



LEGISLATIVE BUDGET & AUDIT COMMITTEE

Representative Ralph Samuels, Chairman

MEMORANDUM

TO: All Legislators and Interested Public

**FROM: Representative Ralph Samuels, Chair
Legislative Budget and Audit Committee**

DATE: March 12, 2008

RE: Attached Rate Questions - William A. Mogel

The attached memorandum from William A. Mogel, an LBA consultant, was submitted to Dr. John A. Neri, another LBA consultant, for his response. LBA did not have a rate expert when Mr. Mogel posed the questions.

Dr. Neri is a rate expert and answered the questions for which information is available. Some of these responses should be considered preliminary until more information is made available from TransCanada. Dr. Neri indicated that a few of the questions should be directed to TransCanada and LBA will pose the questions to TransCanada.

Mr. Mogel's questions are in black and Dr. Neri's responses are in red.

**PRIVILEGED AND CONFIDENTIAL
ATTORNEY-CLIENT PRIVILEGE**

MEMORANDUM

VIA E-MAIL

To: Rep. Ralph Samuels
Ms. Cheryl Sutton

From: William A. Mogel

Date: February 15, 2008

Subject: Proposed Questions for Rate Expert

Preliminary responses are indicated below following each question in the February 15 Mogel Memorandum:

Reference pp. 13-14 of TransCanada's Application for License

- What would the 25-year levelized 100% load factor Recourse Rate be if the throughput, is 2.5 Bcf/d or 3.5 Bcf/d, instead of 4.5 Bcf/d?

The recourse rate would depend on construction cost of the project at the throughput levels of 2.5 and 3.5 Bcf/d. It does not appear from the Application that the recourse rate is levelized. The rate would depend on construction cost of the project at the throughput levels of 2.5 and 3.5 Bcf/d. On a preliminary basis, if we assume the project is designed at 4.5 Bcf/d, the rate impact of the 2.5 and 3.5 Bcf/d throughput levels are calculated as follows using data from the TransCanada Application.

The estimated rates are for the Alaska portion of the line.

Throughput (Bcf/d)	Rate \$/Mcf
4.5	\$1.19
3.5	\$1.53 +28%
2.5	\$2.14 +80%

If the project is scaled back to 2.5 or 3.5 Bcf/d, we would need estimated capital costs for the smaller capacity in order to calculate a rate. This is a good question to pose to TransCanada.

- Is it consistent with FERC precedent to calculate the Recourse Rate without fuel and lost and unaccounted for?

It is consistent with FERC policy to separately state fuel and lost and unaccounted for which is what TransCanada has done in the application.

- What would be the 25-year levelized, 100% load factor rate, for the above throughputs, if the rate base of the Alaska Section (either \$11.7 billion or \$14.2 billion) was increased by \$8.9 billion?

We have asked TransCanada for their levelization model. With that, we can run this type of scenario.

- Is the return on equity of 14% (a yield equal to the 10-year Treasury Note plus 965 basis points) consistent with FERC precedent? How would the return be affected by the changes in throughput and rate base discussed above? What would be the overall return for each of the foregoing situations?

At first blush, an ROE number at 14% for a new project of this size is not out of line with FERC precedent. TransCanada's Risk Premium approach however, while consistent with NEB precedent, is not consistent with FERC precedent. The 965 basis point RP seems high for Canadian regulation. To confirm any of these impressions, we need to research both FERC and NEB precedents more closely regarding authorized RP for pipelines.

In addition to the size of the proposed RP, TransCanada's proposal to lock in of the 965 basis point RP and letting the ROE vary as the yield on the 10-year US Treasury bond varies over the life of the project is not consistent with FERC precedent.

The impact on return at the alternate throughput levels depends on the pipeline design and the associated capital cost.

- Would (in dollars and percentages) the \$1.06/mm Btu rate proposed by TransCanada be subject to any adjustments over the 25-year period? If so, provide Recourse Rate for years 5, 10, 15, 20 and 25.

If the FERC accepts a 25-year levelized rate, it would be locked in until TransCanada chose to make a rate filing at the Commission. Levelization is a procedure to get

pipeline stated rates lower in the early years of the project (the trade off is that rates are higher in the later years of the project). Levelization does not preclude the pipeline from requesting an increase in revenue requirement in the future. Under such circumstances, if granted, the pipeline would then re-levelize to a higher rate.

Regarding Recourse rates for 5, 10, 15, and 20-year periods, we have requested TransCanada's levelization model. With that, we can run this type of scenario.

- Does the .99/MM Btu proposed negotiated rate for the Alaska Section and the 80/mm Btu rate proposed for the Yukon/B.C. Section fully recover TransCanada's costs at throughputs of 2.5 Bcf/d, 3.5 Bcf/d or 4.5Bcf/d, assuming no Recourse Rate contracts?

We would need to get behind their numbers to answer this. This is a good question to pose to TransCanada. We can then review and replicate their reply.

- Describe the economic parameters underlying the negotiated rates' design.

This question should be posed to TransCanada.

- Estimate the level of investment incurred for expansion for the Alaska Section that would have to be "rolled in" to increase the Recourse Rate of \$1.06 billion by 15% (assuming a rate base of \$11.7 billion) (see p. 2.10-8).

This question should be posed to TransCanada.

- Provide an estimate of the commodity charge to be paid by shippers.

This question should be posed to TransCanada.

- Is the proposed debt/equity ratio of 70%/30% through the initial development and construction consistent with FERC precedent? Similarly, will use of a 60%/40% debt/equity ratio for all pipeline expansions and maintenance be in accord with FERC precedent? What effect will the different debt equity ratio have on rates?

70/30 for new projects is not uncommon at the FERC. The 60/40 debt/equity for expansions will need to be researched. We have a request to TransCanada regarding the logic and precedent for the 60/40 debt/equity for expansions.

- Please calculate the initial zonal rate to be used for deliveries and receipts within Alaska (p. 2.2-70).

We have a request to TransCanada regarding proposed methodology. It is important to understand how they propose to allocate cost to Alaska delivery points and design the zone rate.

Reference Section 2.10 of TransCanada's Application for License

- Which rate design principles will be used by TransCanada to set the Recourse Rate if the initial Transportation Services Agreements are for terms other than 25 years?

Presumably, since TransCanada proposes to tie the depreciation rate to the length of contracts, their rate approach will be to adjust the depreciation rate. However, TransCanada does not state how they will design the Recourse rate for terms other than 25 years. Again, this is a good question to pose to TransCanada.

- With regard to the "Sensitivities Chart" on p. 2.10-3, explain each of the four entries' affect on rates.

This question should be posed to TransCanada.

- Describe the effect on the \$207 billion aggregate net back to Alaska Procedures if the pipeline operates at load factors less than 100%.

This question should be posed to TransCanada.