National Energy Board

Reasons for Decision

Trans Québec & Maritimes Pipeline Inc.

RHW-1-94

April 1995

Tolls

National Energy Board

Reasons for Decision

In the Matter of

Trans Québec & Maritimes Pipeline Inc.

Application dated 20 September 1994, as amended, for new tolls effective 1 January 1995

RHW-1-94

April 1995

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Abbreviations

Act	*National Energy Board Act*
AFUDC	Allowance for Funds Used During Construction
Base Year	1 July 1993 to 30 June 1994
Board	National Energy Board
CAPP	Canadian Association of Petroleum Producers
Company	Trans Québec & Maritimes Pipeline Inc.
Consumers	Consumers' Gas Company Ltd., (The)
Gaz Métropolitain	Société en commandite Gaz Métropolitain
Intragaz	Intragaz inc.
kPa	kilopascals
LCT	Large Corporation Tax
NEB	National Energy Board
NOVA	NOVA Gas Transmission Ltd.
O&M	Operating and Maintenance
Quebec	Procureur général du Québec
RH-2-94	Multi-Pipeline Cost of Capital Hearing
RH-4-92	TQM Toll Application for 1993 and 1994
RH-4-87	TQM Toll Application for 1987 and 1988
RH-4-83	TQM Toll Application for 1984
ROE	Rate of Return on Common Equity
SGT	Storage Gas Transportation
STS	Storage Transportation Service
Test Year	1 January 1995 to 31 December 1995
TQM	Trans Québec & Maritimes Pipeline Inc.
TransCanada	TransCanada PipeLines Limited

Recital and Submittors

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

IN THE MATTER OF an application by Trans Québec & Maritimes Pipeline Inc. for certain orders respecting tolls under Part IV of the *National Energy Board Act*, filed with the Board under File No. 4200-T028-6.

Examined by way of written submissions.

BEFORE:

R. Priddle	Chairman
K.W. Vollman	Vice-Chairman
A. Côté-Verhaaf	Member
C Bélanger[1]	Member
R. Illing	Member
R.L. Andrew	Member

INTERVENORS TO HEARING ORDER RHW-1-94:

Alberta Natural Gas Company Ltd.

Canadian Association of Petroleum Producers

Consumers' Gas Company Ltd., (The)

Foothills Pipe Lines Ltd.

Intragaz inc.

Pan-Alberta Gas Ltd.

Procureur général du Québec

Société en commandite Gaz Métropolitain

SOQUIP

TransCanada PipeLines Limited

Union Gas Limited

[1] Effective 2 February 1995, C. Bélanger no longer participated in this proceeding.

Overview

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

The Application

On 20 September 1994, TQM applied to the Board for new tolls to be effective 1 January 1995. The application dealt with rate base, cost of service, cost of capital issues other than those addressed in RH-2-94 and toll design and tariff matters.

Revenue Requirement

The Board approved a net revenue requirement for TQM of $63,632,000 for the 1995 test year which is $3,593,000 less than the applied-for amount.

Rate Base

The Board approved an average rate base for TQM of $298,807,000 for 1995 compared to an applied-for amount of $298,835,000.

Cost of Capital

In RH-2-94, the Board approved a common equity ratio of 30% for TQM compared to an approved ratio of 25% for 1994.

In addition, the Board approved a rate of return on common equity, in RH-2-94, of 12.25% for 1995 which is 75 basis points less than the applied-for rate of 13.0%. The approved overall return on rate base is 10.47% for 1995.

Income Tax

The Board approved a 1995 Income Tax Allowance for TQM of $9,157,000 compared to an applied-for amount of $10,862,000.

The Board directed TQM to commence deducting bond issue costs effective 1 January 1995 in accordance with paragraph 20(1)(e) of the Income Tax Act.

The Board has incorporated the impact of a change in the Large Corporation Tax rate, effective 1 March 1995. This change was announced in the 27 February 1995 Federal Budget.

Operating and Maintenance Expenses

For 1995, the Board approved an all-inclusive salary increase of 2% over TQM's 1994 NEB-approved salary budget. The Board approved a total Operating and Maintenance amount of $7,007,000 for 1995 which reflects reductions to the 1995 applied-for salary increases and regulatory expenses.

Deferral accounts

The Board approved the disposition of the balances of TQM’s four existing deferral accounts as at 31 December 1994 plus carrying charges on these balances up to 30 April 1995.

The Board approved the continuation of the two deferral accounts related to funded debt and unfunded debt for 1995. The NEB Cost Recovery and the Income and Capital Taxes deferral accounts were discontinued.

Toll Design and Tariff Matters

The Board ruled that the existing SGT toll design for Pointe-du-Lac service is inappropriate and directed TQM to develop a new SGT toll design for this service and submit it with its 1996 Tolls Application.

Chapter 1

Background and Application

1.1 Background

Trans Québec & Maritimes Pipeline Inc. ("TQM") operates natural gas transmission facilities as mandatory (agent) of TQM Pipeline Partnership. TQM Pipeline Partnership is comprised of two partners, Société en commandite Gaz Métropolitain ("Gaz Métropolitain") and TransCanada PipeLines Limited ("TransCanada"), each owning 50% of TQM.

The TQM system extends from a point of interconnection with the TransCanada system at Saint-Lazare near Montréal to a point west of Québec City, with laterals to Boisbriand, Saint-Jérôme, Joliette, Louisville, Trois Rivières and Québec City. The mainline from Saint-Lazare to the Boisbriand junction is constructed with 762 mm diameter pipe while the mainline from the Boisbriand junction to Québec City is built with a 610 mm diameter pipe. TQM is currently constructing facilities to cross the St. Lawrence River to the South Shore of Québec City. This 14 kilometre extension is expected to be completed in December 1995.

Natural gas is transmitted by TQM for TransCanada and delivered at the points of interconnection of TQM's pipeline with that of the distributor, Gaz Métropolitain.

TQM determines its cost of service for a forward test year, deducts revenues received from Gaz Métropolitain for miscellaneous transportation and storage services, and charges TransCanada 1/12 of the remaining costs each month. These costs are then included by TransCanada in its overall cost of service. Since TransCanada is the only shipper and has contracted to use all of TQM's capacity, TQM's cost of service is recovered through the firm service toll and charged to TransCanada.

1.2 Application

On 20 September 1994, TQM applied under Part IV of the *National Energy Board Act* (the "Act") for new tolls, to be effective 1 January 1995. TQM subsequently filed revisions to its application dated 2 November and 23 November 1994.

TQM proposed that all issues in its application be dealt with by way of written submissions, noting that the issues of rate of return on common equity ("ROE") and capital structure would be dealt with in the context of RH-2-94.

In Order RHW-1-94 dated 12 October 1994, the Board set out the Directions on Procedure for processing this application by way of a written hearing.

Hearing Order RHW-1-94 was amended twice. The original List of Issues was revised by AO-1-RHW-1-94 dated 9 November 1994. The Timetable of Events to accommodate the late interventions of Intragaz inc. ("Intragaz") and SOQUIP was revised by AO-2-RHW-1-94 dated 20 December 1994.

By Interim Order TGI-5-94, the Board authorized TQM to charge tolls on an interim basis effective 1 January 1995. These tolls were to be calculated on the basis of the 1995 applied-for cost of service as contained in TQM's 23 November 1994 Revision to the application and were to remain in effect until the Board rendered its final decision on the Application for 1995 tolls.

Chapter 2

Revenue Requirement

TQM requested approval of a net revenue requirement of $67,225,000 for 1995. This represents a decrease of $3,888,000 from the 1994 authorized revenue requirement of $71,113,000. The Board authorizes a net revenue requirement for TQM of $63,632,000 for 1995.

A summary of the requested and approved net revenue requirement for 1995, including the Board's adjustments, is shown in Table 2-1. Further details of the Board's adjustments to the 1995 net revenue requirement are provided in Chapters 3, 4, 5 and 6.

Table 2-1
Revenue Requirement for 1995
($ 000)

	Application as Revised	NEB Adjustments	Authorized by NEB
Operating Costs			
Operating and Maintenance	7,338	(331)	7,007
Municipal and Other Taxes	2,796	-	2,796
NEB Cost Recovery	382	-	382
Depreciation and Amortization	13,176	-	13,176
Income Taxes	10,862	(1,705)	9,157
Total Operating Costs	34,554	(2,036)	32,518
Return on Rate Base	32,842	(1,557)	31,285
Total Revenue Requirement	67,396	(3,593)	63,803
Storage Revenue	(171)	-	(171)
Net Revenue Requirement	**67,225**	**(3,593)**	**63,632**

Chapter 3

Rate Base

TQM requested approval of a rate base amount totalling $298,835,000 for 1995. The Board's adjustments to rate base are summarized in Table 3-1.

Table 3-1
Average Rate Base for 1995
($ 000)

	Application as Revised	**NEB Adjustments**	**Authorized by NEB**
Gas Plant in Service			
Gross Plant	473,757	-	473,757
Accumulated Depreciation	(167,513)	-	(167,513)
Net Plant	306,244	-	306,244
Working Capital:			
Cash	612	(28)	584
Materials & Supplies	372	-	372
Line Pack	613	-	613
Prepayments	578	-	578
Total Working Capital	2,175	(28)	2,147
Other Rate Base Items:			
Tax Benefit on Sponsors' Development Costs	(10,337)	-	(10,337)
Unamortized Debt Issue Costs	753	-	753
Total Rate Base	**298,835**	**(28)**	**298,807**

3.1 Gross Plant

TQM forecast average Gross Plant to be $473,757,000 for 1995. This amount reflects plant additions approved by the Board under Part III of the Act since RH-4-92.

Decision

The Board approves the applied-for average Gross Plant amount of $473,757,000 for the 1995 test year.

3.2 Depreciation Rates

TQM requested that its existing depreciation rates which were approved in RH-4-92 be continued in 1995. No intervenor commented on TQM's depreciation rates.

Decision

The Board approves the continued use of TQM's currently-approved depreciation rates for 1995.

3.3 Working Capital Allowance

TQM applied for a total working capital allowance of $2,175,000 for 1995. The only element of the total working capital allowance which was at issue in this proceeding was the proposed cash working capital component of $612,000. The basis for this amount is 1/12 of TQM's annual O&M expenses. As part of its justification for this allowance, TQM submitted a cash time-lag study which was prepared in accordance with the methodology approved by the Board. Although TQM applied for a cash working capital allowance of 1/12 of its annual O&M expenses, the Company's time-lag study indicated a required allowance of 1/10.

The Board requested that TQM recalculate its time-lag analysis study incorporating the assumption that TQM receives payment for expenses in the month after an expense is recorded, rather than in the month after an expense is paid. The revised study results indicated a cash working capital requirement of 1/12 of its annual O&M expenses, which is the same as that applied for by TQM.

Views of the Board

The Board is of the view that the determination of the revenue receipt date is a key issue in the calculation of cash working capital. In making this determination, it is the Board's view that the expense recording date is more important than the date the expense is paid (e.g. the date on which the cheque is written). This is because revenues in any given month are expected to reimburse TQM for expenses recorded in that month.

Decision

The Board approves a cash working capital allowance of 1/12 of TQM's total O&M expenses. The Board directs TQM, in future toll applications, to file a cash time-lag study which considers that TQM receives payment for expenses in the month after an expense is recorded rather than in the month after the expense is paid.

The Board has reduced the applied-for total working capital allowance of $2,175,000 by $28,000 to reflect the adjustments to O&M expenses in Chapter 6.

Chapter 4

Cost of Capital

TQM's Application was based on a rate of return on common equity of 13.0% for 1995, and a deemed common equity component of 35%. Details of the applied-for rates of return and capital structure are shown in Table 4-1.

TQM's applied-for capitalization for the 1995 test year was determined in a manner consistent with the methodology approved in recent Board decisions. Namely, the funded debt component reflects the Company's expected total outstanding long-term debt during the test year and TQM's capitalization is equated to the test-year rate base for the purposes of calculating its return on rate base.

Table 4-1
Applied-For Deemed Average Capital Structure and Rate of Return for 1995

	Amount	Capital Structure	Cost Rate	Cost Component
	($ 000)	(%)	(%)	(%)
Debt - Funded	98,231	32.87	12.69	4.17
Debt - Unfunded	96,012	32.13	7.06	2.27
Total Debt Capital	194,243	65.00		6.44
Equity	104,592	35.00	13.00	4.55
Total Capitalization	**298,835**	**100.00**		
Rate of Return on Rate Base				**10.99**

4.1 Re-examination of RHW-1-94 Cost of Capital Issues

In CAPP's view, cost of capital issues addressed in RHW-1-94 should be re-examined following the release of the RH-2-94 Reasons for Decision in order to determine the impact of RH-2-94 on deemed debt, deemed common equity, the need for associated deferral accounts and other related issues.

TQM submitted that the record before the Board in RHW-1-94 was complete and therefore it would be unnecessary for the Board to reconsider or give parties a second opportunity to make submissions on cost of capital issues.

Views of the Board

The Board notes that the effects of the RH-2-94 Decision have been incorporated in these Reasons for Decision. It is the Board's view that the RHW-1-94 record is complete and sufficient to allow it to render decisions on all cost of capital issues, other than those addressed in RH-2-94.

Decision

The Board denies CAPP's request to re-examine RHW-1-94 cost of capital issues following the release of the RH-2-94 Reasons for Decision.

4.2 Capital Structure for Toll-Making Purposes

CAPP submitted that TQM's utility balance sheet should reflect the capitalization approved by the Board for the utility and the authorized utility rate base. In CAPP's view, TQM's balance sheet shows an overcapitalization of at least $17,488,000 arising from the Company incorrectly including in Gas Plant in Service some $7,369,000 of disallowed rate base costs, and some $10,119,000 of the sponsors' development costs which have not been credited against rate base.

In CAPP's view, these two items should either be deemed to be financed with equity or written off by TQM. If the items were deemed to be financed with equity, then the residual equity available to finance the rate base would be lower. This lower equity would then have the effect of reducing TQM's rate of return on rate base and other expenses.

TQM responded that, in RH-4-87, the Board ruled that TQM's deemed total capitalization should be equal to the approved rate base and that the deemed capital structure should include funded debt (comprised of outstanding bonds), unfunded debt and common equity equal to the approved common equity ratio. TQM submitted that its 1995 applied-for capital structure reflected this methodology.

Views of the Board

The Board is not persuaded that any adjustment to the current capital structure or their respective cost components is appropriate. The Board is of the view that, consistent with the methodology approved in previous Board decisions, all TQM's 30% deemed common equity approved in RH-2-94 should be included in the calculation of the Company's rate of return on rate base.

Decision

The Board denies CAPP's request that TQM's disallowed rate base costs and disallowed sponsors' development costs be deemed to be financed with equity.

4.3 Cost of Debt

4.3.1 Funded Debt

TQM applied for an average funded debt amount of $98,231,000 with an associated cost rate of 12.69% for 1995. On 22 October 1994, TQM's Series A and D bonds matured along with a $7.5 million term loan. TQM refinanced this maturing debt with a $130 million one-year term loan set to mature in October 1995 and $34 million of additional equity from its shareholders, TransCanada and Gaz Métropolitain.

TQM indicated its intention to refinance, in October 1995, most of its short-term debt with Series E, F, and G bonds. The forecast interest rates used by TQM for the prospective bond issues were based on a ScotiaMcLeod forecast yield on Government of Canada bonds for the third quarter of 1995. An additional risk premium was then added, ranging from 65 to 85 basis points depending on the term, to account for corporate risk.

Consistent with the Board's directive in RH-4-87, TQM included its total outstanding funded debt in the determination of total capitalization. Based on this methodology, the funded debt cost rate is calculated by dividing financial charges, including the yearly amortization of debt issue expenses by the average gross proceeds of debt outstanding (see Table 4-2).

Table 4-2
Funded Debt Balances and Cost Rates for 1995

	Proposed Issue Amount	**1995 Weighted Proceeds**	**Average Financial Charges**	**Cost Rate**
	($ 000)	($ 000)	($ 000)	(%)
Series E Bonds (9.05%)	10,000	2,308	209	
Series F Bonds (9.60%)	35,000	8,077	775	
Series G Bonds (10.35%)	70,000	16,154	1,672	
	115,000	26,539	2,656	
Series B Bonds (13.20%)		71,692	9,463	
		98,231	12,119	12.34
Amortization of Debt Discount			351	0.35
Total Funded Debt		**98,231**	**12,470**	**12.69**

Views of the Board

The Board is of the view that TQM's forecast interest rates related to the proposed Series E, F, and G bonds are reasonable. The Board has determined that a deferral account to record variances between the forecast and actual cost of funded debt for 1995 is appropriate (see section 7.2).

Decision

The Board approves a funded debt amount of $98,231,000 with an average cost rate of 12.69% for TQM for 1995.

4.3.2 Unfunded Debt

TQM applied for an average unfunded debt balance of $96,012,000 for 1995 at an average cost rate of 7.06%. This rate was based on a forecast of the average prime rate for 1995, less 50 basis points. This methodology is consistent with the practice outlined in RH-4-92.

To arrive at its prime rate forecast for 1995, TQM averaged the results of a verbal poll of the six major Canadian banks' prime rate forecasts for 1995. The banks' forecasts were made in mid-1994 and ranged from a low of 7.19% to a high of 8.10%. In October 1994, TQM stated that it had completed its negotiations for a one-year $130 million term loan from the Bank of Montreal at an interest rate of prime less 50 basis points.

In CAPP's view, the cost of the unfunded debt represented by the one-year short-term bank loan was reasonable.

Views of the Board

The Board considers that TQM's unfunded debt balance should be costed using its forecast short-term borrowing rate. The Board notes that the prime rate forecasts relied upon by TQM were not opposed by any party during the proceeding. The Board has determined that a deferral account to record variances in the cost of unfunded debt for 1995 is appropriate.

As a result of RH-2-94, TQM's equity component has been reduced by 5% from the applied-for amount of 35%. This reduction has been added to TQM's unfunded debt which results in an adjusted unfunded debt amount of $110,934,000.

Decision

The Board approves an average unfunded debt amount of $110,934,000 with an average cost rate of 7.06% for TQM for 1995.

4.4 Cost of Capital

TQM's application was based on an applied-for deemed common equity ratio of 35% for 1995 compared with a 25% deemed common equity approved by the Board for 1994. In RH-2-94, the Board approved a deemed common equity ratio of 30%.

In addition, TQM's application was based on an ROE of 13.0% for 1995. In RH-2-94, the Board approved an ROE for TQM of 12.25% for 1995.

4.5 Capital Structure and Rate of Return on Rate Base

Decision

The Board approves a rate of return on rate base of 10.47% for the 1995 test year. TQM's approved capital structure and overall rates of return for 1995 are shown in Table 4-3.

Table 4-3
Approved Deemed Average Capital Structure and Rate of Return for 1995

	Amount	Capital Structure	Cost Rate	Cost Component
	($ 000)	(%)	(%)	(%)
Debt - Funded	98,231	32.87	12.69	4.17
Debt - Unfunded	110,934	37.13	7.06	2.62
Total Debt Capital	209,165	70.00		6.79
Equity	89,642	30.00	12.25	3.68
Total Capitalization	**298,807**	**100.00**		
Rate of Return on Rate Base				**10.47**

Chapter 5

Income Taxes

5.1 Debt Issue Costs

CAPP noted that the Income Tax Act currently allows for the deduction of debt issue costs at 20% per year. CAPP was concerned that TQM did not reflect a deduction for debt issue costs in its Utility Income Tax Allowance Schedule. CAPP suggested that the deduction for TQM's proposed 1995 bond issues should be approximately $283,000.

CAPP was also concerned that because, prior to 1988, debt issue costs were fully deductible in the year incurred, TQM's partners may have received the benefit of the full tax deduction for the debt issue costs associated with the existing Series B bonds without providing shippers with a credit for the full tax deduction taken. CAPP reached this conclusion because there was projected to be $450,000 of costs associated with the Series B bonds in the Unamortized Debt Discount Account as at 1 January 1995.

Although TQM did not reflect a deduction for debt issue costs in calculating its income tax allowance, the Company agreed that the Income Tax Act, under paragraph 20(1)(e) contemplates an amortization of debt issue costs over a five-year period at 20% per year. TQM noted, however, that deducting debt issue costs as proposed by CAPP would only reduce the Company's income tax allowance by $19,000. This is because the $283,000 tax deduction would be offset by $255,000 of debt issue costs claimed for accounting purposes.

TQM noted that, since 1984, the issue costs associated with Series B bonds have been amortized over the average life of the bonds for both fiscal and regulatory purposes and this will continue until 1998. As the partners have not derived any benefit from this tax treatment, TQM submitted that it would be inappropriate to change a methodology that has been consistently followed since 1984.

Views of the Board

The Board considers that it would not be appropriate for TQM to change the method of amortizing the debt issue costs associated with Series B bonds.

However, the Board is of the view that TQM should deduct debt issue costs in accordance with paragraph 20(1)(e) of the Income Tax Act.

Decision

For the purposes of calculating its income tax allowance, the Board directs TQM to commence, effective 1 January 1995, deducting bond issue costs, other than those associated with Series B bonds, in accordance with paragraph 20(1)(e) of the Income Tax Act. The Board has made the required adjustments for the 1995 test year (see Table 5-1).

5.2 Flow-through Income Tax Calculation

TQM applied for a 1995 Utility Income Tax Allowance of $10,862,000. Since several of the decisions described in these Reasons affect TQM's calculation of its income tax provision, the Board has made a number of adjustments as shown in Table 5-1.

Table 5-1
Approved Utility Income Tax Allowance for 1995
($ 000)

	Application as Revised	**NEB Adjustments**	**Authorized by NEB**
Utility Income after Taxes[1]	13,597	(2,601)	10,996
Depreciation	13,176	-	13,176
Amortization of Debt Issue Costs	-	255	255
Meals & Lodging	74	-	74
Social Activities	59	-	59
Large Corporation Tax	631	66	697
Capital Cost Allowance	(11,760)	-	(11,760)
Interest AFUDC	(687)	(37)	(724)
20% of Debt Issue Costs	-	(283)	(283)
50% of Meals & Lodging	(37)	-	(37)
50% of Social Activities	(30)	-	(30)
Taxable Income	**15,023**	**(2,600)**	**12,423**
Taxes: 50% at (0.43732)/(1-0.43732)	5,838	(1,010)	4,828
Taxes: 50% at (0.369)/(1-0.369)	4,393	(761)	3,632
Recovery of LCT	631	66	697
Utility Income Tax Allowance	**10,862**	**(1,705)**	**9,157**

Decision

The Board approves a 1995 Utility Income Tax Allowance for TQM of $9,157,000.

[1] Equals the 1995 common equity cost component multiplied by average rate base (Applied for: 4.55% x $298,835; Approved: 3.68% x $298,807)

5.3 Large Corporation Tax

In the Federal Budget of 27 February 1995, it was announced that an increase in the Large Corporation Tax ("LCT") rate would be effective immediately. The LCT Rate was increased from 0.2% to 0.225%. Subsequently, TQM provided the Board with a revised calculation of its LCT provision for 1995.

Views

The Board is of the view that it is appropriate to include the impact of the change in the LCT rate in the calculation of TQM's 1995 Income Tax Allowance.

Decision

The Board approves a provision for LCT in the amount of $697,000 for 1995.

Chapter 6

Operating and Maintenance Expenses

6.1 Overview of Operating and Maintenance Expenses

TQM's application included a request for $7,338,000 in Operating and Maintenance ("O&M") expenses for 1995. This amount represents an increase of $204,000 over the Board approved O&M expenses for 1994 and is $945,000 higher than the actual O&M expenses identified in TQM's application for the 12 month period ending 30 June 1994 ("base year"). The increases were largely the result of the salaries' escalation factor, the escalation factor for non-salary expenses and an increase in regulatory expenses.

6.2 Salary Escalation Factor

TQM estimated its 1995 salary requirement of $3,191,100 by applying a total increase of 4.625% to the actual salary costs paid for the base year. This increase is made up of 1/2 of the 3.25% increase actually paid effective 1 January 1994 plus a forecast increase of 3% to be effective 1 January 1995. The applied-for 3% increase for 1995 is based on a recommendation from TQM's compensation consultant, Towers Perrin. The recommendation indicated that an increase of this magnitude would be required to allow TQM to maintain its current position in the labour market and provide additional funds to cover promotions, progression and adjustments to bring salaries closer to the market median. During the base year, TQM had 59 permanent employees and an average of 1.8 (full-time equivalent) temporary and seasonal employees. TQM did not forecast any increase in the number of permanent employees during 1995 but anticipates a requirement for an average of 2.0 temporary and seasonal employees for the year.

In RH-4-92, the Board approved an overall annual salary increase of 2% for each of the 1993 and 1994 test years. TQM's evidence in RHW-1-94 indicated that the actual salary increase paid in 1993 was in excess of the overall salary increase approved by the Board. The Company stated that although the 1993 salary increase was implemented at a higher rate prior to the release of the Board's decision, the actual salary expenditures were within the total salary amount approved by the Board. In 1994, TQM increased its salary budget by 3.25%. This increase was implemented after considering factors such as the Towers Perrin survey and recommendations, salary forecasts of its parent companies, the local labour market and corporate concerns related to the need to retain its experienced employees.

TQM acknowledged that the percentage increases it granted in 1993 and 1994 were in excess of the Board-approved levels but stated that the higher escalation factors were required in order to ensure that the Company's salaries remained competitive. TQM believes that its salary policy is not overly generous and the granting of salary increases in line with TQM's market environment are warranted in order to ensure the safe and effective operation of the pipeline by retaining its experienced employees.

Le Procureur général du Québec ("Quebec") expressed the view that TQM's 1995 salary increase should not exceed 2% given the current state of the province's economy. In Quebec's view, this increase should be applied to the 1994 salary amount approved by the Board in RH-4-92 and the cost of salary increases greater than those approved by the Board should be borne by TQM's shareholders.

Views of the Board

The Board notes that TQM decided to provide salary increases in excess of the Board-approved amounts in 1993 and 1994. However, the Board is not convinced that shippers should be required to pay the long-term effects of higher than Board-approved salary increases.

In the Board's view, an appropriate 1995 overall salary increase covering economic increase, merit and progression/promotion is 2%. This increase is to be applied to the Board-approved salary level of $3,041,200 for 1994.

Decision

The Board approves an all-inclusive salary increase of 2% for the 1995 test year to be applied to the $3,041,200 salary amount previously approved by the Board in RH-4-92 for 1994. This results in an all-inclusive salary amount of $3,102,000 for 1995 which is a reduction of $89,000 from the 1995 applied-for amount.

6.3 Non-salary Escalation Factor

For 1995, TQM calculated its non-salary O&M expenses by adjusting its actual base year expenditures for inflation and a number of other specific adjustments. TQM used the Conference Board of Canada's inflation forecasts of 1.1% for the last six months of 1994 and 1.9% for 1995.

The increases in non-salary costs which are related to specific cost adjustments make up the bulk of the change in non-salary expenses. The largest element relates to an increase in regulatory expenses which is discussed in detail in section 6.4.

Views of the Board

The Board is of the view that the inflation rates used by TQM for increasing the base period non-salary costs to 1995 levels are reasonable.

Decision

The Board approves inflation rates of 1.1% for the final two quarters of 1994 and 1.9% for 1995 to calculate O&M expenses excluding salaries for the 1995 test year.

6.4 Regulatory Expenses

TQM applied for recovery of regulatory expenses estimated to be $483,500 for 1995. This represents an increase of $274,200 over the base year amount. TQM explained that a portion of the increase is due to the fact that the expenses related to the Company's 1995 toll application have been expensed in one year whereas in its previous toll application (i.e. RH-4-92) these expenses were amortized over a two-year period.

The second factor causing a significant increase in regulatory expenses for 1995 is the costs of TQM's participation in RH-2-94. In TQM's view, it is uncertain what the impact of RH-2-94 will be on regulation in the future and therefore it is appropriate to charge all of the costs related to RH-2-94 in 1995.

Views of the Board

The Board notes that the unusually high regulatory expenses for 1995 is an anomaly primarily resulting from TQM's participation in the RH-2-94 proceeding. The Board does not believe it is appropriate to record the total amount of these expenses in 1995. As a result, the Board is of the view that the 1995 applied-for regulatory expenses of $483,500 should be amortized equally over 1995 and 1996.

Decision

The Board directs that the 1995 applied-for regulatory expenses be reduced by $241,750 and this amount should be included as part of the applied-for regulatory expenses in TQM's 1996 toll application.

6.5 Summary of Operating and Maintenance Expenses

Table 6-1 summarizes the adjustments made by the Board to TQM's applied-for O&M expenses.

Table 6-1
Summary of Operating and Maintenance Expenses for 1995
($ 000)

	Application as Revised	**NEB Adjustments**	**Authorized by NEB**
Salaries	3,191	(89)	3,102
Benefits	714	-	714
Regulatory Expenses	484	(242)	242
All other O&M Expenses	2,949	-	2,949
Total O&M Expenses	**7,338**	**(331)**	**7,007**

Chapter 7

Deferral Accounts

7.1 Existing Deferral Accounts

TQM requested that the balances in its four existing deferral accounts as at 31 December 1994 in the amount of $1,714,634 be paid to TransCanada. However, the Board, by Interim Order TGI-5-94, directed TQM to continue its deferral accounts using the parameters previously approved by the Board until such time as the final order with respect to RHW-1-94 came into effect. No intervenor commented on the applied-for disposition of TQM's deferral accounts. The forecast accumulated balances in TQM's deferral accounts as at 31 December 1994 are shown in Table 7-1.

TQM requested that the Board approve deferral accounts for funded debt and unfunded debt for 1995 (see section 7.2).

Table 7-1
Forecast Deferral Account Balances as at 31 December 1994
($ 000)

	Principal	**Carrying Charges**	**Total**
Funded Debt	895	51	946
Unfunded Debt	154	18	172
NEB Cost Recovery	192	11	203
Income and Capital Taxes	373	21	394
Total	**1,614**	**101**	**1,715**

Views of the Board

The Board is of the view that TQM should be allowed to dispose of the accumulated balances in its existing deferral accounts as at 30 April 1995. In accordance with Interim Order TGI-5-94, TQM should calculate carrying charges on these balances from 1 January 1995 up to the disposition date, using the approved rate of return on rate base for the 1995 test year.

Decision

The Board approves the disposition of the deferral account balances listed in Table 7-1 and the use of the 1995 test year rate of return on rate base for calculating carrying charges from 1 January 1995 up to the disposition date.

The Board approves the discontinuance of the NEB Cost Recovery deferral account and the Income and Capital Taxes deferral account.

7.2 Funded Debt and Unfunded Debt Deferral Account

TQM requested that two deferral accounts be approved by the Board for 1995 to record any variances between forecast and actual interest rates for funded and unfunded debt. The funded debt deferral account will record variances between the approved and actual cost of long-term fixed-rate financing for 1995. The unfunded debt deferral account will record variances between the approved and actual cost of unfunded debt for 1995.

TQM indicated that the cost of refinancing the funded debt was beyond its control and that a 1% variance in its forecast interest rates would result in an increase or decrease in its 1995 cost of service of approximately $300,000.

TQM pointed out that the recent volatility in short-term interest rates supported its request for a deferral account for unfunded debt, and that a 1% variance in its forecast interest rates would result in an increase or decrease in its 1995 cost of service of approximately $1,000,000.

CAPP submitted that no deferral account for debt should be allowed if the Board approved, in RH-2-94, a common equity ratio in excess of 25%. In CAPP's view, if the common equity ratio was increased, then TQM should accept more risk, and the principal short-term risk that the Company should accept is the forecasting risk associated with debt costs.

Views of the Board

The Board notes the potential adverse material impact that interest rate fluctuations could have on TQM's 1995 cost of service, and believes that deferral accounts for variances in cost rates for funded and unfunded debt should be continued to protect the Company and tollpayers.

Decision

The Board approves the continuation of a funded debt deferral account to record variances between the approved and actual cost of long-term fixed rate financing for 1995 and an unfunded debt deferral account to record the variance between the approved and actual cost of unfunded debt for 1995.

The Board also directs TQM to calculate carrying charges on amounts recorded in these deferral accounts using the overall approved rate of return on rate base for the 1995 test year.

Chapter 8

Tariff Matters

8.1 Storage Gas Transportation Toll

The issue of the appropriateness of the existing toll design for Pointe-du-Lac Storage Gas Transportation ("SGT") service was raised by Consumers' Gas Company Ltd. ("Consumers") in its initial intervention. Subsequently, Consumers filed a written submission indicating its belief that the SGT toll design should be modified before TQM provides additional SGT Service or potential future SGT-type service for gas withdrawn from underground storage at Saint-Flavien, Québec. Consumers took the position that SGT service has the characteristics of a firm service and thus the existing toll design for SGT service is inappropriate

SGT service is designed to allow the transportation of storage gas for Gaz Métropolitain from Pointe-du-Lac, Québec to various delivery points on TQM's mainline. This service has been in effect since 9 January 1991.

In RH-2-90, the Board approved the SGT toll as applied-for by TQM. The toll was calculated using the following two fees:

a) receipt fees equal to a monthly rate calculated on the basis of the total cost of the facilities required to provide the SGT service depreciated over a period of 10 years plus a return on the average undepreciated balance of the facilities at an interest rate equal to the approved overall rate of return on rate base of TQM. The monthly rate is adjusted from year to year pursuant to the TQM's overall rate of return as approved by the Board; and

b) administration fees for each month equal to the commodity rate (88.25¢ per 10^3m^3) multiplied by the volume of gas actually withdrawn from Pointe-du-Lac.

The Pointe-du-Lac storage facility is used to provide storage service to Gaz Métropolitain. The facility is operated by Intragaz inc. and is owned by Intragaz and Company, Limited Partnership. In July 1989, the Régie du gaz naturel du Québec approved an application for the storage tariff applicable to the Pointe-du-Lac storage facility on an "avoided cost" basis. A portion of the costs used to calculate the resulting toll was TQM's estimate of the SGT charges of approximately $100,000 per year (amount included in TQM's 1995 Tolls Application is $119,100). Although Gaz Métropolitain pays TQM directly for SGT service, it is fully reimbursed by Intragaz.

Consumers' position that SGT service has the characteristics of a firm service was based on the grounds that interruptions to SGT service only occur in situations where operating pressures on TQM's system exceed 6,000 kPa. Intragaz has a contractual obligation and surface facilities to provide a maximum pressure of 6,000 kPa and for any pressures in excess of this amount, it can only deliver gas on a best efforts basis. Consumers submitted that in order to avoid subsidization of the storage service by TQM's other tollpayers, an appropriate toll design must allocate mainline costs to the SGT service. In Consumers view, this allocation was not reflected by the existing SGT toll design.

In Consumers' view, the toll for SGT service should be based on TQM's average unit cost of service which is a similar approach to that used by TransCanada for its Storage Transportation Service ("STS") toll. Consumers calculated that TQM's gross revenue requirement ($67,396,000) divided by the 1995 forecast volume (3 371 000 10^3m^3) would generate an average unit cost of service of $19.99 per 10^3m^3. This rate was then applied to the 1995 forecast for SGT volume (62 500 10^3m^3) to arrive at a total revenue amount of $1,249,375 rather than the $119,100 forecast under TQM's existing toll design.

TQM submitted that the assertion that SGT is a firm service is wrong and unreasonable. This position is based on an examination of applicable contracts and tariff provisions as well as an examination of operating conditions which demonstrate that TQM does not have any obligation to meet or perform any minimal conditions with regard to the provision of SGT service. In TQM's view, it is unreasonable to suggest such a large tariff increase without any new facts or circumstances to justify the change. Accordingly, TQM requested that the Board reject any change to the existing SGT toll design.

Intragaz submitted that the existing SGT tolls are just and reasonable and are based on an appropriate toll design methodology. Factors such as no new circumstances, reliance by Intragaz on the current toll design as a basis for business decisions, and the unfairness of an approximate 1000% increase in the level of the proposed toll were cited as reasons for the Board to reject Consumers' proposal.

SOQUIP submitted that Consumers' request pertains essentially to the storage of natural gas at Saint-Flavien. It opposed the request on the basis that the Board has deferred consideration of the toll design for transportation of storage gas withdrawn from Saint-Flavien until TQM's 1996 toll application.

Gaz Métropolitain opposed the Consumers' proposal because, in its view, it is unfair, erroneous, self-serving and unworkable. Furthermore, the proposal would have a substantial adverse impact on the economics of storage in Quebec. Finally, Gaz Métropolitain listed shortcomings of Consumers' proposed toll design including the fact that it did not reflect the relevant mainline costs to be recovered nor the distance travelled for the storage gas being transported.

Quebec requested that Consumers' proposal be rejected on the basis that SGT is not a firm service and that TQM's SGT service cannot be considered to be the same as TransCanada's STS service. In addition, they argued that the Board's Decision, in RH-2-90, acknowledged the fair and reasonable character of the existing SGT service toll design.

Views of the Board

The Board is of the view that the Pointe-du-Lac SGT service is essentially a firm service. Any lack of firmness is due to pressure-related operating constraints of Intragaz which are beyond TQM's control.

The Board agrees with Consumers that the existing SGT toll design does not recover a portion of the mainline costs and therefore concludes that the existing SGT service is cross-subsidized by other services.

However, the Board is not convinced that Consumers' proposed toll design is appropriate. The Board notes that the entire delivery volume of Pointe-du-Lac could, for the most part, be consumed by the next downstream delivery point on the system.

Decision

The Board directs that TQM develop a toll design for Pointe-du-Lac SGT service which recovers an appropriate share of mainline costs and which reflects distances travelled by storage gas and that TQM submit its proposal with its 1996 toll application.

Chapter 9

Disposition

The foregoing chapters, together with Board Order TG-2-95, constitute our Reasons for Decision and our Decision in this matter.

R. Priddle
Chairman

K.W. Vollman
Vice-Chairman

A. Côté-Verhaaf
Member

R. Illing
Member

R.L. Andrew
Member

Calgary, Alberta
April 1995

Appendix I

Order TG-2-95

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

AND IN THE MATTER OF an Application by Trans Québec & Maritimes Pipeline Inc. ("TQM") for certain orders respecting tolls and tariffs made under sections 59, 60 and 65 of the Act filed with the National Energy Board ("the Board") under File No. 4200-T028-6.

BEFORE the Board on 6 April 1995.

WHEREAS by Application dated 20 September 1994, as revised, TQM sought approval from the Board, effective 1 January 1995 of fixed transportation tolls for transmission of natural gas through its pipeline facilities;

AND WHEREAS by Interim Order TGI-5-94, dated 22 December 1994, the Board ordered TQM to charge, in respect of the transportation service provided to TransCanada PipeLines Limited ("TransCanada"), an interim monthly toll for the 1995 test year of $5,602,000 commencing 1 January 1995;

AND WHEREAS, pursuant to Order RH-2-94, the Board held a public hearing to consider cost of capital issues affecting Group 1 pipelines, TQM being one of them;

AND WHEREAS the Board, in the RH-2-94 proceeding, approved for TQM a rate of return on common equity of 12.25% and a deemed common equity ratio of 30% for 1995;

AND WHEREAS pursuant to Order RHW-1-94 the Board examined, by way of written submission, the evidence of TQM and all parties with respect to the Application;

THEREFORE IT IS ORDERED THAT:

1. For accounting, tollmaking and tariff purposes, TQM shall implement procedures conforming to the Board’s decisions outlined in the RHW-1-94 Reasons for Decision and with this Order.

2. Order TGI-1-95, 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 at the end of the day 30 April 1995.

3. The tolls which were in effect, on an interim basis, for the period 1 January 1995 to 30 April 1995 are final.

4. TQM shall charge, in respect of its transportation service provided to TransCanada, a monthly toll of $5,302,667 for the period 1 May 1995 to 31 December 1995.

5. TQM shall reimburse TransCanada the aggregate amount of $913,455, being the amount by which tolls set by this Order are less than the tolls charged by TQM under Board Order TGI-1-95, together with carrying charges thereon to be calculated using the approved rate of return on rate base. Carrying charges on the January overpayment of $299,333 will be calculated from 20 February 1995 to 20 May 1995; carrying charges on the February overpayment of $299,333 will be calculated from 20 March 1995 to 20 May 1995; carrying charges on the March overpayment of $299,333 will be calculated from 20 April 1995 to 20 May 1995. TQM shall reflect this credit in its billing for services rendered in April 1995 by 10 May 1995.

6. TQM shall charge la Société en commandite Gaz Métropolitain ("Gaz Métropolitain"), in respect of storage services ("TS"), a toll based upon the TS tariff attached to the Transportation and Storage Service contract dated 17 March 1987, as amended, filed with the Board under covering letter dated 10 April 1987.

7. TQM shall charge Gaz Métropolitain, in respect of storage gas transportation ("SGT") services, a toll based upon the SGT tariff attached to the Storage Gas Transportation Service Contract dated 13 February 1990, as amended, filed with the Board under covering letter dated 20 February 1990.

8. TQM shall forthwith file with the Board and serve on all parties to RHW-1-94, new gas transportation tariffs including general terms and conditions, and tolls conforming with the decisions outlined in the Reasons for Decision dated April 1995 and with this Order.

9. Those provisions of TQM's tariffs and tolls or any portion thereof that are contrary to the RHW-1-94 Reasons for Decision or to any Order of the Board including this Order are hereby disallowed.

NATIONAL ENERGY BOARD

J.S. Richardson
Secretary