



File 4200-M124-2
8 November 2001

Mr. Ian Leadley
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Maritimes & Northeast Pipeline Management Ltd.
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Dear Mr. Leadley:

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

The National Energy Board has completed its consideration of the Article 17 Issue and issues the attached Decision with Reasons on the matter.

Yours truly,

Michel L. Mantha
Secretary

Attachment

c.c.: Mr. L.E. Smith, Q.C., Bennett Jones LLP, facsimile (403) 265-7219
RH-3-2001 Interested Parties

Maritimes & Northeast Pipeline Management Ltd. (M&NP)

RH-3-2001

Reasons for Decision on the Article 17 Issue

1. Introduction

The National Energy Board (the Board or the NEB), pursuant to Hearing Order RH-3-2001, dated 16 July 2001, as modified, set down for public hearing an application of Maritimes & Northeast Pipeline Management Ltd. (M&NP) pursuant to subsection 19(2) and Part IV of the *National Energy Board Act* (the NEB Act).

In its application, M&NP sought Board approval of final tolls commencing 1 October 2000 and ending 31 December 2002. Following issuance of the Hearing Order to establish this proceeding, the Board received a joint submission dated 1 August 2001 made by the following parties: Cartier Pipeline and Company, Limited Partnership; Société en Commandite Gaz Métropolitain; The Consumers' Gas Company Ltd., carrying on business as Enbridge Consumers Gas; Enbridge Gas New Brunswick Inc.; and the Minister of Natural Resources and Energy of the Province of New Brunswick (collectively referred to as the Proponents).

The Proponents of the joint submission sought leave to amend the Issues List for the RH-3-2001 proceeding to include the following proposed new issue:

“As it applies to new pipeline facilities, the proper application and interpretation of Article 17 of the General Terms and Conditions of Maritimes & Northeast Gas Tariff (the Article 17 Issue).”

By letter dated 13 August 2001, the Board amended the List of Issues to include the Article 17 Issue. The scope of this issue was further clarified by the Board in a letter dated 3 October 2001. Article 17 of the tariff of M&NP is commonly referred to as the Lateral Policy.

On 31 August 2001, M&NP advised the Board that it had reached a settlement with the members of its Tolls and Tariff Working Group relating to issues 1 through 3 of the revised RH-3-2001 List of Issues. The Board stayed the further procedural steps outlined in the Timetable of Events in respect of the non-Article 17 issues.

On 14 September 2001, M&NP filed with the Board its proposed Settlement Compliance Filing and on 20 September 2001, the Board established a process to obtain parties' comments on the Settlement Compliance Filing and the need for and nature of a further process to consider the filing. All matters related to the Settlement, therefore, have been dealt with separately from the Article 17 Issue. These Reasons for Decision relate solely to the Article 17 Issue.

The oral hearing to consider the application and interpretation of the Article 17 Issue took place in Dartmouth, Nova Scotia over 11 hearing days commencing on 11 October 2001 and finishing on 25 October 2001. The evidentiary record of this proceeding involved extensive examination of the issue and, in particular, focussed on the following two conceptual sets of facilities:

- the Northwest Facilities - approximately 260 km of 508 mm (20") diameter pipe extending from an interconnection with a proposed Cartier Pipeline Project through northwestern New Brunswick to M&NP's existing mainline near Fredericton; and

- the PEI Facilities - a subsea pipeline extending from a point on M&NP's existing mainline in New Brunswick to Prince Edward Island.

It is important to note that the record in this case involves hypothetical pipeline facilities. The Reasons for Decision contained in this letter apply only to the extent that subsequent filings with the Board do not differ in any material way from the hypothetical facilities that form the basis of the record in these proceedings.

The first question for the Board to determine with respect to the Northwest Facilities is one of the proper interpretation of Article 17 and, specifically, whether Article 17 applies to the Northwest Facilities. If it is the Board's view that Article 17 applies to these facilities, the subsequent question that some Parties asked the Board to consider is whether the facilities would serve an "enduring market", as that phrase has been applied for purposes of Article 17.

The question with respect to the PEI Facilities is how an "estimate of the capital and operating costs of the facilities" should be determined; that is, a question of the application of the Lateral Policy.

The following sets out the Board's views and decisions with respect to the matters at issue in these proceedings. These views and decisions are based on a careful review of the evidentiary record, which was both extensive and helpful. The Board has relied upon that record, as limited by the Board's directions and rulings in these proceedings, and upon its own expertise in these matters. Matters which are not relevant, including those matters set out in the Board's 3 October 2001 letter and any filing related thereto, were not considered by the Board.¹

2. The Northwest Facilities

2.1 Background

The first sentence of Article 17.1 is as follows:

"Customers may request that Pipeline construct a pipeline extension (other than a mainline extension) from Pipeline's existing facilities to deliver gas to one or more Customers, including new delivery points and enlargements or replacements of existing laterals."

Some Parties (including M&NP) represented to the Board that, if the Northwest Facilities are a "lateral" or, alternatively, not a "mainline extension", then Article 17 applies. In contrast, other Parties (including the Proponents) argued that the Northwest Facilities are a "mainline extension" and, thus, facilities to which Article 17 does not apply.

2.2 Principles of Interpretation

An examination of the interpretation of a document such as the Lateral Policy must not only look at the individual words and their meanings, but also at the context within which the words were drafted. This was described by a number of parties in their final argument; for example, Mr. Schultz on behalf of the Canadian Association of Petroleum Producers, stated as follows:

¹For further clarity, the evidence impugned by M&NP in its Notice of Motion to Strike dated 18 September 2001 was not considered by the Board.

“We are all familiar with Driedger's golden rule, which is that one must read words in their entire context, in their grammatical and ordinary sense, and harmoniously with the whole scheme of which the words are a part.”(T 11930)

Mr. Davies, on behalf of PanCanadian Petroleum Limited, stated the Board’s task, simply and effectively, in this way:

“There are two cardinal rules to contract interpretation: The first is to look at the words in the contract; the second rule is to look at what was intended. And, that we submit, is what the Board should do in deciding whether the Northwest facilities are subject to the provisions of Article 17 of the tariff.” (T 12605)

The Board agrees with the above comments and has proceeded in that manner.

2.3 The Words and their Meanings

The principal words at issue within Article 17 are “lateral” and “mainline extension”. The word “lateral” is used only once in Article 17, at the end of the first sentence. The Board observes that these words are not specifically defined within the M&NP tariff, although a lengthy discussion of these words is contained in the record of these proceedings. Hence, in the Board’s view, these words should be examined in the context of generally-accepted industry practice. However, the evidence on the record leads the Board to conclude that there is no commonly accepted, single definition for either of these words.

No party referred to, nor has the Board been able to find, any NEB decision that considered directly the definition of these terms. In some cases described by parties, large diameter, high pressure lines with a major transmission function were described as “laterals” while, in other cases, similar lines were described as “mainline” or “transmission”. In the case of Foothills Pipe Lines Ltd., both legs of the bifurcated southern portion would, by most industry participants, be described as “mainline”, while a proposed line from the Mackenzie Delta to the proposed northern leg was formally referred to as the “Dempster Lateral”. Yet all of these components could be described in similar terms as to their function and purpose. The definitions of the Federal Energy Regulatory Commission, offered as helpful by parties, are not, in the Board’s view, of assistance to the particular interpretation problem presented by Article 17. Further, none of the earlier NEB cases to which reference was made involved a situation where the Board was required to define the term “lateral”. In those NEB cases, it appears that there was no disagreement as to nomenclature; rather, the matters at issue were related to the approval of the facilities under applicable provisions of the NEB Act or involved tolling methodology for specific facilities.

Given this lack of definition, either within the document itself or as commonly understood, the proper interpretation of the words and, more importantly, of Article 17, requires that the Board examine the context in which Article 17 was created and its intent.

2.4 The Intent of the Lateral Policy

In his final argument, Mr. Williamson, on behalf of the Province of Nova Scotia, Petroleum Directorate stated that:

“... the appropriate point of departure for any analysis of the genesis of and the factual matrix surrounding the development of the Laterals Policy is the Joint Review Panel Report on the Sable Gas Projects. It is through a review of the Panel’s findings and conclusions in that Report that one gains an appreciation of the public policy underlying the Laterals Policy.” (T12979)

The Board acknowledges that the Lateral Policy has its genesis in the Sable Joint Panel Proceedings. The Joint Public Review Panel Report (the Report), October 1997, in respect of the development of Sable offshore gas contains, in the Board’s view, a clear explanation of the intent of Article 17. The Panel that produced the Report recognized that the market in the US northeast would form the “anchor market” for the initial production from Sable. The Report also acknowledged and approved the contents of the Joint Position on Tolling and Laterals, an agreement among the Provinces of Nova Scotia and New Brunswick, the Sable Offshore Energy Project and Maritimes and Northeast Pipeline that balanced a number of competing interests². Key provisions of the Joint Position included:

- support for M&NP’s applied-for postage stamp tolling structure as presented to the Joint Review Panel;
- a commitment by M&NP to develop workplans for mainline laterals to Halifax and Saint John;
- an understanding that the laterals for Halifax and Saint John would be subject to federal jurisdiction;
- an agreement by M&NP that future laterals may be the subject of provincial jurisdiction according to the wishes of the province;
- a commitment that M&NP would develop work plans for future laterals to Cape Breton and northern New Brunswick;
- a commitment by the SOEP Producers that 10,000 MMBtu/d of natural gas would be made available in the initial three years for local distribution in Nova Scotia and New Brunswick;
- an agreement to discount firm service tolls to delivery points located in Nova Scotia by 10 percent for the initial eight years and four percent for each of the succeeding two years of service; and
- an agreement to discount firm service tolls to delivery points located in New Brunswick by four percent for the initial three years of service.

Subsequently, a Memorandum of Understanding, dated 3 December 1997 among the SOEP Producers, Maritimes and Northeast Limited Partnership, Nova Scotia Power Inc. (NSPI) and the Province of Nova Scotia, specified that if NSPI entered into a firm service agreement for a daily quantity of at least 45,000 MMBtu/day for at least ten years, an aid for construction with respect to the Halifax Lateral would not be required.

Throughout the Report, the Panel made many references to the objective of the Joint Position to develop markets within the Maritimes. Examples from the Report (pages 68, 69) are as follows:

² The Joint Position represents “the good faith efforts of all parties to find a solution to the conflicting toll recommendations submitted to the Joint Review Panel.” (See Appendix V to the Report)

“M&NP also devised a policy with the objective of encouraging the development of natural gas markets in the Maritimes, called the Lateral Policy.”

“M&NP also requested approval of a Lateral Policy to foster development of the Maritimes natural gas markets.”

“... Second the building of laterals will encourage access and growth of natural gas markets in the Maritimes.”

As demonstrated by the above, the Lateral Policy is unique to M&NP and was designed as part of the overall structure for the start up of production of natural gas from Sable. Moreover, despite M&NP’s assertion that its definition of lateral (Exhibit B-33 in this proceeding) informed the Joint Panel in GH-6-96 of the broad range of facilities which would be covered by Article 17, there was no discussion whatsoever of the extension of the Lateral Policy to markets outside the Maritimes. Accordingly, when one examines the potential impact of the unique aspects of the Lateral Policy on the development of pipeline infrastructure, it becomes clear, in the Board’s view, that the Joint Panel never intended the Lateral Policy to apply beyond the Maritimes.

The focus of the Lateral Policy on the Maritimes is also evident when the intent of the Lateral Policy is considered. In general, gas pipelines which serve customers within provinces in Canada are made up of a combination of federally-regulated transmission lines and provincially-regulated distribution lines. That is the regulatory and jurisdictional model that exists in most provinces³. It is commonly understood that, in these cases, the cost of the distribution system facilities is borne entirely by the provincial customers while the mainline shippers bear responsibility only for the costs of shipping gas on the mainline transmission facilities. The Lateral Policy provides an important exception to this general structure. Section 17.1 states, in part, as follows:

“In the event Pipeline decides to construct such facilities and the contracted demand requested by a Customer generates sufficient revenue each year, based on a test toll of \$0.60/MMBtu (\$ 0.5687/GJ) designed to maintain the competitiveness of Pipeline’s tolls, to recover the annual cost of service associated with the incremental capital and operating costs of the facilities, Pipeline will proceed to construct the facilities without any contribution from the Customer. If the facilities do not generate sufficient revenue to cover the cost of service associated therewith, Pipeline will require a Customer contribution ...”

As a result, the Lateral Policy allows for the potential rolling in⁴ of some or all of the costs of facilities that would normally be paid for in their entirety by the local customers. Subject, of course, to the particular economics of any given lateral, the intent was to provide, in effect, a subsidy to the local provincial markets from all shippers on the pipeline system⁵. In effect, one of the Lateral Policy’s

³ For example, Saskatchewan is served by TransCanada PipeLines Limited, regulated by the NEB, and TransGas distribution lines, regulated by the province. Similarly, in British Columbia, Westcoast Energy Inc. provides mainline transmission service and BC Gas Utility Ltd. (and others) serve the local market.

⁴ The extent of the roll-in may be partial, if an aid-to-construct is required.

⁵ The level of subsidization has, in fact, been less than that originally anticipated due to the use of a 60 cent “test toll”, which is much less than the actual toll on M&NP. Nevertheless, the intent of the Joint Panel remains, in the Board’s view, valid.

objectives was to allow local markets served by the laterals to obtain gas at significantly less cost than would be the case if they had been constructed as part of a separate distribution system. Accordingly, in the view of the Board, the application of the Lateral Policy, with its potential for subsidization of gas service in the Maritimes, should be limited to cases clearly contemplated by the Joint Panel.

2.5 Characterization of the Northwest Facilities

A question that the Board must consider is whether there was any intent that the benefits of the Lateral Policy should apply to the Northwest Facilities. In addressing this question, the Board notes the following facts⁶:

- as described in these proceedings, approximately 90% of the throughput from these facilities will be destined for markets located outside the Maritimes;
- these target markets, for the most part, could not be described as “start up” as they are already served by natural gas infrastructure;
- the Northwest Facilities would connect to existing markets through the Cartier Pipeline, TQM, and the TransCanada system;
- the Northwest Facilities would likely be physically integrated with the rest of the M&NP system;
- all shippers could use the Northwest Facilities;
- all shippers who use the Northwest Facilities would use M&NP’s upstream facilities;
- the same services would be offered on the Northwest Facilities as on the mainline;
- compared with the lateral facilities constructed to date, the Northwest Facilities would be much larger and many times more costly; and
- in theory, the proposed pipeline could compete with the existing M&NP system.

This is, in the Board’s view, clear evidence that the physical and functional characteristics of the Northwest Facilities are significantly different from those of any of the laterals constructed in the Maritimes.

It would be a stretch of logic to apply the Lateral Policy, with its potential for subsidization, to such facilities. In this regard, Mr. Smith noted that the "export shipper subsidy of the uneconomic lateral shippers was in fact one of the very attractive features of the Lateral Policy in the first place" and that "the discrimination inherent in the Laterals Policy operates in favour of domestic lateral shippers and against the interests of export shippers" (T 11840). Mr. Davies, for PanCanadian, further confirmed that the Lateral Policy "provides an incentive - some call it a subsidy - to encourage pipeline extensions to be built from Maritimes & Northeast's mainline to Canadian markets" (T 12623). On this basis, it is inconceivable to this Board, and certainly unsupported by the evidence, that the subsidy aspect of the Laterals Policy would apply to other than proposed Maritime facilities.

⁶ Many of these facts were confirmed by the witnesses of M&NP during their appearance in these proceedings. For example, see the testimony of Mr. T. Curry at T 12103 to 12138.

In summary, it is the Board's view that the Northwest Facilities are a mainline extension, as that term is used in Article 17 and not a lateral, and are not facilities to which the benefits of the Lateral Policy were intended to apply. Accordingly, the Northwest Facilities fall outside the ambit of Article 17.

2.6 Impact of Finding that Article 17 Does Not Apply to Northwest Facilities

During the course of final argument, a number of parties urged the Board to consider carefully the impact of its determinations on further development of the nascent Atlantic basin. One major concern was expressed by Mr. Williamson on behalf of the Province of Nova Scotia as follows:

“It is simply inconceivable that the Laterals Policy could be rationally interpreted in a manner that would result in constraining the development of gas infrastructure into the Maritimes through the test toll, while providing an unconstrained roll-in of costs to provide additional pipeline capacity to an established market existing in Canada. That would be the result of accepting Cartier's and New Brunswick's interpretation of the Laterals Policy” (T 13002).

Others made similar arguments.

The Board understands this concern to be based on the assumption that a finding that Article 17 does not apply is equivalent to a finding that the Northwest Facilities would be tolled on a rolled-in basis.

To be very clear, the Board's finding that Article 17 does not apply to the Northwest Facilities is not a finding that the costs of such facilities would be rolled in with the balance of the M&NP system. A roll-in may or may not be warranted, but that is a matter for another day where the appropriate tolling methodology for the Northwest Facilities can be examined. Further, extensive scrutiny under section 52 of the NEB Act, including all factors relevant to a section 52 determination, will be required, if and when an application is made for these facilities.

Other concerns related to the continuation of the Lateral Policy. Some parties implied that the effect of the Board's decision would be to dismantle the Policy. That is simply not true. The Board does not accept that the “complex web of bargains that have been made to achieve the success of this project” (CAPP,

T 11909) is undermined by this determination. The Lateral Policy would remain in place to assist in the development of the markets in the Maritimes. It would continue to apply, where necessary, to help “encourage access and growth of the natural gas markets in the Maritimes”⁷. For example, the PEI facilities would fall squarely within the contemplation of Article 17 and should qualify for the assistance of the Lateral Policy⁸.

Some parties suggested that the uncertainty associated with the possible building of the Northwest Facilities and the method under which they would be tolled could have a dampening effect on the potential future development of the offshore Atlantic basin. However, no producers or exploration companies currently operating or exploring in the region presented evidence of such impact; the Board only heard of such concerns through cross-examination and primarily during final argument. In the

⁷ Joint Panel Review Report, P. 69.

⁸ The Board notes that no Party argued that the PEI Facilities did not come within the intent of the Lateral Policy.

Board's view, that type of uncertainty is one faced by producers in every basin. Accordingly, the Board fails to see how this decision leaves producers with any uncertainty additional to that inherent in the ongoing exploration and development of Canada's natural gas resources. Moreover, this decision, in and of itself, should have no impact on the competitiveness of M&NP in its anchor market.

2.7 Enduring Market

Given the Board's conclusion that Article 17 of the Tariff does not apply, it is unnecessary to consider whether the market to be served by the Northwest Facilities would constitute an "enduring market".

Nevertheless, the Board would like to comment on the interpretation that M&NP has given to the Board's earlier decision in the GH-2-99 proceeding (Halifax Lateral). M&NP argued that, as a result of that decision in which the Board put M&NP at risk for any revenue shortfall that arises if the Lateral Policy test is not met at any time during the first 25 years of the project, "the bar has been raised". The Board has examined that decision and cannot find therein the conclusion that M&NP would make that the case stands for the proposition that the only evidence of an enduring market is the length of contract term. Article 17.2 sets out a lengthy list of factors that M&NP will use in its consideration of whether a waiver is required; contract term is only one of those. In this regard, the Board agrees with the comments of Mr. Nettleton, speaking on behalf of Enbridge Consumers Gas, when he stated:

"While [the length of contract term] clearly would be the best evidence, and the best evidence was deemed necessary in the Halifax case, that does not mean in other circumstances an enduring market can [not] be demonstrated by other sufficient evidence. If that were not the case, it would mean that the second part of the Article 17 test could never be entertained since the term of the contracts would, by definition, satisfy the 60-cent economic test.

Best evidence and [in]sufficient evidence of an enduring market should not be confused."
(T 12342, 12343)

2.8 Turnback Provision in Tariff

A number of parties urged the Board to direct M&NP to file a turnback policy to be included in its tariff and which would be made applicable in the cases of any proposed expansion. Any matters concerning turnback are beyond the scope of this hearing and should be dealt with, in the first instance, by the Tolls and Tariff Working Group. In the alternative, an application to the Board may be brought under section 59 of the NEB Act.

3. PEI Facilities

3.1 Background

The concerns of the Province of Prince Edward Island and Maritime Electric Company, Limited (Maritime Electric) involved the process by which M&NP establishes an estimate of the capital and operating costs of a proposed new lateral. In final argument, Mr. Lea, on behalf of Maritime Electric, stated:

"... the policy requires lateral customers to commit to paying a lateral contribution or aid-to-construct based only on an M&NP estimate.

Under the present policy the customer has no means of challenging the estimates and there is no other mechanism that would allow the customer to avoid the consequences of an inappropriate estimate.” (T 12482, 12483)

Mr. Lea suggested that the Board ought to direct M&NP to modify the Lateral Policy to provide for disclosure of whatever details there are of estimates provided by M&NP and to provide for resolution by the Board of disputes relating to such estimates.

Similarly, the Province of Prince Edward Island suggested in its evidence that:

“From a procedural and practical perspective, some mechanism should be put in place to allow the customer to challenge cost estimates prepared by M&NP and involve some third party resolution of disputes so that the cost estimates resulting from such process could then be the subject of a facilities application.” (C-29-4, page 3)

M&NP took the position that it must be able to have the final say on these estimates. As stated by Mr. Smith, on M&NP’s behalf, during final argument:

“Maritimes & Northeast submits that as a result of its pipelining experience in the Maritimes to date, it is the party best positioned to develop estimates of future project costs in the region. As Maritimes & Northeast may be at risk of disallowance in a tolls proceeding for differences between forecasts and actuals, in Maritimes & Northeast’s respectful submission, it must be permitted the last word on cost estimates.” (T 11845)

Any suggestions that a third-party estimate be established, or that the Board be involved in establishing the estimates, were rejected by M&NP.

3.2 Views of the Board

The Board has significant sympathy for the concerns of the Province of PEI and Maritime Electric. It is clear from the evidence that significant difficulties were encountered by PEI and Maritime Electric during the course of their negotiations with M&NP.

The Board notes that M&NP has considerable discretion in the determination of matters related to the application of Article 17. The ability of M&NP to “make or break” a project by its exercise of discretion is clear. Absent a reasonable and mutually satisfactory estimate of costs, a proposed lateral may never be brought to the Board for consideration. An objection to the cost estimates during a facilities application review, as suggested by M&NP, appears to the Board to come too late in the process to be useful to parties.

Given that the pipeline bears the ultimate responsibility with respect to these matters, it is likely desirable that M&NP maintain the authority to establish these costs. However, this discretion must always be exercised in good faith. Although M&NP has not, in the Board’s view, failed to operate in good faith, it is important that its methods and results of estimation be openly and candidly discussed with prospective customers. It appears, based on the evidence of Maritime Electric and the Province of PEI, that M&NP could have taken steps to build a higher degree of openness with its potential customers. The Board welcomes the commitment made by M&NP, as expressed during final argument, “to closer consultation in the development of the associated costs” (T 11857). The Board would

encourage the parties to examine the possibility of alternate dispute resolution methods, such as mediation, that could provide an effective and cost-effective alternative to litigation of this issue before the Board.

While it is clear that Article 17 gives to M&NP the final word with respect to estimated costs, it is also clear that the tariff itself is subject to the very broad discretion of the Board. Section 59 of the NEB Act allows the Board to make orders “with respect to all matters relating to traffic, tolls and tariffs”. Should the Province of PEI or Maritime Electric be dissatisfied with the way in which M&NP establishes estimates for Article 17 facilities, it would be open to them to bring a request to the Board under section 59 and for the Board to investigate and issue orders as appropriate. Such a request could be made at any time during the consultation phase. That possibility operates as a check and balance on the exercise of discretion by M&NP.

4. Disposition

The foregoing constitute our Decision and Reasons for Decision on this matter.

J.A. Snider
Presiding Member

J.-P. Théorêt
Member

D. Emes
Member

Calgary, Alberta
November 2001