

**TRANSCANADA PIPELINES LIMITED
BUSINESS AND SERVICES RESTRUCTURING
AND MAINLINE 2012 – 2013 TOLLS APPLICATION**

**AMENDED WRITTEN EVIDENCE OF
MURRAY A. NEWTON
(ENREG GROUP INC.)**

(On behalf of the Industrial Gas Users Association)

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 for:

1. Approvals required to implement a Restructuring Proposal that affects the businesses and services of TransCanada PipeLines Limited, NOVA Gas Transmission Ltd. and Foothills Pipe Lines Ltd.; and
 2. Approval of final tolls for the TransCanada Mainline for 2012 and 2013.
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March 9, 2012

TABLE OF CONTENTS

	Page
1. INTRODUCTION	3-5
2. EXECUTIVE SUMMARY	5-6
3. WHY TRANSCANADA'S TOLLS ARE IMPORTANT TO INDUSTRIALS.....	6-10
4. THE 2007-2011 MAINLINE TOLLS SETTLEMENT.....	10-12
5. UNDER-UTILIZED CAPACITY.....	12-15
6. CRISIS MANAGEMENT.....	15-19
7. THE NATIONAL IMPORTANCE OF THE TRANSCANADA MAINLINE.....	19
8. IGUA'S VIEW OF TRANSCANADA'S APPLICATION.....	20-24
9. NEGOTIATED SETTLEMENTS.....	24-25
10. IGUA'S PROPOSAL.....	25-27
APPENDIX 1: Borden Ladner Gervais letter dated March 26, 2007 and IGUA letter dated February 21, 2007.....	4 pages
APPENDIX 2: Long term solution.....	2 pages
APPENDIX 3: Heenan Blaikie's letter dated December 16, 2010.....	6 pages
APPENDIX 4: Slide # 16 of February 28, 2012 CERI presentation.....	1 page

1. INTRODUCTION

Q1. *PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.*

A1. My name is Murray Newton and my business address is 444 Westminster Avenue, Ottawa, Ontario, K2A 2T8.

Q2. *BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?*

A2. I am President of ENREG GROUP INC. (hereinafter "ENREG"). ENREG is a consultancy firm incorporated under the Canada Business Corporations Act through which I provide regulatory, advocacy and other services to energy industry clients.

Q3. *PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND AND EXPERIENCE.*

A3. After graduating in 1974 with a degree in Political Science from St. Patrick's College (Carleton University), I commenced working in Canada's energy industry. My private and public sector experience has provided me the opportunity to work in a wide variety of corporate cultures with public policy makers, energy regulators, regulated utilities and other energy industry stakeholders who rely on the services provided by regulated service providers. Most recently, I served as President of the Industrial Gas Users Association (hereinafter "IGUA"). Prior to joining IGUA, I was employed in various regulatory and business development capacities in the private sector with Enbridge Pipelines Inc., PetroKazakhstan Inc., Irving Oil Limited, TransCanada PipeLines Limited (hereinafter "TransCanada") and the Independent Petroleum Association of Canada. The early part of my career was spent in the public sector working with the National Energy Board (hereinafter "NEB") and the Canadian federal department of Energy, Mines and Resources (now Natural Resources Canada).

Q4. *WHAT POSITIONS DID YOU HOLD DURING YOUR EMPLOYMENT WITH TRANSCANADA?*

A4. I was employed with TransCanada from 1992 to 1998 in various capacities, including Mainline Rates Manager, Manager of Associated Pipelines, and Director, Regulatory Affairs and Customer Relations with Express Pipelines Ltd.

Q5. *HAVE YOU TESTIFIED PREVIOUSLY BEFORE THE NEB OR OTHER REGULATORY BODIES?*

A5. Yes. I have testified before the NEB on numerous occasions. I have also testified on many occasions for previous employers before various Canadian provincial regulators in Nova Scotia, New Brunswick, Québec, Ontario and Alberta. Also, I have testified in the United States before the Federal Energy Regulatory Commission and the California Public Utilities Commission.

Q6. *ON WHOSE BEHALF ARE YOU SPONSORING EVIDENCE IN THIS PROCEEDING?*

A6. IGUA asked me to represent its member's interests in this proceeding. More specifically, I was retained by IGUA in January 2012 to oversee IGUA's federal and provincial regulatory and advocacy initiatives, as well as to direct IGUA's activities in regard to TransCanada's Mainline 2012-2013 tolls application (hereinafter "Application").

Q7. *WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?*

A7. My evidence provides IGUA's perspective about the tolls crisis facing TransCanada's Mainline and whether TransCanada's Application adequately addresses the crisis. My evidence will also discuss IGUA's proposals that are designed to address competitive problems worsened by the under-utilization of the Mainline.

Q8. *WHY DID IGUA ENGAGE THE SERVICES OF BALLARD SPAHR AND WHAT DID IGUA ASK MS. DENA WIGGINGS TO DO?*

A8. IGUA asked Ballard Spahr to research U.S. legal cases and regulatory precedents for the purpose of exploring the used and useful concept in the U.S. regulatory and legal framework, focusing on situations where changed circumstances render a facility no longer used and useful because of under-utilization. Ms. Wiggins was also asked to research the various approaches, both proposed and implemented, addressing the ratemaking impact where pipeline assets become under-utilized because of changed circumstances.

Q9. *WHY DID IGUA ENGAGE THE SERVICES OF KTM ENERGY CONSULTING SERVICES (KTM) AND WHAT WAS MR. GEOFFREY INGE ASKED TO DO?*

A9. KTM was asked to explore the various measures proposed to U.S. regulators as well as the actual solutions that have been implemented in order to address situations where a regulated utility's assets become under-utilized. Mr. Inge was also asked to work with Mr. Bernard Otis (another consultant engaged by IGUA) for the purpose of providing conclusions that may be drawn from TransCanada's Application and its responses to various written Information Requests with respect to:

- i) the nature and extent of the current under-utilization of TransCanada's Mainline system;
- ii) whether TransCanada's Application provides adequate solutions to the Mainlines' under-utilization; and
- iii) the identification of potential corrective measures that could be applied to TransCanada's under-utilization problem, taking into account the regulatory and legal precedents identified by Ms. Wiggins, while being mindful of the specific fact circumstances presented by the current tolling crisis on the TransCanada Mainline.

Q10. *WHY DID IGUA ENGAGE THE SERVICES OF MR. BERNARD OTIS AND WHAT WAS MR. OTIS ASKED TO DO?*

A10. Mr. Otis was asked to review TransCanada's Application and to work with Mr. Inge for the purpose of identifying the nature and extent of the current under-utilization of TransCanada's Mainline.

2. EXECUTIVE SUMMARY

Q11. *PLEASE SUMMARIZE THE CONCLUSIONS AND RECOMMENDATIONS OUTLINED IN THIS EVIDENCE.*

A11. TransCanada's Application displays no sense of urgency to deal with the under-utilized Mainline. The current TransCanada business model is not responsive to the realities of the market. TransCanada's currently approved tolls are no longer competitive. Similarly, TransCanada's applied-for tolls are also uncompetitive, in large part, because they are

burdened by the recovery of costs associated with under-utilized facilities that are no longer required to deliver TransCanada's forecast gas flows.

These serious tolling issues, caused in large part by the current and foreseeable under-utilization of the Mainline, must be addressed on an urgent basis. Otherwise, the crisis will only deepen to the point where more drastic measures will need to be taken.

IGUA's proposal recommends the NEB remove from rate base, for the purpose of calculating tolls, that portion of net plant which is under-utilized. IGUA's proposals may be layered on top of whatever toll design and cost allocation the NEB ultimately approves in this proceeding. The resulting tolls will generate Mainline tolls that place the Mainline on a more competitive and sustainable footing. Implementation of IGUA's proposals will allow TransCanada's shippers to contract for firm service with more confidence in the knowledge that the fundamental problems associated with Mainline under-utilization are being addressed.

3. WHY TRANSCANADA'S TOLLS ARE IMPORTANT TO INDUSTRIALS

Q12. PLEASE DESCRIBE IGUA'S INTEREST IN THIS PROCEEDING.

A12. The TransCanada Mainline is a vital and strategic Canadian asset. It is critical that corrective measures addressing the root cause of the tolls crisis be implemented as soon as possible to protect the long term sustainability of the Mainline. Difficult under-utilization issues must be addressed now, rather than being further deferred into the future.

IGUA's members are very concerned about rapidly rising Mainline tolls that have become extremely volatile and create so much uncertainty for all industry participants. Volatile swings in Mainline tolls wreak havoc on the Canadian economy and proper business planning. IGUA is concerned about the unprecedented escalation that has seen Mainline tolls rise so dramatically over the past 5 years. IGUA's members are very concerned about the prospect for yet further rate shocks for the remaining Mainline toll payers caused by further firm volumes exiting the Mainline, as a consequence of uncertain and out of control tolls.

Q13. *WHY DO YOU CHARACTERIZE TRANSCANADA'S MAINLINE TOLLS AS BEING "OUT OF CONTROL"?*

A13. TransCanada's actions and inactions over the past several years expose TransCanada's inability to proactively manage its business operations in the face of today's changing market conditions. TransCanada is unable to accurately forecast its Mainline tolls with any degree of precision, even for the calendar year during which it is currently operating. Since 2007, the historic benchmark toll for the Mainline, the 100 percent load factor Eastern Zone (hereinafter "EZ") toll, increased from \$1.03/GJ to \$2.24/GJ. Even this more than doubling in the EZ toll disguises the true magnitude of the tolls crisis. If TransCanada was actually recovering in its Final 2011 tolls the total revenue requirement applicable to its 2011 tolls, the 2011 EZ toll would be closer to \$3.00/GJ. By any responsible measure, this almost tripling in the EZ toll over the past 5 years represents a crisis situation where the tolls may be considered to be out of control.

Q14. *PLEASE DESCRIBE INDUSTRIAL CONSUMERS' ROLE IN CANADA'S NATURAL GAS INDUSTRY.*

A14. The industrial sector plays an extremely important role in Canada's economy. Industrial gas users account for approximately thirty (30%) percent of the natural gas consumed in Canada and industrial operations employ hundreds of thousands of Canadians. Many IGUA members operate multiple industrial operations throughout North America, and their industrial operations located in Central Canada have to rely on the high priced TransCanada Mainline to transport their gas requirements to their Canadian-based operations. Canadian industrial gas users compete against North American competitors who are not burdened by increasing and uncertain upstream gas transportation costs.

Q15. *PLEASE EXPAND ON WHY TRANSCANADA'S TRANSPORTATION TOLLS ARE SO IMPORTANT TO INDUSTRIAL GAS USERS?*

A15. Most industrial gas users operate energy intensive industrial operations where energy costs represent a very significant cost centre for their companies. For a large industrial gas user, every \$0.01/GJ increase in TransCanada's Mainline tolls represents an incremental annual cost of approximately \$100,000 that comes right off its bottom line. As noted above, TransCanada's currently approved \$2.24/GJ Eastern Zone toll is \$1.21/GJ higher than it was in 2007. For a large industrial gas user consuming 10 BCF annually, this represents an increased annual transportation cost in excess of 12 million dollars. Industrial gas users cannot pass through these increased gas transportation costs to their

customers because the price of their products and services are set in the competitive marketplace.

Q16. ARE INDUSTRIAL GAS USERS THE ONLY CONSUMERS NEGATIVELY IMPACTED BY TRANSCANADA'S TOLLS CRISIS?

A16. No. A similar situation exists for other Canadian and American gas consumers who rely on the TransCanada Mainline for their upstream transportation. Residential, commercial, agricultural and transportation sector gas consumers also bear the full brunt of TransCanada's tolls. In addition, gas-fired power producers also bear the burden of TransCanada's increasing transportations costs. To the extent TransCanada's tolls are higher than they ought to be due to under-utilized capacity, this represents an unfair and inappropriate wealth transfer from North American gas consumers to TransCanada's shareholders.

Q17. WITH TODAY'S LOW GAS PRICES, WHY ARE INDUSTRIAL GAS USERS CONCERNED ABOUT TRANSCANADA'S TOLLS?

A17. TransCanada's transportation tolls have prevented industrial gas users from realizing the full benefit of today's low gas prices.

With gas commodity prices trading in the \$2.00 - \$3.00 /GJ range, TransCanada's annual transportation cost represents as much as forty (40%) percent of the total delivered gas cost.

The total "all-in" delivered gas cost is a function of both the unregulated commodity price (which is set by the market) and the regulated portion of the total delivered gas cost, which includes the cost of gathering, transportation, storage and distribution services. Industrial gas users support market pricing where market forces determine gas commodity prices. Therefore, it is important that the remaining critical components of the total delivered gas bill be closely regulated to ensure consumers' interests are protected.

Q18. DO INDUSTRIAL END USERS CONTRACT DIRECTLY WITH TCPL FOR THEIR UPSTREAM GAS TRANSPORTATION REQUIREMENTS?

A18. Although some industrial gas users contract directly with TransCanada for all or a portion of their upstream transport requirements, many others use a portfolio approach to manage their gas supply requirements.

While I am not privy to the commercial arrangements that individual IGUA members have negotiated, I understand that many industrial gas users

rely on gas marketers (perhaps more so in Ontario) for their upstream gas transport. In Québec, most gas users today utilize supply services provided by the Local Gas Distribution Companies (LDCs) for the upstream transport of their gas requirements.

Q19. TO THE EXTENT INDUSTRIAL GAS USERS RELY ON GAS MARKETERS OR LDCS FOR THEIR UPSTREAM TRANSPORT, AND RECOGNIZING THAT YOU HAVE NO KNOWLEDGE OF THE SPECIFIC COMMERCIAL ARRANGEMENTS THAT INDIVIDUAL IGUA MEMBERS HAVE NEGOTIATED WITH THEIR COUNTERPARTIES, HOW CAN YOU BE CERTAIN THAT INDUSTRIAL GAS USERS ABSORB THE COST OF TRANSCANADA'S TOLL INCREASES?

A19. Gas Marketers are in business to generate profits for their owners. Therefore, it is reasonable to conclude that marketers are not absorbing the increasing cost of TransCanada's tolls. While some industrial gas users may have negotiated some form of fixed price for their delivered gas supply, the terms of those commercial agreements may only partially protect them from the impact of TransCanada tolls. Also, when those commercial agreements terminate, the terms of any new agreement will no doubt take into account the then prevailing TransCanada Mainline tolls, as well as an assessment of future market conditions that are expected to prevail during the term of any re-negotiated arrangement.

For those industrial gas users who rely on LDCs for their upstream transport, Ontario and Québec LDCs are able to pass through 100 percent of the cost of their upstream gas transportation costs to their gas distribution customers.

The major Ontario LDCs (Union Gas Limited and Enbridge Gas Distribution) use an Ontario Energy Board (hereinafter "OEB") approved Quarterly Rate Adjustment Mechanism (hereinafter "QRAM") to pass through to their gas distribution customers all NEB approved adjustments to TransCanada's tolls.

Québec presents a similar situation where Gaz Métro and Gazifère are also able to fully pass through the full cost of their upstream gas transportation to their gas distribution customers. The Québec flow-through mechanism is slightly different than the Ontario model, but the effect is the same. For example, Gaz Métro sets its gas distribution rates including a forecast of the cost of its upstream transport. Any variances between the forecast and the actual cost of upstream transportation are recorded in a deferral account for disposition in Gaz Metro's gas

distribution rates the following year, subject to approval by the Régie de l'Énergie.

Q20. IS IGUA SUGGESTING THE LDCS DON'T CARE ABOUT THE LEVEL OF TRANSCANADA'S TOLLS BECAUSE THEY DO NOT BEAR THE BURDEN OF THOSE COSTS?

A20. Absolutely not. IGUA appreciates that the LDCs are also very concerned about Mainline tolls. LDCs want to grow their markets for natural gas within their franchise areas and so it is reasonable to conclude the LDCs are equally concerned about the level of upstream transportation costs that impact the marketability and competitiveness of natural gas within their franchises.

However, because the LDCs are regulated entities themselves, the LDCs may not have the same level of motivation as others to publicly challenge TransCanada on significant cost drivers such as cost of capital. Therefore, it is almost always left to a few stakeholders such as IGUA to question significant costs items that can dramatically impact TransCanada's tolls.

In addition, the absence of an NEB Act Part IV participant funding program prevents other consumer interest groups from actively participating in NEB tolls hearings. Therefore, those parties rely on the LDCs and others to represent their interests at NEB rate hearings.

4. THE 2007-2011 MAINLINE TOLLS SETTLEMENT

Q21. DID IGUA SUPPORT THE 2007-2011 MAINLINE TOLLS SETTLEMENT("SETTLEMENT")?

A21. IGUA opposed the 2007 Tolls Task Force (hereinafter "TTF") resolution. IGUA subsequently submitted a letter of comment to the NEB together with a separate letter addressed to the TTF Chair. **(Appendix 1)**

Q22. DID THE EXISTENCE OF THE 2007-2011 SETTLEMENT CONTRIBUTE TO TRANSCANADA'S FAILURE TO ADDRESS THE TOLLS CRISIS IN A TIMELY MANNER?

A22. The terms of the 5-year Settlement insulated TransCanada from the negative impacts caused by its rapidly declining gas flows. While much discussion surrounding TransCanada's tolls and tariffs has occurred over the past 5 years, both within and outside the formal TTF process, the need

to right-size the under-utilized Mainline to better reflect Mainline gas flows has not been addressed.

Q23. DID IGUA COMMUNICATE CONCERNS TO TRANSCANADA DURING THE TERM OF THE SETTLEMENT ABOUT UNDER-UTILIZED MAINLINE CAPACITY?

A23. Yes. IGUA has been very concerned for some time about the degree to which Mainline capacity is under-utilized. This under-utilized capacity and the resulting costs of supporting that under-utilized infrastructure, and TransCanada's unwillingness to address these matters, have become a major irritant for those who are paying the costs associated with the inefficient operation of the Mainline.

Q24. DID IGUA OFFER ANY PROPOSALS TO TRANSCANADA DURING THE TERM OF THE 5-YEAR SETTLEMENT?

A24. Yes. In late 2010, IGUA developed a document entitled "*Long Term Solution*" (**Appendix 2**) and provided it to TransCanada's senior management for comment.

IGUA developed this document in an attempt to convince TransCanada to agree to work with its stakeholders to expeditiously develop and implement a comprehensive rationalization of its Mainline so its tolls could be made more competitive.

The purpose of the *Long Term Solution* was to prepare and deliver to the TTF a detailed report identifying Mainline transportation capacity excesses [whether Mainline facilities or Transportation By Other (hereinafter "TBO") arrangements], and to recommend rate base reductions and TBO restructurings that could be effected as early as January 1, 2012.

Page 2 of the *Long Term Solution* sets out the various components of the report (including a flow split analysis based on Mainline flow forecasts) to determine the least cost loading of existing Northern Ontario Line (hereinafter "NOL") capacity and Great Lakes Gas Transmission (hereinafter "GLGT") TBO arrangements. The document referenced the need to identify the location and nature of unused or under-utilized capacity together with the development of cost effective approaches to temporarily set aside or to permanently remove assets from rate base in a manner that would decrease tolls. The document also included the investigation of the potential to restructure, reconfigure and/or to redeploy or to sell Mainline assets in ways to improve the Mainlines' alignment with

Mainline markets so as to improve its ability to provide transportation at competitive rates.

Q25. WHAT WAS IGUA'S POSITION ON THE SO-CALLED "CAPP AGREEMENT" THAT WAS NEGOTIATED BETWEEN TRANSCANADA AND CAPP IN 2010 ?

A25. As more fully set out in the letter attached as **Appendix 3**, IGUA opposed the CAPP Agreement because it failed to address issues caused by the under-utilized Mainline. IGUA was concerned that these important under-utilization issues were being deferred into the future.

5. UNDER-UTILIZED CAPACITY

Q26. HOW HAS IGUA CONCLUDED THAT MAINLINE FACILITIES ARE UNDER-UTILIZED?

A26. As explained by Mr. Otis' evidence, Mr. Otis determined the magnitude of under-utilized Mainline capacity being mindful of TransCanada's design criteria, including the loss of its most critical unit during peak demand periods. Mr. Otis included all of TransCanada's forecast 2012 gas flows required to serve all long term firm service (hereinafter "FT"), as well as 100 percent of TransCanada's forecast discretionary Short Term Firm Service (hereinafter "STFT") and Interruptible Service (hereinafter "IT") volumes. This recognizes that some discretionary transportation is likely being used to serve firm markets.

In addition, and as more fully explained in Mr. Otis' evidence, in order to limit debate over key assumptions used by Mr. Otis, we decided to use TransCanada's own 2012 and 2013 Mainline flow forecasts, despite the fact we believe them to be overly optimistic and therefore very likely to be overstated.

To support our concern about an overstated Mainline flow forecast, I have attached to this evidence (see slide # 16 of **Appendix 4**) a copy of a recent export pipeline volume forecast produced by the Canadian Energy Research Institute (hereinafter "CERI"). This forecast was presented by CERI at its February 28, 2012 CERI Gas Conference. CERI characterizes its forecast as a "Realistic" forecast of Alberta export pipelines gas flows through 2030. The CERI forecast shows Mainline gas flows declining further to or below 2 BCFD by 2014, and only recovering about 3 BCFD by 2020.

Q27. *IS IGUA QUESTIONING THE PRUDENCE OF THE COSTS ASSOCIATED WITH THE NEB'S INITIAL CERTIFICATION OF FACILITIES WHICH ARE NO LONGER USED AND USEFUL?*

A27. It is not necessary to challenge prudence in order to address the issue of under-utilized capacity. The central issue is whether it is appropriate to recover in regulated tolls the cost of facilities that are no longer required to meet TransCanada's forecast transportation requirements. This becomes an even more critical issue if one considers TransCanada's forecast Mainline gas flows, which include very substantial volumes of discretionary services such as STFT and IT, to be overly optimistic.

Q28. *DO YOU AGREE WITH THE NOTION THAT MAINLINE FACILITIES ARE USED AND USEFUL IF THEY MAY BE REQUIRED A FEW DAYS DURING THE YEAR AS A RESULT OF SOME UNFORESEEN CATASTROPHE?*

A28. No. It is not appropriate to expect FT toll payers to pay much higher than required firm service tolls 365 days of the year for under-utilized facilities that are not required to meet forecast service requirements. The NEB addressed this at page 50 of its MH-1-2006 Reasons for Decision where it stated:

"These instances corresponded to extraordinary events for which it would not be prudent to have additional gas infrastructure."

Also, IGUA notes that TransCanada's Application proposes to eliminate its commodity charge. The elimination of the commodity charge will allow TransCanada to recover all of its fixed costs in its proposed 1-part reservation charge. Firm service toll payers should not be required to pay demand charges 365 days of the year for unused capacity that is not required to serve foreseeable transportation requirements.

Q29. *HAS THE NEB ADDRESSED HOW IT DETERMINES WHETHER ADEQUATE CAPACITY EXISTS ON THE MAINLINE?*

A29. The NEB addressed this in its MH-1-2006 Reasons for Decision dealing with the proposed transfer of Mainline facilities for use by the Keystone Pipeline GP Ltd. While the IGUA proposal set out later in this evidence would not result in the physical removal of under-utilized facilities, this NEB Decision is informative. For example, at page 48, the NEB said:

"The Board is of the view that the relevant consideration for determining adequate capacity for the Mainline is the pipeline's ability to meet anticipated requests for firm service."

As explained by Mr. Otis, IGUA determined the amount of under-utilized capacity by taking into account the combined total of all of TransCanada's forecast gas flows, including FT, STFT and IT volumes.

Q30. *DOES THE INCLUSION OF COSTS IN TOLLS RELATED TO THE EXISTENCE OF UNDER-UTILIZED CAPACITY VIOLATE ANY PRINCIPLES THE NEB HAS TRADITIONALLY RELIED UPON WHEN DETERMINING JUST AND REASONABLE TOLLS?*

A30. Yes. Including in firm service tolls the costs of under-utilized facilities that are no longer required to serve forecast service requirements is inconsistent with several important principles of a sound tolls methodology.

First, including in firm service tolls the costs of under-utilized facilities that are no longer required to serve foreseeable requirements violates the principle that cost responsibility should follow cost causation because it assigns costs to shippers that are not responsible for causing certain costs to be incurred. It also disrespects the related principle of user-pay by providing significant cross-subsidies to those discretionary shippers who benefit most from the availability of this under-utilized capacity.

Second, including in firm service tolls the costs of under-utilized facilities that are no longer required to serve foreseeable requirements violates the principle that tolls should not be unduly discriminatory. The magnitude of the under-utilized capacity is so significant that it allows discretionary shippers to contract for discretionary services knowing that they will rarely, if ever, be curtailed. This results in long term firm and IT shippers receiving essentially identical transportation services under very different tolls and costs, since firm shippers pay demand charges 365 days of the year and IT shippers do not. This sends incorrect price signals to those discretionary shippers who are receiving a virtual firm service without fear of interruption.

Third, including in firm service tolls the costs of under-utilized facilities that are no longer required to serve forecast requirements does not promote economic efficiency because it results in a wasteful and inefficient use of resources.

Q31. HOW DID IGUA DETERMINE THE AMOUNT OF MAINLINE CAPACITY THAT IS UNDER-UTILIZED?

A31. IGUA has reviewed TransCanada's Application and its responses to various Information Requests for the purpose of identifying the magnitude of the under-utilized capacity that is no longer used and useful. As discussed earlier, to minimize debate, Mr. Otis has relied on TransCanada's own flow forecast for the purpose of identifying forecast Mainline utilization and the resulting percentage of Mainline capacity that is no longer required to serve TransCanada's forecast long term (hereinafter "LT") and short term (hereinafter "ST") firm service requirements. In addition, Mr. Otis also included TransCanada's forecast IT gas flows for both 2012 and 2013 for the purpose of identifying the magnitude of the under-utilized capacity that is no longer used and useful.

6. CRISIS MANAGEMENT

Q32. WHAT IS IGUA'S VIEW OF HOW TRANSCANADA HAS MANAGED THE TOLLS CRISIS?

A32. IGUA is disappointed with TransCanada's failure to actively manage, in a timelier manner, its Mainline operations in the face of its declining competitive situation. There is a clear distinction between the origins and causes of the under-utilization problem and TransCanada's slowness to react to the crisis.

IGUA notes the degree of reliance TransCanada appears to place on the notion that, once certificated by the NEB, all of its costs have been prudently incurred and therefore the costs associated with its under-utilized facilities cannot be challenged. As discussed by Ms. Wiggins, prudence is a backward looking concept, whereas the used and usefulness of facilities is more forward looking. TransCanada's simplistic interpretation reveals a sense of entitlement and disrespect for the shippers that pay TransCanada's tolls. It may also help to explain why TransCanada has been so slow to address the very serious competitive issues confronting the Mainline.

Q33. *WHY DO YOU CONSIDER TRANSCANADA'S INTERPRETATION TO BE OVERLY SIMPLISTIC?*

A33. TransCanada overly simplifies a very complex set of regulatory standards and principles the NEB has applied over the decades to assist it in its consideration of matters that impact the Canadian public interest. The NEB's application of these regulatory standards and principles associated with cost causation, economic efficiency and the need for innovation has evolved over time to reflect changing circumstances. Adoption of TransCanada's rigid interpretation would constrain the NEB in its ability to fulfill its mandate to set just and reasonable tolls.

The notion that NEB certification of facilities forever relieves TransCanada from having to deal with inefficient costs associated with under-utilized facilities that are no longer used and useful is wrong. The NEB's initial certification of facilities is not equivalent to winning a lottery. Market circumstances can change and so the NEB must have the ability to intervene and to order fair remedies in situations where utility management fails to.

Q34. *CAN YOU POINT TO AN NEB DECISION THAT ADDRESSES UNDER-UTILIZED FACILITIES?*

A34. The NEB addressed the treatment of fixed costs associated with under-utilized facilities at pages 36-37 of its GH-5-89 Reasons for Decision. Under the Views of the Board section, the NEB said:

"The Board is sympathetic to the views expressed by parties that TransCanada should bear some risk of under-utilization of its facilities. As the project proponent, TransCanada is not only one of the beneficiaries of pipeline expansion but is also in a position to determine and influence the risk of under-utilization of pipeline space available for contracts. In this context, TransCanada is able to minimize this risk through cost control, financial assurances, evaluation of requests for service, system design and the determination of the size of the expansion applied for."

The NEB went on to explain in its GH-5-89 Reasons for Decision that:

"The Board is prepared to examine, in a future toll hearing, any proposals to share prospectively the risk of under or over-utilization of facilities between TransCanada and users of the pipeline in place of the current practice of disposing of deferral account balances on a case-by-case basis".

The GH-5-89 Decision continued:

"The Board wishes to emphasize that the existence of that deferral account does not mean that the unrecovered fixed costs will automatically be allowed to be passed on to the Shippers by the Board. If the risk of under-utilization should materialize and result in unrecovered demand charges, these will accumulate in the deferral account and be brought forward for disposition in a toll proceeding. The Board will then examine closely the circumstances which led to the under-recovery and determine what portion, if any, should be recovered from shippers."

The NEB also addressed the risks associated with the non-renewal of firm contracts in its RH-1-2001 Reasons for Decision. At page 14, the NEB stated:

"Some sharing of risk between TransCanada and its shippers may be appropriate if considered on a prospective basis. Such consideration should also take into account the appropriate balance between risk and reward and the tolls required to manage such risk."

Q35. DO YOU AGREE WITH TRANSCANADA'S CHARACTERIZATION OF THE VARIOUS FACTORS THAT HAVE CONTRIBUTED TO THE CURRENT TOLLING CRISIS?

A35. I disagree with TransCanada's focus on the degree to which TransCanada suggests changes in the market environment of natural gas supply, demand and transportation emptied the Mainline.

While there is no question that changed market circumstances have changed North American gas flows, the erosion of Mainline firm volumes has been significantly impacted by the uncertainty surrounding TransCanada's volatile tolls. While there may be some aspect of the classic "which came first, the chicken or the egg", the rising and uncertain Mainline tolls have very significantly contributed to the offloading of the Mainline.

With respect to future prospects, I agree with TransCanada that Marcellus gas may have a profound impact on future Mainline gas flow, especially if TransCanada fails to address its under-utilization problems.

TransCanada's reluctance to deal with this under-utilization problem has very seriously shaken the confidence of its stakeholders. The resulting increasing firm service tolls create a fertile environment for others to develop market alternatives to take advantage of the crisis situation.

Q36. CAN YOU PROVIDE EXAMPLES OF THESE MARKET ALTERNATIVES?

A36. Western Canadian producers are investigating the feasibility of finding and attaching new global markets for their natural gas. This will necessitate the construction of new Canadian pipeline infrastructure to transport gas west from the Western Canadian Sedimentary Basin (hereinafter “WCSB”) to new gas liquefaction facilities to be located on the west coast of British Columbia. The gas would then be liquefied into Liquefied Natural Gas (hereinafter “LNG”) and transported by ship to global markets.

In eastern North American markets, industry participants are investigating and developing new pipeline projects that will provide some markets with varying degrees of flexibility to find alternative and less expensive gas transportation options. While some of these projects would likely have been developed in any event because of changing North American gas flows, the current and proposed Mainline transportation tolls encourage and accelerate the development of new ways to deliver gas to eastern Canadian and U.S. Northeast markets in order to avoid using the Mainline.

Q37. ARE THERE ANY OTHER EVENTS NOT MENTIONED BY TRANSCANADA THAT HAVE CONTRIBUTED TO THE MAINLINE TOLLS CRISIS?

A37. Two other important historic events have significantly contributed to the emptying of the Mainline to the point where it is now significantly under-utilized.

The first event relates to TransCanada’s failure to commercially respond to the threat of the then proposed Alliance Pipeline in the 1990’s. Unfortunately, TransCanada’s inability to compete with Alliance during the critical birthing phases of Alliance is analogous in many ways to the current situation today where TransCanada appears to once again be reluctant to offer meaningful solutions to put it on a more competitive footing with market alternatives. Once again, Western Canadian producers are today being forced to look for alternative ways to market their natural gas in order to avoid the Mainline.

The second important historical event took place in 1988 pursuant to the NEB’s GH-2-87 Reasons for Decision where TransCanada was directed to amend its Firm Service (hereinafter “FS”) toll schedule to provide for the continued renewal of all domestic and export FS contracts serving long-term markets. This Decision also directed TransCanada to implement a six-month renewal notice period for those FS contracts being renewed.

These NEB Decisions allowed shippers to renew their expiring transportation contracts with rolling 12 month firm contracts that could be

renewed annually at the shippers' sole discretion, upon six months written notice. This made it very difficult for TransCanada to properly size its facilities expansions because of the combined effect of the approximate two year lead time between the time that the need for a system expansion was identified and the time required to permit and construct the requisite facilities. These decisions had significant consequences for TransCanada's facilities planning at the very same time TransCanada was investing heavily each year in major facilities expansions designed to attach new U.S. Northeast markets to the WCSB. These NEB decisions provide additional justification as to why it is appropriate for the Canadian government to play a role in helping to solve the tolls crisis.

7. THE NATIONAL IMPORTANCE OF THE TRANSCANADA MAINLINE

Q38. IS THERE A ROLE FOR THE CANADIAN GOVERNMENT TO PLAY IN REGARD TO RESOLVING THE MAINLINE TOLLING CRISIS?

A38. Yes. That supporting role is described in Mr. Inge's evidence.

The Mainline is an extremely important strategic Canadian asset with a rich political history that is of critical importance to the millions of Canadians who depend on the Mainline to transport the gas that is used to heat their homes, cook their meals and fuel the commercial and industrial processes upon which Canada's economy is so reliant.

The magnitude and significance of the current tolls crisis is very serious and is national in scope. Mainline tolls, made worse by the cost burden related to under-utilized capacity, affect Canadian stakeholders at both ends of the pipeline. The current tolls impair Western Canadian producers' ability to market their gas into Eastern North American markets and they also impair Eastern Canadian markets' ability to access secure Canadian gas supply.

8. IGUA'S VIEW OF THE TRANSCANADA APPLCIATION

Q39. *HAS IGUA DEVELOPED POSITIONS ON EACH OF THE SPECIFIC PROPOSALS THAT ARE CONTAINED IN THE TRANSCANADA APPLICATION?*

A39. The many issues raised by the TransCanada application are complex and interrelated and so IGUA will not be in a position to communicate its views on all of the various issues raised by TransCanada's Application until the later phases of the public hearing.

Q40. *PLEASE DISCUSS IGUA'S OVERALL OPINION OF TRANSCANADA'S APPLICATION FOR FINAL TOLLS FOR 2012 AND 2013.*

A40. The Application fails to address the core issues associated with under-utilized capacity that significantly contribute to uncompetitive Mainline tolls. Rather than developing proposals to right-size the Mainline consistent with TransCanada's own market and flow forecasts, TransCanada instead merely proposes changes that, through a convoluted combination of toll design and cost allocation proposals, would defer and re-allocate and thereby shift cost responsibility for the toll crisis amongst its various customers.

In one case, (Alberta System Extension), TransCanada proposes to shift costs to industry stakeholders who today do not even use the Mainline. In another, TransCanada proposes a punitive new surcharge applicable to its proposed new Eastern Delivery Area (GMIT TQM EDA). Other components of the Application propose to defer the recovery of hundreds of millions of dollars of current costs to future generations of TransCanada toll payers.

Q41. *DO YOU HAVE ADDITIONAL COMMENTS IN REGARDS TO THE PROPOSED NEW GMIT TQM EDA?*

A41. Under TransCanada's TQM proposal, Québec and American consumers are expected to pay a substantial new \$0.32/GJ surcharge, simply because their geographical locations requires them to use the Trans Québec and Maritimes (hereinafter "TQM") pipeline.

The TransCanada proposal strays from its historic rolled-in tolls methodology whereby TransCanada has supported and defended the roll-in of costs at both ends of its pipeline on the basis that it operates a fully integrated pipeline system where its shippers receive system-wide benefits from rolling-in the costs of its integrated facilities.

The proposed new GMIT TQM EDA introduces very significant new costs to a relatively small number of users in markets that are captive to the TransCanada Mainline, without bringing any new benefits to justify the imposition of this significant toll increase.

Q42. ARE YOU AWARE OF ANY CHANGES IN SUPPLY OR MARKET CIRCUMSTANCES THAT COULD CHANGE TQM'S OPERATIONAL INTEGRATION WITH THE MAINLINE?

A42. The development and commercialization of Québec-based natural gas from the Utica Shale gas play will increase the operational integration between TQM and the Mainline. While the Québec government has placed a temporary moratorium on further shale gas development, industry participants remain confident the basin will become commercial within the next 5 years.

Q43. DOES IGUA HAVE ANY COMMENTS IT WISHES TO MAKE AT THIS TIME IN REGARD TO TRANSCANADA'S REQUEST FOR A HIGHER COST OF CAPITAL?

A43. TransCanada's cost of capital proposals are out of step with the realities of the tolls crisis.

TransCanada's request for a higher cost of capital is especially vexing given the fact that, for decades, the NEB has awarded TransCanada's shareholders higher returns to compensate for perceived future long term business risk. Now that some of these risks have materialized, TransCanada suggests it should be further compensated with an even higher cost of capital, notwithstanding the fact that its shippers have borne all of the increased costs associated with the realization of risks that have materialized over the past several years. Approval of this request would allow TransCanada to effectively double dip into the pockets of its Canadian and American customers since TransCanada's shareholders have already received significant financial benefits from the risk premiums that have been added to the historic rates of return awarded by the NEB.

Q44. WHAT OTHER ASPECTS OF TRANSCANADA'S APPLICATION ARE WORRISOME?

A44. The proposed tolls resulting from TransCanada's Application remain uncompetitive and will likely continue to force TransCanada's customers at both ends of its system to seek out new markets, new supply sources and alternative transportation routes that do not require use of the Mainline. TransCanada's failure to propose more competitive tolls may encourage the development of new infrastructure that bypasses the Mainline altogether. TransCanada does not have a good track record showing it can successfully compete with competitive pipeline threats.

Q45. IS THERE A COMMON THEME THAT UNDERPINS THE TRANSCANADA PROPOSALS?

A45. Yes. None of TransCanada's proposals demonstrate a meaningful effort to share the financial burden of the restructuring that is required to reform TransCanada's broken business model and uncompetitive tolls. Rather than attempting to develop workable solutions that have some hope of successfully responding to its tolls crisis, TransCanada instead expects its shippers to continue to pay higher and higher tolls.

Q46. IS IT SIGNIFICANT THAT TRANSCANADA HAS VOLUNTARILY CONTRIBUTED \$25 MILLION (TRANSCANADA CONTRIBUTION) IN ORDER TO REDUCE BOTH THE 2012 AND 2013 REVENUE REQUIREMENT?

A46. The relatively small amount of TransCanada's contribution, and the conditions under which it has been offered, are enlightening regarding TransCanada's commitment to reform its tolls. The modest \$25 million "voluntary contribution" for each of 2012 and 2013 is dwarfed by both the size of its \$1.6 billion annual revenue requirement as well as the requested increase to its cost of capital. As TransCanada threatens in its Application, this voluntary contribution is contingent on the approval of the Restructuring Proposal.

Q47. DOES IGUA SUPPORT TRANSCANADA'S PROPOSED MULTI-YEAR FIXED PRICE ("MFP") SERVICE?

A47. IGUA supports the concept of a fixed price firm service that provides shippers with the option to fix their tolls for a defined period. However, the concept as contemplated by TransCanada's proposal, lacks sufficient detail to allow shippers to evaluate its attractiveness. The pricing of the proposed MFP service is so vague at this point that it is meaningless. For example, TransCanada explains that the year 1 toll for the proposed MFP will reflect the actual interim or final tolls approved by the NEB. The tolls for years 2 through 5 will apparently be based on TransCanada's estimate of projected cost-based tolls at the time the MFP is offered.

Q48. WHAT HARM IS THERE FOR THE NEB TO APPROVE TRANSCANADA'S PROPOSED TOLLS, THEREFORE PROVIDING TRANSCANADA WITH SOME TIME TO SEE WHETHER ITS PROPOSALS WORK?

A48. While it is understandable that some may prefer to postpone making tough decisions today in the hope that TransCanada's tolling crisis will disappear, that is not a prudent way to manage the tolls crisis. TransCanada has already delayed dealing with this crisis for too long.

Q49. DOES THE CURRENT BUSINESS MODEL DISCOURAGE TRANSCANADA FROM DEVELOPING MEANINGFUL SOLUTIONS TO THE TOLLS CRISIS?

A49. Yes. The proliferation of revenue and cost deferral accounts, and the manner in which revenue and cost variances are recovered in future tolls, insulate TransCanada from aggressively pursuing more meaningful measures to deal with its tolling crisis. Rather than developing and implementing serious austerity measures designed to help deal with the cost side of TransCanada's tolling crisis, TransCanada has instead elected to defer hundreds of millions of dollars into the future for future generations of toll payers to bear. The Application also includes proposals that may further amplify the crisis.

Q50. PLEASE PROVIDE AN EXAMPLE OF ONE OF THESE PROPOSALS THAT MAY AMPLIFY THE CRISIS.

A50. As discussed earlier, TransCanada's request for a much higher cost of capital is one example. TransCanada's shareholders have been awarded higher returns to compensate for future long term business risk. Now that some of those future risks have materialized, TransCanada expects its customers to absorb the costs associated with those risks through the payment of higher tolls caused by an increased cost of capital.

9. NEGOTIATED SETTLEMENTS

Q51. DOES IGUA SUPPORT NEGOTIATED SETTLEMENTS?

A51. IGUA favours negotiated settlements over litigation. IGUA has been and will continue to be a consistent supporter of processes that can lead to negotiated settlements.

However, IGUA has concerns about the proliferation of "package deal" negotiated settlements that may be used as a tool to discourage concerned parties from litigation. The threat is often made, that changing even one small component of such a negotiated package settlement will jeopardize the entire agreement. This has resulted in poor tolls settlements that do not stand up well under the test of time.

Q52. HOW IS YOUR CONCERN ABOUT PACKAGE DEAL NEGOTIATED SETTLEMENTS RELEVANT TO THE CURRENT APPLICATION THAT IS NOT THE RESULT OF A NEGOTIATED SETTLEMENT?

A52. TransCanada's Application presents its proposed concoction of cost allocation, toll design and service changes as a package deal. TransCanada threatens that if its application is not accepted in its entirety, several key components included in its Application will no longer be applicable. This is a bold attempt on TransCanada's part to restrict parties' ability to consider the merits, or lack thereof, of important individual components of the Application.

10. IGUA'S PROPOSAL

Q53. PLEASE DESCRIBE IGUA'S OVERALL APPROACH TO TRANSCANADA TOLLING CRISIS.

A53. The current TransCanada business model is no longer responsive to the realities of the market. TransCanada's currently approved tolls are no longer competitive. Similarly, TransCanada's applied-for proposed tolls, if approved by the NEB, will also be uncompetitive, in large part, because they are burdened by the recovery of costs associated with facilities that are no longer required to deliver TransCanada's forecast gas flows.

On the other hand, IGUA's proposals are designed to produce Mainline tolls that are more competitive and are sustainable over the long term. Under IGUA's proposal, TransCanada's shareholders are expected to share in the cost of the solution that are required to address its under-utilized capacity.

Q54. PLEASE BRIEFLY SUMMARIZE IGUA'S PROPOSAL THAT IS DESIGNED TO ADDRESS THE UNDER-UTILIZED MAINLINE.

A54. The IGUA proposal is based on the securitization concept referenced by TransCanada in its response to NEB IR 3.1. Mr. Inge has developed a securitization proposal that provides a structured and long term solution to the tolls crisis by shrinking the size of the regulated company to conform to TransCanada's own Mainline flow forecasts. Mr. Inge has excluded the under-utilized Prairies and Northern Ontario Line ("NOL") net plant from the calculation of tolls.

Q55. PLEASE LIST THE OBJECTIVES UNDERPINNING IGUA'S PROPOSALS.

A55. IGUA's proposal is designed to achieve the following five objectives:

- i) lower and more competitive tolls;
- ii) reduced tolls volatility;
- iii) an enduring solution that addresses the root causes of uncompetitive tolls;
- iv) address the under-utilized Mainline; and
- v) introduce a measure of risk and cost sharing.

Q56. *PLEASE SUMMARIZE THE VARIOUS TOLLING ALTERNATIVES THAT IGUA CONSIDERED.*

A56. As explained in Mr. Inge's evidence, various alternative measures were identified and considered to address the under-utilization of the Mainline. All of the options considered begin with the premise that the costs of under-utilized assets should be excluded from tolls.

Q57. *PLEASE EXPLAIN WHY IGUA SELECTED THE TOLLING PROPOSAL IT IS ADVANCING IN THIS PROCEEDING.*

A57. The securitization option proposed by IGUA provides a structured, long term solution to the tolls crisis. It also produces significant tolls reductions that may be layered on top of whatever toll design and cost allocation the NEB approves pursuant to this proceeding.

For illustrative purposes, Mr. Inge has calculated the tolls that would result if IGUA's securitization proposal is layered on top of the tolls produced by TransCanada's proposals.

Q58. *PLEASE EXPLAIN THE KEY FEATURES OF IGUA'S TOLLING PROPOSAL AND DISCUSS HOW IGUA'S PROPOSAL ADDRESSES THE TOLLS CRISIS.*

A58. As more fully explained in Mr. Inge's evidence, IGUA's securitization proposal essentially shrinks the size of the regulated company by removing from rate base, for the purpose of calculating tolls, that portion of excess capacity on the Prairies and NOL segments of the Mainline that are under-utilized.

Because no one party is responsible for the under-utilized Mainline, we concluded that a 50/50 sharing of costs between toll payers and shareholders is appropriate. As more fully explained by Mr. Inge, the toll payer contribution will be funded with government-sponsored debt to be repaid through a volumetric rate rider to be applied to all gas flows on the Mainline.

Q59. *WHY IS IT APPROPRIATE THAT TRANSCANADA'S SHAREHOLDERS SHARE 50 PERCENT OF THE COSTS ASSOCIATED WITH IGUA'S SECURITIZATION PROPOSAL?*

A59. An equitable sharing of risk and costs is fundamental to IGUA's position. TransCanada is the only party that has the ability to manage its business risks. It makes no sense that risks should be fully borne by those who have no ability to control or manage those risks.

An equitable sharing of risk and the costs associated with those risks better aligns TransCanada's business interests with those of its toll paying customers. This will create an environment where TransCanada has a stake in the game. By exposing TransCanada to a measure of risk sharing with its toll payers, TransCanada will be more aligned to work with its stakeholders to make its tolls more competitive.

Q60. *DOES IGUA'S PROPOSAL PROVIDE TRANSCANADA WITH AN OPPORTUNITY TO RETURN NET PLANT TO RATE BASE IF MAINLINE UTILIZATION SIGNIFICANTLY IMPROVES?*

A60. As noted in Mr. Inge's evidence, the securitization solution can be designed to be reversible if volumes return to the Mainline in sufficient numbers so as to significantly increase the utilization of the Mainline.

Q61. *DOES THIS CONCLUDE YOUR EVIDENCE?*

A61. Yes.