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March 20 2008

Legislative Budget & Audit Committee
Alaska State Capitol,
Juneau, Alaska
99801-1182

Attention: Representative Ralph Samuels
Chairman

Subject: Alaska Gasline Inducement Act
TransCanada Application for License
Additional Clarifying Information

Dear Representative Samuels:

TransCanada acknowledges receipt of your correspondence dated February 29, 2008 (C) (third of three documents) in which TransCanada is asked to provide additional clarifying information to its November 30, 2007 Application for License. In that regard, please find attached our response to the questions.

We are submitting this reply to you by two means:

- we are today e-mailing an electronic copy to your attention at Representative_Ralph_Samuels@legis.state.ak.us ; and
- we are today forwarding the originally signed document by courier to your office.

I remain available to provide further information or participate in discussions that the State may wish to initiate.

Sincerely,

Anthony (Tony) M. Palmer
Vice President, Alaska Development

SUBJECT: RATES

Legislative Budget & Audit Committee Request

On December 14, 2007, TransCanada responded to a December 11, 2007, letter from the Department of Natural Resources. In its response to State of Alaska Request #4, TransCanada stated that, *"TransCanada determined that an equitable and balanced proposal would include firm service for 25 or more years, authorized overrun service ("AOS"), but no other interruptible service for the initial years. Although TransCanada recognizes the State's interest in offering interruptible service to delivery points in Alaska, TransCanada determined that offering interruptible service other than AOS in the initial years could make it more difficult to obtain financing for the initial project."*

The State is interested in offering interruptible service to delivery points in Alaska. Can TransCanada define what it means by initial years? Are the initial years the term of years committed to by the shippers at the first binding open season, i.e., 25 to 35 years, or could the initial years be a term of years less than that?

In the same response letter TransCanada goes on to say, "TransCanada will utilize all revenues collected from AOS to first service the Capital Cost Overrun Loan. Once the Capital Cost Overrun Loan is repaid in full, TransCanada will credit all AOS revenues to the account of the firm transportation shippers."

Please explain more fully how this works through the use of an example.

TransCanada Response

Other Interruptible Services

TransCanada believes it is premature to define the timing for the "initial years" during which no interruptible services, other than AOS, would be offered on the pipeline. There are many factors which would influence TransCanada's assessment of the appropriate number of years. These factors include, but are not limited to, the following:

- Results of the initial Open Season, and subsequent Open Seasons if the initial Open Season is unsuccessful;
- Details of any agreement with the U.S. Government on sharing capital cost overrun risk through the Capital Cost Overrun Loan concept as proposed by TransCanada in its AGIA Application; and
- Terms and conditions for any agreement under which the U.S. Government would act as a bridge shipper to allow the Project to proceed in advance of a successful Open Season.

These factors are relevant because the issue of whether and when it might be economically rational to offer interruptible service is directly related to the level of confidence TransCanada and Project lenders have that the fixed cost of the system will be recovered through one mechanism or another. Thus, if creditworthy parties execute firm transportation contracts for 25 years for 100% of the capacity then it is more likely that TransCanada, or

any project sponsor, would be willing to offer interruptible service because it would no longer cannibalize recovery of the fixed costs of the system. Also, TransCanada will want to ensure equitable treatment for firm Shippers that have committed long-term to the Project.

AOS Mechanism

Under TransCanada's proposed AOS mechanism, firm Shippers would be required to pay full tariffs regardless of any AOS revenue until the Capital Cost Overrun Loan is repaid in full. Following the repayment of the Capital Cost Overrun Loan, AOS revenues would be credited to the account of firm Shippers. This would effectively reduce the net tariffs for firm Shippers by the amount of AOS revenues received. For example, if post-repayment of the Capital Cost Overrun Loan, AOS revenues for a month were equal to 5% of the firm demand charges then firm Shippers would receive a 5% credit for that month.

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Executive Summary p. 13 states, *"The rate of return on equity will be set annually at 965 basis points above the rate for U.S. 10-year Treasury Note in effect at the beginning of that year."*

1. Is this a common means for establishing return on equity in Canada or the U.S.?
2. How is return on equity normally established in Canada and in the U.S.?
3. How is the present proposal consistent with or different than what is normal in Canada and the U.S.?

TransCanada Response

1. It is common in both Canada and the U.S. to determine the return on equity ("ROE") that will apply prior to constructing a new pipeline. The method of adding a risk premium to the risk-free rate of return is accepted by academics as the Equity Risk Premium ("ERP") approach. ERP analysis is widely accepted in Canada and, although not commonly used in the U.S., has been presented before the FERC in recent proceedings.
2. In the U.S., the FERC and state regulators commonly use the Discounted Cash Flow ("DCF") method. This method relies on stock market information and other publicly available information to estimate the expected equity returns for investors.

   In Canada, formulas are frequently used to determine the allowed ROEs of pipelines which are not under settlement. These formulas relate to the ERP method, since the allowed ROE moves with government bond yields. Canadian regulators set their initial ROEs, to which their formulas would apply, based on ERP and DCF analysis, along with other information. Canadian pipelines have been, for a number of years, expressing concerns that the current formula employed by the federal regulator, the National Energy Board, provides inadequate returns on pipeline investments. As a result, for new capital investments, many Canadian pipelines have negotiated returns that are 300 basis points or more in excess of the formula-based ROE.
3. TransCanada's AGIA Application is consistent with the regulatory policy of both countries in that a pipeline is entitled to a return that is commensurate with its risks, which allows a pipeline company to remain financially sound, and allows it to attract capital on reasonable terms. It is also common in both countries for a pipeline company to determine its return and other terms, before proceeding with project investment and construction. The proposed method of adjusting returns is most similar to that used in Canadian ROE formulas. FERC-determined ROEs are normally held constant until the next rate settlement or formal rate case.

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Executive Summary p. 14 states, *"Consistent with FERC's Open Season regulations, the Alaska Section would provide a distance sensitive transportation rate for deliveries and receipts within the State. If acceptable to FERC, one single in-State zone based on weighted average volume distance will be created to represent all in-state deliveries. In accordance with AS 43.90.130(12), TransCanada commits to provide a minimum of five in-State delivery points… with one of these points anticipated to make gas available to a potential intrastate pipeline delivering gas to the Alaska Rail Belt region."*

1. Please explain how the weighted average volume distance works.
2. Do you use the distance to the border in your calculation or the distance to the last delivery point in Alaska?

The application states one of the delivery points may make gas available to a potential intrastate pipeline that would make deliveries to the Alaska Rail Belt region. However, the possibility of an off-take point for LNG export is not discussed.

3. Will the option for an off-take point for LNG export also be accommodated in the open season?
4. Will a distance sensitive rate be available for this option as well?

TransCanada Response

1. The weighted average volume distance methodology would allow all intrastate delivery Shippers to pay the same tariff rate at the various in-State Delivery Points.

   The weighted average volume distance toll for intrastate deliveries would be determined through the following steps:

   a) Determine the weighted average volume distance of haul for all intrastate deliveries
   b) Allocate the Alaska Section's annual revenue requirement between the intrastate deliveries and deliveries to the Alaska/Yukon border.
   c) Calculate the intrastate delivery toll for all in-state deliveries.

   e.g. In its application, TransCanada estimates that the Alaska Section toll (including fuel) would be $0.96 and the toll for the gas treatment plant would be $0.77 (including fuel). If the weighted average volume distance for Alaska Delivery Points is 70%, then all intrastate deliveries would pay 100% of the gas treatment plant toll plus 70% of the Alaska Section toll to the Alaska/Yukon border for a total of $1.44.

2. Distance to the border will be used to calculate the annual revenue requirement allocation between intrastate deliveries and the Alaska/Yukon border deliveries. Therefore, the distance to the Alaska/Yukon border would be taken into account when determining the weighted average volume distance toll for the in-state deliveries.

3. An off-take point on the Alaska Section for LNG export would be provided in the Open Season if sufficient interest is expressed by prospective Shippers in the pre-Open Season.
4. A distance sensitive rate would be available for the LNG option.

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Executive Summary p. 16 states, *"TransCanada will work with the State to jointly seek authorization to use the Federal loan guarantee available for the APP to fund any construction cost overruns. Negotiated Rate Shippers will have the option to repay those loans using a toll surcharge that is only to be paid when natural gas commodity prices at the Alberta Hub are above a pre-determined minimum threshold."*

1. When will the Shippers know the pre-determined minimum threshold?
2. Will they know by the initial binding open season?
3. How will the pre-determined minimum threshold be determined? You mentioned that the Negotiated Rate shippers will have this alternative available, how will it affect the recourse rate shippers in Alaska?

TransCanada Response

1. TransCanada expects the pre-determined minimum threshold for triggering the toll surcharge to service the Capital Cost Overrun Loan would be known to the Shippers once an agreement with the U.S. Government on the details of using the U.S. Loan Guarantee for Capital Cost Overruns credit support is reached.
2. If TransCanada is awarded the AGIA license, TransCanada will seek expeditious approval by the U.S. Government for its U.S. Loan Guarantee proposal. Whether the U.S. Government will approve that proposal, and when, is not within TransCanada's control.
3. Determination of the minimum threshold would be a result of discussions with the U.S. Government on using the U.S Loan Guarantee for Capital Cost Overrun credit support. It is premature to define precisely how it might be determined. However, TransCanada would propose that the minimum threshold should at least be sufficient to cover the base tariffs for the GTP and the Pipeline to the Alberta Hub plus some reasonable margin for upstream development and operating costs.

   The pre-determined minimum threshold would not have any effect on the Recourse Rate Shippers since only Negotiated Rate Shippers have the option to elect as a Surcharge Shipper. As described in Section 2.2.3.11(2) "U.S. Loan Guarantee for Capital Cost Overrun" on page 2.2-72 of TransCanada's AGIA Application, Recourse Rate Shippers would pay the base tariffs for the GTP and Pipeline that reflect the actual cost of such facilities.

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Development Plan pp. 2.2-67-68, states, *"For the purposes of tariff/toll calculations herein, TransCanada has assumed the rate of return on equity would be 14% throughout the Project Development, Execution and Operations Phases."*

1. If the NEB or FERC authorize less than a 14% rate of return, do any of the other proposed TransCanada terms change? For example, the 2% cost overrun reduction in rate of return?
2. Will the State be required to support TransCanada's proposed 14% rate of return on equity before the FERC and NEB?

TransCanada Response

1. TransCanada's AGIA Application includes an overall package of terms that in our view reflects an equitable allocation of risks and rewards to the pipeline company, its Shippers and other stakeholders. At present, TransCanada will not speculate on the related impacts on other components of its proposal if the FERC or NEB changes one component.
2. If TransCanada is awarded the AGIA Licence, TransCanada will advance the Project in partnership with the State consistent with the plan as set out in its AGIA Application. Since the State will rightly expect TransCanada to meet its AGIA's obligations, TransCanada will also expect the State will support TransCanada's proposed rate on return on equity and its other proposed terms of transportation services before the FERC and NEB.