LAWSON LUNDELL
BARRISTERS AND SOLICITORS

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INTRODUCTION

Welcome to Lawson Lundell's second quarterly newsletter dedicated to the energy industry in Western Canada. In this newsletter we describe recent developments of interest in British Columbia, Alberta, the Northwest Territories, the Yukon and the Western United States. For further information about topics in this newsletter, about Lawson Lundell, or to receive back-copies of the newsletter, please contact one of our lawyers identified on the back page, or visit our web-site at www.lawsonlundell.com.

EDITORIAL COMMENT: ENRON

The implosion of Enron has been front-page news over the last several months and the effects on the North American energy industry have been dramatic. But what does it mean to the energy industry in Western Canada specifically? Enron Canada Corp. has sold its Sundance B power purchase arrangement to TCPL and AltaGas Services, thereby moving out of the competitive supply of physical electricity. Enron Canada Corp., after much legal manoeuvring attempting to satisfy trading counterparties of its creditworthiness, has significantly downsized and what the future holds for it is uncertain. The fight will continue between Enron Canada and counterparties who are alleged to owe money under terminated contracts.

UBS Warburg, which acquired the EnronOnline web-based trading system, is planning to take on a core group of Enron Canada employees and appears to be gearing up to recommence operation, although without the existing Enron Canada book of business.

The Enron debacle has caused market participants to focus on one thing, almost to the exclusion of all others – trading counterparties' balance sheets. If counterparty credit has been an important issue facing market participants in recent years, it is the key issue today. Many if not all organizations are taking a closer look at their enabling and trading agreements to ensure that the credit-risk provisions contain appropriate protective provisions. In addition to the impacts on counterparty credit issues, the Enron collapse has resulted in intense scrutiny of the remaining market players by those with whom they do business. With the credit issue likely creating a barrier to entry into the market of marketing companies that might have become players a year ago, the impact on the liquidity of the market will likely be felt for some time.

REGIONAL

National Energy Board – Negotiated Settlement Guidelines

The National Energy Board's *Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs* have been in use since 1994. A limitation in

the current Guidelines is the lack of a mechanism to deal with "settlements" that lack unanimous support from interveners – so called "contested settlements". On January 30, 2002 the Board proposed new Guidelines that would allow the Board to approve a "contested settlement", and also allow for a more active staff role in the negotiation process. The deadline for filing comments is March 20, 2002.

National Energy Board – Aboriginal Consultation

On March 4, 2002, the Board issued a Memorandum of Guidance regarding consultations with aboriginal peoples. In it, the Board expressed the view that while it does not have a direct responsibility to consult with aboriginal people, it does have a responsibility to determine whether the Crown has adequately consulted in cases where implementation of the decision may interfere with aboriginal or treaty rights. The Board indicated that in future it will require applicants to clearly identify the aboriginal people who may be affected by a project and provide evidence that there has been adequate Crown consultation with them. This will require proponents to either be involved with the Crown in the consultation process or to acquire the necessary evidence from the Crown.

Potential Northern Pipelines

On December 6, 2001, the Northern Pipeline Environmental Impact Assessment and Regulatory Chairs Committee comprising the chairs of the National Energy Board, the Mackenzie Valley Environmental Impact Review Board, the Mackenzie Valley Land and Water Board, the Northwest Territories Water Board, the Inuvialuit Settlement Region Joint Secretariat, the Inuvialuit Land Administration, the Gwich'in Land and Water Board, the Canadian Environmental Agency, and the Sahtu Land and Water Board issued a draft cooperation plan in connection with the environmental impact assessment and regulatory review of a northern gas pipeline project through the Northwest Territories. This committee report was undertaken to attempt to rationalize the myriad of regulatory processes in place in connection with a Mackenzie Valley Pipeline. While its recommendations, if accepted, would considerably reduce the regulatory complexity that might otherwise exist, the remaining process was predicted to take in the order of 44 months.

Comments on the draft cooperation plan were invited by March 8, 2002. Immediately prior to that date, the Chair of the NEB publicly indicated that he hoped the time frame for the process could be reduced to 24-36 months without being specific as to what changes, if any, were contemplated from the draft cooperation plan.

Sale of Westcoast Energy to Duke Energy

The $8.5B purchase of Westcoast Energy by Duke Energy closed on March 14, having been approved by Industry Canada on March 8.

B.C. Court of Appeal Decisions: Duty to Consult Extended to Private Companies

The B.C. Court of Appeal has recently issued two important decisions regarding the duty to consult aboriginal groups about resource development projects. In *Taku River Tlingit First Nation v. Ringstad*, released in January, the Court dealt with the issue of when the duty to consult arises. Earlier cases had held that, until an aboriginal group had established its aboriginal rights, government was not obligated to consult the group about impacts on rights they asserted. In *Taku River Tlingit*, the Court held that the duty to consult is not dependent on a court having decided on the existence of aboriginal rights. In the circumstance of the case, it was likely that the Tlingit could establish some aboriginal rights or title, the provincial and federal governments were engaged in land claims negotiations with the Tlingit on that basis. Therefore, government was obligated to consult the Tlingit about the potential infringement of their rights.

On February 27, the Court of Appeal released its decision in *Haida Nation v. B.C. and Weyerhaeuser*. *Weyerhaeuser* takes the duty to consult beyond the limits established in previous cases. In *Weyerhaeuser*, the Court of Appeal held that a private company, Weyerhaeuser, was subject to the duty to consult. If upheld, this represents a significant and unexpected extension of the duty to consult.

Supreme Court of Canada: Bank of Montreal v. Dynex Petroleum

In *Bank of Montreal* v. *Dynex Petroleum Ltd.*, 2002 SCC 7, the Court has affirmed the proposition that a royalty interest or an overriding royalty interest can be an interest in land. In particular, citing *Vandergrift* v. *Coseka Resources Ltd.* (1989), 67 Alta. L.R. (2d) 17 (Q.B.) @ 27, the Court said that if:

"1) the language used in describing the interest is sufficiently precise to show that the parties intended the royalty to be a grant of an interest in land, rather than a contractual right to a portion of the oil and gas substances recovered from the land, and

2) the interest, out of which the royalty is carved, is itself an interest in land."

then a royalty or an overriding royalty interest is an interest in land.

This is significant because until now, there was no definitive legal test that a draftsperson of a royalty agreement could try to meet if it was the intention of the parties to create an interest in land. Parties need to be sure to assess their standard form agreements to ensure that, if it is their intention to create an interest in land, the language of the agreement has the necessary degree of precision to show that intention.

BRITISH COLUMBIA

B.C. Energy Policy Review

The Task Force's final report has been delivered to the British Columbia government, but there is no word on when it will be released to the public.

B.C. Offshore Oil and Gas Review

In October of 2001, the B.C. Government established an Offshore Oil and Gas Scientific Panel which delivered its final report to the Minister of Energy and Mines on January 15, 2002. According to Minister Neufeld, the report has not been released to the public pending consultation with the federal government regarding possible lifting of the long standing provincial and federal moratoria on B.C. offshore oil and gas activity.

On March 6, 2002, the Haida Nation filed an action in the Supreme Court of British Columbia against the provincial and federal governments, claiming aboriginal title to all of the land, inland waters, seabed and sea defined as Haida Gwaii and shown on a map as including all of the Queen Charlotte Islands to a line drawn in the sea halfway between the Queen Charlotte Islands, the B.C. mainland, and the north end of Vancouver Island. This area appears to include about half of Hecate Strait and Queen Charlotte Sound, the areas with the greatest oil and gas potential on the B.C. coast. The Haida ask, among other things, that the British Columbia Supreme Court quash all licences, leases, permits and other tenures over Haida Gwaii as may be incompatible with aboriginal title or with the exercise of aboriginal rights.

BC Gas Inland Pacific Connector Project

BC Gas applied on February 6 to the BC Environmental Assessment Office for approval of the 237 km, 24 inch Pacific Connector Project, from Southern Crossing near Oliver to Huntingdon, in Abbotsford, plus related infrastructure. The stated purpose of the project is to "enable natural gas to be delivered to the BC gas Coastal Transmission System at the existing Huntingdon station to serve the Pacific Northwest's growing peak day and seasonal gas requirements... to help prevent the dramatic increases in natural gas prices that were experienced in 2001...". Comments on the application may be made until April 19, 2002.

Westcoast Energy Southern Mainline Expansion Project

Westcoast has applied to the Board for approval of a $338.4M expansion of its Southern Mainline system in B.C. The project would expand capacity on the existing system by 200 Mcf/day through the construction of eight loop segments totalling 89.5 kilometers. The Board has ordered a two-phase hearing process, commencing July 8 (Phase 1) and September 30 (Phase 2). Interested parties that wish to intervene in Phase 1 must advise the Board by April 19.

Georgia Strait Crossing (GSX)

In January of this year, the Joint Review Panel concluded its public consultation sessions, and issued an expanded and clarified list of issues. The Panel is acting in two capacities, both to consider the environmental assessment of the project under the *Canadian Environmental Assessment Act* and the issuance of a certificate under the *NEB Act*.

On January 31, 2002, the Panel requested submissions from the parties as to whether the Panel has statutory authority to consider the environmental effects of the combustion of gas to be transported by the pipeline and of gas combustion at existing and proposed Vancouver Island generation facilities. The Panel also asked if it should consider the environmental effects of gas combustion if it had authority to do so. The final deadline for written submissions is March 22, 2002, after which the Panel will decide whether to hold oral hearings on the issue. The main hearing on the application is due to commence on June 17, 2002.

In the meantime, FERC gave its preliminary approval to the project on March 13 on non-environmental issues.

More information on the GSX Project, the recent submissions and the review process itself is available at: www.neb-one.gc.ca and www.ceaa-acee.gc.ca

ALBERTA

Nova Gas Transmission Ltd.: Application for Approval of Costs for Delivery Service to the Fort McMurray Area

Nova brought an application to the Alberta Energy & Utilities Board for approval of the recovery of costs for the extension of mainline service to Fort McMurray after receiving three separate requests for delivery service to that area. Nova determined that the combined requests fell within its Guidelines for new delivery service. It also determined that to provide the requested service, Nova would have to construct new facilities, acquire capacity on an existing pipeline through a transportation by other agreement (TBO), or purchase facilities.

On February 5, the Board approved the recovery of TBO costs until December 31, 2002 and in doing so made several findings of interest. First, the Board affirmed that the prior approval of a pipeline in any given area does not fix the regulatory and commercial framework for that area. In particular, the Board said that it would continue to evaluate any proposal for pipeline service based on the Board's assessment of the proposal's consistency with the overall regulatory framework and the broad public interest.

Second, the Board voiced the concern that as long as the costs of intra-Alberta delivery service are recovered through the existing methodology, there may be a transfer of income from system-wide shippers to a few which could inhibit competition and result in inefficient intra-Alberta delivery services.

Finally, to the extent that Nova plans to continue including costs to serve the Fort McMurray area in its overall revenue requirement, the Board expects that Nova will either submit an agreement regarding cost allocation among receipts, intra-Alberta and ex-Alberta deliveries, or file an application with the Board prior to December 31, 2002.

ESBI Alberta Ltd. Transmission Congestion Management Principles Application – Part A: Scope of Proceeding – Decision 2002-17

Following a pre-hearing conference held January 31, 2002, the EUB issued its decision establishing the scope of the congestion management module hearing which is set to commence April 22, 2002. The following determinations will govern the scope of the hearing:

- It will be limited to consideration and approval of congestion management principles that are consistent with the existing legislative framework.

- Depth will be limited to consideration and establishment of general principles.

- Consideration of the Transmission Development Plan will be limited to certain planning assumptions.

- Scope of the proceeding – will include the appropriate method of handling real-time transmission congestion.

- Consideration of high-level principles relating to tariff design to recover congestion management costs, including general principles of cost allocation.

- Consideration of transmission rights as a congestion management tool and whether transmission rights for exporters should be granted as part of the proposed incremental cost export tariff.

Finally, the Board noted that it will exercise "considerable caution" in approving congestion management principles to avoid interfering with the economic signals intended by the EU Act for the development of new generation in Alberta.

The outcome of the congestion management proceeding will provide the principles that the Transmission Administrator and stakeholders will apply in moving forward with the development of a tariff that incorporates congestion management principles.

New Power Generation Projects

The EUB has approved applications by EPCOR, TransAlta and AES Calgary ULC: EPCOR received approval to expand its coal-fired plant at Genesse by an additional 490 MW; TransAlta received approval to expand its coal fired power plant at Keephills by an additional 900 MW; finally, AES received approval to construct and operate a new, gas-fired power plant with a capacity of 525 MW. Board approval does not guarantee that the projects will proceed.

Licensee Liability Rating Program / Energy Development License Transfers

In our Winter 2001 Newsletter we reported on the EUB's proposed interim changes to the licence transfer and corporate liability screening processes. On December 4, 2001 the Board issued ID 2001-8 describing the revised licensee liability rating (LLR) program and energy development licence transfer requirements.

The interim directive introduces a replacement LLR program as both the liability assessment tool on a transfer and the monthly licensee liability assessment tool. It applies to all upstream oil and gas facilities included in the expanded orphan program. For the purposes of the program, a licensee's deemed asset will be considered to be its "eligible Alberta cash flow" and its deemed liability will be considered to be the abandonment and reclamation liability for wells and facilities within the orphan program for which it is the licensee.

The EUB will calculate the LLR for each licensee on a monthly basis and for a transferor and transferee on receipt of a licence transfer application. A licensee who's deemed liability exceeds its deemed assets will be required to place a security deposit with EUB equal to the difference between its deemed liabilities and assets. ID 2001-8 will be effective May 1, 2002. It will replace the minimum well screening requirements of s.3.069 of the *Oil and Gas Conservation Regulations*, ID 2000-11, and ID 2000-11 amendment. The interim WFR process has been extended to April 30, 2002.

NORTHWEST TERRITORIES

NWT Power Corporation General Rate Application

On February 15, 2002, the Public Utilities Board of the Northwest Territories ("PUB") issued Decision 1-2002 approving a negotiated settlement of Phase I of the Northwest Territories Power Corporation's ("NWTPC") General Rate Application ("GRA"). The GRA was filed by the NWTPC in May of 2001 seeking a substantial increase in the utility's revenue requirements (Phase I) and rate increases sufficient to cover the increased revenue requirement (Phase

II). The negotiated settlement has the overall effect of reducing the NWTPC's revenue requirement an aggregate of $10,421,000 over two years. This Decision of the PUB completes Phase I of the GRA. The next step in the process will be for the PUB to establish a hearing process to consider Phase II – rate increases sufficient to cover the increased revenue requirement.

YUKON

On April 1 the Yukon Territory will rename and restructure the Yukon Department of Economic Development into the Yukon Department of Energy, Mines and Resources, which will have all territorial responsibility relating to oil and gas.

WESTERN UNITED STATES

U.S. Supreme Court Upholds Order 888

On March 4 the United States Supreme Court upheld FERC's ground-breaking Order 888. In that order, jurisdictional electric transmission owners were ordered to provide non-discriminatory, open access, wholesale transmission service, and the marketing affiliates of non-jurisdictional transmission owners had their right to sell at market-based rates made conditional on their transmission-owning parents providing the same service. In upholding Order 888, the Court refused to order open access retail services, which relief had been sought by Enron, among others.

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