ENERGY (OIL & GAS) REGULATORY

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Federal energy regulatory proceedings over the past year continued consideration of issues raised in the context of northern gas projects as well as facilities applications for transportation of Alberta oil sands production. The National Energy Board ("NEB") also made decisions regarding proposed new services on the TransCanada PipeLines Limited ("TCPL") Mainline gas transportation system that were designed for gas-fired electrical power generators in Ontario.

At the provincial level, regulators were again being asked to determine the scope of their jurisdiction. Over the past year the Alberta Energy and Utilities Board ("AEUB") considered whether or not it had the jurisdiction to conduct an investigation to fix just and reasonable rates for a previously unregulated pipeline as well as the legal entitlement to coalbed methane ("CBM") on split-title freehold lands. The Ontario Energy Board ("OEB") faced questions relating to the disposition of proceeds from the sale of capital assets. The AEUB also dealt with oil sands development applications amid concerns about the cumulative impacts on the local environment and infrastructure.

DEVELOPMENTS IN FEDERAL REGULATORY PROCEEDINGS

Northern Gas

In September 2004, the Mackenzie Gas Project[1] application was filed with the NEB, seeking approval to transport gas from the Mackenzie Delta to Alberta. The NEB hearing process is being coordinated with a joint review panel ("JRP") hearing in accordance with the Agreement for Coordination of the Regulatory Review of the Mackenzie Gas Project, dated April 22, 2004. The NEB hearings commenced on January 25, 2006, in Inuvik, Northwest Territories, and the JRP hearings started in February 2006. The evidentiary portion of the NEB hearing concluded December 14, 2006, but argument must await the JRP report that will result from the ongoing JRP process.

The Mackenzie Gas Project is comprised of (1) three anchor fields in the Mackenzie Delta, (2) the Mackenzie gathering system ("MGS") for the transmission of gas and NGLs from the anchor fields to an Inuvik-area facility ("IAF") and for the further transmission of NGLs to Norman Wells, and (3) the Mackenzie Valley pipeline ("MVP") for the transmission of gas from the IAF to northern Alberta. The Project Sponsors applied to the NEB for a certificate of public convenience and necessity approving the construction and operation of the MVP and for approval of the proposed toll and tariff principles on the MVP. The Project Sponsors brought a separate application under the *Canada Oil and Gas Operations Act* ("*COGO Act*") for approval of construction and operation of the MGS.

On April 7, 2006, the Mackenzie Explorer Group[2] ("MEG") sought an order from the NEB declaring that the proposed MGS and MVP will be a single "pipeline" as defined in the *National Energy Board Act* ("*NEB Act*") and that both will be subject to NEB regulation regarding tolls and tariffs once they are built and placed in service. MEG's members are actively involved in exploration and development of energy resources in and around the Beaufort-Mackenzie basin and expect to become shippers on the MGS and MVP in order to develop their resources.

MEG argued that the legal and policy framework for transmission and related services should be the same for both the MGS and the MVP. MEG proposed that the MGS and the MVP should be "designed, constructed and operated as a basin-opening, open-access transmission system that is subject to financial regulation in the public interest." The Project Sponsors maintained that the NEB has no regulatory oversight of services on the MGS and that it does not have the authority to adjudicate upon the justness and reasonableness of the fees and tariffs for the MGS.

In its letter of July 10, 2006,[3] the NEB reviewed the purpose and scheme of both the *COGO Act* and the *NEB Act* and determined that the *COGO Act* specifically addresses gas processing facilities within the Northwest Territories and NGL transportation that is entirely within the Northwest Territories. The NEB noted that a gas-processing facility can be a work connected to an NEB-regulated pipeline and regulated by the *NEB Act*, but that not every facility physically connected to a NEB-regulated pipeline is part of that pipeline. In denying the relief sought by MEG, the NEB concluded that "the demarcation between the *COGO Act* regulated facilities and the *NEB Act* regulated facilities is between the outlet of the IAF and the inlet of the MVP."

The members of MEG, with the exception of EnCana Corporation, sought leave to appeal the NEB decision to the Federal Court of Appeal on the basis that if the shippers are not protected from the exercise of market power by the proponents of the Mackenzie Gas Project, the Canadian public interest will be detrimentally affected. The MEG position is that the MGS and the MVP will be constructed and operated as a single undertaking that constitutes an interprovincial pipeline subject to regulation under the *NEB Act*. The court granted leave to appeal the NEB's decision on September 19, 2006.

On November 10, 2006 the Federal Court granted an application for judicial review brought by the Dene Tha' First Nation ("Dene Tha'"),[4] finding that the federal Ministers of Environment, Fisheries and Oceans, Indian and Northern Affairs and Transport ("Ministers") breached their duty to consult with the Dene Tha'. The Court ordered a "remedies hearing", stayed the JRP from considering any aspect of the Mackenzie Gas Project that affects either the treaty lands of the Dene Tha' or the aboriginal rights claimed by the Dene Tha', and enjoined the

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JRP from issuing any report on its proceedings to the NEB. The Ministers filed an appeal and on January 30, 2007 the Federal Court lifted the stay, but ordered that the final report of the JRP not be issued until otherwise permitted by the Court.

The Dene Tha' filed with the NEB a further Notice of Motion on November 30, 2006, asking the panel to determine the Board's jurisdiction over the NGTL facilities that are to be constructed to provide the interconnect between the MVP and the existing NGTL facilities in Alberta. A procedural conference was held on January 11, 2007 to discuss the Dene Tha's request for directions regarding its Notice of Motion. The Board, by letter of February 2, 2007, determined that the issues raised by the Dene Tha's motion would best be dealt with in a separate proceeding and designated five Board members as the panel to consider the matter when filed.

Transportation of Alberta Oil Sands Production

Major pipeline projects to transport growing Alberta oil sands production continue to be heard and adjudicated by regulators.

The Enbridge Inc. ("Enbridge") Spearhead proposal, which increases market access for Canadian crude by extending service into the Cushing, Oklahoma and US Gulf Coast regions, was approved by the NEB in June 2005.[5] The Spearhead proposal included a toll structure on the Enbridge Canadian Mainline that provided 5 year support agreements for reversed US pipelines in order to ensure that tolls on those pipelines were competitive. Flint Hills Resources, Ltd. ("Flint Hills") objected to this financial support, alleging that the NEB lacked the jurisdiction to authorize Enbridge to include in the Canadian Mainline's revenue requirement costs incurred to finance infrastructure or infrastructure improvements located entirely outside of Canada. An appeal of the NEB decision by Flint Hills was dismissed by the Federal Court of Appeal on October 4, 2006.[6] When setting tolls under the *NEB Act*, the Court held that the NEB is not "barred from taking into account costs incurred by pipeline operators on the basis that they serve to improve infrastructure belonging to others."

Kinder Morgan Canada Inc.'s ("KMCI") TMX Anchor Loop project, which provides an incremental 40,000 barrels per day capacity on the Trans Mountain pipeline between Edmonton, Alberta and Vancouver, BC was brought before the NEB by Terasen Pipelines (Trans Mountain) Inc. ("Trans Mountain") and received regulatory approval in October 2006.[7] The hearing included a motion brought by the Simpcw First Nation ("SFN") seeking an order to reopen and extend the deadlines set out in the NEB hearing order by six months on the basis that the SFN was denied procedural fairness in the regulatory and environmental process and was not afforded enough opportunity to participate in the application. The NEB dismissed the SFN motion on the basis that the SFN did not meet its burden of proof, as there was no evidence on the hearing record setting out why the processes adopted were not procedurally fair, nor was an affidavit in support of the motion filed with the NEB. The NEB went on to conclude that, in any event, Trans Mountain did provide the SFN with numerous opportunities to be involved in its processes and that the SFN was also given the opportunity to participate in the NEB's process, which it did.

The TransCanada Keystone pipeline project combines the conversion of existing and underutilized capacity on the Mainline gas transmission system of TCPL with new pipeline construction to take Alberta oil sands production to US markets. The initial application by TCPL and Keystone to transfer Mainline gas facilities to crude oil service was approved in NEB decision MH-1-2006.[8] The position of TCPL and Keystone was that although the Mainline facilities remained used and useful in gas service, they were no longer necessary for gas service. Given the demonstrated need for additional crude oil service, it was argued that it was in the overall public interest that the Mainline facilities be transferred to crude oil service.

A group of gas shippers, relying on the recent decision of the Supreme Court of Canada ("SCC") in *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)* ("*ATCO*"), argued that the applicable regulatory standard was "no-harm to customers". The NEB distinguished the ATCO decision on the basis that the regulatory standard of the AEUB was not in issue in that proceeding. The NEB also noted that the broad scope and express public interest mandate in the *NEB Act* required it to consider all factors that are relevant to the public interest, which include but are not limited to the adverse impacts that may result to gas shippers as a result of the transfer. The NEB further concluded that even if the no-harm standard was applied, the applicants met that standard. A facilities application in respect of the Keystone crude oil pipeline was filed on December 12, 2006 and is currently before the NEB.

Other projects that have received regulatory approval include KMCI's CPX dilbit project, which consists of a looping of the Terasen Corridor pipeline from the Alberta oil sands to Edmonton. Projects that have engaged the regulatory process include the Enbridge Alberta Clipper expansion of its Canadian Mainline crude oil system and the Enbridge application for AEUB approval of its Waupisoo pipeline, which would link the Alberta oil sands to upgraders, refineries and interprovincial oil pipelines in Edmonton. Other publicly announced projects include additional phases to the TMX project, including an expansion of the existing Trans Mountain pipeline and a branch line to the northwest BC coast; the Enbridge Gateway pipeline, which would extend from the Edmonton region to a new marine terminal in Kitimat, BC for service to Pacific and Asian markets; and an Altex Energy Ltd. proposal to ship Alberta oil sands production directly to Texas.

New Mainline Services for Gas-Fired Generation

In response to anticipated growth in gas-fired electrical power generation in Ontario, TCPL applied to the NEB for an order approving amendments to its Mainline Tariff to implement two new services that would better meet the large and variable needs of gas-fired power generators.[10] The first service is a new firm transportation service that permits intra-day nominations as frequently as every 15 minutes. This service would be tolled at a 10 per cent premium over the existing firm transportation service. The second service would complement the first service by using compression and linepack to provide flexibility to gas-fired power generators for balancing purposes on the TCPL Mainline, thereby reducing exposure to Mainline balancing penalties.

The NEB approved the new services, but rejected the proposed incremental cost-based toll for the second service based on concerns that the proposed toll could result in shippers located close to one another paying significantly different tolls. The NEB therefore directed TCPL to develop an alternative tolling methodology for the second service.

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DEVELOPMENTS IN PROVINCIAL REGULATORY PROCEEDINGS

Jurisdiction of the AEUB

The AEUB's jurisdiction to conduct an investigation and to fix just and reasonable rates for a previously unregulated pipeline under the *Alberta Gas Utilities Act* ("*GUA*") was recently put in issue by Suncor Energy Inc. ("Suncor").[11] In March 2006, Suncor applied to the AEUB for an investigation of the services and tolls applicable to the Ventures pipeline. Suncor holds long-term contracts for service on the 24-inch Ventures oil sands pipeline. The Ventures pipeline is held by TransCanada Pipeline Ventures Limited Partnership ("Ventures Partnership"). NOVA Gas Transmission Ltd. ("NGTL") holds a 99.99 per cent limited partnership interest in the Ventures Partnership, while the other 0.01 per cent is held by TransCanada Pipeline Ventures Ltd. ("Ventures Ltd."), the general partner of the Ventures Partnership.

In its October 24, 2006 preliminary decision, the AEUB considered the question of whether the Ventures pipeline is a "gas utility" under the *GUA*. Suncor's position was that because the Ventures pipeline transmits, transports and delivers gas directly to Suncor, Williams Energy and NGTL, it falls within the definition of "gas utility" as set out in the *GUA*. Ventures Ltd. disagreed, arguing that the Ventures pipeline does not supply gas "to or for the public," as set out in the *GUA*'s definition of gas utility. Ventures Ltd. argued that Suncor did not fit the definition of being a member of the public and should not be in need of regulatory protection as it is a sophisticated party that freely entered into long-term contracts for service.

The AEUB determined that the words "to or for the public or any member of the public, whether an individual or a corporation," as found in the "gas utility" definition in the *GUA*, suggest a liberal reading of the provision that is broad enough to include Suncor. The AEUB further determined that Ventures Ltd. indirectly provides service to the public on the Ventures pipeline through a "transportation by others" agreement with NGTL. As a result, the AEUB found that the Ventures pipeline is serving the public and that it is a "gas utility" as defined in the *GUA*. Since the *GUA* provides the AEUB with the authority to investigate any matter concerning a gas utility, the AEUB determined that it had the jurisdiction "to conduct an investigation into the Ventures pipeline and the affairs of its owner(s)." The AEUB concluded that it would proceed with an investigation to determine whether the rates charged are unjust or unreasonable or unjustly discriminatory. Ventures Ltd. is pursuing an application to the Alberta Court of Appeal seeking leave to appeal the AEUB's decision and the AEUB has agreed to suspend commencement of the investigation pending a ruling from the court.

Coalbed Methane

In Decision 2007-024,[12] the AEUB was faced with the issue of the legal entitlement to CBM on split-title freehold mineral lands in the context of issuing licences under the *Oil and Gas Conservation Act* ("*OGCA*"). The issue arose when the owners of the coal rights challenged the validity of CBM licences previously issued by the AEUB to the holders of natural gas leases for the lands in question. The coal owners argued that as the fee simple owners of the coal, they were entitled to the CBM and that the natural gas lessees were not entitled to obtain approvals to produce the CBM. The AEUB ultimately determined that the CBM licences were properly issued.

From a technical perspective, the parties agreed that CBM is the gas produced from coal, but disagreed on how CBM is stored in the coal and whether it is part of the coal or simply stored in the coal in *in situ* conditions. The AEUB was of the view that CBM is not an intrinsic component of coal, but is a gas stored in and produced from the coal. The AEUB also determined that it has the jurisdiction under the *OGCA* to determine whether an applicant is entitled to the right to produce the gas from a well for the purpose of granting a licence even if there is a *bona fide* dispute over the applicant's entitlement to the gas. However, the AEUB acknowledged that the ultimate authority to determine the legal entitlement to the resource rests with the courts.

Disposition of Proceeds from the Sale of Capital Assets

Following the SCC's decision in ATCO, the OEB addressed an application by Union Gas for approval of the disposition of funds held in certain deferral accounts, including the proceeds from the sale of cushion gas that was no longer needed in Union Gas' storage operations. Since cushion gas, sometimes called base pressure gas, is required for the operation of gas storage pools and not intended for sale, it is generally considered an undepreciated capital asset. Relying on ATCO, Union Gas sought to retain the entire cushion gas proceeds on the basis that the sale of the cushion gas did not harm or prejudice its customers and that the OEB lacked the jurisdiction to apportion proceeds from the sale of capital property to reduce rates.

In Decision and Order EB-2005-0211[13] the OEB narrowly construed the decision of the SCC in ATCO and distinguished it on the basis that the Ontario legislation differs from the Alberta act considered in ATCO. Rather than being a question of allocating the proceeds of sale to ratepayers, the OEB determined that the sale of cushion gas was a question relating to the consequences of the sale in the process of setting rates. Based on this characterization, the OEB concluded that the issue fell within its broad jurisdiction in respect of rates. The OEB also rejected the arguments of Union Gas with respect to retroactive rate making, which resulted from the delay in waiting for the SCC decision in ATCO, and Union Gas' allegations of reasonable apprehension of bias, which were based on the OEB's participation in the ATCO proceeding before the SCC.

The OEB subsequently decided to review Decision and Order EB-2005-0211 and to consider a similar decision on the apportionment of assets.[14] In that decision the OEB upheld its prior ruling and noted that under Ontario legislation gas distribution utilities are not required to seek approval for the sale of capital property that is no longer necessary in serving the public. The OEB held that since the application arose in the context of a rates proceeding, its broad rate making power under the *Ontario Energy Board Act* provided it with the authority to allocate proceeds in situations where a utility has sold an asset. This decision is subject to an appeal filed with the Ontario Superior Court of Justice.

Oil Sands Development

Federal/Provincial Joint Review Panels were established to review applications filed with the AEUB for approval of Imperial Oil Resources Limited's Kearl Oil Sands Project and Albian Sands Energy Inc.'s Muskeg River Mine Expansion.[15] Each of the applications was approved by a Joint Review Panel as being in the public interest, but was subject to a number of environmental and technical conditions. The Joint Review Panels in both cases emphasized the "critical challenges" related

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to cumulative impacts on key environmental sectors and local infrastructure and stated that "[W]ith each additional oil sands project, the growing demands and the absence of sustainable long-term solutions weigh more heavily in the determination of the public interest."

[1]Mackenzie Gas Project sponsors are Imperial Oil Resources Ventures Ltd., Aboriginal Pipeline Group, ConocoPhillips Canada (North) Ltd., ExxonMobil Canada Properties and Shell Canada Ltd. ("Project Sponsors").
[2]The Mackenzie Explorer Group consists of Anadarko Canada Corp., BP Canada Energy Co., Chevron Canada Ltd., Devon Canada Corp., EnCana Corp., and Nytis Exploration Co. Inc.
[3]NEB letter dated July 10, 2006, to All Parties to Hearing Order GH-1-2004, Ruling #16 Mackenzie Explorers Group (MEG) Notice of Motion No. 10.
[4]*Dene Tha' First Nation v. Canada (Minister of the Environment),* [2006] F.C.J. No. 1677, 2006 FC 1354.
[5]National Energy Board Reasons for Decision RH-1-2005, Enbridge Pipelines Inc., June 2005.
[6]*Flint Hills Resources, Ltd. v. Canada (National Energy Board)*, [2006] F.C.J. No. 1489, 2006 FCA 320.
[7]National Energy Board Reasons for Decision OH-1-2006, Terasen Pipelines (Trans Mountain) Inc., October 2006.
[8]National Energy Board Reasons for Decision MH-1-2006, TransCanada PipeLines Limited and TransCanada Keystone Pipeline GP Ltd., February 2007.
[9][2006] 1 S.C.R. 140.
[10]National Energy Board Reasons for Decision RH-1-2006, TransCanada PipeLines Limted, November 2006.
[11]Alberta Energy and Utilities Board Decision 2006-105, Suncor Energy Inc., October 24, 2006.
[12]Alberta Energy and Utilities Board Decision 2007-024, Bearspaw Petroleum Ltd., Devon Canada Corporation, and Fairborne Energy Ltd., March 28, 2007.
[13]Ontario Energy Board EB-2005-0211 Decision and Order, June 28, 2006.
[14]Ontario Energy Board EB-2005-0211 and EB-2006-0081 Decision and Order, January 30, 2007.
[15]Joint Review Panel Report of the AEUB and the Government of Canada, EUB Decision 2007-013: Imperial Oil Resources Ventures Limited, Application for an Oil Sands Mine and Bitumen Processing Facility (Kearl Oil Sands Project) in the Fort McMurray Area, February 27, 2007; Joint Review Panel Report of the AEUB and the Government of Canada, EUB Decision 2006-128 Albian Sands Energy Inc., Application to Expand the Oil Sands Mining and Processing Plant Facilities at the Muskeg River Min, December 17, 2006.

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