CANADA

National Energy Board

Reasons for Decision

Trans-Northern Pipelines Inc.

RHW-3-96

June 1996

Toll Settlement

National Energy Board

Reasons for Decision

In the Matter of

Trans-Northern Pipelines Inc.

Application dated 22 April 1996 for approval of an incentive toll settlement

RHW-3-96

June 1996

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Abbreviations

Act	National Energy Board Act
Board or NEB	National Energy Board
CPI	Consumer Price Index
TNPI, the Company or Trans-Northern	Trans-Northern Pipelines Inc.

Recital and Submittors

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

IN THE MATTER OF an application by Trans-Northern Pipelines Inc. dated 22 April 1996 for approval of an incentive toll settlement and associated toll orders pursuant to Part IV of the Act; and

IN THE MATTER OF National Energy Board Hearing Order RHW-3-96;

EXAMINED by means of written submissions.

BEFORE:

A. Côté-Verhaaf	Presiding Member
K.W. Vollman	Member
R.L. Andrew	Member

SUBMITTORS:

Ministry of Natural Resources of the Government of Québec

Petro-Canada Limited

Shell Canada Limited

Chapter 1

Background and Application

By application dated 22 April 1996, Trans-Northern Pipelines Inc. (TNPI, "Trans-Northern" or "the Company") applied to the National Energy Board ("NEB" or "the Board") pursuant to Part IV of the *National Energy Board Act* ("Act") for approval of an incentive toll settlement and associated orders for 1996 onward. Included in Trans-Northern's filing were letters of support from various shippers and interested parties.

On 9 May 1996, the Board decided to adopt a written procedure to consider the settlement reached between Trans-Northern and its shippers. It invited interested persons to comment on the settlement and to indicate whether they supported or opposed the settlement. Trans-Northern was allowed to submit reply comments. The Board received comments in support of the settlement from Shell Canada Limited, Petro-Canada Limited and the Ministry of Natural Resources of the Government of Québec, and received no comments against the settlement. On 28 May 1996, Trans-Northern filed its reply comments.

Trans-Northern's tolls were made interim effective 1 January 1996 by Order TOI-2-95. This order remained in effect until the Board rendered its final decision on the Company's application.

Chapter 2

Toll Settlement

The agreement between Trans-Northern and its shippers has been reproduced in its entirety in Appendix II. For a complete understanding or more details of the terms of the settlement, parties should refer to the original document.

The key features of the settlement are as follows:

1. The "starting point" revenue requirement for 1996 is set at $29,350,000;

2. The revenue requirement would be recalculated annually using the following "adjusting entries": Transportation Revenue Variance, Consumer Price Index ("CPI"), Income Sharing, Oil Gain/Loss, Unforeseen Events, Property Taxes, Legislated Changes, Requested Changes, Carrying Charges and an Income Tax Allowance;

3. Tolls would be set annually based on the revenue requirement and projected volumes;

4. The settlement covers the years 1996 to 2000 and extends thereafter unless written notice is received or served on shippers six months prior to the beginning of any year beyond the year 2000;

5. After-tax earnings above the threshold of $3,200,000 would be shared with shippers on a 50/50 basis;

6. The CPI adjustment would be reduced annually by an efficiency factor of up to 1% of controllable costs beginning in 1999; and

7. Relief is requested from the requirement to comply with all reporting and filing requirements of Order TO-9-90, including specific relief from the requirement to make a toll filing in the event forecast return on equity exceeds a specified approved level. Trans-Northern also requested an exemption from filing performance measure data as required in the Memorandum of Guidance dated February 1994.

Trans-Northern proposed that its existing tolls be made interim each 1 January with final tolls filed on or before 1 March. The difference between the interim tolls and the final tolls for the year would be retroactively billed or refunded in the month of March each year.

Prior to the end of February each year, Trans-Northern will file a copy of its financial statements together with a statement of the expected revenue requirement for the next year. This filing will include the throughput forecast for the next year as well as actual throughput for the previous year.

The settlement provides for the NEB or a shipper to audit the calculations performed by Trans-Northern in arriving at the annual revenue requirement and to verify the calculations used to determine the tolls that are set to collect the revenue requirement.

Negotiated Settlement Guidelines

The Board examined the settlement in the light of its *Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs* dated 23 August 1994. In particular, the Board was guided by the following provisions:

- All parties having an interest in a pipeline's traffic, tolls and tariffs should have a fair opportunity to participate and have their interests recognized and appropriately weighed in a negotiated settlement. The settlement process should be open and all interested parties should be invited to participate in the actual settlement negotiations.

- Upon filing of information related to a settlement, interested parties would be provided with an opportunity to comment on the settlement. Should the settlement not be opposed by any party, the Board would normally be able to conclude that the resultant tolls are just and reasonable without a public hearing.

- When presented with a settlement package, the Board will either accept or reject the package in its entirety.

Views of the Board

The Board is satisfied that all parties with an interest in the tolls of Trans-Northern have had an opportunity to inform themselves on the merits of the settlement and to comment on Trans-Northern's application and the settlement. The Board notes that no party has expressed opposition to any aspect of the agreement.

The Board also finds Trans-Northern's request for relief from all reporting and filing requirements pursuant to TO-9-90 and to the Memorandum of Guidance dated 16 February 1994 to be reasonable. The Board notes Trans-Northern's continued compliance with the *Oil Pipeline Uniform Accounting Regulations*.

Decision

The Board approves the settlement as filed and directs Trans-Northern to file final tolls for 1996 in accordance with this decision. Order TO-3-96 gives effect to this decision.

Chapter 3

Disposition

The foregoing constitutes our Decision and Reasons for Decision on this matter.

A. Côté-Verhaaf
Presiding Member

K.W. Vollman
Member

R.L. Andrew
Member

Calgary, Alberta
June 1996

Appendix I

Order TO-3-96

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

IN THE MATTER OF an application by Trans-Northern Pipelines Inc. ("Trans-Northern") dated 22 April 1996 for approval of an incentive toll settlement ("Agreement") for the years 1996 onward and associated toll orders pursuant to Part IV of the Act; filed with the National Energy Board under File No. 4200-T002-3.

BEFORE the Board on 21 June 1996.

WHEREAS Trans-Northern has applied for orders pursuant to Part IV of the Act fixing tolls which Trans-Northern may charge in the years 1996 onward for the transportation of refined petroleum products;

AND WHEREAS Trans-Northern, since 1 January 1996, has been charging the tolls approved by the Board in Order TOI-2-95 on an interim basis;

AND WHEREAS the Agreement has been negotiated with Trans-Northern's shippers and prescribes the method to be used to determine tolls for the years 1996 onward;

AND WHEREAS Trans-Northern requests that for 1997 and thereafter existing tolls calculated in accordance with the Agreement be charged on an interim basis effective 1 January pending the approval of final tolls to be filed on or before 1 March of that year;

AND WHEREAS Trans-Northern's shippers have indicated their support for Trans-Northern's application;

AND WHEREAS the Board has found Trans-Northern's final tolls for 1996 calculated in accordance with the Agreement to be just and reasonable;

IT IS ORDERED THAT:

1. The agreed-upon 1996 revenue requirement of $29.4 million and throughput forecast of 9 338 000 cubic metres are approved.

2. Order TOI-2-95, which authorized tolls that Trans-Northern may charge on an interim basis, effective 1 January 1996, is revoked and the tolls that have been authorized thereunder are hereby disallowed.

3. Trans-Northern is directed to refund or recover that part of the tolls charged by the Company under Order TOI-2-95, which is either greater or less than the tolls determined by the Board to

be just and reasonable in this Order, together with carrying charges on the amount so refunded or recovered calculated in accordance with the Agreement.

4. In any year of the settlement, tolls in effect shall be charged on an interim basis effective 1 January of the year which follows until final tolls for that year are approved by a further Order of the Board.

5. Trans-Northern shall on or before 1 March 1997, and each year thereafter, file with the Board and serve upon interested parties new tolls for that year calculated in accordance with the Agreement and supported by reasonable detail to permit confirmation of their compliance with the methodology set out in the Agreement.

6. In filing tolls with interested parties pursuant to paragraph 5, Trans-Northern shall advise these parties that they may file comments on the proposed tolls with the Board and Trans-Northern within ten calendar days from the date of filing.

7. Upon the issuance of final tolls for the year, Trans-Northern shall refund or recover the difference between final tolls and the tolls which have been charged on an interim basis pursuant to paragraph 5, together with carrying charges calculated in accordance with the Agreement.

NATIONAL ENERGY BOARD

J.S. Richardson
Secretary

Appendix II

Settlement Agreement

INCENTIVE TOLL PRINCIPLES OF SETTLEMENT

Between

TRANS-NORTHERN PIPELINES INC.
("TNPI")

and

SHIPPERS ON THE TNPI SYSTEM
("Shippers")

1.0 <u>INTRODUCTION</u>

1.1 TNPI is a body corporate incorporated under the laws of Canada, having its registered office in the Town of Richmond Hill, in the Province of Ontario. TNPI owns and operates a National Energy Board regulated refined petroleum products pipeline.

1.2 Shippers on the TNPI system account for 100% of the throughput on the system.

1.3 TNPI and the Shippers have negotiated the principles of the proposed settlement in respect of the establishment of the Revenue Requirement to be utilized by TNPI in the derivation of tolls on the TNPI system for the transportation of petroleum products to be effective for the period commencing January 1, 1996.

1.4 TNPI and the Shippers have agreed that TNPI should seek National Energy Board ("NEB") approval for the 1996 revenue requirement and for a future toll methodology containing certain incentive features, in accordance with the Toll Settlement contained herein.

1.5 It is intended that the incentive based Toll methodology contemplated by this Toll Settlement will better align the interest of TNPI and its toll payers by providing a framework which encourages cost efficiencies and the minimization of tolls for service, relative to the tolls which would have existed under a cost of service approach, and simultaneously permits TNPI an opportunity to increase profitability. Moreover, the proposal is intended to encourage maximization of throughput on the TNPI system, reduce burdens associated with the traditional cost of service regulation, and provide a long-term basis for efficient and effective toll regulation of TNPI.

1.6 TNPI and the Shippers have reached the Toll Settlement on a negotiated basis, and agree that no component of the Toll Settlement is to be construed as representing the position of any party on the appropriate result which would obtain in the absence of a negotiated settlement. The parties intend that the settlement be viewed as a whole, and that there should be no prejudice to the positions of any party in the future. No element of the Toll Settlement should be considered as acceptable to any party in isolation from all other aspects of the settlement. Specifically, TNPI and the Shippers confirm that the proportion of common equity to the total TNPI capitalization shall be maintained within the range as set out in the negotiated settlement approved by the NEB for TNPI in Board Order TO-3-95. TNPI and the Shippers intend that the Toll Settlement will be applicable solely to TNPI and will have no application to or form a precedent for other NEB-regulated pipelines.

2.0 <u>DEFINITIONS</u>

2.1 In this Toll Settlement the following terms have the meaning set out below:

a) <u>"adjusting entry" or "adjusting entries"</u>
An "adjusting entry" (entries) is an adjustment applied to the next year’s "revenue requirement".

b) <u>"carrying charge"</u>
The "carrying charge" means the carrying costs calculated on balances as of December 31 at the average of the 12 monthly Bank Rates published in the Bank of Canada Statistical Review plus 50 basis points.

c) <u>"controllable costs"</u>
"Controllable costs" are defined as the total variable costs, unrelated to pumping power, oil loss, interest charges, pipeline rents, taxes other than income taxes, depreciation expenses and NEB cost recovery expense.

d) <u>"earnings"</u>
"Earnings" shall be the net income excluding the after tax effect of the transportation revenue variance, carried forward from the previous year.

e) <u>"earnings threshold"</u>
"Earnings threshold" means the negotiated net income threshold of $3,200,000 above which sharing will take place on a 50/50 basis.

f) <u>"efficiency factor"</u>
"Efficiency factor" is defined as being the amount by which the annual adjustment for the change in the Consumers Price Index (CPI) is reduced for the years 1999 and following. This amount is equivalent to 1% of the "controllable costs".

g) <u>"forecast Consumer Price Index (CPI)"</u>
The "forecast Consumer Price Index (CPI)" means the most current forecast of the rate of change in the Consumer Price Index for Canada from the Conference

Board of Canada, Canadian Outlook, Economic Forecast, Winter Edition, for each applicable year, divided by 100.

h) "revenue requirement"
The "revenue requirement" is the amount of revenue required to be collected in a calendar year as calculated after application of "adjusting entries".

i) "start point"
The "start point" means the revenue requirement amount of $29,350,000 for the initial year (1996). This amount will be adjusted in future years to reflect the annual change in CPI and will be reduced in 1997 for a non-recurring project cost as shown in Section 4.2.

3.0 TERM

3.0 The parameters of the incentive tolling methodology that have been negotiated encompass the period beginning January 1, 1996 and continue for a minimum of five years. The parties intend that term of this agreement continues beyond the five year period until notice in writing is received by one of the parties to re-negotiate the agreement. The parties have agreed that such written notice must be given six months prior to such re-negotiation.

4.0 REVENUE REQUIREMENTS / TOLL CALCULATION

4.1 Calculation of Revenue Requirement and Tolls - 1996 Start Point
The calculation of the 1996 revenue requirement for TNPI indicates a "start point" for incentive tolling of $29,350,000. This has been calculated in accordance with current approved regulatory mechanisms and includes all expenses, an allowance for income taxes and an after tax "earnings threshold" of $3,200,000.

The proposed 1996 tolls will be calculated by use of the $29,350,000 "revenue requirement" and the accepted 1996 shipper nominations. Toll methodology will conform to that which has been accepted by the NEB in previous TNPI toll setting applications.

4.2 Calculation of Revenue Requirement and Tolls in Future Years - Mechanism
For the years 1997 and following, tolls will be calculated based on an adjusted "revenue requirement". The adjusted "revenue requirement" will be calculated as follows:

For 1997:

1996 Revenue Requirement		$29,350,000
plus/minus:	transportation revenue variance	xxx
less:	adjustment for non-recurring project costs in 1996	*($1,100,000)
plus:	projected change in CPI	xxx
plus/minus:	net of "adjusting entries"	xxx
less:	sharing of net income in excess of "earnings threshold"	(xxx)
plus/minus:	adjustment for income tax allowance	xxx
	Revenue requirement for 1997	xxx

Note: * The "revenue requirement" in 1997 will be reduced by $1,100,000 of project expenses that are related to specific projects that do not continue beyond 1996.

4.3 Adjusting Entries:

a) Transportation Revenue Variance (TRV):
The TRV is the difference between actual revenue earned and the "revenue requirement".

The TRV (±) is included in the "revenue requirement" for the following year. Overages are credited at 81% and shortfalls are debited at 86%.

Note: Costs are attracted at a steeper rate on revenue increases than they are reduced on revenue decreases. This is due to the steep hydraulic demand curve and the negating of power contract saving opportunities as pipeline throughput increases. Analysis indicates a delta of 5% in the costs associated with increased and decreased volumes. i.e. Each additional dollar in revenue attracts $0.19 in incremental power and operating costs while each dollar decrease in revenue saves $0.14.

b) CPI:
The CPI adjustment is the amount by which the start point is increased to reflect year over year changes in the CPI.

Beginning in Year 4 of the agreement (1999) and thereafter, the adjustment for CPI will be reduced by a 1% "efficiency factor". (In the event that the change in CPI is less than 1%, the lesser change shall be applied.)

c) Net Income Sharing
The "earnings threshold" is $3,200,000 for the period of the agreement. Increases in after tax "earnings" above the "earnings threshold" will be shared on a 50/50 basis between TNPI and shippers. The 50% shared amount will reduce the transportation revenue requirement in the following year.

d) Other "Adjusting Entries"

(i) Oil Gain/Loss:

Included in the determination of the 1996 start point is an amount for oil loss of $300,000. This provision includes both the measurement gain or loss and downgrade expenses caused by normal operations. This figure is based on the historical amounts that have been included in the cost of service, as approved by the NEB.

Gains or losses above or below the $300,000 level will be shared on a 50/50 basis through an "adjusting entry" which will reduce or increase the transportation revenue requirement in the following year.

(ii) Unforseen Events:

An adjustment will be made for unforseen events in excess of $60,000 per occurrence. Unforseen events are described as unplanned, unbudgeted items such as an Act of God, leak damages and repairs, major equipment malfunctions and other items of an unplanned nature.

(iii) Property Taxes:

An adjustment will be made for increases in municipal property taxes if the year over year increase in these taxes exceeds 5%.

(iv) Legislated Changes:

An adjustment will be made to reflect costs incurred by legislated changes. e.g. New taxes, changes to income tax rates or methods, government requirements for safety, health or environmental, NEB orders, etc.

(v) Requested Changes (Industry/Regulatory):

An adjustment will be made for costs incurred for significant industry or regulatory requests for service not currently provided. e.g. capital additions requested by shippers, NEB, etc.

(vi) Carrying Charge:

All adjustments, debit and credit, will be subject to a "carrying charge".

An allowance for income taxes will be calculated on items (i) through (v).

5.0 TOLLS

Shippers shall continue to supply nominations of volumes to be shipped in accordance with the Conditions of Transportation published by TNPI, from time to time. These nominations shall form the basis for determining the throughput for the next year.

Tolls shall be made interim each January 1 with fixed tolls set for March 1. The difference between the interim tolls and the fixed tolls for the year will be retroactively billed or refunded in the month of March each year.

Annual tolls will be calculated based on the "revenue requirement" for the year using established toll methodology and will include applicable "carrying charges".

6.0. REPORTING AND FILING REQUIREMENTS

Each year TNPI shall file with the NEB and provide upon request from shippers or interested parties a copy of its financial statements together with a statement of the expected "revenue requirement" for the next year.

7.0 AUDIT RIGHTS

The NEB or a shipper shall have the right to audit, or at their expense to have an external auditor audit, the calculations performed by TNPI in arriving at the annual revenue requirement and to verify the calculations used to determine the tolls that are set to collect the revenue requirement.

8.0 DISPUTE SETTLEMENT

Tolls set by TNPI shall be filed pursuant to Section 60(1)(a) of the NEB Act each year. The NEB shall have jurisdiction over both the setting of the tolls and of any disputes that arise.

Table A2-1
Schedule 1
Net Revenue Requirement
$ 000

Line	Description	Supporting Schedule	1997
1	**Prior Year's Start Point**		29,350
2	Less adjustment for non-recurring project costs in 1996		(1,100)
3	Inflation variance	Sch #9	0
4	Subtotal		28,250
5	Projected change in CPI (e.g. 2.5% in 1997) (Line 4 x CPI)		706
6	Less: Efficiency Adjustment (after year 3)	Sch #3	0
7	Start Point		28,956
8	**Plus/Minus Adjusting Entries:**		
9	Transportation Revenue Variance (TRV)	Sch #2	(365)
10	Oil Gain/Loss	Sch #4	(50)
11	Unforseen Events	Sch #5	80
12	Property Taxes	Sch #6	99
13	Legislated Changes	Sch #7	47
14	Requested Changes	Sch #8	0
15	Carrying Charges	Sch #11	(26)
16	Less: Sharing of "Earnings" in excess of "Earnings Threshold"	Sch #10	(188)
17	Plus/Minus: Adjustment for income tax allowance		0
18	**Net Revenue Requirement**		28,553

Table A2-2
Schedule 2
Transportation Revenue Variance (TRV)
$ 000

Line	Description		1996
1	Actual Transportation Revenue		29,800
2	Less: Forecast Net Revenue Requirement		29,350
3	Transportation Revenue (Shortfall)/Overage		450
4	Adjustment	@ 81% for overage @ 86% for shortfalls	365
5	**Transportation Revenue Adjustment Amount** Total amount to adjust the following year's Revenue Requirement		(365)

Table A2-3
Schedule 3
Efficiency Adjustment (after year 3)
$ 000

Line	Description		Year 4
1	Total Operating Expenses		xx,xxx
2	Less:	Pumping power	x,xxx
3		Oil loss (gain)	x,xxx
4		Interest charges	x,xxx
5		Pipeline rents	x,xxx
6		Taxes other than Income taxes	x,xxx
7		Depreciation	x,xxx
8		NEB cost recovery expense	x,xxx
9		Total controllable expenses	x,xxx
10	Efficiency Factor = 1%		
11	Efficiency Adjustment (1% of line 9)		xx

Table A2-4
Schedule 4
Oil Gain/Loss Adjustment
$ 000

Line	Description	1996
1	Actual oil loss (gain)	200
2	Less: Allowed oil loss (gain)	300
3	Oil loss/gain sharing amount	(100)
4	50% of sharing amount	(50)

Table A2-5
Schedule 5
Unforseen Events
Costs in excess of $60,000 per occurrence
$ 000

Line			Total Costs
	Event #1	**Description: e.g. Major equipment repair**	
1		Operating costs	80
	Event #2	**Description**	
2		Operating costs	0
3	**Total**	**Unforseen Events**	80

Table A2-6
Schedule 6
Property Tax Adjustment
$ 000

Line	Description	1996
1	Property taxes - base (prior year's actual)	2,144
2	Plus allowed 5% increase	107
3	Subtotal	2,251
4	Less: Actual property taxes	2,350
5	Excess property taxes (if positive) *	99

* If negative then there is no adjustment

Table A2-7
Schedule 7
Legislated Changes
e.g. a new 2% surtax
$ 000

Line	Description	2% Surtax
1	Income tax before surtax	2,331
2	Income tax effect of a 2% surtax	47
3	Adjustment amount	47

Table A2-8
Schedule 8
Requested Changes
$ 000

Line			Total Costs
	Request #1	**Description:**	
1		Operating costs	0
	Request #2	**Description**	
2		Operating costs	0
3	**Total**	**Requested Changes**	0

Table A2-9
Schedule 9
Inflation Variance
(for years after 1996)
$ 000

Line	Description	1998
1	Base for CPI calculations (Line 7 (prior year), Schedule 1)	28,956
2	Actual inflation factor (prior year)	2.0%
3	Forecast inflation factor (prior year)	2.5%
4	Variance (line 2 - line 3)	-0.5%
5	Inflation variance adjustment (line 1 x line 4)	(145)
6	**Inflation Variance** Total amount to be credited to following year's Revenue Requirement	(145)

Table A2-10
Schedule 10
Net Income Sharing Adjustment
$ 000

Line	Description	1996
1	Net income before sharing	3,416
2	Threshold earnings	3,200
3	Net income sharing amount	216
4	50% of sharing amount (after tax) (Line 3 x 50%)	108
5	Sharing amount (before tax) (Line 4 / (1 - 0.426)	188

Table A2-11
Schedule 11
Carrying Charges
$ 000

	From Schedule #	Adjusting Entries
Transportation Revenue Variance	Sch #2	(365)
Oil Gain/Loss	Sch #4	(50)
Unforseen Events	Sch #5	80
Property Taxes	Sch #6	99
Legislated Changes	Sch #7	47
Requested Changes	Sch #8	0
Inflation Variance	Sch #9	0
Net Income Sharing	Sch #10	(188)
Change in Income Tax Allowance		0
Subtotal of Adjusting Entries		(377)
Carrying Charges @ 7%		(26)