

1 **7.0 DEFERRAL AND RESERVE ACCOUNTS**

2 **7.1 INTRODUCTION**

3 **Q1. What is the purpose of this evidence?**

4 A1. NGTL describes in this section the general concepts governing the use of deferral and
5 reserve accounts, the specific accounts it proposes for 2004 and its reasons for each of
6 them.

7 **Q2. What are the deferral and reserve accounts NGTL is applying for in 2004?**

8 A2. NGTL proposes the following deferral accounts:

- 9 • Revenue;
- 10 • Future Legislative Tax Changes and Reassessments of Income and Large
11 Corporation Taxes;
- 12 • Pipeline Integrity;
- 13 • Foreign Exchange Gains/Losses on Interest Payments;
- 14 • Transportation by Others;
- 15 • CO₂ Management Service; and
- 16 • Utility Tap Facility.

17 NGTL proposes the following reserve accounts:

- 18 • Regulatory Hearing Costs and
- 19 • Foreign Exchange.

20 **7.2 DEFERRAL AND RESERVE ACCOUNT MECHANICS**

21 **Q3. When are deferral and reserve accounts appropriate?**

22 A3. Deferral and reserve accounts are appropriate where factors beyond NGTL's reasonable
23 control create material and unmanageable risk for the company and its customers. These
24 accounts are used to record variances between forecast and actual costs or revenues, so

1 that customers bear the actual costs and experience the results of the actual revenue that
2 they generate.

3 **Q4. What are the criteria used to determine the need for specific deferral accounts?**

4 A4. In EUB Decision U96001 (page 167), the Board stated that it:

5 ... agrees with the establishment of deferral accounts by NGTL in
6 circumstances where:

- 7 (1) NGTL is not able to accurately forecast the cost or revenue;
8 (2) the cost or revenue cannot be reasonably controlled; and,
9 (3) the potential variance is material.

10 In addition to the circumstances contemplated in Decision U96001, deferral accounts
11 may also be appropriate in instances where a new service is being provided, whether due
12 to the inherent uncertainty involved in the new service, due to customer requests that a
13 deferral account be used, or both. NGTL believes these criteria are met for each of the
14 deferral accounts requested for 2004.

15 **Q5. How will the deferral accounts work?**

16 A5. NGTL will record the variances between the forecast revenue or cost and the actual
17 amounts collected or incurred for each cost or revenue item in the appropriate deferral
18 account on a monthly basis. Carrying charges or credits will be calculated, at the overall
19 rate of return, on the balance in each deferral account at the end of each month and
20 recorded in the respective deferral account.

21 In the subsequent test year, NGTL will provide information on the balances existing in
22 each of the deferral accounts. These balances, and the disposition of such, will be
23 subject to the review and approval of the Board.

24 **Q6. How do reserve accounts differ from deferral accounts?**

25 A6. Reserve accounts are used for costs that are material and provide benefits over a longer
26 period of time but which are paid infrequently or at unpredictable intervals. The intent of
27 a reserve account is to set up a reserve for infrequent costs by collecting a fixed amount

1 monthly. The monthly amount collected is added to the reserve account and actual costs
2 incurred are then paid from this account. This differs from the intent of a deferral
3 account, which is to manage variances between forecast and actual costs. Variances
4 between the amounts collected and actual costs incurred can also occur in reserve
5 accounts. In these instances, such variances would be subject to review and disposition
6 by the Board.

7 Reserve accounts also differ from deferral accounts in the area of carrying charges.
8 Instead of calculating carrying charges on the balance, NGTL is proposing in this
9 Application that reserve account balances be included as a component of rate base. As
10 such, the balances are included in the operating return calculation on a monthly basis.

11 In NGTL's 1995 GRA, reserve accounts were treated as no cost capital. As has been
12 mentioned, NGTL is proposing to include them in rate base in this Application. NGTL
13 considers reserve accounts to be working capital, as opposed to a source of financing,
14 and believes that they are more appropriately included in rate base with other working
15 capital. In addition, this treatment will further align accounting practices amongst the
16 regulated business of NGTL's parent, TCPL, which serves to improve efficiency.

17 **7.3 HISTORICAL USE OF DEFERRAL AND RESERVE ACCOUNTS**

18 **Q7. Were any of the requested deferral and reserve accounts approved in the 1995** 19 **GRA?**

20 A7. Yes, the Foreign Exchange Gains/Losses on Interest Payments, the Transportation by
21 Others and the Future Legislative Tax Changes and Reassessment of Income and Large
22 Corporation Taxes deferral accounts are the same as deferral accounts approved in
23 Decision U96001. Also, the Firm Service Demand Revenue and the Throughput Volume
24 Revenue deferral accounts that were approved in Decision U96001 have been combined
25 into the Revenue deferral account in this GRA. Finally, the Board approved the use of
26 the Regulatory Hearing Costs reserve account in Decision U96001.

1 **Q8. What happened to those deferral accounts during the term of the Cost Efficiency**
2 **Incentive Settlement (CEIS)?**

3 A8. The Firm Service Demand Revenue and Throughput Volume Revenue deferral accounts
4 continued to be used during the term of the CEIS. The ability to recover the costs of new
5 programs related to pipeline integrity through a non-routine adjustment mechanism was
6 also a provision of the CEIS. All other deferral accounts were placed in abeyance under
7 the conditions of Article 19.4 of the CEIS. The CEIS also provided for the deferral
8 accounts to be reinstated at the end of the agreement.

9 **Q9. Were any of the requested 2004 deferral and reserve accounts used during the term**
10 **of the 2001/2002 Alberta System Rate Settlement (ASRS)?**

11 A9. Yes. The Firm Service Demand Revenue and Throughput Volume Revenue deferral
12 accounts, which are combined into the Revenue deferral account in this GRA, were used
13 during the term of the ASRS. The ASRS also included pipeline integrity cost variances
14 and variances due to tax reassessments or changes in tax rates as non-routine
15 adjustments. Finally, the ASRS introduced the Foreign Exchange reserve account that is
16 being applied for in this Application.

17 **Q10. Were any of the requested 2004 deferral and reserve accounts used during the term**
18 **of the 2003 Alberta System Revenue Requirement Settlement (ASRRS)?**

19 A10. Yes. The Firm Service Demand Revenue and Throughput Volume Revenue deferral
20 accounts, which are combined into the Revenue deferral account in this GRA, were used
21 during the term of the ASRRS. The ASRRS also included the Foreign Exchange reserve
22 account and included the CO₂ Management Service Variance, pipeline integrity cost
23 variances, and variances due to tax reassessments or changes in tax rates as non-routine
24 adjustments.

1 **Q11. Are any of the deferral and reserve accounts being requested new?**

2 A11. Yes, the Utility Tap Facility account relates to a new program being implemented. Each
3 of the other deferral and reserve accounts requested by NGTL for 2004 has been used at
4 some point in the past.

5 **7.4 DEFERRAL ACCOUNT DESCRIPTIONS**

6 **7.4.1 Revenue Deferral Account**

7 **Q12. Is the Revenue deferral account a new deferral account?**

8 A12. NGTL is proposing to combine the Firm Service Demand Revenue and Throughput
9 Volume Revenue deferral accounts that have been used in previous years into one
10 account called the Revenue deferral account.

11 NGTL believes a simplified, clearer picture is presented by combining these two
12 accounts.

13 **Q13. What will be included in the Revenue deferral account?**

14 A13. The Revenue deferral account will include the same items previously captured in the
15 Firm Service Demand Revenue and Throughput Volume Revenue deferral accounts,
16 specifically:

17 1. Variances in revenues resulting from actual Firm Transportation Contract
18 Demand revenue differing from the forecast of Firm Transportation Contract
19 Demand revenue used in establishing the 2004 test year rates. This includes all
20 variances related to all Firm Transportation.

21 2. Variances in revenues resulting from actual Interruptible Transportation Services
22 revenue differing from the forecast of Interruptible Transportation Services
23 revenue used in establishing the 2004 test year rates. This includes all variances
24 from interruptible receipt and interruptible delivery revenues, as well as revenues

1 from alternate access deliveries, Facilities Connection Service and Other
2 Services.

3 **Q14. Why is this deferral account required?**

4 A14. NGTL has developed rates for the 2004 GRA based on a forecast of the amount of Firm
5 Transportation Contract Demand and Interruptible Transportation that will be in place
6 with customers throughout 2004.

7 Three main factors, described below, affect the level of Firm Transportation contract
8 demand and are difficult to forecast.

9 **1. Renewal of Firm Transportation Contracts**

10 Customers can renew Firm Transportation Contracts one year prior to the
11 termination date. However, a substantial portion of the system total contract
12 demand is eligible for renewal in late 2004 and the uncertainty associated with
13 the renewal of Firm Transportation contracts is significant.

14 **2. Incremental Requests for Firm Transportation**

15 As there is capacity available, the Alberta System customers may be able to
16 obtain Firm Transportation to match the dynamics of the marketplace. As a
17 result, NGTL has included a forecast of incremental firm transportation for 2004.
18 However, due to the dynamics of the marketplace, the amount is difficult to
19 forecast with reasonable accuracy.

20 **3. Delay and Cancellation of Firm Transportation**

21 Under certain circumstances, NGTL will allow customers to delay the billing
22 commencement date of Firm Transportation. Delay of billing commencement is
23 generally not more than six months and results from changes in customers'
24 facilities development and business plans. The corresponding delay is then added
25 to the end of the contract to ensure that the original term as determined by
26 NGTL's Economic Criteria for Determining Contractual Obligation remains

1 intact. Also, Alberta System customers may cancel their requests for Firm
2 Transportation pursuant to NGTL's Project and Expenditure Authorization,
3 resulting in reimbursement to NGTL for any costs that have been incurred. These
4 two factors create uncertainty in NGTL's forecast of firm transportation demand.

5 There is also uncertainty in forecasting total throughput and the amount that will be
6 contracted for Interruptible Transportation Services. Market volatility makes it difficult
7 to accurately forecast the utilization of individual services. In addition, after NGTL has
8 billed these volumes to customers, common stream operator throughput volume
9 reallocations can create revenue variances.

10 **7.4.2 Future Legislative Tax Changes and Reassessments of Income and Large** 11 **Corporation Taxes Deferral Account**

12 **Q15. What is the purpose of the Future Legislative Tax Changes and Reassessments of** 13 **Income and Large Corporation Taxes deferral account?**

14 A15. The purpose of this account is to capture variances between forecast and actual income
15 tax and Large Corporation Tax resulting from new taxes or legislative changes to
16 existing rates or regulations. In addition, any taxes paid or refunds received as a result of
17 reassessments by government authorities will be recorded in this account.
18 Reassessments may, in some cases, be in respect of taxation years several years prior to
19 2004. Variances due to changes in taxable income that are not due to legislative
20 changes, such as differences in equity return or depreciation expense, are not included in
21 this account.

22 **Q16. Why is the Future Legislative Tax Changes and Reassessments of Income and** 23 **Large Corporation Taxes deferral account required?**

24 A16. NGTL has based its test year forecast of income tax and Large Corporation Tax on
25 income tax and Large Corporation Tax rates and rules as presently legislated. However,
26 2004 tax rates could be different from the currently legislated rates, in particular for
27 provincial income tax as tax rate reductions have been announced but not enacted. The
28 actual rates will not be known until government budgets for 2004 are tabled. At both a

1 federal and provincial level, there exist uncertainties that could impact tax rates or lead
2 to the imposition of new taxes or the elimination of existing taxes.

3 The impact of potential reassessments is another factor that cannot be forecast with
4 reasonable accuracy. NGTL is unable to forecast either the timing or amount of
5 reassessments because of the many uncertainties surrounding the timing and length of
6 audits. The final amount is not known until audits are completed and the reassessments
7 subsequently received.

8 **7.4.3 Pipeline Integrity Deferral Account**

9 **Q17. What is the purpose of the Pipeline Integrity deferral account?**

10 A17. The purpose of this account is to capture the variances resulting from differences
11 between actual and forecast pipeline integrity costs in 2004. These costs include both
12 pipeline integrity operating expenses and capital-related pipeline integrity costs.

13 **Q18. Why is the Pipeline Integrity deferral account required?**

14 A18. NGTL's pipeline integrity program is a critical factor in maintaining the safety and
15 reliability of the pipeline system.

16 The program is, by nature, cyclical. For example, hydrostatic testing and in-line
17 inspections are repeated on a multi-year periodic basis. The program involves testing
18 and inspecting the system to identify potential weaknesses and to correct them before
19 they lead to major problems. The results obtained from the inspections and testing
20 determine the extent of further work required. Often this work occurs in the same
21 calendar year as the inspection. Therefore, it is difficult to reliably forecast the level of
22 expenditures that will be required for the upcoming test year.

1 **7.4.4 Foreign Exchange Gains/Losses on Interest Payments Deferral Account**

2 **Q19. What is the purpose of the Foreign Exchange Gains/Losses on Interest Payments**
3 **deferral account?**

4 A19. The purpose of this account is to capture the variances resulting from differences
5 between actual and forecast foreign exchange gains and losses on foreign-denominated
6 debt interest payments in 2004.

7 **Q20. Why is the Foreign Exchange Gains/Losses on Interest Payments deferral account**
8 **required?**

9 A20. The Alberta System's capital structure includes of a number of foreign debt issues.
10 Historically, NGTL has required the flexibility to access non-Canadian markets to
11 maintain its capital program. A natural consequence of this type of financial flexibility is
12 the possibility of foreign exchange gains and losses on interest payments and debt
13 principal repayments. NGTL's exposure is substantial. During 2004, NGTL will have
14 long-term foreign debt in excess of U.S. \$570 million (net of swaps) with an annual debt
15 interest expense in excess of U.S. \$45 million.

16 The Canadian dollar has recently experienced unprecedented volatility against the U.S.
17 dollar ranging from a low of \$1.6132 CAD/USD on January 18, 2002 to a high of
18 \$1.3342 CAD/USD on June 18, 2003. In light of these movements, the Canadian dollar
19 value of U.S. dollar interest payments could vary materially during the test year. For
20 example, a \$0.20 swing in the Canadian dollar versus the U.S. dollar could result in a \$9
21 million variance. NGTL cannot effectively hedge this foreign exchange exposure due to
22 the time lag between the date of filing and the date of decision on this Application. As a
23 result, NGTL cannot reasonably forecast nor control these costs.

1 **7.4.5 Transportation by Others Deferral Account**

2 **Q21. What is the purpose of the Transportation by Others deferral account?**

3 A21. The purpose of this account is to capture the variances resulting from differences
4 between actual and forecast costs for Transportation by Others (TBO) in 2004.

5 **Q22. Why is the Transportation by Others deferral account required?**

6 A22. Underpinning the forecasts of the 2004 TBO costs are significant uncertainties
7 surrounding new TBO arrangements which may result in material costs variances
8 between forecast and actual costs. These uncertainties include the timing of the approval
9 of the TBO service with Ventures, timing of the approval of the Simmons pipeline
10 system acquisition, and the potential TBO arrangement for the service on the Kearn Lake
11 pipeline. Each of these arrangements are discussed in detail in Section 8 of this
12 Application. As these uncertainties are largely beyond NGTL's control, and the
13 resulting cost variances may be material, NGTL has determined that a Transportation by
14 Others deferral account is appropriate for 2004.

15 **7.4.6 CO₂ Management Service Deferral Account**

16 **Q23. What is the purpose of the CO₂ Management Service deferral account?**

17 A23. The purpose of this account is to capture the variance between forecast and actual
18 revenues and forecast and actual costs attributable to the CO₂ Management Service in
19 2004. Any incentive earned by NGTL under the provisions of the CO₂ incentive
20 mechanism will also be recorded in this account.

21 **Q24. Why is the CO₂ Management Service deferral account required?**

22 A24. In accordance with EUB Decision 2002-84 approving the CO₂ Management Service, the
23 difference between the revenues generated by the CO₂ Management Service and all
24 associated costs will be recorded in a deferral account. The balance in the deferral
25 account, minus incentive revenue earned by NGTL, will be applied to the system-wide
26 revenue requirement in the subsequent year.

1 **7.4.7 Utility Tap Facility Deferral Account**

2 **Q25. What is the purpose of the Utility Tap Facility deferral account?**

3 A25. This account will capture amounts paid by NGTL in 2004 to Local Distribution
4 Companies (LDCs) for reimbursement of costs incurred by the LDCs to repair facilities
5 affected by gas quality-related incidents. NGTL has not forecast any of these costs in the
6 2004 revenue requirement requested in this Application. Rather, NGTL will accrue costs
7 incurred in 2004 in this deferral account and will seek to recover such costs as part of its
8 2005 revenue requirement. The maximum aggregate amount to be charged to this
9 account in 2004 will not exceed \$50,000.

10 **Q26. Why is the Utility Tap Facility deferral account needed?**

11 A26. This deferral account is required as a result of the establishment of the Gas Delivery
12 Quality – Gas Quality at Utility Tap Facilities Process (the “Process”). The Process
13 addresses concerns with gas quality at utility tap facilities connected to the Alberta
14 System and provides for the establishment of this deferral account.

15 The Process received the support of the TTP through an unopposed vote on Resolution
16 T2000-16 on June 10, 2003. The Board accepted the resolution as a filing for
17 information in a letter dated July 14, 2003.

1 **7.5 RESERVE ACCOUNT DESCRIPTIONS**

2 **7.5.1 Regulatory Hearing Costs Reserve Account**

3 **Q27. What is included in the Regulatory Hearing Costs reserve account?**

4 A27. This reserve account will reflect the net balance of the Regulatory Hearing Costs amount
5 collected during the 2004 test year offset by actual costs incurred. Such costs will only
6 be reimbursed following approval by the EUB.

7 Three kinds of costs will be captured in the Regulatory Hearing Costs reserve account:

- 8 (1) The portion of the Board's annual funding assessment payable by NGTL;
- 9 (2) Intervenor costs as approved by the Board; and
- 10 (3) NGTL's external hearing costs, which include legal and consultant's fees, as
11 approved by the Board.

12 **Q28. Why is the Regulatory Hearing Costs reserve account needed?**

13 A28. The reserve account is required because NGTL is unable to accurately forecast the
14 amount or timing of the costs of regulatory proceedings for 2004. In addition to this
15 Phase 1 portion of the 2004 GRA, NGTL will incur costs related to other regulatory
16 proceedings, such as the Generic Cost of Capital Proceeding and the Phase 2 portion of
17 the 2004 GRA. NGTL has limited ability to control its regulatory hearing costs and
18 intervenor costs, which are driven by factors such as the need, timing, duration and
19 complexity of regulatory proceedings.

20 NGTL is applying for a reserve account for 2004 based on its return to the GRA process
21 after a period of negotiated settlements. The establishment of this account will facilitate
22 the process of Board approval of Regulatory Hearing Costs prior to their reimbursement
23 through this reserve account. This is consistent with the Board's stated objective when it
24 first approved the Hearing Costs reserve account to "bring administration of cost awards
25 within the effective control of the Board."

1 **7.5.2 Foreign Exchange Reserve Account**

2 **Q29. What is the purpose of the Foreign Exchange reserve account?**

3 A29. The Foreign Exchange reserve account is a continuation of the account established
4 under Article 7 of the ASRS and continued under the ASRRS. As a result, the balance as
5 at December 31, 2003 will be carried forward as the opening 2004 test year balance.
6 This balance represents the net of the Annual Foreign Exchange Amortization Amounts
7 collected and actual Foreign Exchange Gains or Losses incurred throughout 2001, 2002,
8 and 2003.

9 Throughout 2004, the balance of this account will be adjusted by:

- 10 (1) The 2004 Annual Foreign Exchange Amortization Amount collected and
11 (2) Actual foreign exchange gains or losses incurred on foreign-denominated debt
12 maturities during 2004.

13 During the terms of the ASRS and ASRRS, carrying charges were calculated on the
14 balance in the Foreign Exchange reserve account. In this Application, the Foreign
15 Exchange reserve account is included in rate base, thus affecting operating return.

16 **Q30. Why is the Foreign Exchange reserve account required?**

17 A30. The use of the Foreign Exchange reserve account is part of a mechanism that was
18 developed in the ASRS as a means of improving intergenerational equity on the
19 recovery of foreign exchange gains/losses incurred when U.S. dollar debt principal
20 amounts are repaid. Section 2.8.2 of this Application explains this mechanism in further
21 detail.

22 Foreign exchange gains/losses on U.S. dollar debt principal relate to long-term debt
23 issues that provide financing for many years. However, the cash impact of the
24 gains/losses incurred on these issues does not occur until each issue matures and is
25 repaid. Therefore, in order to improve intergenerational equity between the use of the

1 financing provided by the debt issue and the cash gain/loss incurred, a reserve account
2 is requested.

3 NGTL will record the amortization of foreign exchange gains or losses on foreign
4 currency debt principal in the reserve account. This reserve will be used to accumulate
5 the necessary funds to pay for gains or losses incurred when NGTL repays its foreign
6 debt principal. As foreign debt is repaid, the exchange gains or losses attributable to that
7 debt will be applied to the balance in the reserve account. When all of the foreign debt
8 has been repaid, which is expected to be in 2029, any remaining balance in the reserve
9 account will be disposed of through the following year's revenue requirement.

10 **7.6 1995 DEFERRAL AND RESERVE ACCOUNT BALANCES AND DISPOSITION**

11 **Q31. How has NGTL disposed of the 1995 deferral and reserve account balances?**

12 A31. In accordance with Article 19.4 of the Cost Efficiency Incentive Settlement (CEIS)
13 which went into effect on January 1, 1996, the December 31, 1995 balances in the
14 deferral reserve accounts, approved by the EUB in Decision U96001, were deemed to be
15 equal and offset the amount of the deferred income tax drawdown at January 1, 1996,
16 and the income tax effect thereon. The balances in the reserve accounts were refunded to
17 the Alberta System customers through tolls. Consequently, these accounts are assumed
18 to have a nil balance since January 1, 1996.

19 **7.7 2003 DEFERRAL AND RESERVE ACCOUNT BALANCES AND DISPOSITION**

20 **Q32. How will NGTL dispose of the 2003 deferral and reserve account balances?**

21 A32. In accordance with EUB Decision 2003-051, NGTL will include a Non-Routine
22 Adjustment in the calculation of final rates for 2004. The amount of the Non-Routine
23 Adjustment will be determined in accordance with Article 5 of the ASRRS. NGTL is,
24 however, proposing one exception to Article 5. According to Article 5.2 (b)(iv), at the
25 end of the term of the ASRRS, the Non-Routine Adjustment should include the balance
26 as at the time of expiration or termination in the Foreign Exchange reserve account plus
27 carrying charges and applicable taxes. NGTL is instead proposing to transfer the balance

1 in the Foreign Exchange reserve account at the end of 2003 to the opening balance of
2 the 2004 Foreign Exchange reserve account and continue using the amortization
3 mechanism established in the ASRS.

4 At the end of 2004, the Non-Routine Adjustment deferral account will contain
5 unamortized 2003 severance costs. In accordance with Article 9 of the ASRRS,
6 severance costs associated with employees that are terminated during 2003 are being
7 amortized over 24 months, beginning in the month following the termination date of
8 each employee. As a result, amortization of these severance costs will be included in
9 both the 2004 and 2005 revenue requirements. The remaining unamortized balance at
10 December 31, 2004, will be included as a Non-Routine Adjustment in the 2005 Total
11 Revenue Requirement, in accordance with Article 9.1 (b) of the ASRRS.