No provisions of the Settlement are illegal, contrary to the Act or otherwise contrary to the public interest; and
- (d) The Settlement will provide for tolls during the Term that are just and reasonable and are not unjustly discriminatory.

35. TransCanada submits that the Settlement and its reflection in this Application produce adequate information on the public record for the Board to understand the basis for the agreement and to assess its reasonableness.

Relief Requested

36. TransCanada requests from the Board:

- (a) an order approving the Settlement;

- (d) TransCanada's agreement for the redemption of the JSDs which have a remaining term of 40 years and expire on October 1, 2047, is made in exchange for an increased deemed common equity ratio, which changes the deemed capital structure.
- (e) Stakeholder's agreement for an increased deemed common equity ratio in this Settlement is made in exchange for the realization of a foreign exchange gain, which the Mainline is uniquely positioned to flow through to shippers.
- (f) Given the unique position of the Mainline System in respect of the JSD's to capture a foreign exchange gain, TransCanada will not rely on the Mainline System's increased equity thickness achieved in this Settlement as rationale for seeking to increase equity thickness on:
 - (i) the Alberta pipeline system and facilities owned and operated by Nova Gas Transmission Ltd. and located in Alberta (the "**Alberta System**");
 - (ii) the BC System; and
 - (iii) the Foothills System,

For the 2007 test year, the forecasted Return is \$612.987 million.

- (6) **Income Taxes (Line 6)** will be forecasted annually. Income Taxes for the 2007 test year shall include one-fifth of the tax impact associated with the net gain on redemption of the JSD's. Taxes for the subsequent years associated with the net gain on the redemption of the JSD's will be amortized equally over the remaining Term of this Settlement. The disposition of the net gain on redemption is described in sub-paragraph 1(B) (13). For the 2007 test year, the forecasted Income Taxes is \$178.480 million.
- (7) **Depreciation (Line 7)** will be forecasted annually based on the rates provided in Appendix "B", which will be applied to total gas plant in service. The depreciation expense collected will be allocated based on the Segmented Average Rates set out in Appendix "B" which rates have been determined based on a segmented approach that separately estimates the economic lives of the following three main segments of the Mainline System:
 - (i) the Prairies line (Empress to Station 41 including the Emerson extension);
 - (ii) the Northern Ontario line (Station 41 to Station 116 including the Sault St. Marie line); and
 - (iii) the Eastern Triangle (east of station 116 including the St. Clair to Dawn and Niagara to Kirkwall lines).

This segmented approach to depreciation will not impact TransCanada's toll methodology during the Term of this Settlement.