



2001 in Review: Recent Canadian Regulatory Developments Affecting Natural Gas Pipelines

By

[Christopher W. Sanderson, Q.C.](#)

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2001 IN REVIEW: RECENT CANADIAN REGULATORY DEVELOPMENTS AFFECTING NATURAL GAS PIPELINES¹

1. Introduction

2001 began eventfully as the unprecedented prices for natural gas led to frenzied markets and unprecedented bottlenecks in the natural gas delivery system, particularly in western Canada. Since then, average to below average price levels have eased panic but left producers and consumers alike aware of how dramatically transportation constraints can affect commodity prices.

This heightened awareness of the significance of transportation arrangements has re-emphasized the importance of the regulatory framework governing natural gas transmission. Against this backdrop, this paper will outline the significant regulatory decisions and related events in 2001 and early 2002 affecting the regulation of natural gas pipelines in Canada. The recent regulatory developments, which have occurred over the past year or so, are reviewed below. The paper begins by summarizing some important federal decisions of the National Energy Board and then turns to provincial decisions with the focus on Alberta and B.C.

2. Federal Developments

A. General Initiatives

(1) Pipeline Harmonization

The most significant development in Canadian pipeline regulation in 2001 likely was the substantial steps that were taken towards transferring the responsibility for determining tolls relating to the transportation of gas through Alberta by Nova Gas Transmission Ltd. (“NGTL”) from AEUB to NEB regulation. Since TransCanada Pipelines Ltd.’s (“TCPL”) merger with NGTL in 1998, provincial regulation of the system has been tenuous. Since then, a significant percentage of new production from the Western Canadian Sedimentary Basin (“WCSB”) has been from outside Alberta, particularly in B.C. and the Northwest Territories, and with the prospect of Mackenzie Delta gas becoming more real, the notion of a provincially regulated portion of a national natural gas delivery system has become more and more anomalous.

Canadian governments have responded to these changed circumstances. In 1999 they struck a task force comprised of the energy ministries of the ten provinces, the two territories, and the federal government (the “Task Force”). By August of 2001, this Task Force was set to present a two-part recommendation to a joint meeting of all of the responsible ministers. The first recommendation focussed on the smaller Group 2 pipelines regulated by

¹ Prepared by Chris Sanderson, Q.C. with the invaluable assistance of his partners, Jeff Christian in the Vancouver office of Lawson Lundell and Cecilia Low in the Calgary office.

the NEB. The Task Force recognized that although a pipeline might cross provincial or international boundaries, the interests affected by it were primarily local in nature. Accordingly, the Task Force has recommended that new and existing Group 2 pipelines be given the option to become subject to provincial regulations.

The second recommendation focussed on NGTL's facilities in Alberta (the "Alberta System"). The Task Force called for splitting the jurisdictional responsibility over the Alberta System between Alberta and the federal government. The intent of the recommendation was to ensure that Alberta maintained control of wellhead activities including gathering and processing but that the mainline transmission system, which was moving gas through Alberta, would be subject to federal regulation.

The meeting at which these recommendations were to be considered was scheduled for September 11, 2001. Shortly before the meeting, CAPP wrote to the Task Force seeking time to engage in a consultative process to determine how best to implement the ideas being developed by the Task Force. CAPP and TCPL had both been kept advised through the Task Force's deliberations, but CAPP expressed discomfort about how the recommendations might be implemented.

In the event, the September 11 meeting was cut short by the events of that day and the ministers have not met as a group since to consider the recommendations of the Task Force. In the meantime, as a result of CAPP's request, an industry task force has been set up and is developing recommendations on the best means to meet the government's objectives of ensuring that through Alberta gas is transported under a federal regulatory regime.

It is anticipated that a recommendation for the manner in which the Alberta system will be regulated will be forthcoming in the second quarter of this year. For its part, TCPL has made clear it intends to proceed with a split jurisdiction model in one form or another by the fall of this year. It has elaborated its thoughts on the implications of this initiative in its Transportation Services White Paper (the "White Paper") dated January 16, 2002.

In the White Paper, TCPL proposes a system which will expand the existing Nova Inventory Transfer ("NIT") market beyond the borders of Alberta so that gas delivered in B.C. and, conceptually, the Northwest Territories will enjoy the marketing benefits offered by NIT. TCPL itself identifies these benefits as follows:

- Buy and sell gas efficiently in a market with a high level of liquidity
- Conduct non-physical gas transactions

- Conduct balancing transactions at a liquid exchange point
- Contract transportation independently into and out of the NIT market
- Buy and/or sell gas anonymously.

To complement the expanded NIT, TCPL proposes to define a market area encompassing all of its facilities downstream of North Bay by establishing a notional market centre where industry participants can buy and sell gas with a high degree of liquidity and efficiency. By creating a single supply area and a single market area separated by long haul transmission, TCPL has emphasized the national character of its undertaking and made seamless regulation of its principal system a necessary result.

The proposals of the Task Force and of TCPL will not be implemented overnight. Legislative change will be required and regulatory adjustments necessary. We can expect these to occur over the next two-four years.

(2) Guidelines for Negotiated Traffic, Tolls and Tariffs.

The National Energy Board's guidelines for negotiated settlements have been in use since 1994. A key limitation in the current guidelines is the lack of any mechanism to deal with "settlements" that do not have unanimous support from interveners – so called "contested settlements". By letter dated January 30, 2002, the NEB has proposed Guidelines which would allow the Board to approve a "contested settlement", and also allow for a more active staff role in the negotiating process. The deadline for filing comments is March 20, 2002.

(3) Consultation with Aboriginal Peoples

On March 4, 2002, the NEB issued a Memorandum of Guidance with respect to consultations with aboriginal peoples (https://www.neb-one.gc.ca/whatsnew/AboriginalConsultation_e.pdf). In it, the Board expressed the view that while it does not have a direct responsibility to consult itself with aboriginal people, it does have a responsibility to determine whether there has been adequate Crown consultation before rendering its decision in cases where the effect of the decision may interfere with an aboriginal or treaty right. The Board indicated that for that reason 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.

The obligation on companies to consult, at least in British Columbia, has been further elaborated in the very recent decision of the British Columbia Court of Appeal in *Haida Nation v. B.C. and Weyerhaeuser*, 2002 B.C.C.A. 147.

In this decision, for the first time the Court has said that the consultation obligation rests not only on the Crown but also on companies proposing to undertake projects which may affect aboriginal interests. This is a departure in British Columbia law and may have profound implications for the consultation obligations associated with the construction of new pipelines.

B. Major Gas Pipelines: Applications and Decisions

(1) Multi-Pipeline Cost of Capital

On December 6, 2001, the Board approved a rate of return on common equity for some Group 1 companies, including TransCanada Pipelines, of 9.53% for 2002². This decision is pursuant to the ROE adjustment mechanism approved in the Multi-Pipeline Cost of Capital Decision (RH-2-94).

However, TransCanada, in an application for approval of its cost of capital for use in calculating mainline tolls for 2001 and 2002 has applied for a variation of the generic methodology set out in RH-2-94. The net result would be a return of 12.5% on a deemed common equity ration of 40%. TransCanada's argument is that 12.5% more accurately reflects the other investment opportunities available to it. The hearing into the application commenced on February 27.

(2) Maritimes and North-East Pipeline Ltd.

By Order TG-3-2001³ the Board approved M&NP's application to charge tolls in accordance with its Settlement Compliance filing with the exception of the application of M&NP's lateral policy as embodied in Article 17⁴ of the proposed terms and conditions of service to certain potential extension to M&NP's system. The latter was dealt with by way of a separate proceeding. This Order led to two significant further developments

First, on September 14, 2001, M&NP filed its Settlement Compliance⁵ filing with the Board for approval pursuant to s. 19(2) and Part IV of the *National Energy Board Act*. The filing incorporated the terms and conditions of M&NP's August 31, 2001 Settlement Agreement. All interested parties but the Union of New Brunswick Indians supported the filing and urged the Board to approve it.

² Rate of Return on Common Equity (ROE) for 2001 (File 4750-A000-11), 6 December, 2001

³ In the Matter of the National Energy Board Act (the Act) and the regulations made thereunder; and In the Matter of an application by Maritimes & Northeast Pipeline Management Ltd. (M&NP) dated 23 March 2001 for approval of final tolls pursuant to subsection 19(2) and Part IV of the Act, filed with the National Energy Board (the Board) under File 4200-M124-2

⁴ 9 November 2001

⁵ Maritimes & Northeast Pipeline Management Ltd. Hearing Order RS-3-2001, Reasons for Decision on the Article 17 Issue

The UNBI opposed the acceptance of the Settlement without a hearing, and raised a number of issues all relating to the need for benefits to aboriginal peoples of New Brunswick. In particular, in the proceedings leading up to the Settlement, the UNBI had asked the Board to ensure that M&NP make financial provision in their tolls for the interests of aboriginal peoples they represented and to enter into long-term agreements with the First Nations of New Brunswick.

While the Board found that the fact that the UNBI is not a toll payer was of no consequence “in their status to challenge the settlement agreement”, it also found that the matters raised by the UNBI did not relate directly to the Settlement Agreement and related tolls proceeding and that there were more appropriate forums in which to address their concerns. The Board considered that the benefits of the Settlement outweighed the objections raised by the UNBI. The fact that those objections did not relate, in substantial measure to Part IV matters was clearly a significant factor in the Board’s decision.

As noted above, the Board subsequently has indicated a wish to reconsider its approval process where settlements are not unanimous and the developments on M&NP may have been the final event persuading the Board this reassessment was necessary.

Second, the Article 17 hearing required the Board to fully examine the lateral policy issue. While doing so, the Board accepted evidence that focussed on the potential development of 260 km of 20” diameter pipe extending from an interconnection with the proposed Cartier Pipeline Project through northern New Brunswick to M&NP’s mainline. The Cartier Pipeline would extend to Quebec City from the New Brunswick border, thus permitting Sable Island gas to reach a major Canadian market. The Board concluded the new line would be a mainline extension and not a lateral.

However, the Board took care to point out that it had not determined that the costs of such facilities would necessarily be rolled-in with the balance of the M&NP system. Cartier Pipeline subsequently made an application to the Board for approval of an appropriate toll treatment but recently withdrew its application, ostensibly for lack of producer support.

(3) TransCanada

By Order AO-2-TGI-6-2000 dated November 1, 2001⁶, (the “Order”) the Board continued Trans Canada’s current interim tolls as set by Order AO-1-TGI-6-2000

⁶ IN THE MATTER OF the National Energy Board Act (the Act) and the regulations made thereunder; and IN THE MATTER OF an application filed with the National Energy Board (the Board) under File 4200-T001-15 by TransCanada Pipelines Limited (TransCanada) for certain orders respecting tolls specified in a tariff pursuant to Part IV, Sections 59, 60, 64 and 65 of the Act

pending a final order of the Board in the RH-4-2001⁷ proceeding. During the course of this proceeding, the Board signalled a number of potential changes to come.

First, the Board considered that the question of sharing the related impacts of non-renewal of firm contracts is a significant issue facing TCPL and its stakeholders and that because of the broad range of issues involved, there was a need for a thorough and comprehensive consideration of all factors involved in assessing the potential solutions. Citing a distinction between risk sharing and sharing the realization of that risk, absent clear evidence of imprudence, the Board declined to impose an after the fact financial impact on TCPL which it had not traditionally borne. The Board did say that some sharing of the risk of non-renewal between TCPL and its shippers may be appropriate to consider on a prospective basis and that the appropriate balance between risk and reward and risk management tools ought to be considered in the future.

Second, while the Board was satisfied that it was appropriate to continue with a traditional cost of service methodology for 2001 and 2002, it found that for the longer term, a review of Trans Canada's business and regulatory framework is necessary.

Third, with respect to new services, the Board approved TCPL's proposed new FT Make-Up and AOS Credits services available for FT shippers. The Board accepted the arguments that for older pipeline systems to remain viable in the new competitive markets they needed to be able to take action to retain their firm shippers and optimize the utilization of their systems. In response to the argument that the proposed services were unduly discriminatory, the Board found that "With a complex, modern pipeline system and tariff, it would be unreasonable and impractical to require a pipeline to offer only those services that could be utilized by all shippers to the same extent."

(4) Westcoast

By way of Order MO-4-2001⁸ the Board approved Westcoast's application for leave to purchase the Maxhamish pipeline from AEC Oil and Gas Co. Ltd.

While owned and operated by AEC, the Maxhamish pipeline was a provincially approved and regulated pipeline. In response to arguments made on behalf of the B.C. Minister of Energy and Mines, the Board found that the Maxhamish pipeline would be functionally integrated into the Westcoast system and would be subject to the common management, operation and control of the rest of the system. As a

⁷ TransCanada PipeLines Limited 2001 and 2002 Fair Return Application dated 6 June 2001

⁸ IN THE MATTER OF the National Energy Board Act (the Act) and the regulations made thereunder; and IN THE MATTER OF an application pursuant to section 74 of the Act by Westcoast Energy Inc. (Westcoast), filed with the National Energy Board (the Board) under File 3200-W005-10

result, it would not remain fundamentally provincial in character if purchased by Westcoast.

In addition, the Board found, in response to arguments made on behalf of the Minister, that in light of the fact that Westcoast had applied for a certificate to operate an existing pipeline, the Board's overriding responsibility was to satisfy itself that the pipeline will be used and useful for a reasonable period of time. The Board did not consider whether any benefits would accrue through the change in ownership.

Westcoast has also 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 8 loop segments totalling 89.5 kilometres. The Board has ordered a 2 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.

Finally, the \$8.5B purchase of Westcoast Energy by Duke cleared another regulatory hurdle on February 27, when the FERC approved the take-over by Duke of 2 Westcoast U.S. subsidiaries. The transaction is scheduled to close on March 31.

(5) Petro Canada Medicine Hat Pipeline

The NEB approved Petro Canada's application to construct and operate a natural gas pipeline⁹ to take gas from its own compressor stations in the Medicine Hat area to the TCPL mainline at Burstall, Saskatchewan.

NGTL objected to the application arguing that the proposed pipeline was a by-pass of its system. While the Board recognized that the proposed pipeline amounted to a duplication of facilities in the region (the AEC, Suffield pipeline is also in the area), it specifically noted that Petro Canada had "diligently explored" the alternatives, including attempts to negotiate an LRS rate with NGTL and that it had concluded that constructing and operating the Medicine Hat pipeline was its most economic alternative.

C. 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, the Sahtu Land and Water Board issued a draft cooperation plan in connection with the environmental

⁹ GH-3-2001 Reasons for Decision Issued 20 December 2001

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 the Mackenzie Valley Pipeline. While its recommendations, if accepted, would considerably reduce the regulatory complexity which 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.

3. Provincial

A. Alberta

(1) NGTL

Nova Gas Transmission Ltd. Application for Approval of Costs for Delivery Service to the Fort McMurray Area – 2002-16¹⁰

This was the first application by NGTL seeking to recover costs for the extension of mainline service since the Board issued Decision 2000-6 in which it approved a fundamental change in NGTL's rate design and in the terms and conditions of intra-Alberta service.

NGTL had received requests for delivery service to the Fort McMurray area from Petro-Canada, Suncor and Syncrude. NGTL determined that the combined requests fell within the Guidelines for new delivery service and that, in order to provide the requested service, NGTL would have to either construct new facilities, acquire capacity on an existing pipeline through a transportation by other agreement (TBO) or purchase facilities.

In its reasons for decision 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 service based on the Board's assessment of the proposal's consistency with the overall regulatory framework and the broad public interest.

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

¹⁰ Nova Gas Transmission Ltd. Application for Approval of Costs Delivery Service to the Fort McMurray Area Decision 2002-16 Application 2001084 File 5631-7

expressed the view that the cost accountability issues are not necessarily confined to mainline delivery extensions for the intra-Alberta market, but apply to expansion of NGTL's system in general. As a result, the Board approved the inclusion of costs of the TBO service until December 31, 2002 and noted that it expected that NGTL would either submit an agreement regarding cost allocation among receipts, intra-Alberta and ex-Alberta deliveries, or an application will be filed with the Board prior to December 31, 2002.

(2) Williams Energy (Canada) Inc.

Certain property owners on the Williams Energy Natural Gas Liquids System in Alberta, (formerly part of TransCanada Midstream Natural Gas Liquids), wrote to the NEB seeking a declaration that the pipe on their land should be regulated by the NEB instead of the AEUB. The property owners agreed that the Williams' system was operated on an integrated basis with facilities outside Alberta but the Board concluded there was inadequate evidence to support this allegation and dismissed the application.

B. British Columbia

(1) General Initiatives

The general election of May, 2001 in British Columbia has led to a significant government initiative to develop a new energy policy. Pending the presentation of the final report of the task force charged with this responsibility, scheduled for March 15, 2002, there have been no general initiatives affecting pipeline regulation in B.C.

(2) Specific Pipelines

(a) BC Gas

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 up to April 19, 2002.

(b) Pacific Northern Gas Ltd. (“PNG”)

On May 25, 2001¹¹, the BCUC issued a decision with respect to PNG’s rates which authorized the establishment of a load retention rate for PNG’s largest customer, Methanex Corporation (the “May 25 Decision”). On September 28, 2001, Methanex filed an application with the BCUC, arguing that because negotiations had failed to establish a load retention rate, the Commission ought to impose a load retention rate on PNG at a rate which Methanex argued had been established in the May 25 Decision. In response to Methanex’s application, the Commission declared PNG’s existing rates to Methanex interim and ordered that the matter be set down for hearing.

In the meantime, PNG filed an application for a general rate increase and the Commission ordered that the two applications be heard together.

The resulting hearing commenced March 6, 2002 and evidence is now complete with argument pending. This decision has the potential to be significant in the context of the principles which will govern the establishment of load retention rates in British Columbia.

¹¹ IN THE MATTER OF An Application by Pacific Northern Gas Ltd. for October to December 2000 Rates and 2001 Revenue Requirements Application and An Application by Methanex Corporation Order No. G-51-01

Vancouver

1600 Cathedral Place
925 West Georgia Street
Vancouver, British Columbia
Canada V6C 3L2
Telephone 604.685.3456
Facsimile 604.669.1620

Calgary

3700, 205-5th Avenue SW
Bow Valley Square 2
Calgary, Alberta
Canada T2P 2V7
Telephone 403.269.6900
Facsimile 403.269.9494

Yellowknife

P.O. Box 818
200, 4915 – 48 Street
YK Centre East
Yellowknife, Northwest Territories
Canada X1A 2N6
Telephone 867.669.5500
Toll Free 1.888.465.7608
Facsimile 867.920.2206

genmail@lawsonlundell.com
www.lawsonlundell.com

