WESTERN CANADIAN BUSINESS LAW

LAWSON LUNDELL LLP

BARRISTERS & SOLICITORS

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INTRODUCTION

Lawson Lundell LLP's Energy Law Group is pleased to present the following stories in this edition of our quarterly newsletter:

- the California PUC issues rules that will limit the import of electricity generated by GHG intensive resources;
- the BCUC declares an electricity purchase agreement between BC Hydro and Alcan to be not in the public interest, and "wholly unenforceable";
- the BCUC's practice of conditioning CPCNs on mechanisms that limit cost recovery is challenged;
- the Alberta EUB confirms the West Corridor route for Edmonton Calgary 500 kV transmission upgrade is appropriate, though not markedly superior to other routes;
- the Alberta Court of Appeal confirms the AEUB's decision regarding the "first well" exemption from off target penalties; and
- the NWT Power Corporation is proceeding with plans to expand the existing Talston hydroelectric project, and to corporately restructure to facilitate further similar projects.

Lawyers who authored the stories in this newsletter are Krista Hughes (in Calgary, at 403-781-9468); Geoffrey Wiest (in Yellowknife, at 867-669-5544) and Jeff Christian (in Vancouver, at 604-631-9115). Questions regarding this newsletter ought to be directed to the editor, Jeff Christian, at 604-631-9115.

"*A Regulatory Roadmap: Successfully Navigating Oil and Gas Licensing Regimes in the North*": this paper was authored by Keith Bergner and Mariana Storoni and presented to the Canadian Institute's Oil and Gas Law Summit in Calgary. A copy may be found at: www.lawsonlundell.com/resources/Oil.Gas.Licensing.Regimes.2007.pdf

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

REGIONAL

California PUC Issues Rules that will Limit the Import of Electricity Generated by GHG Intensive Resources

On January 25, 2007 the California Public Utilities Commission (CPUC) issued decision 07-01-039, establishing an interim emissions performance standard that can significantly limit long-term imports into California of electricity generated from coal-fired and other GHG-intensive plants. The order is applicable to load-serving entities in California, and their acquisition of baseload generation (minimum 60% capacity factor), either through their own new investment, or through electricity purchase contracts exceeding 5 years in term. Such baseload generation must have GHG emissions rates "no higher" than combined cycle gas turbine generation,

which the CPUC has determined means 1,100 pounds of CO_2 per megawatt-hour.

The contractual limits apply to each individual power plant from which the baseload supply will be procured. Moreover, to ensure substantial compliance with the standards, electricity purchase supply contracts with terms of 5 years or more must specify the (compliant) generation plants from which the electricity will be procured or must contain assurances that all energy supplied under the contact is, except in limited circumstances, procured from "pre-approved renewable technologies or resources". The burden will be on the load serving entities to demonstrate that their electricity purchase contracts comply with the new standards.

The emission standards are required, says the CPUC, "to reduce California's financial risk exposure to the compliance costs associated with future GHG emissions" that might arise as California develops and implements an enforceable "load-based GHG emissions cap". With almost 20% of the state's electricity consumption generated from coal-fired plants outside California, and with California being one of the largest electricity markets in the Western Interconnection, the new rules are bound to have an impact on the development of new electricity supply in the entire region.

BRITISH COLUMBIA

Alcan Electricity Sale Agreements Rejected by BCUC

On December 29, 2006 the BC Utilities Commission declared recently-signed Alcan energy sale agreements with BC Hydro to be not in the public interest and wholly unenforceable. Under these agreements Alcan would have delivered 170 average megawatts (aMW) of "Tier 1" energy to BC Hydro starting in 2007 and declining to 55 aMW in 2015 through to the end of contract term; and 55 to 60 aMW of "Tier 2" energy. The Tier 1 and Tier 2 energy differ in terms of price, and other terms and conditions of energy delivery. The price that BC Hydro would have paid for the energy depended on whether Alcan completed a modernisation project at its Kitimat aluminium smelting facilities. If the modernisation project were to be completed by December 31, 2014, then the price would be based on the weighted-average price BC Hydro expects to pay successful bidders into its 2006 Call for Energy (about $80/MWh).

In a very short summary of its decision the BCUC stated that prices in the 2006 Call for Energy "were obtained through a competitive process for a specific product with pre determined terms and conditions", while concluding that the Alcan agreements were "negotiated in a tri-lateral environment with no pre-determined terms and conditions". Moreover, wrote the BCUC, the pricing provisions of the Alcan agreements "should have reflected both Alcan's opportunity cost and the specific risks to both Alcan and BC Hydro arising from the recall notice [issued pursuant to the prior electricity sale agreement]". The BCUC made it clear that its decision was not based on concerns regarding the linkage between the agreements, and any incentives or disincentives for Alcan's smelter modernization project at Kitimat. Finally, the BCUC concluded that the test of what constitutes the public interest is a flexible test, and that there is a broad range of interests that should be considered in determining whether an energy supply contract is in the public interest.

The BCUC's full reasons for decision were released on February 2, 2007 and are available on the BCUC's website at http://www.bcuc.com/ApplicationView.aspx?ApplicationId=135. Each of the Province, Alcan and BC Hydro has applied to the BC Court of Appeal for leave to appeal the BCUC's decision.

Legal Issue Looming: Can the BCUC Condition its CPCNs on Mechanisms That Limit a Utility's Ability to Recover Prudently Incurred Costs?

In a number of recent decisions the BCUC has issued certificates of public convenience and necessity (CPCNs) to utilities allowing them to proceed with projects, but on condition that they bear some or all of any cost over runs regardless of cause. For example, a recent decision

by the BCUC granted a CPCN to the BC Transmission Corporation in regard to its Vancouver Island Transmission Reinforcement Project and that CPCN was conditioned on a cost control mechanism that purports to incent better project management by penalizing BCTC by 25% of its allowed return on equity if the project costs are more than its P90 estimate, and rewarding BCTC with a 25% increase in its allowed return on equity if the project costs are less than the P10 estimate. Similar mechanisms have been imposed in CPCNs issued to FortisBC (Big White Supply Project) and Terasen (Whistler Natural Gas Project).

The issue of whether the Commission can lawfully impose such conditions has now been raised by BC Hydro, in its final reply submissions regarding its CPCN application for the Aberfeldie Redevelopment Project (a proposed redevelopment of a 30 year old 5 MW hydroelectric facility into a 24 MW facility). Responding to intervenor submissions advocating such a condition in the Aberfeldie CPCN, BC Hydro has argued that such conditions may unlawfully limit a utility's ability to obtain approval of rates that are just and reasonable, to the extent it is precluded by such a mechanism from recovering its prudently incurred costs and a reasonable return on its investment. A decision on the application is expected shortly.

BC Hydro's F07/F08 Revenue Requirements Settlement: Clarification

In our last newsletter we were not as clear in our description of BC Hydro's recent rate increases as we could have been. The approved rate increase for F2008 is 3.64% higher than F2006 rates and 2.1% higher than the approved F2007 rates, inclusive of the rate rider.

ALBERTA

AEUB Confirms Selection of West Corridor for 500kV Transmission Line

On December 6, 2006, the Alberta Energy and Utilities Board (AEUB or Board) issued Decision 2006-114 in which the Board confirmed that the West Corridor selected by the Alberta Electric System Operator (AESO) for siting the 500kV transmission line required to reinforce Alberta's north-south transmission system is appropriate.

As previously reported in our newsletters, the Board agreed to reconsider the general route approval of the West Corridor in response to numerous requests from landowners concerned that evidence regarding the appropriateness of the corridor was not before the Board when it made its original decision in 2005. As part of the review hearing, the AEUB heard new evidence about agricultural impacts, population density, land values, environmental and recreational impacts, health and safety and First Nations impacts from groups representing more than 1,600 landowners. On re-evaluating the AESO's general routing selection in light of the new evidence, the Board found that each of the East, West and Central corridors considered by the AESO (and a fourth corridor proposed by ATCO Electric) present a similar degree of challenge for future transmission development, and that no one corridor was markedly superior. Concluding that intervenors had not established that the West Corridor was unsuitable for future transmission development, the Board confirmed the West Corridor general routing for the line.

AltaLink Management Ltd., the transmission facility operator direct-assigned responsibility for construction of the transmission line, filed facilities applications related to the line last fall. To date, AltaLink's facilities application to confirm the exact routing through the West Corridor has been delayed twice at the request of intervenors. The facilities hearing is currently scheduled to begin in mid-March 2007.

Alberta Court of Appeal Confirms "First Well" Exemption Criteria

The Alberta Court of Appeal recently confirmed the criteria for the AEUB to apply off-target penalties for oil wells in Alberta. In 2005, West Energy Ltd. (West) sought an off-target penalty to be applied to Highpine Oil & Gas Limited (Highpine), whose well shares an oil pool with West. Alberta legislation requires drilling within specific target areas for specific pools. However,

to support companies willing to take the risk associated with drilling exploratory wells, penalties are not generally imposed if a well meets the criteria for a "first well".

Initially, the Board determined that Highpine's oil well met the criteria for a first well so it did not impose a penalty. On reconsideration, the Board varied its earlier decision and decided that Highpine's well did not meet the criteria of a "first well" and that it would be subject to an off-target penalty. Highpine applied to the Alberta Court of Appeal for leave to appeal the AEUB's decision. In *Highpine Oil & Gas Limited v. Alberta* (Energy and Utilities Board), 2006 ABCA 269, issued September 28, 2006, the Court confirmed the AEUB's interpretation of subsection 4.060 of the Oil and Gas Conservation Regulations that the first drilled oil well must be operating under conditions that could allow for sustained production within six months of the spud date to avoid the penalty.

The Court confirmed that, unlike gas wells which must only demonstrate commercial viability, oil wells must be actually connected to processing facilities to demonstrate the capability of production. The fact that Highpine did not have production facilities in place within six months of the spud date was conclusive, and the Board's determination was not open to appeal. Thus, the Court denied leave to appeal.

NORTHWEST TERRITORIES

Hydroelectric Expansion in the Northwest Territories

Deze Energy Corporation has announced that it is preparing to submit applications for permitting for the proposed Taltson hydroelectric expansion project to the Mackenzie Valley Land and Water Board. Deze Energy Corporation is a partnership between the Northwest Territories Energy Corporation, a subsidiary of the Northwest Territories Power Corporation, the Akaitcho Territory Government and Metis Energy Company Ltd. The project has the support of aboriginal groups in the area, except for the people of Lutselk'e.

The existing Taltson hydro electricity station is located on the Taltson River some 56 km north-east of Fort Smith. The Talston hydroelectric expansion project increases the capacity of the existing facility to create energy which can then be sold to the diamond mines north of the Taltson site. The project also involves the construction of a 435 kilometre transmission line from the hydroelectric site to the mines.

The Northwest Territories Power Corporation has also announced its intention to seek approval from the Government of the Northwest Territories to undergo a corporate restructuring which will enhance its ability to undertake projects such as the Taltson hydroelectric project. The proposal would involve the creation of a new holding corporation which would insolate Northwest Territories Power Corporation, its assets and its customers from the risk associated with higher-risk hydro projects such as the Taltson expansion project.

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