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INTRODUCTION

This edition of the Energy Law Newsletter has stories out of British Columbia and Alberta. In addition, we include a feature article on the advent of residential retail competition in natural gas in British Columbia.

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Back editions of this newsletter may be found at www.lawsonlundell.com in the Energy Law Group section.

ALBERTA

AEUB Voids Own Decisions Regarding 500kV Transmission Line

On September 30, 2007, on its own motion and without notice, the Alberta Energy and Utilities Board (AEUB) issued a decision voiding its approvals of both the Alberta Electric System Operator's (AESO) need assessment and general routing selection and AltaLink Management Ltd.'s (AltaLink) subsequent facilities application related to the proposed 500kV transmission reinforcement between Edmonton and Calgary. The AEUB concluded that it had lost jurisdiction on the basis that

circumstances had accumulated such that a reasonable apprehension of bias existed in the Board's ability to discharge its duties impartially.

As previously reported in our newsletters, the AEUB public hearing into AltaLink's facilities application was delayed last spring as a result of incidents in which people at the hearing were physically confronted or threatened with violence. In response to the violent behaviour, the AEUB revised hearing procedures and implemented security measures which included, among other things, hiring plainclothes security personnel to monitor intervenor activity. While security arrangements overall were considered to be appropriate and prudent given the assessed risk, two separate investigations of the security measures taken by the AEUB concluded that certain activities were improper. Arguably the worst allegations are that security personnel listened in on a conference call between intervenors and their legal counsel. The Alberta Information and Privacy Commissioner concluded that although the AEUB was authorized to collect certain personal information in the circumstances, the information collected was not necessary for the provision of a safe environment for AEUB staff and hearing participants, and therefore was unauthorized.

In response to the AEUB's voiding of the decisions, AESO advises that it will start the public consultation process on the north-

south 500kV reinforcement over again as soon as possible. AESO continues to advocate the critical need for the project to address reliability of the Alberta system.

AESO Lifts 900MW Wind Generation Cap

In September, 2007 the AESO removed the 900MW threshold on wind power generation. In response to concerns about the Alberta system's ability to absorb significant volumes of intermittent resources, in 2006 the AESO had capped wind facility interconnection to the Alberta system at 900MW until such time as appropriate mitigation measures were established to ensure wind power did not jeopardize system reliability. The AESO has implemented a Market and Operational Framework for Wind Integration (MOFWI) premised on the notion that reasonable forecasts of wind generation should enable it to establish an operating plan to accommodate the forecast wind energy by using the energy market merit order, regulating reserves, load/supply following services and wind generation power management. Significant work remains to finalize the MOFWI framework, including recommendations and requirements from the wind forecasting pilot project which are not expected before the end of 2008. However, the AESO considered it appropriate to remove the cap immediately in light of general acceptance by industry of the proposed framework, the rapid

pace of wind development, and the progress made in clarifying wind power management requirements and system operating tools to date. There is currently 497MW of wind generation installed on the Alberta system. A further 5,500MW of wind projects are in the transmission interconnection queue.

Alberta Court of Appeal to Review AEUB Powers to Include or Remove Property of a Utility in Rate Base

The Alberta Court of Appeal recently granted Atco Gas and Pipelines Ltd.'s (ATCO) application for leave to appeal AEUB Decisions 2005-63 and 2007-005 and Interim Order U2005-133. In those decisions the AEUB required ATCO to maintain certain natural gas reservoir storage assets (the "Carbon Facilities") in rate base. With the restructuring of the gas industry resulting in the Carbon Facilities no longer being used directly by ATCO for public utility service but rather leased to third parties, ATCO sought removal of the Carbon Facilities from rate base on the premise that the facilities are not and have not been used as part of a gas distribution system. The AEUB concluded that the Carbon Facilities properly remain in ATCO's rate base as the facilities have been and remain used or required to be used for the purposes of revenue generation. ATCO requested leave to appeal these decisions and orders to the Alberta Court of Appeal. In *Atco Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2007

ABCA 324, issued October 24, 2007, the Court granted ATCO's application, concluding that the appeal raises important questions regarding whether pure revenue generation serves a purpose for a utility such that it can be an asset in a rate base, and the AEUB's ability to regulate assets owned by a utility. The appeal is expected to proceed later this year.

Alberta Government Increases Energy Sector Royalties by 20 Percent

On October 25, 2007 the Alberta Government announced a new royalty regime that will see a 20% increase in royalties for the development of the province's non-renewable energy resources. Starting in 2009, oil and gas companies are expected to be paying roughly \$1.4 billion more a year in royalties. The controversial announcement was in response to a September, 2007 report by a government-appointed expert panel that concluded that Albertans were not receiving their fair share of the province's non-renewable resources, and recommended a \$2 billion annual increase in royalties. Components of the new royalty regime include the following:

- New, simplified royalty formulas for conventional oil and natural gas that will operate on sliding scales determined based on commodity prices and well productivity. Conventional oil royalty rates will range up to 50%,



with rate caps at \$120 per barrel, and all specialty royalty programs and tiers are to be eliminated. Gas royalties, set by a sliding rate formula sensitive to price and production volume, will range from 5 to 50%, with rate caps at \$17.50 Cdn/MMBtu. Royalties for natural gas liquids will be set at 40% for pentanes and 30% for butanes and propane.

- The government will increase its royalty share from oil sands development by implementing a sliding scale for oil sands royalty rates ranging from 1 to 9% pre payout and 25 to 40% post-payout, depending on the price of oil. Specifically, the base royalty will start at 1%, and increase for every dollar the world oil price is priced above \$55 per barrel, to a maximum of 9% when oil is priced at \$120 or higher. The net royalty will start at 25%, and will similarly increase for every dollar oil is priced above \$55 per barrel to a maximum of 40% when oil is priced at \$120 or higher.
- In lieu of cash royalties, where feasible, the province plans to exercise its existing right to receive “royalty-in-kind” on oil sands projects. By taking raw bitumen delivered to the Crown-operated Alberta Petroleum Marketing Commission in lieu of royalties, the province seeks to support value-added, Alberta-based upgrading projects.

- Existing oil sands projects will not be grandfathered - both Suncor and Syncrude, with existing royalty agreements not set to expire until 2016, are expected to be transitioned to the new royalty framework.

BRITISH COLUMBIA

BCUC Issues Rate Design Decision on BC Hydro Application

On March 15, 2007 BC Hydro filed its first general rate design application in 16 years (after a lengthy government-imposed rate freeze that ended in 2003, an enquiry into the allocation of the benefits of BC Hydro’s low-cost Heritage Resources, two revenue requirements proceedings and its first comprehensive long-term resource planning review in this year). In the application BC Hydro sought approval for rate changes based on its current cost of service analysis, including a small increase in residential rates and a significant decrease in small commercial rates. It also sought to eliminate a declining block rate structure for large commercial customers, amend its system extension rules to make the calculation of the utility extension allowance more transparent, and phase-out an interruptible residential incentive rate established for residential customers when BC Hydro had significant system surpluses.

Despite the near-unanimous desire of intervenors and BC Hydro to attempt a negotiated settlement of the application, the BC Utilities Commission (BCUC), in light of the long hiatus since the last general rate design application, directed that the application should be reviewed in an oral hearing. That hearing was held in July, and on October 26, 2007 the BCUC issued its Phase I decision. (Phases II and III are still underway, and address rate issues in communities that are not connected to the high-voltage transmission system.)

As might be expected, the cost of service study received a great deal of intervenor and BCUC interest. In particular, BC Hydro’s proposal to allocate transmission and demand related generation costs on a 12 coincident peak (CP) basis was successfully challenged by industrial and commercial customers, as well as Terasen Gas. In rejecting BC Hydro’s proposal, and directing an allocation on a 4 CP basis, the BCUC has re-allocated a significant portion of BC Hydro’s cost base to residential customers. The specific effect of this ruling, and other cost of service decisions, will be known when BC Hydro makes its compliance filing shortly, but is expected to result in significant increases to residential rates, and significant decreases to commercial rates.



Large commercial customers received a reprieve in the form of a BCUC rejection of BC Hydro's proposal to re-structure the declining block rate they are currently served under, as did interruptible residential customers, whose discounted rate will not be phased out as proposed by BC Hydro. Regarding the large commercial customers, BC Hydro is to file a new re-structuring proposal in sufficient time to be implemented in April 2009. Regarding interruptible residential customers, BC Hydro is specifically directed to exercise its tariff rights including, presumably, the right to interrupt those customers.

As requested by BC Hydro, the BCUC declined to determine whether BC Hydro's tariffs and rates should be designed to discourage the use of electricity in favour of natural gas for space and water heating purposes. This issue was raised by Terasen Gas, which proposed several changes to BC Hydro's tariffs to effect that objective. The BCUC accepted BC Hydro's submissions that this was an issue that, in light of recent provincial energy and GHG emission policies, ought to be left to government to resolve.

British Columbia Action on GHG Emission Reductions

In his September address to the Union of B.C. Municipalities, the Premier announced that the Western Climate Initiative is working collaboratively to develop a cap

and trade system by next August. British Columbia will also require hard caps on GHG emissions from all heavy emitters in B.C. All ministries and Crown agencies will be legally required to be carbon neutral by 2010 – “no ifs, ands or buts”. Local governments will not be included in the legislation, but are encouraged to become carbon neutral by 2012.

New legislation will also prohibit coal fired electricity projects without 100 percent carbon sequestration, and all electricity produced will be required to have net zero GHG emissions by 2016.

Lastly, but far from least, the Premier announced the government will direct BC Hydro to fully implement a “smart” metering initiative by 2012. All of BC Hydro's 1.7 million residential and commercial electro mechanical meters are to be replaced by new meters that record consumption by the hour, enabling time of use rates, and display the energy consumption level inside the home or business. The in-home display will allow the consumer to see and react to price signals.

There is apparently much more to come in the coming months. Next up, perhaps, is the introduction of legislation this fall session to mandate the aggressive GHG reductions by 2020.

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Feature Article: Residential Natural Gas Unbundling in BC

Prior to 1987, natural gas was supplied to end use customers in British Columbia by monopoly service providers only on a bundled basis. In 1987, Inland Natural Gas Ltd., a predecessor company to Terasen Gas Inc. (“TGI”), pioneered open access in this province by applying to establish transportation service rates for its industrial and large commercial customers. Open access was made available to those customers commencing in 1987. The introduction of commodity unbundling for residential and small commercial sectors took much longer, and has faced some early problems. This article summarizes the story.

In July 1996, the BC Utilities Commission (BCUC) established a process to review the retail market for those goods and services which had not traditionally been marketed by a utility. In April 1997, following a stakeholder workshop and the issuance and review of a BCUC staff position paper, the BCUC issued its Retail Markets Downstream of the Utility Meter Guidelines (the “RMDUM Guidelines”), which contain the findings of the BCUC with respect to the participation of utilities and their non-regulated businesses (“NRBs”) in the retail markets downstream of the utility meter.

In accordance with the RMDUM Guidelines, another predecessor of TGI, BC Gas Utility Ltd., filed with the BCUC a Code of Conduct governing the relationship between TGI and its NRBs for the provision of utility resources, and a Transfer Pricing Policy addressing the pricing of resources and services provided by TGI to NRBs and divisions of the utility providing unregulated products or services. The BCUC approved TGI’s Code of Conduct and Transfer Pricing Policy in December 1997.

In November 1998, the BCUC requested TGI to propose a proforma unbundled tariff to provide both residential and small commercial customers with the option of transportation service, and the ability to purchase their gas from a non-utility provider. However, difficulties in developing an appropriate business model and a need for legislative amendments delayed the project.

In the B.C. Provincial Government Energy Plan in 2002, a strong emphasis was placed on commodity unbundling for residential and small commercial customers. In accordance with Policy Action No. 19 of the 2002 Energy Plan, the *Utilities Commission Act* was amended in the spring of 2003 to allow direct natural gas sales to residential and small commercial customers, and to require the licensing of marketers who serve those customers.

In January 2004, the BCUC approved the Code of Conduct for Gas Marketers, the purpose of which is stated to be the fostering of a sense of responsibility towards consumers and the general public by all those engaged in natural gas marketing in BC. Also in January 2004, the BCUC approved the Rules for Gas Marketers, which are designed to assist the administration of gas marketer licensing. In August 2006, following an oral public hearing, the BCUC granted TGI a Certificate of Public Convenience and Necessity for the Commodity Unbundling Project for Residential Customers.

On May 1, 2007, the BCUC announced the commencement of the Residential Commodity Unbundling Program (“RCUP”). The RCUP allowed natural gas marketers to sell long-term, fixed-price natural gas contracts to residential users. Between May 1, 2007 and June 27, 2007, gas marketers enrolled over 70,000 customers. However, aggressive enrollment practices by some marketers resulted in the BCUC receiving a considerable number of complaints from customers. The large number of complaints prompted the BCUC to review the RCUP in June 2007 and ultimately to amend the Code of Conduct for Gas Marketers to provide for stricter regulation.

TGI continues to offer the same flow-through, variable rate gas supply as always, and is the default gas commodity supplier. TGI also continues to be the monopoly distribution provider. Marketers, on the other hand, offer only fixed price contracts for the gas commodity for terms of one to five years. There are currently 12 natural gas marketers licensed by the BCUC to sell fixed-price natural gas contracts to residential customers.

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