

NATIONAL ENERGY BOARD

File OF-Tolls-Group1-A159-2007-01 01

**Alliance Pipeline Ltd.
2008 Tolls**

**National Energy Board
Ruling dated June 11, 2008 on ICES Notice of Motion
Information Requests**

Alliance Response

June 25, 2008

ICES-APL-001 (as framed in NEB ruling)

Request: In Exhibit B-1, please explain the apparent discrepancy in depreciation expense between the amount shown on the Summary of the Revenue Requirement for 2008 (\$88,553,100) and the amount shown on the supporting Schedule C (\$81,137,900).

Response: In 2007, in preparation for the 2008 toll filing, Alliance was forecasting the retirement of certain transmission plant. Prior to 2008, Alliance had not recorded any plant as retired, and, as a consequence, the additions to Accumulated Depreciation equaled the Depreciation and Amortization component of the revenue requirement in each prior year. In January, 2008, Alliance retired compressor equipment, metering and regulating equipment, and some minor amounts of pipe and compressor structures. The proper accounting treatment of these retirements gave rise to the "additional change" in Accumulated Depreciation.

For the 2008 retirements, in accordance with subsection 36(1) of the *Gas Pipeline Uniform Accounting Regulations* ("GPUAR"), the book cost of the retired equipment (\$39.1 million in total) was credited to the relevant transmission plant accounts (compressor equipment, metering and regulating equipment, and compressor building and structures). The gross book cost (\$39.1 million) is included in the amounts shown on Exhibit B-1, Attachment "E", Schedule "C" at Lines 3, 7, 8, and 9 under the column "Additions".

In accordance with subsection 36(2) of the GPUAR, the book cost of the retired equipment was debited to Accumulated Depreciation. The gross book cost (\$39.1 million) is included in the amount shown on Exhibit B-1, Attachment "E", Schedule "C" at Line 24 under the column "Additions".

The approximately \$7.4 million difference between the Depreciation and Amortization revenue requirement amount shown at Line 3 on Exhibit B-1, Attachment "E", Summary Revenue Requirement for January 1, 2008 to December 31, 2008 (\$88,553,100) and the Total Accumulated Depreciation amount shown at Line 24 on Exhibit B-1, Attachment "E", Schedule "C" (\$81,137,900) represents the difference between the net book value

and the gross book cost of the plant retired as discussed above.
The net book value of the plant retired was credited to
Accumulated Depreciation and debited to
"Renewals/Replacements" shown at Line 21 on Exhibit B-1,
Attachment "E", Schedule "C".

ICES-APL-003(d) (as framed in NEB ruling)

Request: Provide a detailed discussion of compressor overhauls and the effect of such overhauls on the performance of the compressor units. Please quantify any change in fuel consumption in 2008 and beyond resulting from the proposed overhauls.

Response: Timely and proper maintenance is fundamental to the continued high and reliable performance of Alliance's compressor fleet. Such maintenance includes routine condition monitoring, semi-annual inspections, and periodic hot section change-outs and major overhauls (as addressed in Alliance's ongoing service contract with the original equipment manufacturer).

Notwithstanding the use of leading-edge technology and materials, the sophisticated components of a compressor/turbine unit will gradually degrade over time in their inherently harsh operating environment. The rate of degradation will depend on such factors as the firing temperature of the unit, the rigour of usage, and the number of starts. In the case of Alliance's mainline units, the firing temperature is in the order of 1540 °F or 865 °C.

The hot section components of Alliance's mainline units are typically expected to last in the order of 25,000 operating hours (or about 2.85 operating years). Such components include combustors, blades, nozzles, tip seals, and the like. The precise operating life of the components will vary to some limited degree, and has to be confirmed through the condition monitoring and inspection process. At the appropriate juncture, the hot section needs to be changed out; otherwise, the unit will eventually fail to operate. The hot section is modular in nature, and is changed out with new or refurbished equipment from the original equipment manufacturer. As a matter of clarification, these hot section change-outs are sometimes referred to as minor overhauls.

Major overhauls of compressor/turbine units are required after about 50,000 operating hours (or 5.7 operating years), with the precise timing again confirmed through the condition monitoring and inspection process. In addition to another hot section change-out, the overhaul process also involves the change-out of a host of

other components (bearings, seals, casings, and the like).

For a more complete context, and to illustrate the rigour and scale of the maintenance and overhaul program, Alliance has attached a copy of the "Main Maintenance Tasks" annex from its continuing service agreement with the original equipment manufacturer (Appendix ICES-APL-003(d)).

The central and twin objectives of the maintenance and overhaul program are (i) to ensure continued safe and reliable operation and (ii) to realize the economic life of the compressor and turbine equipment. While a properly run program does not act to extend the economic life of the equipment, a deficient program will surely act to shorten the equipment's economic life.

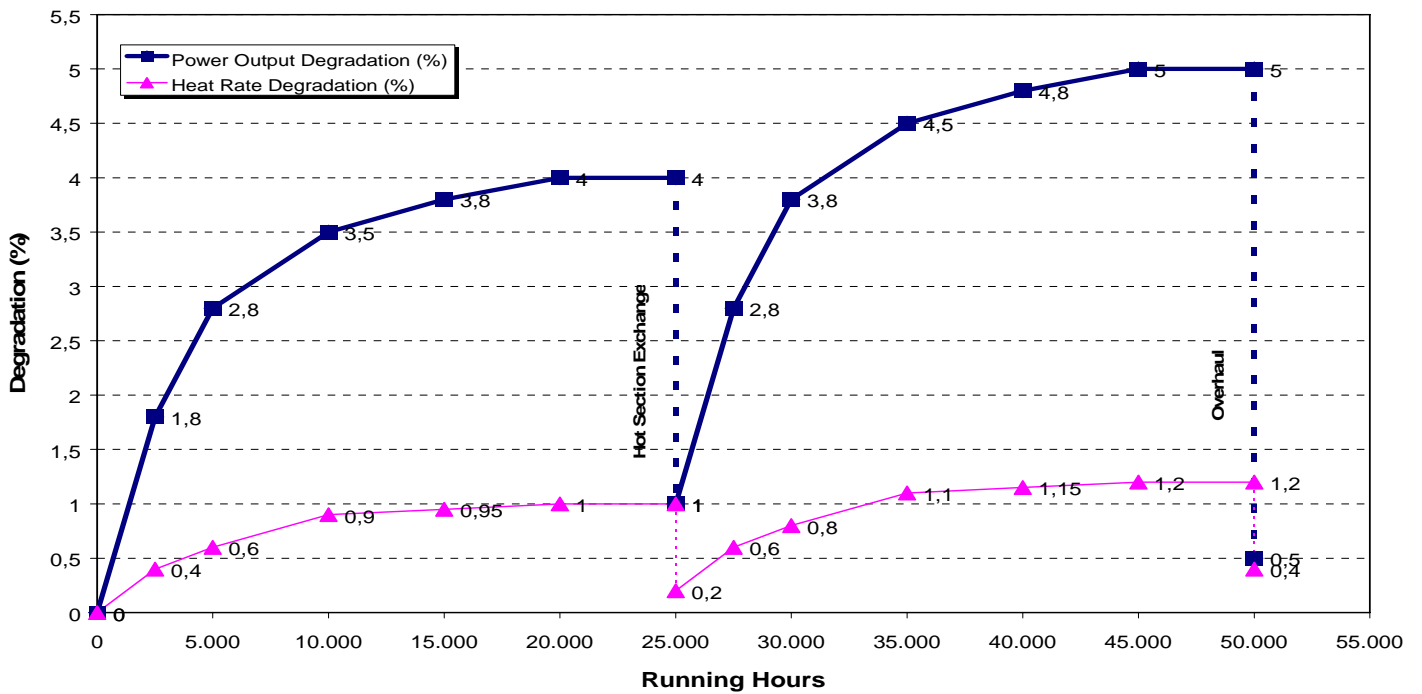
As another point of clarification, relative to initial performance levels, the maintenance and overhaul program is not designed to improve performance or yield other long-term advantages such as fuel savings. Hot section change-outs and major overhauls will help recover some of the performance lost at the margin between overhauls, but will not improve performance relative to initial levels.

This recovery aspect is illustrated by the pair of curves on the following page showing the effect of minor and major overhauls on power and heat rate. As shown, the overhaul program recovers performance, but not to original levels.

In direct response to the information request, the overhaul program will not lead to any fuel savings in 2008 and beyond.

In summary, an appropriate maintenance program is fundamental to the continued safe and reliable operation of compressor and turbine equipment, and to maximizing the use of such assets throughout their economic life. In many respects, it is akin to having an appropriate maintenance program for a car engine. Aside from maintaining high performance levels (and attendant high throughput capabilities), a prudent maintenance program will also preserve warranty and insurance coverages.

**Variation from "New and Clean" guaranteed values
 (Non recoverable by washing)**



ICES-APL-005(b) (as framed in NEB ruling)

Request: Provide the basis for Alliance's conclusions that the plant units and dollar threshold for capital was not aligned with industry and that some plant units were obsolete.

Response: Alliance concluded that its plant and dollar thresholds for capital were misaligned with industry based on reviews of historical NEB decisions, regulatory submissions to the NEB, and the Tax Court of Canada judgment in the *Rainbow Pipe Line Co. v. The Queen*.¹

Alliance's research indicated that other NEB-regulated Group 1 pipeline companies were expensing compressor overhauls, pipeline integrity work, and other maintenance activities.² For its own part, Alliance had been capitalizing assets for accounting and regulatory purposes, but expensing them for income tax purposes since they did not meet the Canadian Revenue Agency requirements for capitalization.

Alliance has therefore modified its plant and property listing to better align itself with industry practice. The dollar thresholds are designed to complement Alliance's plant and property listing, and were modified to better reflect the updated plant unit listing. Alliance attempted to obtain current plant and property listings for other NEB-regulated pipelines, but understands that current listings are not publicly available.

¹ *Rainbow Pipe Lines v. The Queen* (TCC, Docket 96-4369-IT-G). At para. 31, J.T.C.C. Mogan determined that a certain cost constituted a capital expenditure since it met the following four conditions: (i) the cost was non-recurring; (ii) it was a major repair; (iii) it brought into existence an asset (the replaced [40 km] portion of the 24 inch [diameter] section of the main trunk line); and (iv) it was substantial in relation to the book value of the whole pipeline, other expenses and annual profits.

² For example, refer to the NEB Reasons for Decision in RH-1-2002 (TransCanada Mainline, 2003 Tolls and Tariff Application) at pp. 22-23, the NEB's Reasons for Decision in RH-2-2004 (TransCanada Mainline, Tolls and Tariff) at pp. 30-31, the Foothills Pipe Lines Ltd. Report of the Difference Between 2003 Budgeted and 2002 Budgeted Operating and Maintenance Expenses March 200, at p. 2, the Foothills Pipe Lines Report to the NEB of the Difference Between 2003 Budget and 2003 Actuals Operating and Maintenance Expenses February 2004, at p. 2., and the Foothills Pipe Lines Report to the NEB of the Difference Between 2004 Budget and 2003 Budget Operating and Maintenance Expenses February 2004 at p. 2.

Alliance considers that this change is also consistent with the Board's intent in issuing its direction on the Regulation of Operations and Maintenance Activities on Pipeline under the *National Energy Board Act* and the updated Section 58 Streamlining Order (XG/XO-100-2005) in mid-2005.

In its determination that some plant units were obsolete, Alliance examined historical capital Authorizations for Expenditure ("AFE's"). Alliance consulted internal engineering and technical staff to determine the nature of the activities involved in each AFE. It was discovered in many instances that assets (under Alliance's previous plant and property listing) had been replaced and that the original plant units were no longer used or useful. In some cases, the original asset had been fully utilized; however, in other cases, the original plant unit was found to be obsolete (i.e. no longer meeting the requirements of the Alliance system) and required replacement for that reason.

ICES-APL-010 (as framed in NEB ruling)

Request: Please discuss the extent to which costs from the operation of heat recovery units are included in Alliance's revenue requirement and the extent to which revenues for heat recovery offset the costs in the revenue requirement.

Response: There are presently waste heat recovery units in operation at two of Alliance's mainline compressor station sites in Saskatchewan, and like units are in the later stages of construction at Alliance's other two mainline compressor station sites in that province.

The heat recovery facilities are all owned by the NRGreen Power Limited Partnership, the general partner of which is NRGreen Power Ltd.

As indicated in the response to ICES-APL-002, Alliance Canada provides services under contract to NRGreen and charges NRGreen for all costs and charges incurred by Alliance Canada on NRGreen's behalf. As also clarified, all revenue resulting from the provision of services to NRGreen is credited to the Alliance Canada cost of service for toll setting purposes.

In addition to being reimbursed for the costs of the services it provides to NRGreen, Alliance receives an annual fee. In this connection, Alliance negotiated with NRGreen an annual waste heat access fee of \$100,000 per year. This payment is also intended to account for the recovery of any minor ongoing incremental operating costs associated with the waste heat undertaking. As disclosed in Alliance's October 31, 2007 toll adjustment submission, \$100,000 was credited to the Alliance cost of service for calendar year 2007, with \$225,000 to be credited to Alliance's forecast cost of service for calendar year 2008 (reference Line 13 of the revenue requirement summary for each of 2007 and 2008).

The \$100,000 credit to the 2007 cost of service relates solely to the waste heat electrical power generation facilities at the Kerrobert (SK) Compressor Station, which went into commercial service at the start of that calendar year. The \$225,000 credit for 2008 comprises a full-year credit for the Kerrobert waste heat facilities,

and pro-rata credits for the waste heat facilities at the other three Saskatchewan compressor station sites that are to come into service this year (including the Loreburn waste heat facilities that have just recently come into operation).

In response to the specific information request, the credited revenues for waste heat access more than offset any minor costs in Alliance's revenue requirement arising from the operation of waste heat recovery units. To confirm, there is no disruption to the Alliance pipeline transmission operation or alteration of operating regime as a result of the NRGreen waste heat undertaking.

ICES-APL-024 (as framed in NEB ruling)

Request: Provide a justification for the 10 new employees relative to the current staff levels. Please discuss whether the duties of the 10 new employees would involve any work on non-regulated activities. Please provide the business case upon which Alliance relied for the 10 staff additions.

Response: Alliance is headquartered in Calgary, Alberta and has regional operating offices at five locations in Western Canada (namely at Grande Prairie, Whitecourt, and Morinville in the Province of Alberta and Kerrobert and Regina in the Province of Saskatchewan). Alliance also has four regional operating offices in the U.S., as well as a smaller-size corporate office in Minnesota that reports through to the Calgary head office.

As addressed in Alliance's response to ICES-APL-002, allocation and charge-out mechanisms are in place to appropriately segregate costs between the Canadian and U.S. portion of the pipeline system. Likewise, and again as described, mechanisms are in place to appropriately segregate costs pertaining to unregulated activities (in the case of NRGreen) and any development initiatives outside the existing Alliance business model.

The functional areas of Alliance include (i) Executive; (ii) Legal Services; (iii) Human Resources & Corporate Services (human resources, learning and development, administrative services, communications, and health, safety & security); (iv) Transportation Services & Development (business development, regulatory, customer service, and gas control); (v) Engineering & Construction (general engineering, facilities engineering, pipeline integrity, land, and corridor management); (vi) Treasury & Finance (finance, regulatory accounting & economics, taxation, audit & governance, strategic analysis, and information services); (vii) System Optimization & Effectiveness (technical services, supply chain, and environment); and (viii) Operations (receipt/delivery and mainline).

At year-end 2007, Alliance overall full-time equivalent head count stood at 320 (i.e. for the Canadian and U.S. portions of the pipeline system combined).

As previously indicated, Alliance's overall head count is increasing by ten during 2008. Some of the overall drivers for this increase are as follows:

(1) Reorganization - In 2007, Alliance implemented a company-wide reorganization to better support its business needs. Among other things, this reorganization resulted in the filling of the Chief Operating Officer position which had been vacant since the end of 2004, the creation of a focused System Optimization & Effectiveness group, and the assembling of a focused Human Resources & Corporate Services group. Coming into 2008, the effects of the reorganization were still bearing on staffing levels.

(2) Turnover Rates - Alliance has been experiencing an increase in turnover rates, particularly in the hot Calgary job market. This turnover rate has averaged about 12% over the last three years with no sign of industry softening. This has stressed organization capacity, including in relation to lost institutional knowledge, increased training and supervising time, and required ramp-up time for new employees replacing outgoing experienced personnel.

(3) Increased Activity Along Pipeline Right-of-Way- Alliance has had to appropriately contend with increased activity levels along the pipeline right-of-way, including in the context of damage prevention and pipeline integrity matters. These activities include, among other things, crossings associated with a large inter-modal (rail and truck) yard in Fort Saskatchewan, a class location change resulting from a casino development near Whitecourt, and an upgrader facility development on the pipeline right-of-way in Fort Saskatchewan. Additionally, and as canvassed during the information request process, Alliance has had a ramp-up in required major maintenance for the turbo-machinery at its compressor stations (particularly owing to the operational cycles for minor and major overhauls).

(4) Compliance Activities – Alliance has also faced increased compliance requirements, including in relation to areas as diverse as financial reporting and pipeline integrity management.

Please refer to Appendix ICES-APL-024 for further information relating more specifically to the basis for each of the ten positions being added this calendar year.

In the context of this information request, Alliance can confirm that “unregulated activities” are limited to NRGreen matters. In this same connection, the new positions that have some limited potential scope for NRGreen involvement include the Canadian-based General Manager, the Corrosion Technician, the Maintenance Technician, and the Project Engineer. Again, however, mechanisms are in place to ensure that any such involvement is charged through to NRGreen (and hence kept outside the pipeline cost of service).