Stranded Gas Hearings

(0409021300b Minutes)

The National Energy Board's Regulation of the Canadian Segment(s) of an Alaska Natural Gas Pipeline

Margery Fowke, National Energy Board (NEB) - Canada, September 2, 2004.

MS. MARGERY FOWKE, National Energy Board, Canada, said she would speak on two matters with respect to the board's jurisdiction of practice – those are incremental and rolled-in tolls and the board's ability to order expansions of facilities in certain cases.

I thought I'd spend a few moments to talk about the board's mandate and jurisdiction and processes for anybody who might not be familiar with the National Energy Board (NEB). The board has both regulatory and advisory responsibilities, which have changed little since our inception in 1959. We have jurisdiction regarding the certification of pipelines, tolls and tariffs, construction of pipeline and ongoing safe operation of the pipeline and the ability of the board to require a pipeline company to provide facilities for other shippers. The board also regulates the export and import of natural gas and oil, the export of electricity, the construction of international power lines, the exploration on federally regulated lands - that's offshore and north of 60, and the board provides advice to the federal government of Canada. It's not that it's an exhaustive list, but it's the highlights of what we do.

This map shows generally the natural gas and oil pipelines that are regulated by the board, the ones in Canada, of course. The board regulates over 27,000 miles of pipelines, inter-provincial and national pipelines. The board is a quasi-judicial tribunal with all the powers of a court of record. We have nine full-time members and the Act provides for temporary members as well. We currently have eight full-time members. A quorum of the board to sit on most hearings is three members and the process at a board hearing would be similar to what most of you would be familiar with – witnesses are sworn, they're cross examined by parties of opposing interests, the board counsel and the board ask questions and then there's final arguments at the end of the hearing.

When an application for the construction of a pipeline is filed, the Act requires that we have a public hearing and that that hearing be oral. Section 52 of the Act sets out some of the things that the board must consider when we look at an application for a pipeline such as supply, markets, economic feasibility. With respect to economic matters, one of the main focuses of the board right now is with respect to third-party impacts. In addition, one of the main issues these days is environment. With respect to a pipeline of interest to you, the Canadian Environmental Assessment Act would apply. There would likely be a joint review panel, which would involve territorial, federal, including the national energy board and aboriginal representatives. I can't say with any certainty what the process would be for an application that could be filed for a pipeline coming out of Alaska, but I can tell you that the model that is currently being used for the Mackenzie project is that there is a joint review panel, which will consider the environmental matters. The board has one member that's appointed to that panel and I believe there are eight members on it.

The board at the same time will conduct a hearing into all matters within its jurisdiction and will incorporate the joint review panel with respect to environment. The member that's on the joint review panel will report back to the board on it. Once all of the hearings are complete, if the joint review panel allows for it and the NEB is of the view that it should be approved, then a certificate of public convenience and necessity would be issued. This allows the pipeline company to construct the pipeline and operate it.

In terms of our working with FERC, the board has recently entered into a memorandum of understanding (MOU) with FERC and I've provided that at tab 3. The parties recognized that it's in the public interest to coordinate their efforts, that there may be cases where coordinated

reviews may be considered, that timing should be coordinated and the parties agree to notify the other party if there is an application to it where the matter is being heard by the other tribunal.

I'd like to move to toll regulation by NEB. When new facilities, either greenfield or an expansion, are being applied for, the board usually considers tolling matters at the same hearing. The requirement in the Act is that tolls be just and reasonable and that they be charged equally to all persons for traffic of the same description over the same route in substantially the same circumstances. That is in section 62 of the board's act.

The board can set tolls using a number of different methodologies. We can use the traditional cost of service methodology or any other to set tolls ourselves. Tolls can also be negotiated or they can be subject to a settlement. The board is very accepting of settlements. We have settlement guidelines, which can be found on our web and they require that all parties have a chance to participate in the settlement. A settlement can provide for unique and different arrangements and most new construction of pipelines in recent history have had tolls that are either negotiated in part or subject to a settlement. The only requirement the board has is that we be able to find that the tolls are just and reasonable. Pretty much everything else is up for grabs.

The board has broken down the pipeline companies that it regulates into two different groups. Group 1 companies are the larger companies, such as TransCanada Pipelines Ltd., Westcoast Energy Inc. and Enbridge. Group 2 companies are the smaller pipelines and they are regulated on a complaint basis.

I was asked to address the frequency of toll hearings and whether the pipeline has the option or the obligation to refile its tolls in the face of declining costs. The frequency of toll hearings really varies. For some group 1 companies, if they can't come to a settlement with their shippers, it's virtually an annual event and that's the case with TransCanada Pipelines – the largest pipeline that we regulate. They are right now pretty much annually before us.

At any time after a board decision, the pipeline or an interested person can file a request for a review of the board decision. One of the grounds for the review is changed circumstances. So, if there were declining costs, a review application could be filed with the board. The board would then have to examine it to determine whether a review should be held and, if so, whether the previous decision needs to be changed. Some pipelines have multi-year settlements and in such a case, we wouldn't expect the company or the participants to be back before us during the term of that settlement. In the settlements, usually changes that could come up through the term of the settlement are taken into account by some cost sharing factor or risk sharing factor. If the parties to the settlement were to agree that they needed to reassess the settlement in the middle of the term, it could be done and it is right now being done in one of the oil pipelines. I think, as well, my view, if you are in the middle of a long settlement and it could be shown that the tools were no longer just and reasonable, that you would have an argument to come back to the board and have it look at the settlement again. The onus would be on the party trying to bring the settlement back towards the board to show that it should be changed and that the tolls are not just and reasonable, but I think it could be done.

If you're talking about a group 2 company, they're regulated on the complaint basis and if there is a third party shipper, tolls have to be filed with the board, but it doesn't examine them to any great extent unless there is a complaint filed. So, if there were changes in the costs to the pipeline and a shipper wanted to file a complaint to request that the board look at those tolls, the board could do it at that point in time. So, in short, while there's no obligation on a company to file new tolls in the face of declining costs or any other change circumstances, there are means by which the pipeline or another interested party could bring the matter back to the board for consideration of the issue. As well, the board could of its own motion bring the matter up for discussion.

I'd like to turn now to the question of rolled-in versus incremental tolls. Let me start by saying that

there are no rules at the NEB on this issue. There's nothing in the Act; there's nothing in the regulations and we have no policy that we have issued with respect to rolled-in versus incremental tolls. There are some past decisions where the board has considered the matter, but I'd like you to note that we are not bound by past decisions and, in fact, we must consider every relevant issue in a new hearing. So, we can't rely on past decisions alone. We have to reexamine issues. I'd also like to note that the seminal cases in this issue were in 1987 and 1989; so there's not a lot of anything recent.

Any expansion of a pipeline out of Alaska would be fairly far down the road and we all know, there's a lot of unanswered variables that could be at play. We also don't know what the regulatory environment would be. I've seen a lot of changes in my time at the board; I foresee that there will be changes in the next 10 to 15 years. I can't tell you what the board would do with an application at the time of an expansion in terms of rolled-in versus incremental tolls, but I can tell is what the board's past decisions have said and I can tell what some of the considerations that the board has taken into account in making those decisions.

There have been a number of decisions, but unfortunately for our purposes, none of them are particularly recent. I'm going to focus on GH-2-87 and GH-5-89, which are TransCanada hearing decisions and those are the most helpful decisions on the matter. I've also included references here to the Westcoast Energy Inc. decisions, but Westcoast is a very different system. It includes gathering lines and processing plants; it has historically had a much different tolling regime with a lot of specific tolls for specific services. So, the Westcoast decisions aren't particularly helpful. I've included the references for some oil pipeline decisions – Interprovincial Pipe Line Inc. and Trans Mountain Pipe Line Company Ltd. are both oil companies – and I'll briefly touch on those. All of the board decisions are on the website. The last two numbers in the decision are the year of the decision. So, GH-2-87 was a hearing that started in 1987. I've included behind tab 4 some excerpts for our decisions from GH-2-87, GH-5-89 and GH-5-94, the Westcoast decision.

I'd like to discuss the specifics of just a few cases and what I think are the board considerations that run through these decisions. In GH-2-87, it was a TransCanada facilities application. The board decided that the rolled-in method of cost allocation and toll design would be appropriate for the proposed facilities. The board looked at practical and legal considerations. The board made it clear that existing customers do not possess acquired rights to enjoy the use of the older facilities at lower embedded costs. The payment of tolls in the past did not confer any benefit beyond the provision of the service at that time. The board didn't equate those who paid with the service with those who paid for facilities. The board also endorsed the concept that TransCanada is an integrated system. In the board's view, the new facilities contributed to the capacity and integrity of the system as a whole. Therefore, the board determined that the toll should be charged on a rolled-in basis. However, the board also found that if the services required by only a limited number of shippers and the facilities could be separately identified from the integrated rate base, that the principals of cost-causation and user pay would apply to insure that there was no undue cross subsidization by other toll payers. Therefore, in this hearing, GH-2-87, the provision of additional delivery pressure at any delivery point would be recovered through stand-alone tolls.

In GH-5-89, which was the biggest TransCanada expansion that we've ever considered, the board considered the rolled-in versus incremental tolling methodology. The board reaffirmed its findings in GH-2-87 that the previous toll-payers have to acquire rights. They can't be exempted from a toll increase simply because they paid tolls in the past. The board found, again, that on completion, the facilities would be integral to the TransCanada Pipeline system. It looked at cost causation and found that the aggregate demand of all shippers gives rise to the need for additional pipeline capacity. The board looked at economic efficiency and stated that rolled-in tolls would send appropriate price signals. The board found that incremental tolls would create economic distortions because existing shippers would not be exposed to the appropriate market signals. The board was of the view that the magnitude of the expansion didn't justify changing the methodology nor did the riskiness of the market. It stated that factors such as size, cost of impact

on tolls might be factors that the board would take into account when determining whether or not to authorize the construction of the facilities, but they didn't justify discrimination among shippers on the basis of when they commenced or would commence paying tolls.

The one Westcoast case that I did want to mention is GH-5-94 and in that case, the board found for rolled-in tolls placing significant weight on the extent to which the proposed facilities would be integral to the Westcoast facilities in that specific area. The board stated that in its view shippers didn't pay for specific facilities; they contracted for specific services.

There are a few oil pipeline decisions on rolled-in tolls. In all of the Interprovincial Pipe Line decisions, the board found that the toll should be stand-alone, not rolled-in. This was based on the fact that the facilities would only be used by a small number of shippers. Not all of the shippers are not all commodity groups. Therefore, the principles of user pay would be best reflected by stand-alone tolls. The board found there is no unjust discrimination in shippers, because all those using the specific services were being treated the same way. The board also noted the need to minimize cross-subsidization and to allow for business decisions to be made on the basis or appropriate price signals.

The Trans Mountain decisions that I referred to allowed all or part of the expansion to be rolled-in where it found the facilities would be for use of all of the shippers or where it would enhance the overall efficiency of the entire system.

So, from all of these decisions, I've pulled what seemed to be in my view, the important considerations that the board has taken into account. I would stress to you that this is not a board pronouncement. The board has not issued anything on it. I would also point out to you that although the board has stated in numerous decisions that it supports the principles set out in the GH-5-89 decision, any time the issue of tolling methodology comes up, it must be addressed on a case-by-case basis.

The second matter that I was asked to focus on was the ability of the board to order the provision of facilities. Subsection 71(3) of the NEB Act allows the board to order a company to provide adequate and suitable facilities for the transmission of, in this case, gas. There are two tests in this action; the board has to consider it necessary and desirable to do so in the public interest and the board has to find that no undue burden will be placed on the pipeline company by requiring the company to do so. This section has been very infrequently considered.

The few decisions that we have had that consider this section don't provide much guidance for us on how the board would consider an application now. I've provided the excerpts from these decisions behind tab 5. In the first case that I could find, GH-3-86, the board considered an application by Cyanamid Canada Pipeline Inc. to construct facilities to require TransCanada Pipelines to provide interconnection facilities. If you look at that decision, you'll note that they're talking about section 59 instead of section 71 – just a change of numbering the late '80s. The board found that the application by Cyanamid to construct its own facilities should be approved and that the approval would have no significance if the board weren't prepared to grant the interconnection. Therefore, the board found the interconnection to be in the public interest and found there would be no undue burden on TransCanada. That's just about the extent of the board's reasoning. It was very short on the section 71 issue and doesn't provide as much guidance on the matter. It's also the only case I could find where the board actually ordered the interconnection of facilities.

In MH-2-88, the board was considering both subsection 71-2 and 71-3; 71-2 is the ability of the board to require a gas pipeline to receive, transport and deliver gas. In this case, the board found that the pipeline company could transport the gas with the current configuration of its system and therefore, it found it unnecessary to order a 71-3 to construct additional facilities.

In GH-4-91, it was again a TransCanada facilities application and the board heard an application under 71-3 from a prospective shipper to provide services and facilities. The board was not convinced that the applicant had demonstrated need for the facilities and therefore denied the 71-3.

Finally, in GH-3-96, it was again an application under both 71-2 and 71-3. The pipeline company was opposed to providing the service, but admitted on the stand that it could do so without additional facilities. The board told them that they had to provide the service, but didn't require them to construct any facilities under 71-3.

So, the important considerations that I take from those four cases are that first, there must be a clear demonstration for the need for the facilities and second, that the transportation can be provided by the pipeline company on its existing facilities, the board will not order new facilities to be constructed. There has been no discussion in any decision of the tests that are in 71-3. In my view, if an application came forward now, the board would have to be looking at what those tests are and what they mean and there would probably need to be some discussion of them. I know in recent hearings where there has been discussion on the record about 71-3, there has been quite a bit of debate about what the tests mean. The board has not found it necessary to discuss in any reason. So, we don't know what the board's view is, but we do know that there has been a lot of discussion on it.

That's all I was intending to present today. I hope it has been of some assistance to you..