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April 30, 2007

Ontario Energy Board
P.O. Box 2319
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Toronto, Ontario
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By e-mail
Original by courier

Attention: **Ms. Kirsten Walli**
Board Secretary

Dear Ms. Walli:

Subject: **Multi Year Incentive Rate Regulation for Natural Gas Utilities**
OEB File No. EB-2006-0209
TransCanada PipeLines Limited ("TransCanada")
Submission regarding Incentive Regulation Discussion Papers

As per the Board's letter dated March 30, 2007, TransCanada submits its comments on the Discussion Paper entitled "Price Cap Index Design for Ontario's Natural Gas Utilities" ("PEG Study").

Please contact me at (403) 920-7165 should the Board have any questions about TransCanada's submission.

Yours truly,

Original Signed By

Jim Bartlett
Manager, Regulatory Research & Analysis

Ontario Energy Board ("OEB")
Comment on Incentive Regulation Discussion Papers
Submission of TransCanada PipeLines Limited ("TransCanada")

TransCanada plays a major role in serving the Ontario natural gas market. The integrated TransCanada Mainline System has the capacity to deliver 5,200 TJ/d of natural gas into Ontario, making it an important supplier to the Ontario market. TransCanada contracts for Union M12 and C1 transportation capacity as a component of its integrated system. In 2006, TransCanada held M12 Dawn to Parkway capacity totalling 312,250 GJ/d, M12 Dawn to Kirkwall capacity totalling 1,175,488 GJ/d and C1 Parkway to Kirkwall capacity of 128,316 GJ/d. The total cost paid by TransCanada to Union in 2006 for this transportation service was $40.8 million. Since M12 and C1 rates are included in the Incentive Regulation model proposed by the OEB, there can be major cost impacts on TransCanada.

TransCanada supports the objective of increased efficiency in the regulatory process, and recognizes that multi-year incentive regulation models can be used to reach this objective. However, TransCanada is of the view that these models must be carefully designed so that rates continue to be just and reasonable, and that this is an objective best achieved by ensuring that rates reflect the cost of providing service. TransCanada has reviewed the Discussion Paper "Price Cap Index Design for Ontario's Natural Gas Utilities" ("PEG Study") prepared by Pacific Economics Group LLC ("PEG") for the OEB, and has identified a number of concerns in regard to whether the models discussed therein will ensure rates continue to be just and reasonable. TransCanada's comments will focus on these concerns.

TransCanada's first concern is that the Price Cap Index ("PCI") calculated for Union Gas Limited's ("Union") non-residential customers does not correspond with historical rate trends and no explanation is provided to justify a significant variation from those trends.

Historical "Price of Transmission to Parkway"[1] information is provided in the following table:

Year	Price of Transmission to Parkway[2]
2004	$2.33
2003	$2.49
2002	$2.55
2001	$2.56
2000	$2.55

This rate has decreased from $2.55 to $2.33 from 2000 to 2004, or 8.6%. Clearly the cost based trend has been a reduction in Dawn to Parkway transmission rates over time. This compares to PEG's proposed Price Cap Index of +2.79% per year for Union non-residential customers which TransCanada assumes would be applied to M12 and C1 rates. This historical information provides a strong indication that the PCI factors calculated for the non-residential customer group in the PEG Study do not reflect cost and thus are not just and reasonable.

TransCanada's second concern is that it appears that data for M12 and C1 services was not included in the PEG Study, resulting in the cost causation characteristics of these customer groups being ignored by PEG. In order to ensure that rates continue to reflect costs, the M12/C1 customer class costs and utilization patterns should be considered within the non-residential customer grouping when the PCI for this group is determined.

TransCanada's third concern involves the application in the PEG Study of the average use factor, which is a component of the PCI calculation. The purpose of the average use factor is to reflect in the PCI the fact that residential and commercial customers use less gas through time as they obtain more efficient furnaces, improve insulation, etc. Including this factor allows utility rates for residential and commercial customers to

[1] PEG spreadsheet column AV.
[2] PEG spreadsheet column AV.

increase in the face of declining average use to keep the utility whole. However, declining average use is not observed in the non-residential customer group and so the declining average use factor should not apply to this group. This is not reflected in the PEG Study. Instead, a declining average use factor is applied to all customer classes including non-residential. In TransCanada's view, applying an average use factor to non-residential customers leads to cross-subsidization and the decoupling of non-residential rates from the costs of providing these services. In order to ensure just and reasonable rates going forward, the average use factor should not be applied to the non-residential customer classes

TransCanada's fourth concern relates to the use of the special adjustment factor ("ADJ") in the PEG Study and, in particular, the results obtained for Union's non-residential service group. The PEG Study provides, at page 63, that the result for the non-residential services "is something of an anomaly". TransCanada agrees, noting that Enbridge's ADJ factor set out at page 63 is 1.88% higher than Union's, and is more than the GDP IPI trend of 1.77%. It is unclear how these ADJ factors are calculated in the PEG Study. TransCanada requests that a re-calculation and more detailed explanation of the ADJ factor for Union's non-residential rate classes be provided in a future version of the PEG Study.

In conclusion, TransCanada is of the view that the multi-year incentive regulation model must be carefully designed so that rates continue to be just and reasonable, and that this can be best achieved by ensuring that rates reflect, as closely as possible, the cost of providing service. In summary, TransCanada's concerns with the PEG Study include a concern that the proposed PCI for the Union non-residential service group does not reflect historical experience which, absent evidence to the contrary, should be reflective of future trends. TransCanada is also concerned that in order to accurately calculate a PCI for non-residential customers, an average use factor must not be applied and the ADJ factor must be clearly explained and recalculated.