CANADA

National Energy Board

Reasons for Decision

GHW-4-89

March 1990

Review of Certain Aspects of the Market-Based Procedure

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In the Matter of

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Appendices

Abbreviations

Act	*National Energy Board Act*
AEC	AEC Oil and Gas Company, a Division of Alberta Energy Company Ltd.
Agreement, 1985 Agreement	Agreement on Natural Gas Markets and Prices, 31 October 1985
A&S	Alberta and Southern Gas Co.
Altresco	Altresco Financial, Inc.
Amoco	Amoco Canada Petroleum Company Ltd.
ANR	ANR Pipeline Company
APMC, Alberta	Alberta Petroleum Marketing Commission on behalf of the Government of Alberta
BC Gas	BC Gas Inc.
BCPC	British-Columbia Petroleum Corporation
Beta	Kamine Development Corp. and Beta Development Co.
Blue Range	Blue Range Energy Corporation
British Columbia	Ministry of Energy, Mines and Petroleum Resources, British Columbia
Brymore	Brymore Energy Ltd.
BVI, Bow Valley	Bow Valley Industries Ltd.
Canadian Hunter	Canadian Hunter Exploration Ltd.
CCPA	Canadian Chemical Producers Association
CETI	Cogen Energy Technology Inc.
C-I-L	C-I-L Inc.
Consumers Gas	The Consumers' Gas Company Ltd.
CPA	Canadian Petroleum Association
Direct	Direct Energy Marketing Limited
EIA	Export Impact Assessment
Edge	C.G. Edge and Associates
FTA	Free Trade Agreement
GMi	Gaz Métropolitain, inc.
Gulf	Gulf Canada Resources Limited
Husky	Husky Oil Operations Ltd.
Harvey	Ross Harvey M.P.

ICG (Ontario)	ICG Utilities (Ontario) Ltd.
IGUA	Industrial Gas Users Association
Indeck Energy	Indeck Energy Services, Inc.
Indeck Gas	Indeck Gas Supply Corporation
IPAC	Independent Petroleum Association of Canada
MBP	Market-Based Procedure for Gas Export Licensing
Morgan, Morgan Hydrocarbons	Morgan Hydrocarbons Inc.
NEB or Board	National Energy Board
NEPCO	New England Power Company
Niagara Mohawk	Niagara Mohawk Power Corporation
Norcen	Norcen Energy Resources Limited
Northridge	Northridge Petroleum Marketing, Inc.
Northstar	Northstar Energy Corporation
Ontario	Minister of Energy for Ontario
Pan-Alberta	Pan-Alberta Gas Ltd.
PanCanadian	PanCanadian Petroleum Limited
Petro-Canada	Petro-Canada Inc.
Poco	Poco Petroleum Ltd.
ProGas	ProGas Limited
Quebec	Ministère de l'Énergie et des Ressources, Québec
Saskatchewan	Department of Energy and Mines, Saskatchewan
SDGE	San Diego Gas & Electric Company
Selkirk/ MASSPOWER	Selkirk Cogen Partners, L.P. and MASSPOWER
SEPAC	Small Explorers and Producers Association of Canada
Shell	Shell Canada Limited
TCPL	TransCanada PipeLines Limited
Trical	Trical Resources Inc.
Union	Union Gas Limited
Universal	Universal Explorations Ltd.
U.S.	United States of America
Vector	Vector Energy Inc.
WGML	Western Gas Marketing Limited
Westcoast	Westcoast Energy Inc.

Recital and Submittors

IN THE MATTER OF the *National Energy Board Act*, R.S.C. 1985, c. N-7 and the regulations made thereunder; and

IN THE MATTER OF the draft *NEB Rules of Practice and Procedure* dated 21 April 1987; and

IN THE MATTER OF a review of certain aspects of the Market-Based Procedure, held by way of written submissions pursuant to section 21 of the NEB Act, as more particularly described in Board Order GHW-4-89

BEFORE:

R. Priddle	Chairman
J.-G. Fredette	Vice Chairman
R.B. Horner, Q.C.	Member
W.G. Stewart	Member
A.B. Gilmour	Member
A. Côté-Verhaaf	Member
M.J. Musgrove	Member
C. Bélanger	Member
R. Illing	Member
D.B. Smith	Member
K.W. Volkman	Member

SUBMITTORS:

AEC Oil and Gas Company, a Division of Alberta Energy Company Ltd.
Alberta and Southern Gas Co.
Alberta Northeast Gas Limited
Alberta Petroleum Marketing Commission, on behalf of the Government of Alberta
Altresco Financial, Inc.
Amoco Canada Petroleum Company Ltd.
ANR Pipeline Company
BC Gas Inc.
Blue Range Energy Corporation
Bow Valley Industries Ltd.
British Columbia Petroleum Corporation
Brymore Energy Ltd.
Canada Geothermal Oil Ltd.
Canadian Chemical Producers' Association
Canadian Hunter Exploration Ltd.
Canadian Hydrocarbons Marketing Inc.
Canadian Petroleum Association
CanStates Gas Marketing
C-I-L Inc.
C.G. Edge & Associates Inc.
Cogen Energy Technology Inc.
Columbia Gas Development of Canada Ltd.

Consumers' Gas Company Ltd., The
Council of Canadians
Department of Energy and Mines, Saskatchewan
Direct Energy Marketing Limited
Dorset Exploration Limited
Enserch Development Corporation
Esso Resources Canada Limited
Exajoule Energy Consulting Ltd.
G.A. Robb Associates
Gaz Métropolitain, inc.
Gulf Canada Resources Limited
Husky Oil Operations Ltd.
ICG Utilities (Ontario) Ltd.
Industrial Gas Users Association
Indeck Energy Services, Inc.
Indeck Gas Supply Corporation
Independent Petroleum Association of Canada
Industrial Gas Consumers Association of Canada
Iroquois Gas Transmission System, L.P.
Kamine Development Corp. and Beta Development Co.
Minister of Energy for Ontario
Ministère de l'Energie et des Ressources, Québec
Ministry of Energy, Mines and Petroleum Resources, British Columbia
Morgan Hydrocarbons Inc.
New Brunswick Power
New England Power Company
New York State Energy Office
Niagara Mohawk Power Corporation
Norcen Energy Resources Limited
North Canadian Marketing Inc.
Northstar Energy Corporation
Northridge Petroleum Marketing, Inc.
Opinac Exploration Limited
Pan-Alberta Gas Ltd.
PanCanadian Petroleum Limited
Petro-Canada Inc.
Poco Petroleum Ltd.
ProGas Limited
Ross Harvey, M.P.
San Diego Gas & Electric Company
Selkirk Cogen Partners, L.P. and MASSPOWER
Shell Canada Limited
Small Explorers and Producers Association of Canada
Suncor Inc.
Tennesse Gas Pipeline Company
Trical Resources Inc.
Ulster Petroleums Ltd.
Unigas Corporation
Union Gas Limited
Universal Explorations Ltd.

Vector Energy Inc.
Vermont Gas Systems, Inc.
Westcoast Energy Inc.
Western Gas Marketing Limited

Chapter 1
Background

Section 118 of the *National Energy Board Act* (“Act”) provides the legislative basis for the factors the National Energy Board ("Board" or "NEB") must take into account in licensing exports of natural gas:

> “*On an application for a licence, the Board shall have regard to all considerations which appear to it to be relevant and, without limiting the generality of the foregoing, the Board shall*
>
> *(a) satisfy itself that the quantity of oil, gas, or power to be exported does not exceed the surplus remaining after due allowance has been made for the reasonably foreseeable requirements for use in Canada having regard, in the case of an application to export oil or gas, to the trends in the discovery of oil or gas in Canada;*
>
> *(b) satisfied itself that the price to be charged by an applicant for power exported by him is just and reasonable in relation to the public interest.*”

Paragraph 118(b) contains a reference to price which is, however, confined to exports of electricity.

In 1987, the Board conducted a review of its natural gas export licensing procedures which focussed particularly on the criteria it would use to comply with paragraph 118(a). In its decision[1] the Board stated that it was introducing a new Market-Based Procedure (MBP) founded on the premise that the marketplace will generally operate in such a way that Canadian requirements for natural gas will be met at fair market prices.

The MBP provides that the Board will act in two ways to ensure that natural gas licensed for export is both surplus to reasonably foreseeable Canadian requirements and in the public interest: it will hold public hearings to consider applications for licences to export natural gas and it will monitor Canadian energy markets on an ongoing basis.

The Board stated that, during public hearings to consider applications for licences to export natural gas, the Board’s assessment as to whether the market is functioning in a satisfactory way will consist of three main components:

(1) Complaints Procedure

The inclusion of a complaints mechanism in the surplus determination procedures was based on the principle that gas should not be authorized for export if Canadian users have not had an opportunity to buy gas for their needs on terms and conditions, including price, similar to those of the proposed export. Applicants for export licences have to be prepared to address any concerns on this score which may be identified in the hearing by domestic users of natural gas.

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[1] Chapter 4 of the Reasons for Decision in the Matter of Review of Natural Gas Surplus Determination Procedures, July 1987 (see Appendix I).

(2) Export Impact Assessment ("EA")

The purpose of the EA is to allow the Board to determine whether a proposed export is likely to cause Canadians difficulty in meeting their energy requirements at fair market prices.

(3) Public Interest Determination

In addition to using the complaints procedure and EIA to ascertain that gas proposed to be exported is surplus, the Board stated that it would continue, as required by Section 118 of the Act, to have regard to all other factors it considers relevant in determining whether proposed exports are in the national public interest.

In its Reasons for Decision, the Board included an illustrative list of factors to be considered in determining whether proposed exports would be in the public interest. The Board indicated that it intended to consider, *inter alia*, details of the supply and sales arrangements and evidence that the export revenues will fully recover the costs to Canada incurred in making the export. The latter factor is assessed using a social benefit-cost analysis framework which quantifies the net benefits to Canada of the proposed export. In particular, the Board stated that it:

> "*... continues to see a role for cost-benefit analysis in assessing any tradeoff between security of supply and benefits from export and in determining whether there are net benefits to Canada. Thus, cost-benefit analysis will continue to be an implant tool of the Board in assuring itself that proposed exports are in the public interest.*"

Since 1987, the MBP has been used as the basis for review of applications for natural gas export licences. The Board has, however, recently found it appropriate to review certain aspects of the MBP, namely the EIA and, in this proceeding, the benefit-cost analysis.

During 1989 the Board considered, by way of written submission, views of interested parties with respect to the use of the EIA. The Board decided to retain the EIA as part of the MBP, but revised the procedures for introducing EIA evidence into public hearings.

Concern had been expressed about the use of benefit-cost analysis in the Board's natural gas licensing procedures by interested parties in a number of gas export licence hearings and concern was also expressed at a November 1989 workshop held by Board staff on benefit-cost analysis. In light of these concerns, the Board decided to conduct a review of the role that benefit-cost analysis should play in the MBP. The Board also decided to seek parties' views on the extent to which it should, as part of the public interest component of the MBP, examine the provisions of export contracts to determine whether the contracts allow flexibility to reflect changing market conditions over time.

Under cover of a letter dated 18 December 1989, the Board issued Hearing Order GHW-4-89,[1] requesting written submissions on five questions:

(1) Should the Board continue to use benefit-cost analysis as a factor in the MBP for determining whether exports of natural gas are in the public interest?

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[1] See Appendix II.

(2) If the Board should continue to use benefit cost analysis as part of the MBP, what role should that analysis play in the Board's decision-making process?

(3) If the Board should continue to use benefit cost analysis as part of the MBP, is the methodology employed by the Board in its benefit cost analysis since the introduction of the MBP appropriate?

(4) If the Board should discontinue the use of benefit-cost analysis as part of the MBP, how else should the Board take account of the differences between social and private costs in determining whether a proposed export is in the public interest? These differences result principally from the user cost component of total incremental production costs and from the incremental costs of transportation as distinct from rolled-in transportation costs.

(5) To what extent should the Board, as part of the MBP, examine the provisions of export contracts to determine whether those contracts allow flexibility in order to reflect changing market conditions over time?

For purposes of this proceeding, the Board requested that parties not address the question of whether the Board has the jurisdiction to use benefit-cost analysis, but rather focus on whether and how the Board should use benefit-cost analysis in considering export applications. Ninety-four parties indicated their interest in this review. Submissions were received from 76 interested parties, including companies, associations, individuals, provincial governments and government agencies.

Chapter 2
Discussion of the Issues

This chapter summarizes the views of parties and the Board on the five questions posed to interested parties by the Board in Attachment I of Hearing Order GHW-4-89.

2.1 "Should the Board continue to use benefit-cost analysis as a factor in the MBP for determining whether exports of natural gas are in the public interest?"

The views of parties favouring the retention of benefit-cost analysis as a factor in the MAP are summarized below, followed by those of parties opposing its continued use.

2.1.1 Views of Parties in favour of Retaining Benefit-Cost Analysis

Parties in favour of the retention of benefit-cost analysis submitted the reasons outlined below in support of their positions.

(i) Statutory Mandate to Protect the Public Interest

Many of the parties supporting the continued use of benefit-cost analysis submitted that the Board has a statutory mandate under Section 118 of the Act to "have regard to all considerations that appear to it to be relevant" in determining whether proposed exports are in the national public interest. These submittors were of the view that benefit-cost analysis is a necessary component of the public interest determination and that lessening of the Board's emphasis on the public interest in the context of the MBP would be contrary to the Board's mandate, as well as detrimental to the best interests of the Canadian public. Ontario submitted that, in the absence of the use of benefit-cost analysis, it was not clear that the Board could meet its mandate under Section 118 to protect the public interest.

BC Gas and ICG (Ontario) made reference to the Board's inclusion of benefit-cost analysis in the MBP and to its use in recent Board decisions as being indicative of its role in protecting the national public interest.

C-I-L and Union, among others, noted that with the advent of the Free Trade Agreement ("FTA") many Canadian statutes, including the NEB Act, have been amended to reflect the provisions of the FTA. However, they submitted that the Board's mandate under Section 118 has not been altered by either deregulation or FTA. Union further argued, in its reply submission, that benefit-cost analysis should not be interpreted as a minimum price test and therefore should not be considered to contravene article 904(b) of the FTA.

(ii) Need to Account For Divergence Between Social and Private Costs and Benefits

Most submittors supporting the Board's continued use of benefit-cost analysis were of the view that private sector decisions do not necessarily take account of all factors that might be viewed as costs and benefits from a social perspective and that, consequently, private sector decisions

can lead to a socially inefficient allocation of resources. IGUA and Ontario submitted that benefit-cost analysis is widely accepted, by both the private sector and governments, as a framework for addressing the market imperfections that arise from differences between the private and public decision-making processes. Quebec submitted that benefit-cost analysis is the only appropriate method to establish a balance between public and private interests.

Several submittors (including CCPA, C-I-L Consumers Gas, IGUA, Ontario, Quebec, and Union) were of the view that the rolled-in toll methodology currently endorsed by the NEB creates market distortions because shippers of incremental volumes do not pay a toll which reflects the real cost of transporting these incremental volumes. These submittors argued that benefit-cost analysis provides a method for assessing the desirability of incremental exports which properly includes a measure of the associated incremental transportation costs. It was suggested by some of these submittors that this market distortion could alternatively be reduced or eliminated if the Board authorized incremental tolls (or some variant thereof) in circumstances where such tolls would be appropriate.

Some submittors suggested that another market distortion which necessitated the continued use of benefit cost analysis was in the area of user costs. BC Gas and Consumers Gas indicated that although some alternatives exist to address the differential between rolled-in and incremental transportation costs, no replacement for benefit-cost analysis is apparent with respect to the identification and measurement of user costs.

Other market distortions referenced in the submissions included the lack of availability of accurate and timely information to buyers and sellers (GMi, IGUA) and environmental costs (Council of Canadians).

(iii) Ineffectiveness of the Complaints Procedure and the Export Impact Assessment

Several of the submittors commented on other aspects of the MBP and argued that because they are not effective, or at least have not yet been shown to be effective, the Board should retain benefit-cost analysis to ensure that proposed natural gas exports are in the national public interest.

Consumers Gas submitted that the Board should continue to use benefit-cost analysis as an essential factor in determining whether or not proposed exports are in the public interest, particularly in light of the ineffective nature of the complaints procedure and the EIA for surplus determination. In Consumers Gas view, the benefit-cost analysis is the only component of the MAP that works effectively. Consumers Gas and Union (in its reply submission) provided a number of reasons why, in their view, the complaints procedure is ineffective. These included:

- it is unrealistic, unreasonable and unfair to expect that short-term direct purchase customers would act in the manner contemplated by the complaints procedure (Consumers Gas);

- there is insufficient time between the publication of the notice of hearing and the prescribed date for filing of a complaint for domestic purchasers to establish grounds for a complaint (Consumers Gas, Union);

- the procedure discriminates against domestic buyers because it imposes on them the contracting preferences of export buyers, who primarily rely on Canadian sources for longer term supply while obtaining short and medium term supply in U.S. markets (Consumers Gas);

- the procedure is not company-specific, a factor which allows large aggregators of natural gas to direct their supplies to the larger U.S. market, relegating the Canadian market to less secure supply (Union);

- a domestic purchaser may not be in a position to purchase additional supplies at the time the export approval is sought because at that particular time it has enough supply under contract (Union); and

- the procedure does not provide an avenue to voice concerns with regard to uneven treatment imposed by a provincial body placing more restrictive terms on domestic sales than export sales through removal permit policies (Union).

ICG (Ontario) submitted that the fact there has to date not been a substantive complaint raised by any domestic consumer is not evidence that the mechanism is effective, or that it serves the Canadian public interest.

Consumers Gas was of the view that the EIA is ineffective for surplus determination purposes, particularly with the recent changes made by the Board to amend the filing requirements.

Ontario submitted that the effectiveness of the complaints procedure and EIA remains to be shown and that the benefit-cost analysis should be retained.

GMi, while supporting the continued use of benefit-cost analysis, did not agree with the positions of other submittors in regard to the complaints procedure and EIA. GMi's view was that the complaints procedure has not yet been tested because it has not been needed and, further, the proposition that well-informed consumer interests would not file an objection under the complaints procedure when they believed it to be necessary is untenable. GMi also indicated that the recent changes made to the EA filing requirements had addressed its concerns with this component of the MBP.

(iv) Consistency with Federal Government Policy

BC Gas suggested that the use of benefit-cost analysis is consistent with the federal governments intention that the price of gas recover its appropriate share of the costs incurred in making the export. In this regard, BC Gas quoted a former Minister of Energy, Mines and Resources,[1] to the effect that recovery of an appropriate share of costs is one of the most important of the criteria for acceptability which export arrangements are expected to satisfy in order to meet standards of public interest.

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[1] Speech delivered by the Minister of Energy, Mines and Resources, The Honourable Marcel Masse, to the American Bar Association in June, 1987.

In summary, parties in favour of the continued use of benefit-cost analysis supported their positions with the following principal reasons: the Board has a statutory mandate to protect the public interest and benefit-cost analysis is a necessary component of the public interest determination; divergences between private and social benefits and costs do exist and benefit-cost analysis is an accepted method of addressing these market imperfections; other aspects of the MBP, specifically the complaints procedure and EIA, are ineffective; and the use of benefit-cost analysis is consistent with federal government policy.

2.1.2 Views of Parties Opposing Continued Use of Benefit-Cost Analysis

The parties opposing continued use of benefit-cost analysis submitted the reasons outlined below in support of their positions.

(i) Inconsistency With a Market-Oriented Energy Policy Framework

Most parties opposing the continued use of benefit-cost analysis submitted that its use was inconsistent with the energy policy framework established in The Western Accord[1] and the 1985 Agreement[2]. This framework is based on the premise that the marketplace should generally determine the supply, demand and price for natural gas. These parties argued that, in a deregulated competitive environment, benefit-cost analysis is an impediment to contractual arrangements freely negotiated between buyers and sellers. This view was reflected in GMi's reply submission, which states that:

"the basis of a system of market-determined pricing is the assumption that the judgments of market participants with respect to these matters are the best that are available in a market based economy, and that they can be expected to lead to results that are in the overall public interest."

The APMC, on behalf of the province of Alberta, submitted that if benefit-cost analysis were used to evaluate export sales, the market views of the regulator would be substituted for those of market participants.

Shell expressed the view that benefit-cost analysis may have had a role in 1987 when the Board reviewed its gas surplus determination procedures. At that time, markets were in transition from a regulated to a deregulated pricing environment. However, they submitted that markets have now evolved sufficiently to allow the market to dictate the conditions of export transactions.

Canadian Hunter stated in its submission that, in a normally functioning market, a portfolio of contracts would emerge that would on average generate good economics. In the absence of evidence of serious market failure, Canadian Hunter suggested that it was inappropriate for the Board to use benefit-cost analysis to deny occasional "marginal" or "bad" deals. It further

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1 The Western Accord: Agreement between the Government of Canada, Alberta, Saskatchewan and British Columbia on Oil and Gas Pricing and Taxation, March 1986.

2 Agreement among the Governments of Canada, Alberta, British Columbia and Saskatchewan on Natural Gas Markets and Prices, October 1995 (see Appendix III).

suggested that if a significant market failure were found to exist, other remedies are available to the Board.

Westcoast submitted that the relative importance of benefit-cost analysis has been over-emphasized in recent export licence applications, arguing that, in the July 1987 Reasons for Decision setting out the MBP, the Board indicated that benefit-cost analysis would only be one of many factors it would consider in determining whether a proposed export was in the public interest.

(ii) Questionable Necessity

The majority of submittors opposing continued use of benefit-cost analysis were of the view that other aspects of the MBP ensure that the public interest is protected and that it is therefore unnecessary to retain benefit-cost analysis.

These submittors argued that a properly functioning competitive market, combined with the complaints procedure, monitoring, and to a lesser extent the EIA would ensure that the interests of the producing and consuming sectors were protected, thereby allowing the Board to fulfill its public interest mandate under Section 118 of the Act.

Many of these submittors also argued that the market distortions with which the Board has indicated it is concerned, particularly user costs and transportation costs, are small or do not exist, or are accounted for through other mechanisms. As a result, they submitted that the use of benefit-cost analysis is unnecessary.

With respect to user costs, submittors were of the view that differences between private and public perspectives were not as significant as the Board has suggested and, further, the Board has not sufficiently considered the role of the provincial and private royalty holders in taking account of user costs. In regard to the latter, WGML and others argued that the producing provinces, as the resource owners, have in place royalty and lease bidding mechanisms which must be assumed to account for the user costs associated with the present sale of the resource.

With respect to the transportation cost differential arising from the use of a rolled-in tolling methodology, many submittors recognized that this market distortion exists, but expressed the view that it should be addressed as part of the facilities review or the toll-setting process, rather than in the context of applications under Part VI of the Act. Some submittors commented on the use of benefit-cost analysis, or alternative economic feasibility tests, under Part III of the Act. Alternatively, some parties suggested that the Board should accept the inefficiencies that arise with the current toll methodology and not attempt to take account of this effect in considering Part VI applications.

The APMC and Saskatchewan, among others, suggested that the failure of a project to pass the benefit-cost test may reflect differences in the views of the NEB and market participants with respect to future market conditions, rather than evidence of market failure.

British Columbia was of the view that continued use of benefit-cost analysis is unnecessary and that the Board should accept provincial removal permits as sufficient evidence that the Board's requirements for issuing an export licence have been met with respect to surplus determination, reserves and the public interest.

Other submittors suggested that it is inappropriate to treat natural gas in a unique manner relative to other commodities.

(iii) Methodological Concerns and Uncertainty Regarding Assumptions

Many of the submittors opposing the continued use of benefit-cost analysis also argued that questions related to the methodology and uncertainty regarding the assumptions used in the analysis were sufficiently great that it could not be an appropriate substitute for the decisions of market participants.

Concerns related to methodology included the appropriate forecast level of export demand to use in the calculation of total incremental production costs, the treatment of by-product revenue in the analysis and the use of industry-aggregate rather than applicant specific estimates of future gas supply costs. Views of submittors on these methodological issues are described in more detail later in this Chapter.

The principal uncertainties submittors identified in regard to assumptions were related to projections of future industry average costs and projected export levels and the relationship between supply costs and natural gas prices. Views of submittors on these questions are also described in more detail in this Chapter.

Submittors stated that the effective use of the Board's methodology in the context of export licence applications depends heavily on reliable projections of these parameters. Canadian Hunter and WGML among others, noted that price and volume projections by the Board and industry in the past have frequently been unreliable.

In view of the uncertainty regarding the methodology and assumptions in the analysis, submittors argued that it is inappropriate for the Board to use benefit-cost analysis as the basis for intervention in the market.

Additionally, some submittors, including Altresco, ANR and CETI, were of the view that the lack of predictability of the results of the benefit-cost analysis creates uncertainty among market participants which could have a negative impact on the export market for Canadian gas.

(iv) Inconsistency With the NEB Act

BVI, Indeck Gas, IPAC and Niagara Mohawk suggested that the use of benefit-cost analysis is inconsistent with Section 118 of the NEB Act, cited on page 1 of these Reasons.

This assertion was based on the view that paragraph 118 (a) relates only to volume or quantity and that paragraph 118 (b), which references price and the public interest, specifically excludes natural gas. IPAC concluded that the price of gas in relation to the public interest is not to be

considered in an application for an export licence. Niagara Mohawk submitted that the intent of the 1982 amendment to the NEB Act which removed natural gas from paragraph 118 (b) was to reduce the emphasis by the Board on factors associated with the price of gas.

(v) Inconsistency With the 1985 Agreement

Saskatchewan considered the use of benefit cost analysis to be inconsistent with the Board's undertaking in a Memorandum of Guidance of July 1987 respecting Criterion 1 of the 1985 Agreement.

On 27 July 1987 the Board, following a request for advice from the Minister of Energy, Mines and Resources, requested that all applicants seeking Board approval of new or amended export sales contracts file information regarding recovery of costs incurred in making the export in the Memorandum of Guidance to all interested parties, the Board, referring to the Minister's letter, stated that "Criterion 1 should be interpreted to mean that the revenue generated by each export licence on an annual basis is sufficient to cover the intraprovincial -and interprovincial transportation costs in Canada and to netback a price that is acceptable to the producers supplying the natural gas, as demonstrated by their support for the arrangement (Criterion 5)."[1]

Saskatchewan interpreted this to mean that the Board agreed that price examination for recovery of costs within reviews of export licence applications would be limited to the recovery of transportation costs. IPAC expressed a similar view.

(vi) Inconsistency With the FTA

Many submittors, including CPA, IPAC, Saskatchewan, SEPAC and several U.S. importers, suggested that the use of benefit cost analysis is, or could be, inconsistent with the FTA.

Several submittors took the position that benefit-cost analysis can be considered discriminatory under the FTA because it is applied to export sales but not to domestic sales.

Many submittors were of the view that benefit-cost analysis, as currently employed by the Board, has the effect of imposing a minimum price test on export licence applications and is therefore in contravention of the FTA. This conclusion was generally based on the Board's use of industry-aggregate cost data for all applicants, with the result that it is primarily the price of a particular applicant's sales that determines whether or not the analysis indicates positive net benefits.

In summary, parties opposed to the continued use of benefit-cost analysis supported their positions with the following principal reasons: the use of benefit-cost analysis is inconsistent with the current market-oriented energy policy framework; it is of questionable necessity because other aspects of the MBP adequately protect the public interest and because market distortions are not significant or are accounted for through other mechanisms; it is not an appropriate substitute for the decisions of market participants due to concerns related to the methodology and uncertainty regarding assumptions used in the analysis; and, it is inconsistent with the Act, the 1985 Agreement and the FTA.

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[1] See Appendix III for a copy of the Minister's letter and the s Memorandum of Guide.

2.1.3 Views of the Board

The Board has carefully considered the views of parties on whether it should continue to use social benefit-cost analysis as a factor in the MBP for determining whether proposed exports of natural gas are in the public interest.

Submittors provided a number of reasons in support of their views in favour of, or in opposition to, continued use of benefit-cost analysis. These reasons pertained to:

- the role of other aspects of the MBP in protecting the public interest;
- the role of provincial removal permit processes in protecting the public interest;
- the Board's statutory mandate under Section 118 of the Act;
- the implications of the 1985 Agreement in regard to the use of benefit-cost analysis;
- the implications of the FTA in regard to the use of benefit-cost analysis;
- the current energy policy framework; and
- the nature of differences between private and public valuations of net benefits.

Each of these issues is addressed in turn below.

(i) The Role of Other Aspects of the MBP

The Board does not agree in full with those submittors who argued that the use of benefit-cost analysis should be discontinued because other aspects of the MBP, namely the complaints procedure, the EIA and monitoring, adequately protect the public interest. The above criteria are intended to ensure that the gas to be exported is surplus to reasonably foreseeable Canadian requirements, as required by paragraph 118(a) of the Act. The Board does not accept that because the surplus requirement of the Act is met, an export of gas is necessarily in the public interest. It was for this reason that the Board included a determination of the broader public interest in the MBP.

Neither does the Board agree in full with those submittors who argued that social benefit-cost analysis should be retained because it is the only effective component of the MBP and that the complaints mechanism and EIA are not, or have not yet been shown to be, effective for surplus determination. As noted above, the complaints and the export impact assessment are intended to determine whether gas proposed to be exported is surplus to reasonably foreseeable Canadian requirements. Benefit-cost analysis, as applied to review of gas export applications, does not address equity of access to gas supply or whether gas to be exported is surplus to Canadian requirements. It is intended solely to provide an evaluation as to whether the export is likely to recover its appropriate share of costs incurred in Canada. The Board is therefore of the view that concerns regarding the effectiveness of other aspects of the MBP do not, in and of themselves, provide a sufficient basis for retention of benefit-cost analysis, if it cannot be shown to be a viable public interest test on its own merits.

The Board has recently reviewed the role of the EIA and is satisfied that it provides information helpful to the Board in fulfilling its mandate under Section 118 of the Act.

In response to concerns raised by some submittors, the Board notes that the complaints procedure is intended only to ensure that Canadian users have an opportunity to buy gas for their needs, on terms and conditions similar to those of the proposed export, at the time of the export licence application. It does not provide this opportunity to domestic purchasers on an ongoing basis into the future.

(ii) The Role of Provincial Removal Permit Processes

British Columbia was of the view that the Board should rely on the provincial removal permit review process to ensure that the national public interest is protected. While the Board recognizes that there is some commonality in the criteria which an applicant must meet to obtain a provincial removal permit and those which must be satisfied under the MBP, it does not agree that the national public interest mandate under Section 118 of the Act can be met by the Board solely through reliance on the provincial review process.

(iii) The Board's Statutory Mandate

Section 118 of the Act provides that, in considering an application for a licence to export gas, the Board shall have regard to "all considerations that appear to it to be relevant". The statute goes on to state that the Board shall satisfy itself that the quantity of gas to be exported does not exceed the surplus remaining after due allowance has been made for reasonably foreseeable requirements for use in Canada, having regard to the trends in the discovery of gas in Canada.

The Board views Section 118 as allowing it to use broad discretion as to the factors which may be considered in determining whether a proposed export of gas is in the national public interest. Other than the specific provision relating to surplus, the criteria which the Board is to use, or the factors which it is to take into consideration in fulfilling its mandate under Section 118 are not prescribed, but are at the Board's discretion. The Board notes that this mandate was not altered by changes in the energy policy framework, although the Board itself modified its procedures to reflect the market-oriented energy policy environment. The Board is also mindful that in exercising its powers and performing its duties, it must give effect to the FTA as required by subsection 119.2(l) of the Act.

Some parties to the proceeding argued that to fulfill its mandate, the Board must use benefit-cost analysis to assess export applications. Others argued that the use of benefit cost analysis is inconsistent with the wording of the statute. The Board does not agree with either of these positions. The Board did indicate in its July 1987 Reasons for Decision describing the MBP that, as part of its public interest determination, it would consider evidence that the export revenues would fully recover the costs to Canada incurred in making the export. It also indicated that benefit-cost analysis would continue to be an important tool for use by the Board in assuring itself that proposed exports are in the public interest. However, the Board is of the opinion that it is solely for itself to determine whether such a tool continues to be of use to it in fulfilling its mandate. The Board is satisfied that it can fulfill its mandate under Section

118 of the Act and can find proposed exports to be in the public interest without using benefit-cost analysis to assess export applications.

(iv) Implications of the 1985 Agreement

Some submittors to the proceeding argued that the Board's use of benefit-cost analysis in assessing gas export applications is consistent with the federal governments stated intention that the export price of gas should recover its appropriate share of the costs incurred in making the export. Others argued that the government's views on cost recovery were limited to recovery of transportation costs associated with making the export.

The Board notes that The Western Accord and the 1985 Agreement made reference to cost recovery in the context of exports of natural gas. The Agreement stated that, to obtain approval, all export applicants must demonstrate that their negotiated contractual arrangements meet certain criteria for acceptability, including the requirement that the export price recover its appropriate share of costs incurred (Criterion 1).

In June 1987, the Minister of Energy, Mines and Resources wrote to the Board indicating that the criteria in the 1985 Agreement were not meant to impede or interfere with the private sector negotiating process, but rather were intended to provide the industry with guidance in formulating negotiated arrangements that were, and would continue to be, in the broad public interest. He requested the Board to provide him with advice regarding the criteria of cost recovery, specifically with respect to recovery of transportation costs.

The Board is of the view that nothing in The Western Accord or the 1985 Agreement requires the Board to continue to use benefit cost analysis in assessing gas export applications. While cost recovery was referred to in the Agreement, significant changes have occurred in natural gas markets since 1987. In particular, the Board notes that markets have matured considerably over this period. In view of the market changes which have occurred, and the fact that the Minister's 1987 letter indicated that the criteria in the Agreement were not meant to impede the private sector negotiating process, and that his request for advice related only to the recovery of transportation costs associated with making exports, the Board believes that it would not be inconsistent with government policy to discontinue using benefit-cost analysis in considering export applications.

Conversely, the Board believes that the continued use of benefit analysis in the context of its MBP would not necessarily be inconsistent with government policy, as was alleged by some submittors.

(v) Implications of the FTA

The Board notes that a number of submittors opposing the continued use of benefit-cost analysis were of the view that its continued use is, or could be, inconsistent with the FTA. As the question of the Board's jurisdiction in light of the FTA is beyond the scope of this proceeding, the Board will not respond to these arguments in these Reasons.

(vi) The Energy Policy Framework

Submittors opposing the continued use of benefit-cost analysis argued that its use is inconsistent with the current market-oriented Canadian energy policy framework. The Board notes that the MBP was developed on the premise that the marketplace will generally operate in such a way that Canadian requirements for natural gas will be met at fair market prices. However, the Board does not agree that the use of benefit-cost analysis is, in principle, inconsistent with this premise. An important factor affecting the efficiency of markets is whether there are significant differences between the public and private valuations of a project's costs and benefits. If there were evidence of such differences, the Board would consider it appropriate to assess these differences and intervene, where necessary, to satisfy itself that proposed exports are in the national public interest. The Board is, however, strongly of the view that in the current market-oriented policy framework, it must be clearly established that markets are not working efficiently and that the public interest is not sufficiently protected before regulatory intervention is warranted.

(vii) The Nature of Differences Between Private and Public Valuations of Net Benefits

The Board agrees with those parties who submitted that social benefit-cost analysis, in which a stream of forecast revenues is compared to a stream of forecast costs on a present worth basis, is the established and appropriate analytical approach for attempting to determine whether social benefits from projects exceed social costs. At the time the MBP was developed, and in decisions pertaining to gas export licence applications since that time, the Board has considered it appropriate to consider evidence in the form of a conventional benefit-cost analysis to determine whether projected revenues would be sufficient to recover projected social costs incurred in making the proposed export. However, the Board also recognizes that it is appropriate to periodically review its procedures, both in light of changing market circumstances and experience gained in their application.

Any differences between private and public valuations of net benefits, addressed by the Board through the use of benefit-cost analysis, arise primarily in the areas of gas production costs and transportation costs. Of these two factors, future gas production costs usually have a far more significant influence on the results of the analysis than do gas transportation costs.

Regarding future gas production costs, in a benefit-cost analysis conducted from a social perspective the additional costs of meeting aggregate future gas requirements are measured; these additional costs arise when additional consumption causes a more rapid progression of production from lower to higher cost resources. Forecasts of industry aggregate gas production costs per year are prepared including and excluding the annual volumes of the project under examination. Each of these cost projections is brought to present value using the social discount rate. The difference between present value gas costs with versus without the proposed export volumes is the "total incremental production cost" associated with those volumes.

A private firm doing an analysis of the net benefits which it would realize from supplying a new export project would use its view of its natural gas supply costs and a discount rate reflecting a rate of return which it found satisfactory.

The Board agrees with those submittors who expressed the view that there is considerable legitimate debate about the size of any difference which exists between the private and public evaluation of gas production costs. This is the case particularly because there is a wide range of uncertainty about the appropriate values of the social and private discount rates, the level and shape of aggregate gas supply cost curves, and the basis upon which individual producers develop their respective views of relevant natural gas supply costs. As a result, there is a corresponding uncertainty about the magnitude of any difference between public and private costs of gas production. The Board also agrees that, to the extent differences exist between public and private evaluations of gas supply costs, royalty and land bonus mechanisms established by the governments of the producing provinces may be regarded as a means to account for at least part of the divergence. These arrangements, however, are not necessarily structured with this specific objective in mind.

The above considerations raise for the Board the question as to whether there is sufficient evidence of a difference between public and private determinations of gas production costs to warrant regulatory intervention on this account, particularly when the current policy environment and the Board's MBP emphasize reliance on market forces to determine patterns of natural gas supply and demand.

The Board has recognized the uncertainty inherent in the analysis by asking applicants to conduct a fairly wide range of sensitivity tests for key parameters. However, the Board notes that not only is the appropriate range of assumptions uncertain, but that the benefit cost results tend to be highly sensitive to the assumptions in the analysis.

The Board has carefully considered the views of the parties with respect to each of the reasons cited in support of, or in opposition to, continued use of benefit-cost analysis as a factor in the MBP. The Board concludes that, particularly in view of the uncertainty regarding the existence and size of any difference between public and private valuations of gas production costs and the wide fluctuation of the results depending on the assumptions used, it is not appropriate to use benefit-cost analysis as a determinative factor in gas export licensing.

The Board does, however, recognize that there may be real differences between pipeline tolls and the social costs of transportation, especially in cases where the principle of rolled-in tolling is applied. If this were to become an issue in the context of Part III or Part IV proceedings it could be addressed by an economic evaluation of pipeline facilities applied for pursuant to Part III of the Act or by consideration of toll methodology in Part IV.

2.2 If the Board should continue to use benefit-cost analysis as part of the MBP, what role should that analysis play in the Board's decision-making process?

For the most part, only those parties who supported the continued use of benefit-cost analysis responded to this question.

2.2.1 Views of Submittors

A small minority of producers, exporters, marketers and U.S. importers provided qualified support for continued use of benefit-cost analysis for review of export licence applications. These submittors (including A&S, Altresco, NEPCO, Norcen, Poco, Vector and others) were generally of the view that benefit-cost analysis should be only one of several factors the Board considers in assessing the public interest and that it should not be a major factor in the Board's decision-making process.

The provinces of Ontario and Quebec, the domestic natural gas distribution companies which made submissions, CCPA, C-I-L, the Council of Canadians, IGUA and others supported the continued use of benefit-cost analysis as a factor in the MBP. However, there was no consensus among these submittors as to the role benefit-cost analysis should play in the Board's decision-making process.

BC Gas, CCPA, C-I-L, Consumers Gas, the Council of Canadians, IGUA and Union submitted that the results of the benefit-cost analysis should be given significant weight in the Board's analysis of export licence applications. BC Gas and Union were of the view that the Board could not generally find an application to be in the public interest unless it had positive net benefits. IGUA suggested that the weight assigned to the results of the benefit-cost analysis could be reduced if an alternative toll methodology were adopted which internalized the costs of pipeline facilities required to transport gas to new markets and if more timely market information were made available. The Council of Canadians submitted that applications which fail the benefit-cost test should be denied.

Both Ontario and Quebec recognized that benefit cost analysis is one of several factors the Board can consider in determining whether an application is in the public interest. Ontario was of the view that it should have an important role. Quebec submitted that it should be used prudently and with flexibility.

ICG (Ontario) submitted that benefit-cost analysis was one of several important factors that the Board must consider, but that it should not necessarily be determinative and the weight given it should be dependent upon the circumstances of a particular application.

GMi was of the view that no action should be taken on the basis of the benefit-cost analysis alone, because the analysis is not sufficiently well developed. GMi suggested that it was appropriate to use the benefit-cost results in the decision-making process only if the results are validated through an objection under the complaints procedure.

2.2.2 Views of the Board

As outlined earlier in these Reasons, the Board does not agree with those parties who took the view that the results of benefit-cost analyses should continue to be given significant weight in the Board's analysis of export licence applications.

The Board notes that some parties supporting the continued use of social benefit-cost analysis suggested that it be used in the decision-making process only if the results are validated through an objection under the complaints procedure or, alternatively, that it not necessarily be determinative.

The Board doubts whether the availability of a benefit-cost analysis would appreciably assist a domestic user of natural gas in deciding whether to register an objection under the complaints procedure. As noted earlier in these Reasons, benefit cost analysis, as applied to the review of gas export

applications, does not address equity of access to gas supply or whether gas to be exported is surplus to Canadian requirements.

The Board has considered whether benefit-cost analysis should be retained as a means of monitoring or for information purposes. In the Board's view the limitations of benefit-cost analysis previously discussed, and the resulting limited value of the results of the analysis to the Board or to the market for information purposes, are such that its retention for these purposes does not justify the costs that would thereby be imposed on applicants.

2.3 If the Board should continue to use benefit-cost analysis as part of the MBP, is the methodology employed by the Board in its benefit-cost analysis since the introduction of the MBP appropriate?

Given the Board's decision regarding the continued use of benefit-cost analysis in gas export licensing decisions, the Board will not comment on this question. The views of submittors on the scope of the analysis, technical aspects of methodology and reliability of data are presented below.

2.3.1 Scope of the Benefit-Cost Analysis

Of those parties who supported the continued use of benefit-cost analysis as part of the MBP, only Ontario and Quebec stated without qualification that the existing methodology is appropriate.

Many of the other parties who supported the continued use of benefit-cost analysis as part of the MBP suggested that the existing methodology did not go far enough in measuring the effects of new gas exports and associated pipeline expansions on all affected parties. Consumers Gas suggested that, in addition to measuring direct associated costs and benefits, the analysis should be extended to include the macro-economic effects of new gas exports. These macro-economic effects would include estimates of the potentially depressing effect additional exports could have on the prices and volumes of existing exports, and the possible displacement of electricity exports. In addition, other external effects such as environmental costs, foreign exchange benefits generated by the export sales, benefits generated by the employment of otherwise unemployed persons, and some additional tariff and tax externalities would be included.

Consumers Gas also suggested that, when faced with a facilities application and several associated export licence applications, the Board should require that a macro benefit-cost analysis of the combined applications be conducted. If this macro analysis indicated that it was unlikely that net benefits to Canada would be generated, then it would be necessary to choose among the submitted export licence applications. Consumers Gas argued that, in this case, each individual application should not only have to satisfy the Board's benefit cost criteria, but that it should have to demonstrate that it had higher net benefits than other export applications.

C-I-L argued that the Board's analysis should be extended to include environmental costs and any induced loss of industry and jobs to the U.S. associated with new exports. IGUA argued that the analysis should be extended to include an estimate of potential lost domestic and export sales due to the higher pipeline tolls that would likely result from constructing new pipeline facilities to accommodate the new exports. The CCPA argued that the analysis should also include an assessment of the impact on tolls.

The Council of Canadians also argued that the analysis should be extended to include environmental costs as well as the impact new gas exports could have on the volumes and prices of electricity exports. In addition, the Council stated that the current methodology does not include an estimate of the outflow from Canada of some of the profits earned from new gas exports.

C-I-L, Consumers Gas, the Council of Canadians and IGUA all argued that the existing benefit-cost methodology is deficient because it does not identify the distributional effects of new exports and pipeline facilities on all affected parties. In other words, although the analysis yields an estimate of net benefits to Canada, it does not identify the magnitude of benefits and costs as they accrue to or are incurred by the different affected producer and consumer groups.

Harvey stated that any changes made to benefit cost analysis should make it more stringent. He did not provide specific suggestions as to how this might be done.

2.3.2 Technical Aspects of the Board's Benefit-Cost Methodology

As summarized above, several parties who supported the continued use of benefit-cost analysis suggested that the scope of the analysis be extended but made little comment on aspects of the existing methodology. Most producing interests opposed the continued use of benefit-cost analysis and many of them criticized the appropriateness of the Board's methodology. Several of these parties) indicated that, although their comments on benefit-cost analysis methodology were being made in the context of a Part VI review, they would apply equally to the extent that this approach to benefit-cost analysis was used to assess Part III facilities applications.

Submissions on the technical aspects of the Board's benefit-cost methodology can be grouped under the following sub-headings:

(i) the use of industry-aggregate versus applicant-specific cost and by-product data;

(ii) the appropriate forecast of export demand to use in the calculation of total incremental production costs;

(iii) the treatment of by-product revenue in the analysis; and

(iv) the methodology for projecting future prices and costs.

Each of these is addressed in turn below.

(i) Use of Industry-Aggregate versus Applicant-Specific Data

Many producing interests and U.S. importers argued against the Board's use of industry aggregate cost and by-product data in the analysis and suggested that the Board instead use applicant-specific data. Many producers argued that the use of industry aggregate data could adversely prejudice their applications because, although their production costs could be below the industry average, this would not be reflected in the Board's methodology. Similarly, although their by-product yields could be above the industry average, their applications could be prejudiced by only crediting them with average by-product revenues. British Columbia supported the producers' views on this issue.

On the other hand, Consumers Gas argued that, when gas exports increase in aggregate, it is likely that industry-average production costs also increase. In its view, only the use of industry-aggregate cost data will properly reflect the real cost incurred.

(ii) Appropriate Forecast of Gas Demand to Use in the Calculation of Total Incremental Production Costs

Many producers, several U.S. importers, and the New York State Energy Office expressed the view that it is methodologically incorrect to use a forecast of export demand in the user cost calculation. The CPA, for example, argued that future export opportunities are already reflected in producers' marketing decisions and in the discount rate used in the benefit-cost analysis. The CPA stated that there would be a logical inconsistency in using a forecast of export demand because the user costs generated by such a forecast might cause the Board to deny licences for many applications and, hence, the export forecast could not be realized. It also said that the use of a forecast inappropriately burdens current export applications with costs attributable to future exports not yet licensed by the Board.

Rather than using a forecast of export demand, several producing interests argued that the correct method would be to use a forecast of exports expected to flow under licences outstanding at the time of the application. The CPA and WGML also both indicated that an acceptable alternative would be to use a projection of export sales that could flow given existing pipeline capacity in place in Canada.

Ontario, Consumers Gas and Union stated that they were in agreement with the use of a forecast of export demand in the user cost calculation. Consumers Gas, however, noted that the forecast which the Board has been using in its analyses is almost certainly too low and, hence, has probably resulted in an understatement of the user costs associated with export licence applications.

(iii) The Treatment of By-product Revenue in the Analysis

The Board has been accounting for by-product revenues in its analyses by crediting gas supply costs with the revenue earned from the sale of by-products. The CPA disagreed with this approach, stating that this methodology has the effect of making by-product revenue estimates dependent upon gas export revenues and independent of time. The Board's assumption of a constant real value for by-product revenues over time was also criticized as being inconsistent with the projected real escalation of oil prices in the Board's analyses. Finally, the CPA argued that the benefits from by-product revenue production were understated in the Board's analyses because the revenues from by-products extracted at straddle plants are not included.

(iv) Price and Cost Formation Methodology

The CPA questioned the Board's assumption that gas export prices would closely track marginal costs of gas production in Canada. It suggested that this methodology should be validated empirically before it is used as the basis for projecting net benefits in the Board's analyses.

In the 1988 Supply and Demand Report, the Board developed two illustrative future scenarios, known as the low and high oil price scenarios. In these scenarios, the Board postulated that gas supply costs would be higher in the high oil price scenario than in the low oil price scenario. The CPA disagreed with the Board's linking of gas supply costs to estimates of gas prices in these two scenarios, arguing that costs should not be a function of gas demand and prices, particularly in the long run.

2.3.3 Uncertainty of Forecasts and of Estimates of Future Gas Supply Costs

Many producing interests and some U.S. importers argued that there is much imprecision associated with the forecasts of demand, prices and, in particular, of the supply costs used in the analysis. IPAC and several other producers argued that the results of a benefit-cost analysis are sensitive to the assumptions used in the analysis and, hence, a wide range of results can be- generated. In their view, the uncertainty of the assumptions and the wide range of possible results militate against the Board putting a great deal of reliance on the results of benefit-cost analysis. The CPA further argued that, in projecting future gas supply costs, the Board should take into account possible cost reducing factors such as technological advances and the existence of excess gas plant capacity.

2.4 If the Board should discontinue the use of benefit-cost analysis as part of the MBP, how else should the Board take account of the differences between social and private costs in determining whether a proposed export is in the public interest?

2.4.1 Views of Submittors

In response to this question, no submittors suggested alternatives to benefit-cost analysis that the Board might implement under Part VI hearings to account for the difference between private and social costs associated with natural gas exports. As summarized earlier, most of those parties who opposed the continued use of benefit cost analysis as a component of the MBP argued that it is not necessary for the Board to take account of these differences. The main argument made in support of this position was that the difference between the social and private evaluations of gas production costs is very unclear and, hence, it is questionable whether the Board should attempt to take this difference into account in its consideration of licence applications.

A number of producing interests, including Gulf, Husky, IPAC, Pan-Alberta, PanCanadian, Petro-Canada, ProGas and Shell did recognize that there is a potentially significant divergence between private and social costs with respect to pipeline transportation. Several producers, including the above parties, argued that any steps taken to correct for this potential divergence should be undertaken in the context either of a Part III hearing on a pipeline facilities application or a Part IV hearing on pipeline tolls.

A number of parties expressed their general views on the appropriate test to be applied to facilities applications under Part III of the Act. These submissions are summarized below.

AEC, IPAC and Pan-Alberta each stated that a cost recovery test should be applied to pipeline expansion applications under Part III of the Act. Each of these parties envisaged a test which included the real incremental transportation costs associated with a facilities expansion but which incorporated a

private sector estimate of gas production costs. PanCanadian supported the use of benefit-cost analysis to test facilities expansions under Part III of the Act, but recommended that user costs be estimated in accordance with the CPA's suggestions under question 3[1]. Bow Valley, Indeck Gas and Indeck Energy recommended that a transportation cost recovery analysis be applied to Part III facilities applications. This test would examine whether or not the incremental toll revenues from incremental export shipments would be sufficient to cover the incremental facilities costs incurred.

A number of producing interests, including Canadian Hunter, IPAC, Morgan Hydrocarbons and Universal, held that the Board should continue to use rolled-in tolls. In contrast, Edge, a number of large producers, including Amoco, CPA, Gulf, Husky, and Shell and suggested that, if the Board is concerned about a market failure with respect to gas transportation, it should consider adopting incremental tolls. Most of these parties argued that, if incremental tolls were adopted, producers would see the true costs of transporting their gas and any transportation market failure would be internalized to the projects for which the transportation is intended. Petro-Canada supported the adoption of the l.2 test for the economic feasibility of new facilities which the CPA bad proposed in the GH-1-89 proceeding. Edge said that use of benefit-cost analysis could be appropriate in Part III proceedings but only if large environmental or socioeconomic impacts were involved.

Saskatchewan suggested that the Board examine the divergence between private and social costs under the existing rolled-in toll methodology and, if the economic distortions were found to be unacceptably large, the Board should reopen the toll methodology question. A few producers also recommended that the question of the appropriate economic test to be applied to facilities applications and the tolling methodology issue be resolved in the context of a Part III hearing with input from all interested parties.

BC Gas argued that incremental tolls should be implemented for large export licence applications in order to avoid undue subsidization of exports. Consumers Gas also noted that, if incremental tolls were adopted, a benefit-cost analysis would not be needed to correct for any market failure with respect to transportation costs because the tolls would reflect real transportation costs. Ontario also stated that the divergence with respect to transportation costs could perhaps be resolved through the implementation of an alternative toll methodology. However, both Ontario and Consumers Gas maintained that benefit-cost analysis would still be necessary to assess the user costs associated with export licence applications.

Among gas consuming interests, each of CCPA, C-I-L and IGUA suggested that the Board should consider adopting incremental tolls to correct the market distortions related to rolled-in tolls.

In addition to comments on benefit-cost methodology, some submittors made comments on the process by which evidence on benefit-cost analysis is incorporated into the hearing record.

A number of producing interests, U.S. importers, and the governments of Quebec and New York argued that, if the Board were to continue to use benefit-cost analysis as part of its review of gas

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[1] The CPA suggest that, in the calculation of user costs, the Board should use a forecast of exports likely to flow under existing licences (or, in the alternative, a forecast of exports constrained by existing pipeline capacity); that, in projecting future supply costs, the Board should take into account cost-reducing factors such as technological improvements; and that any systematic links between gas supply costs and gas prices be logically and empirically validated.

export licence applications, all of the assumptions and data that go into the analysis should be part of the hearing record and all interested parties should be given a full opportunity to respond to the results of any benefit-cost analysis prior to the closing of the hearing record.

The Council of Canadians suggested that the Board initiate a series of public hearings which would review the entire question of the regulation of energy exports.

2.4.2 Views of the Board

As indicated, the Board has decided that the uncertainty which exists as to the difference between private and social costs of gas production is such as to disqualify benefit-cost analysis as a determinative factor in natural gas export licensing decisions.

However, as noted earlier, the Board recognizes that there may be real differences between pipeline tolls and the social costs of transportation, especially in cases where the principle of rolled-in tolling is applied. If this were to become an issue it could be dealt with by an economic evaluation of pipeline facilities applied for pursuant to Part III of the Act or by consideration of toll methodology in Part IV.

2.5 "To what extent should the Board, as part of the MBP, examine the provisions of export contracts to determine whether those contracts allow flexibility in order to reflect changing market conditions over time?"

2.5.1 Views of Submittors

On this question, reasons cited in favour of such examination included:

- it is consistent with, or required by, the Agreement;
- it is required because of the long term nature of gas export contracts and the need to recover related facilities investments;
- it is consistent with the requirement in the Act that the export be in the public interest and that it be supported by substantive commercial arrangements;
- it is required to ensure fair and competitive prices and highest quality customers; and
- it is consistent with similar U.S. regulation.

Reasons cited against such examination included:

- in a free market it is unnecessary and inappropriate for the Board to interfere in arm’s length pricing arrangements between buyers and sellers;
- it is unnecessary for the Board to ensure contact flexibility since the transition period to deregulated prices is over;
- provincial regulation can address any concern the Board might have; and

- it is inappropriate for the Board to seek to enhance a seller's position,

Producers' views were mixed as to whether the Board should continue to examine export contracts to ensure that they contain provisions which permit adjustments to reflect changing market conditions. Producers were, however, in general agreement that the Board, in determining the adequacy of negotiated contract provisions, should not substitute its view for that of the marketplace.

CPA cited the 1985 Agreement and stated that regulatory overview of initial contracts and subsequent amendments was not inconsistent with free market policies that interact with international trade and regulated gas transmission utilities. CPA did not favor the review of contracts as being an excuse to interfere with freely negotiated arrangements. The CPA also noted that, since most U.S. states have least-cost gas purchasing requirements, it is essential that both countries find the sale to be market-responsive.

IPAC stated that, to be consistent with the Act and the 1985 Agreement, the Board should examine contracts to ensure they contain provisions permitting adjustments to reflect changing market conditions over the life of contract. IPAC added, however, that a market-oriented pricing regime must be allowed to function. The Board's role should only be to ensure that adjustment provisions are included; it must not impose its view of the market on contractual agreements. SEPAC felt the Board should not intervene with respect to price flexibility in contracts. In SEPAC's view price flexibility should be freely negotiated and the wide cross-section of contracts should provide stability to the industry in aggregate.

Views of individual producers on the issue were generally consistent with those of the associations. Blue Range, Brymore, Canadian Hunter, Husky, Morgan, Northstar, Poco and Trical felt that it was inconsistent with allowing the market to operate freely for the Board to assess contract flexibility. AEC would limit the Board's examination to situations where pipelines were being expanded and Gulf would limit it to expansions where rolled-in tolls applied. Bow Valley and Shell would have the Board confirm that flexible contract provisions were included but would not have the Board intervene. Shell and Canadian Hunter felt that intervention was not necessary because the transition period to a free market was essentially complete.

Norcen's view was that the Board's assessment of contract flexibility could be used to ensure prices were fair and competitive. PanCanadian also saw a strong role for the Board's assessment of contract flexibility to ensure that markets work effectively, highest quality customers are attracted and that there is a counterweight to U.S. state regulation.

The majority view of exporters, marketers and pipeline companies was that, in a properly operating market, there is not a significant need for the Board to assess whether export contracts contain adequate provisions to permit adjustment to changing market conditions. In general, however, these companies did not object to a review by the Board.

Direct, Vector and Westcoast felt it was no longer appropriate for the Board to assess the contracts. Direct stated that the transition period to a deregulated market was over and that for the Board to override the market would be contrary to the intent of deregulation. Vector was of the view that contract provisions were the sole responsibility of the contracting parties. Westcoast argued that only non-arm's length deals might warrant Board review and that producers might wish to have a portfolio of contracts, some with relatively inflexible terms, to ensure desired certainty of revenues.

A&S accepted the current government policy and Board mandate, but recommended that the Board not take a predefined view of what constitutes acceptable levels of flexibility. It argued that the market is dynamic and that creative approaches should be accepted. The guiding criterion of the Board's evaluation should be whether the parties have struck a reasonable commercial balance.

Northridge argued that prices of natural gas are best established through arm's length transactions and that this would serve the interest of governments, producers and consumers. The company stated, however, that if the assessment of contract flexibility continued, the Board should only be concerned with ensuring that, at most, over five-year intervals, contracts provide for the price to adjust. This would cause prices to approximate Canadian prices, protect the public interest and minimize government and/or regulatory involvement in the marketplace.

Pan-Alberta believed it was reasonable for the Board to continue assessing contract flexibility because of the long term nature of contracts and the large investment in pipeline facilities. ProGas suggested that freely negotiated contracts should be accepted but that the Board should be allowed to review contracts only in the event a concern arises regarding benefit-cost analysis. ProGas did not consider an isolated review appropriate if a project otherwise meets Board criteria for the issuance of an export licence.

WGML provided extensive views on this question. Although the company's thesis was that a well functioning market will optimize the overall welfare to society, WGML saw a role for the Board in ensuring that this is so. WGML had no objection to the Board considering long term price flexibility but was concerned about the meaning and weight given to this criterion. It was difficult for WGML to believe, at least where large aggregators are involved, that there would be inadequate long run price flexibility agreed to by the exporter and producers. The negotiation of price provisions is complex and is not something the Board should interfere with lightly. The Board should not be concerned with protecting gas producers from themselves. WGML said: "The presumption should be that producers will look after their own interests and by doing so they will look after the public interest."

It was the strong consensus of domestic gas distributors that the Board should continue to assess contracts to ensure that prices can adjust to changing market conditions.

BC Gas suggested the Board be cautious in approving formula pricing adjustments which may not reflect a shift to higher value uses over time. The company felt that a review of contract flexibility is necessary to prevent costs falling on Canadians as had occurred as a result of the Northwest Pipeline Corporation exercise of force majeure. It also noted similar U.S. regulatory requirements and suggested that U.S. customers could take comfort from such scrutiny.

Consumers Gas supported the Board's examination of all contract provisions as part of its public interest determination. Consumers Gas cited the examination as being consistent with the 1985 Agreement as well as with U.S. regulation. ICG (Ontario) argued that if the Board's ability to make a determination on contract flexibility were impaired, its ability to determine the public interest would also be impaired. ICG also cited consistency with the 1985 Agreement and the MBP and the need for the Board to be assured that the export projects are supported by substantive commercial arrangements as reasons for the examination. Union was in general agreement with the views and reasons provided by other distributors and expressed concern that pipeline facilities could go unutilized if contracts had an inappropriate price predetermination provision.

The main concern of the CCPA and IGUA was that there was a risk of pipeline demand charges not being paid if contracts did not endure.

Most U.S. importers were of the view that the Board should not consider contract flexibility as a factor in determining whether to approve an application for an export licence. U.S. importers felt that as a general principle the Board should not intervene in the marketplace and that if there is a willing seller and a willing buyer then no more should be required. The Board should accept variety and diversity in contract provisions which reflect arrangements that fit the needs of individual market circumstances.

Altresco noted that there are U.S. regulatory requirements similar to the Board's which are also inappropriate and that the Board should not enhance a seller's position. ANR said that the Board should intervene in the market only in extreme cases.

Beta felt that it was reasonable for the Board to examine contract flexibility but that caution should be exercised so that negotiations would not be inhibited. Niagara Mohawk was of the view that, while the Board can examine the contracts, it should examine both domestic and export contracts. If producers and Alberta are satisfied, Niagara Mohawk argued, the Board should be satisfied as well. Selkirk/MASSPOWER and SDGE referred to the 1985 Agreement and the Minister's letters to the Board and pointed out that application of the criteria was not meant to impede or interfere with the market.

NEPCO was concerned that scrutiny of export contracts would lead the industry toward standardized contracts fashioned by regulators. NEPCO considered this to be fundamentally inconsistent with deregulation. The company also felt that applicants should not be compelled to submit competitively-sensitive contract information as part of their Part VI filings.

The producing provinces were generally of the view that it is not necessary for the Board to examine contract flexibility. Saskatchewan stated that firm guidelines are incompatible with allowing the market to function. The British Columbia government and the BCPC were also opposed to Board review of contracts on the basis that it is not necessary because of provincial regulation and that there could be good reason within a company's sales portfolio to include relatively inflexible contracts. The APMC recognized that the 1985 Agreement provided for contract flexibility and as a signatory to the Agreement felt it was not at liberty to comment on the issue.

Quebec and Ontario were generally supportive of the Board continuing this role and cited the 1985 Agreement in support of their positions. Ontario also cited the Board's 27 July 1987 Memorandum of Guidance and expressed the view that examination of contract flexibility is required in order to check whether benefits will materialize. It is also required to avoid negative impact on shippers on TCPL by ensuring that exports flow and that shippers honor commitments to pay for expensive incremental facilities.

2.5.2 Views of the Board

The Board has carefully considered the views of parties on the question of the extent to which contracts should be examined to determine whether they allow flexibility to reflect changing market conditions over time.

The concern that government/regulatory overview is warranted with respect to natural gas markets was set out in the 1985 Agreement. In the Agreement the governments set out "criteria of acceptability" against which export contracts were to be judged. The third criterion is that export contracts must contain provisions which permit adjustments to reflect changing market conditions over the life of the contract. Many submittors referred to this criterion.

In a Memorandum of Guidance issued in 1986[1] the Board indicated how it would review applications for new or amended contracts to determine whether the contracts meet the requirements of Criterion 3.

The Board notes that in the letter to the Chairman dated 24 June 1987 the Minister of Energy, Mines and Resources commented on the intent of the criteria in the 1985 Agreement:

> "*These criteria are not meant to impede or interfere with the private sector negotiating process. The Government of Canada is committed to a market-oriented energy trade. The criteria are, however, intended to provide our industry with clear guidance in formulating negotiated arrangements that are, and will continue to be, in the broad public interest.*"

The Board recognizes that there have been dramatic changes in natural gas markets in recent years and in the regulation of gas markets both in Canada and the United States. Virtually all contracts contain pricing clauses which allow for some degree of flexibility over the contract term. Major market participants have experienced price volatility and have either adapted to it or have taken cognizance of it in their negotiations.

The Board will continue to examine contracts to assure itself that those underlying proposed exports have commercial substance. It will also take into account whether contracts are likely to be durable over their term. The Board, however, recognizes that there may be cases where contracts are attractive notwithstanding a lack of flexibility.

In implementing the criterion relating to contract flexibility the Board will operate on the presumption that, where contracts are freely negotiated at arm's length, they will be in the public as well as the private interest. The Board sees itself intervening in this regard only in exceptional circumstances.

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[1] Memorandum of Guidance on National Energy Regulatory Procedures and Information Requirements for Applicants Filing for: A. Short-term Gas Export Orders; and B. Long-term in Gas Export Licences, 14 November 1986.

Chapter 3
Decision

The public hearing component of the Board's Market-Based Procedure contains three categories of factors which the Board examines in determining whether to grant a licence for the export of natural gas. The first two categories, the Complaints Procedure and the Export Impact Assessment, are designed to assist the Board in determining, pursuant to paragraph 118(a) of the Act, whether proposed exports are surplus to Canadian needs. The third category, namely public interest determination, is intended to include all other factors which, in the opening words of Section 118 of the NEB Act, the Board considers relevant in determining whether proposed exports are in the national public interest.

Among the factors included in the third category is whether net benefits to Canada would likely result from the proposed export. In its Reasons for Decision describing the MBP the Board indicated that it would assess the net benefits to Canada using benefit-cost analysis. The Board wishes to emphasize that benefit-cost analysis is not related to the determination of quantities of gas which are surplus to reasonably foreseeable requirements for use in Canada.

The Board's use of benefit-cost analysis predates the implementation of the MBP. Since the late 1970's, the Board has used benefit-cost analysis, adapted over time to reflect changing circumstances, to test whether the benefits from gas exports exceed their social costs. This analysis compares a stream of forecast revenues with a stream of forecast costs, both expressed in present value terms.

In the case of gas exports, any difference between private and public evaluations of net benefits relate primarily to gas production costs and transportation costs. Of these two factors, gas production costs usually have a preponderant impact on the outcome of the analysis.

There is much uncertainty about the existence and size of any difference between the social evaluation of production costs and the private evaluation of these costs. This uncertainty relates particularly to the appropriate values of the discount rates and the level and shape of the gas supply curves used in the respective evaluations.

To the extent that any difference exists between social and private estimates of gas supply costs, the producing provinces do have in place mechanisms to capture rents available from the sale of gas by means of royalty and lease-bidding mechanisms. These may be regarded as means to account for at least part of any difference between private and social production costs.

The Board observes that because the existence and size of the discrepancy between social production costs and private costs of the gas is very uncertain, it is not sufficiently clear that there is any difference which the market has failed to take into account, rendering questionable the usefulness of a social analysis in respect of the production cost of gas. Further, the Board notes that, as applied to the calculation of the value of total incremental production costs, benefit-cost results tend to fluctuate widely, depending on the assumptions and forecasts used. These observations are particularly significant in the current policy environment which relies on market forces to determine how gas will be bought and sold.

In view of the above factors the Board concludes that it is not appropriate to use benefit-cost analysis as a determinative factor in gas export licensing.

The Board has considered whether to retain benefit cost analysis as a means of export monitoring or for information purposes. Given all of the limitations outlined above, the Board doubts whether its retention for monitoring or information purposes would be worth the costs imposed on applicants.

In view of the foregoing, the Board has decided not to use benefit-cost analysis in its gas export licensing procedures and will henceforth not require applicants for licences pursuant to Part VI of the Act to provide evidence on the net social benefits of their projects. The Board notes that this decision is confined to the use of benefit-cost analysis in Part VI proceedings. Furthermore, the Board is satisfied that it can fulfill its mandate under Section 118 of the Act and can find proposed exports to be in the public interest without using benefit-cost analysis to assess export applications. As required by section 118, the Board will continue to have regard to all considerations which appear to it to be relevant in determining whether proposed exports are in the national public interest.

The Board, however, recognizes there is one circumstance in which private costs may differ from social costs, namely in pipeline transportation when the principle of rolled-in tolling is applied. Where the cost of providing increments to gas transmission service differs from the average cost of that service, which may often be the case, the incremental users of the expanded system, paying a rolled-in toll, are clearly not being charged with the relevant social costs. If this were to become an issue in the context of Part III or Part IV proceedings it could be addressed by an economic evaluation of pipeline facilities applied for pursuant to Part III of the Act or by consideration of pipeline toll methodology in Part IV.

The Board will continue to examine contracts underlying gas export applications to assure itself that they have commercial substance. It will also take into account whether contracts are likely to be durable over their term. The Board recognizes that there may be cases where contracts are attractive notwithstanding a lack of flexibility. In implementing the criterion relating to contract flexibility the Board will operate on the presumption that, where contracts are freely negotiated at arm’s length, they will be in the public as well as the private interest. The Board sees itself intervening in this regard only in exceptional circumstances.

Chapter 4
Disposition

The foregoing chapters set forth our Reasons for Decision and our Decision in the matter of the review of certain aspects of the Market-Based Procedure.

R. Priddle
Chairman

J.-G. Fredette
Vice Chairman

R.B. Horner, Q.C.
Member

W.G. Stewart
Member

A.B. Gilmour
Member

A. Côté-Verhaaf
Member

M.J. Musgrove
Member

C. Bélanger
Member

R. Illing
Member

D.B. Smith
Member

K.W. Vollman
Member

Appendix I
Decision of the Board in the matter of the Review of Natural Gas Surplus Determination Procedures - July 1987

In Chapters 2 and 3 the Board has made findings on the continuing appropriateness of the existing surplus determination procedures and on the various alternative procedures suggested by the parties at the hearing.

With respect to the existing procedures, while the R/P Ratio Procedure has merits in some circumstances, it would now be anomalous and contrary to free market operation if the level of gas supply to Canadians were to be determined by other than market forces. For this reason, the Board finds the existing procedures to be no longer appropriate.

For reasons set forth in Chapter 3, the Board finds that the specific alternative procedures suggested by parties to the hearing are not suited to existing circumstances.

The Board has decided that it is appropriate to adopt surplus determination procedures which do not unduly interfere with the market when it is working to serve Canadian needs adequately and fairly, but which will provide for the intervention by the Board whenever it finds that additional exports might cause the market to have difficulty in meeting reasonably foreseeable Canadian requirements.

The Market-Based Procedure

The new procedure, which will be referred to as the Market-Based Procedure, is founded on the premise that the marketplace will generally operate in such a way that Canadian requirements for natural gas will be met at fair market prices.

The Board will act in two ways to ensure that natural gas to be licensed for export is surplus to reasonably foreseeable Canadian requirements: one will be in the context of public hearings to consider applications to export natural gas; the other will be by monitoring Canadian energy markets on an ongoing basis.

A. Public Hearings

During public hearings to consider applications for licences to export natural gas, the Board's assessment as to whether the market is functioning in a satisfactory way will consist of three main components:

1) Complaints Procedure
2) Export Impact Assessment
3) Public Interest Determination.

B. Ongoing Monitoring

The Board's ongoing monitoring will consist of two main components:

1) Assessment of Canadian Energy Supply and Demand
2) Natural Gas Market Assessment.

Each of these components is detailed below.

A. Public Hearings

The Board is required, by statute, to hold a public hearing on applications to export natural gas for periods longer than two years. Exports for periods not exceeding two years can be authorized by order without need for a public hearing.

Before issuing a licence to export natural gas, the Board is required, by Paragraph 83(a) of the Act, to find that the proposed export is surplus to reasonably foreseeable Canadian needs. The Board will use a complaints procedure to assist it in deciding whether the proposed export is surplus.

1) Complaints Procedure

The inclusion of a complaints mechanism in the new surplus determination procedures is based on the principle that gas should not be authorized for export if Canadian users have not had an opportunity to buy gas for their needs on terms and conditions similar to those of the proposed export. Applicants for export licences will have to be prepared to address any concerns on this score which may be identified in the complaints procedure which is described below.

When an application for export is filed with the Board, interested parties will have an opportunity to examine the various elements of the proposal. It will be open to domestic users of natural gas to come forward and object to the export on the grounds that they cannot obtain additional supplies of gas under contract on terms and conditions, including price, similar to those in the export proposal. If objections are filed with the Board, the Complainants and the Applicant may attempt to resolve outstanding differences. Indeed, the Board itself may decide not to set down an export application for hearing until parties have been given an opportunity to attempt to cure any complaints.

At the public hearing, the Board will consider the merits of the application together with any outstanding complaints. The Board will hear evidence from all affected parties on relevant matters including information on the efforts of Complainants to contract for gas and on the ability and willingness of Applicants to meet the needs of the Complainants. Much might hinge on the equivalence of the contractual terms in the export arrangement and those sought by the Complainants. It is unlikely these terms will be identical in every respect and, in determining whether terms and conditions are similar, the Board will have regard, in particular, to any differences in the costs to an Applicant of selling to the export customer as compared to selling to the Complainants.

If after completion of the public hearing there are no outstanding complaints which the Board finds to be valid, the Board may conclude, subject to the results of the export impact assessment (see (2)), that the Canadian market is adequately supplied and may determine that the proposed export is surplus to reasonably foreseeable Canadian requirements. If, on the other hand, outstanding valid complaints of Canadian users have not been resolved, the Board may either deny the application or defer issuing a final decision on it until a further opportunity has been given for the situation to be rectified.

2) Export Impact Assessment

Applicants for licences to export natural gas will be required to submit an assessment of the impact of their export proposal on Canadian energy and natural gas markets. This impact assessment will be considered at the public hearing convened to examine the application.

The purpose of the impact assessment will be to allow the Board to determine whether a proposed export is likely to cause Canadians difficulty in meeting their energy requirements at fair market prices.

The nature of the export impact assessment, whether quantitative or qualitative, will depend upon the size and significance of the proposed export. The extent and detail of the analysis should be commensurate with the size of the proposed export

In dealing with the ability of the Canadian gas producing sector to satisfy Canadian needs, given the proposed export, Applicants will be expected to analyze the relevant geological, engineering, economic and institutional factors influencing gas supply. These factors may include the following: exploration and development costs; levels of drilling activity; the trend in reserves additions relative to drilling effort; the size, location and potential production characteristics of gas pools; importation requirements from wellhead to market and the feasibility of any new transportation facilities required.

In addressing any need for Canadian gas users to adjust their energy consumption patterns by means of energy conservation or switching to alternative fuels, Applicants will be expected to assess the following factors: the scope for additional conservation; the price of gas relative to other energy forms; the fuel switching capability of Canadian gas users; and any lags in conservation and fuel-switching and the expected costs involved.

Applicants will also be expected to address the impact of their proposed exports on future natural gas prices. Given the uncertainty associated with future values of key factors underlying natural gas supply and demand, such as world oil prices, Applicants will be expected to do the impact assessment using a reasonable range of values for those factors.

The burden of proof will rest with the Applicant to satisfy the Board that the proposed export is surplus. The hearing process will provide all parties with an opportunity to test the Applicant's evidence and to present evidence supporting or opposing the export proposal.

3) Public Interim Determination

In addition to using the complaints procedure and export impact assessment outlined above to ascertain that gas proposed to be exported is surplus, the Board will continue, as required by Section 83 of the Act, to have regard to all other factors it considers relevant in determining whether proposed exports are in the national public interest.

Among factors the Board will consider will be evidence that the gas proposed to be exported is under contract and full details of the nature of the supply and sales arrangements as well as copies of executed contracts; evidence of producers' support for the proposed export; evidence on the status of permits to remove gas from the producing province involved; evidence that export volumes will be taken; evidence that the export revenues will fully recover the costs to Canada incurred in making the export and that the export price will not be less than the price to Canadians for similar service;

evidence on the availability of pipeline space, on the need to build additional pipeline and other facilities in Canada and in the importing country, and on the likelihood and timing of Canadian need for any of the facilities constructed in Canada upon termination of the export and the impact of such repatriated use upon the economics of the proposed export; and information on any relevant government policies or positions.

This listing of factors the Board may regard as relevant is illustrative rather than exhaustive. It is intended to indicate the kind of matters the Board will consider in assessing whether the export proposal is in the national public interest. The onus will be on the Applicant to so persuade the Board.

As stated in its April 1986 Report, the Board continues to see a role for cost-benefit analysis in assessing any trade-off between security of supply and benefits from export and in determining whether there are net benefits to Canada. Thus, cost-benefit analysis will continue to be an important tool of the Board in assuring itself that proposed exports are in the public interest.

B. Ongoing Monitoring

1) Assessment of Canadian Energy Supply and Demand

The Board will monitor Canadian energy markets so as to be alert to any difficulties for Canadians in adjusting to changes in natural gas supply and demand.

The NEB Act requires the Board to keep under review the outlook for Canadian supply of all major energy commodities, including electricity, oil and natural gas and their by-products and the demand for Canadian energy in Canada and abroad. As part of this function the Board, since its inception, has prepared and maintained forecasts of energy supply and demand and has, from time to time, published related reports after obtaining the views of provincial governments, industry and other interested parties. The latest of these reports, dated October 1986, was issued in December 1986. The Board intends that this study be updated in 1988. Such assessments will continue to be produced and published at intervals of approximately two years.

Among matters to be analyzed will be the evolving shares of the energy market served by the various energy forms and the implications for the adjustment of the natural gas market in light of the market-oriented pricing regime.

2) Natural Gas Market Assessment

As a second part of its ongoing monitoring, the Board will analyse natural gas supply, demand and prices and will periodically publish reports on its findings.

The focus of these reports will be narrower and shorter-term than that of the above-mentioned total energy reports. A detailed assessment of the structure and functioning of natural gas markets will be provided. There will be coverage of recent developments and near-term prospects for natural gas markets and comments on competitive activity in the market, on pipeline utilization for Canadian and export purposes and on the quantity and quality of gas supply.

Concluding Observations

The Board makes the following observations with respect to its new Market-Based Procedure for surplus determination:

1) It is, in the Board's view, the only procedure which is fully compatible with market-determined pricing. The setting aside of any predetermined amount of gas reserves by means of a surplus formula cannot help but interfere with the proper functioning of the market. In discharging its regulatory responsibilities, the Board is conscious of the need to encourage, rather than impede, the proper functioning of energy markets.

2) The Board's new Market-Based Procedure is not any less certain than its previous R/P Ratio Procedure. While a formula approach of any sort gives an aura of precision to the determination of surplus, it relies heavily on the ability to forecast accurately a large number of variables on both the supply and demand side of the equation.

3) While the Board has found that the setting of guidelines or standards at the national level for the length of distributors' contracts is undesirable or beyond its mandate, this does not imply a judgment by the Board as to the desirability or otherwise of provincial authorities taking positions as to the lengths of contract they believe prudent for their gas users.

4) The Board believes there are safeguards against extraordinary demands being suddenly placed on Canadian supply by the export market. Chief among these safeguards are the limitations imposed by existing pipeline capacity, and the time needed for public hearings of applications to export gas or to construct additional pipeline facilities in Canada or the United States.

5) The Board does not see the need for a period of transition to its new procedures. However, as is usually the case, the Board will evaluate the merits of any intervenor's request for additional time to prepare itself for dealing with an application.

Appendix II
Board Letter dated 18 December 1989 and Hearing Order GHW-4-89

File No.: 7200-3

18 December 1989

TO: INTERESTED PARTIES - GAS DISTRIBUTION LIST

RE: REVIEW OF ASPECTS OF THE MARKET BASED PROCEDURE

The Board has decided to review the role that benefit-cost analysis should play in the Market Based Procedure employed by the Board in considering applications to export natural gas pursuant to Part VI of the *National Energy Board Act*. It has taken this decision in light of concerns expressed by interested parties in respect of recent bearings to consider export applications and at a November Workshop held by Board staff to discuss benefit cost analysis.[1] The Board has also decided to seek parties views on the extent to which it should, as part of the Market-Based Procedure, examine the provisions of export contracts to determine whether those contracts allow flexibility in order to reflect changing market conditions over time.

For the purpose of this proceeding, the Board would request parties not to address the question of whether the Board has the jurisdiction to use benefit-cost analysis but rather to focus on whether and how the Board should use benefit-cost analysis in considering export applications.

The procedure to be followed for this review is set out in the attached Directions on Procedure. While the schedule imposes tight deadlines, the Board believes it would be desirable to have this matter resolved as soon as possible and before further export applications are considered. To achieve this end, the Board has decided to postpone the commencement date of the hearing to be held pursuant to Order GH-6-89. A revised Directions on Procedure setting the date for that bearing will be issued shortly. It is anticipated that the Board's consideration of this review will be completed before the commencement date of the hearing to be held pursuant to GH-5-89, and that the dates set out in the Board's 1 December 1989 decision stemming from the GH-5-89 pre-hearing conference will not have to be changed. Dates for filing documents in both hearings will remain as indicated in the respective Directions on Procedure unless parties are otherwise advised.

[1] A copy of the Workshop proceedings will be available shortly.

The Board wishes to emphasize that this is a generic review of certain aspects of the Market-Based Procedure and not a review of any specific export decisions. Depending on the outcome of the generic review, the Board may decide it is necessary or desirable to review specific export decisions but a determination on that question cannot be made until after this review has been completed.

Yours truly,

Marie Tobin,
Secretary

Att.

File No.: 7200-3

18 December 1989

HEARING ORDER GHW-4-89

Directions on Procedure

Review of Certain Aspects of the Market-Based Procedure

The July 1987 National Energy Board (“the Board”) Reasons for Decision described the Market-Based Procedure ("the MBP") the Board intended to use when considering applications to export natural gas pursuant to Part VI of the *National Energy Board Act* (“the Act”). Under that procedure, the Board indicated that as part of its public interest determination, it intended to consider, *inter alia*, details of the sales arrangements and evidence that the export revenues would fully recover the costs to Canada incurred in making the export. The Board also stated that benefit-cost analysis would continue to be an important tool of the Board in assuring itself that proposed exports are in the public interest.

The Board has decided pursuant to section 21 of the Act, to review certain aspects of the MBP, particularly the role of benefit-cost analysis, and for that purpose, to hold a hearing by way of written submissions to obtain parties’ views.

The Board directs as follows:

PUBLIC VIEWING

1. A copy of documents related to this matter will be available for viewing in the Board’s Library, Room 962, 473 Albert Street, Ottawa, Ontario and its office in Calgary, Alberta at 4500-16th Avenue, N.W.

INTERESTED PARTIES

2. Parties intending to make a written submission are required to notify the Secretary by 15 January 1990.

3. The Secretary will issue a list of interested parties shortly after 15 January 1990.

LIST OF ISSUES

4. The Board intends to examine the issues specified in Appendix 1.

WRITTEN SUBMISSIONS AND REPLY

5. Written submissions shall be filed with the Secretary and served on all other parties to the proceeding by 26 January 1990.

6. Any reply to written submissions from interested parties shall be filed with the Secretary and served on other parties by 7 February 1990.

FILING AND SERVICE REQUIREMENTS

7. Where parties are directed by these Directions on Procedure or by the draft *NEB Rules of Practice and Procedure* to file or serve documents on other parties, the following number of copies shall be served or filed:

   (1) for documents to be filed with the Board, provide 35 copies; and

   (2) for documents to be served on other parties, provide 1 copy.

GENERAL

8. All parties are asked to quote Hearing Order No. GHW-4-89 when corresponding with the Board in this matter.

9. These Directions supplement the draft *NEB Rules of Practice and Procedure*.

10. For information on this hearing or the procedures governing the hearing, contact, Vivien St. George, Regulatory Support Officer, at 998-7196.

NATIONAL ENERGY BOARD

Marie Tobin
Secretary

Appendix I to Order GHW-4-89

LIST OF ISSUES

In addressing these issues, parties are requested to assume that the Board has jurisdiction to use benefit-cost analysis in considering and disposing of gas export applications.

1. Should the Board continue to use benefit-cost analysis as a factor in the MBP for determining whether exports of natural gas are in the public interest? Please state the rationale for your position on this issue.

2. If, in your view, the Board should continue to use benefit-cost analysis as part of the MBP, what role should that analysis play in the Board's decision-making process?

3. If, in your view, the Board should continue to use benefit-cost analysis as part of the MBP, is the methodology employed by the Board in its benefit-cost analysis since the introduction of the MBP appropriate?

4. If, in your view, the Board should discontinue the use of benefit-cost analysis as part of the MBP, how else should the Board take account of the differences between social and private costs in determining whether a proposed export is in the public interest? These differences result principally from the user cost component of total incremental production costs and from the incremental costs of transportation as distinct from rolled-in transportation costs.

5. To what extent should the Board, as part of the MBP, examine the provisions of export contracts to determine whether those contracts allow flexibility in order to reflect changing market conditions over time?

Appendix III
(i) Agreement on Natural Gas Markets and Prices, 31 October 1985

Agreement on

Natural Gas

Markets and Prices

AGREEMENT AMONG THE GOVERNMENTS OF CANADA, ALBERTA, BRITISH COLUMBIA AND SASKATCHEWAN ON NATURAL GAS MARKETS AND PRICES

INTENT

1. In the Western Accord of March 28, 1985 on Energy Pricing and Taxation, the governments of Canada, Alberta, British Columbia and Saskatchewan agreed that a more flexible and market-oriented pricing regime was required for the domestic pricing of natural gas. The present Agreement is intended to create the conditions for such a regime, including an orderly transition which is fair to consumers and producers and which will enhance the possibilities for price and other terms to be freely negotiated between buyers and sellers. This will have favourable effects on investment, employment and trade and will provide energy security for all Canadians.

PRINCIPLES

2. Effective November 1, 1986, the prices of all natural gas in interprovincial trade will be determined by negotiation between buyers and sellers. Access will be immediately enhanced for Canadian buyers to natural gas supplies and for Canadian producers to natural gas markets while at the same time assuring that the reasonably foreseeable requirements of gas for use in Canada are protected.

3. The twelve month period commencing November 1, 1985 is the transition to a fully market sensitive pricing regime. While prices will continue to be prescribed by governments, immediate steps will be taken to enable gas consumers to enter into supply arrangements with gas producers at negotiated prices (direct sales), which prices will then promptly be endorsed by governments in the context of the administered system. After this transition period, purchase and sale of natural gas will be freely negotiated, and prices will no longer be prescribed.

4. It is the intention of the parties to the Agreement to foster a competitive market for natural gas in Canada, consistent with the regulated character of the transmission and distribution sectors of the gas industry. In this regard the governments commit, without qualification, that once the transition to the new marketing and pricing system is completed, the system will stay in place for the foreseeable future.

DOMESTIC NATURAL GAS SALES

A. Direct Sales and Competitive Market Programs

5. Effective November 1, 1985, consumers may purchase natural gas from producers at negotiated prices, either directly or under buy-sell arrangements with distributors, provided distributor contract carriage arrangements are available in respect of such purchases. This provision is in no sense intended to interfere with provincial jurisdiction in regard to regulation of gas distribution utilities.

6. For the period November 1, 1985 to October 31, 1986 consumers who seek release from existing contractual arrangements with distributors shall be eligible to purchase natural gas from producers at negotiated prices, as described in paragraph 5 above, only where the producers supplying the gas under the existing contractual arrangements have agreed to such release.

7. To enable the market-responsive pricing system to operate within the intent of this Agreement, the governments request the National Energy Board to review the following concerns:

   i) whether inappropriate duplication of demand charges will result from possible displacement of one volume of gas by another; and

   ii) whether the policy regarding the availability of T-Service, as outlined in the Board's latest TransCanada PipeLines toll decision is still appropriate, taking into account, among other things, interested parties' views on the fair and equitable sharing of take-or-pay charges.

8. Effective November 1, 1985, competitive marketing programs (CMP) to meet special market requirements may be negotiated between distributors, shippers and the producers who are providing the natural gas volumes associated with such programs.

9. A consumer purchasing natural gas under a direct sale or a competitive marketing program must waive eligibility for payments under the Natural Gas Market Incentive Program (NGMIP), for those volumes taken under the direct sale or CMP.

B. New Sales to Distributors

10. Effective November 1, 1985, a distributor may under new or renegotiated contracts, purchase natural gas from shippers or directly from producers at negotiated prices. Notwithstanding such an arrangement, prior to November 1, 1986, the distributor shall take the full volumes of gas committed under existing contracts before accepting the delivery of any volumes of gas under a new contract.

C. Existing Sales to Distributors

11. The price of gas delivered under existing shipper-distributor contracts shall remain at $2.79804 per gigajoule at the Alberta border for the period November 1, 1985 to October 31, 1986.

12. The National Energy Board has approved for implementation November 1, 1985, an increase in TransCanada PipeLines' (TCPL) transportation tolls. In order to maintain the Alberta Border Price and the Toronto Wholesale Price at their current levels, and to allow TCPL to recover its approved costs for the transportation of natural gas consumed in domestic markets, the Government of Canada agrees to pay an amount equal to the value of revenues foregone over the period November 1, 1985 to October 31st 1986. These payments will be made under a Transportation Assistance Program financed by an extension of the Market Development Incentive Program (MDIP) to October 31, 1986.

13. Prior to November 1, 1986, negotiations shall commence between distributors, shippers and the producers supplying the gas in question respecting the price to be paid for natural gas

delivered under existing contracts. Prices resulting from such negotiations shall come into effect November 1, 1986 and as agreed thereafter. Where contract renegotiation between buyers and sellers, whether of price or volume, takes place in good faith and on a voluntary basis, governments will not obstruct the resulting commercial transactions.

14. In the absence of an Agreement between a shipper and a distributor, or a producer and a shipper, on the price to be paid for gas under existing contracts on November 1, 1986, and thereafter, the price shall be determined through arbitration.

15. With respect to gas produced in Alberta, the Government of Alberta intends to amend the *Arbitration Act*. The amendment would enable pricing disputes between producers and purchasers to be arbitrated under the act or under alternative arrangements established by contract between the parties. The amendments will ensure that the arbitration of pricing disputes is done in an impartial and equitable manner consistent with the policy of implementing a more market-responsive domestic gas pricing system. Specifically, the Government of Alberta commits to amend Section 17 of the act to permit the arbitrator to take into account all relevant factors required to arrive at a fair decision on the price of the natural gas in question.

EXPORT NATURAL GAS SALES

16. The governments anticipate that reviews of surplus tests underway or shortly to be initiated by the National Energy Board and by the appropriate provincial authorities will result in significantly freer access to domestic and export markets and thus will contribute to the achievement of the market-oriented pricing system contemplated in this Agreement.

17. Effective November 1, 1985, the Government of Canada will take appropriate steps to amend its existing policy on short term export sales of natural gas. Specifically:

    i) the "incrementality test" shall be eliminated;

    ii) the "competing fuels test" shall be eliminated; and

    iii) the National Energy Board VI Regulations, Section 8 shall be amended to allow the export of natural gas by order without volume limitation for terms not exceeding 24 months.

18. Effective November 1, 1985, the Government of Canada will amend its policy in regard to the conditions exporters of natural gas must meet for gas exported under licence. To obtain approval, all licence holders must demonstrate that their negotiated contractual arrangements meet the following criteria:

    i) the price of exported gas must recover its appropriate share of costs incurred;

    ii) the price of exported natural gas shall not be less than the price charged to Canadians for similar types of service in the area or zone adjacent to the export point;

    iii) export contracts must contain provisions which permit adjustments to reflect changing market conditions over the life of the contract;

iv) exporters must demonstrate that export arrangements provide reasonable assurance that volumes contracted will be taken; and

v) exporters must demonstrate that producers supplying gas for an export project endorse the terms of the export arrangement and any subsequent revisions thereof.

19. The Government of Alberta agrees that the export flowback system shall continue in its current form, subject to the actions contemplated in paragraph 12, until November 1, 1986, at which time the system will be eliminated.

NATURAL GAS IMPORTS

20. There is provision for the import of natural gas in the *National Energy Board Act* and Regulations.

GENERAL APPLICATION

21. The Government of Canada has broad responsibilities to ensure that trade among provinces and between Canada and its foreign trading partners is conducted in a manner which will provide benefits for all Canadians. Nothing in this Agreement shall limit Canada's power or its ability to meet its responsibilities in relation to interprovincial and international trade.

22. The governments of Alberta, British Columbia and Saskatchewan have broad responsibilities with respect to the development of their natural resources. Nothing in this Agreement shall limit the producing provinces' powers or their ability to meet their responsibilities in relation to their ownership and management of their natural resources.

23. The producing provinces shall retain their right to condition the removal of natural gas from the province to protect provincial public interest. Notwithstanding this basic right of ownership, the producing provinces do not intend to use this right to frustrate the intent of this Agreement. Specifically:

i) Alberta and British Columbia will initiate a review of their respective surplus tests to ensure that the tests will contribute to the achievement of the market-oriented pricing system contemplated in this Agreement.

ii) Alberta will review the wording of the *Gas Resources Preservation Act*, specifically Section 5(3)(c), and as necessary, intends to amend the legislation to ensure that it does not require new sales to be incremental to existing sales prior to November 1, 1986.

iii) Saskatchewan, in order to decrease its reliance on extraprovincial sources of gas, will permit limited quantities of its gas for sale outside the province and for direct sale within the province, as a market incentive to stimulate exploration of conventional resources. So long as Saskatchewan is reliant on extraprovincial gas, the price of gas sold outside the province shall be not less than the price at which gas may be purchased in Saskatchewan.

24. Non-arm's-length sales of natural gas between producers and shippers, between producers and distributors, or between producers and consumers shall be subject to appropriate provincial

legislation for purposes of determining and collecting royalty or mineral tax revenues payable to the respective provincial Crown.

25. In conjunction with the transition to a more flexible and market-oriented pricing regime for domestic natural gas sales, the governments agreed that an early and all-encompassing review of the role and operations of interprovincial and international pipelines engaged in the buying, selling and transmission of gas is in order. Towards this end, the parties agree that the review will be carried out by an impartial panel appointed by the Minister of Energy, Mines and Resources in consultation with the ministers representing the governments of Alberta, British Columbia and Saskatchewan. The review shall be completed no later than June 30, 1986 and a final report submitted to the Minister of Energy, Mines and Resources on or before July 31, 1986. The details of panel membership, mandate and reporting relationship will be made public separately.

CONSUMING PROVINCES

26. It is anticipated that the governments of the consuming provinces who are not signatories to this Agreement will make changes to ensure the effectiveness of the market-sensitive gas pricing regime, including legislative changes and the provision of direction to provincial agencies to provide consumers with alternative sources of supply through the availability of transportation services on distribution systems, and to provide distributors with greater flexibility in determining prices for gas sold by them.

MONITORING

27. To ensure that the intent and objectives of this Agreement are achieved, a senior official representing each of the parties to this Agreement shall be appointed to monitor the implementation of the provisions contained herein and, among other things, the degree to which regulatory processes have resulted in significantly freer market access. These officials shall report their findings on a quarterly basis to their respective ministers.

28. The parties to this Agreement intend to enact expeditiously the appropriate legislative and regulatory changes necessary to implement the market-oriented pricing policy contemplated herein.

Dated on this 31st day of October, 1995.

For the Government of Canada

Pat Carney
Minister of Energy, Mines
and Resources

For the Government of Alberta

John Zaozirny
Minister of Energy and Natural
Resources

For the Government of British Columbia

Stephen Rogers
Minister of Energy,
Mines and Petroleum
Resources

For the Government of Saskatchewan

Paul Schoenhals
Minister of Energy and Mines

Appendix III
(ii) Letter dated 24 june 1987 from the Minister of Energy, Mines and Resources

June 24, 1987

Mr. Roland Priddle
Chairman
National Energy Board
473 Albert Street
Ottawa, Ontario
K1A 0E5

Dear Mr. Priddle:

I am writing to you concerning implementation of Canada's natural gas export pricing policy.

As you know, since 1 November 1984, it has been the policy of the Government of Canada to encourage natural gas exports based on negotiated contractual arrangements, subject to certain Criteria for Acceptability. With respect to natural gas exported under licence, these criteria are set out in Clause 18 of the 31 October 1985 Agreement among the Governments of Canada, Alberta, British Columbia and Saskatchewan on Natural Gas Markets and Prices as follow:

i) the price of exported gas must recover its appropriate share of costs incurred;

ii) the price of exported natural gas shall not be less than the price charged to Canadians for similar types of service in the area or zone adjacent to the export point;

iii) export contracts must contain provisions which permit adjustments to reflect changing market conditions over the life of the contract;

iv) exporters must demonstrate that export arrangements provide reasonable assurance that volumes contracted will be taken; and

v) exporters must demonstrate that producers supplying gas for an export project endorse the terms of the export arrangement and any subsequent revisions thereof.

These criteria are not meant to impede or interfere with the private sector negotiating process. The Government of Canada is committed to a market-oriented energy trade. The criteria are, however, intended to provide our industry with clear guidance in formulating negotiated arrangements that are, and will continue to be, in the broad public interest.

In my letter to you of 29 October 1986 concerning implementation of Canada's natural gas export pricing policy by the National Energy Board, I indicated that I no longer expected the Board to undertake prior approval of the price for natural gas exported under licence or order, nor to condition export arrangements with reference to Canadian natural gas prices. I noted that, in future, adherence to

the domestic - export price criterion would be implemented through a system of monitoring prices of actual transactions. Such monitoring is now being carried out by a federal-provincial committee.

I am aware that, in its 14 November 1986 Memorandum of Guidance to the industry respecting, inter alia, regulatory procedures and information requirements for applicants filing for natural gas export licences, the Board indicated its intention to review new or amended long-term export contracts to determine compliance with the requirements of Criteria 3 through 5 as contained in the Agreement.

I believe that the Board shared the confidence of the Government of Canada that Criterion 1, recovery of an appropriate share of costs incurred, could be adequately satisfied by negotiated contractual arrangements. In particular, I am aware that the pricing provisions in contracts underpinning nearly all flowing volumes are structured on a two-part demand/commodity basis, the demand charge primarily including transportation tolls associated with the firm capacity required to ship natural gas from the producing region to the export point. Based on a long-standing principle of comity, we assumed that these negotiated demand charges would be automatically recovered from U.S. import customers on an as-billed passthrough basis. Thus, there was reasonable assurance that the fixed, transportation-related costs associated with firm export sales would be recovered from the importer.

Recent decisions of the U.S. Federal Energy Regulatory Commission (FERC) put our shared assumptions in doubt. As I understand, Opinions 256 and 256-A will allow as-billed passthrough only of those elements of negotiated Canadian demand charges that would be included under the FERC's rate design of choice, modified fixed-variable. Although it is not clear how the decision will be applied on a case-by-case basis, opinions 256 and 256-A would appear to disallow recovery in importers demand charges of the full Canadian tolls associated with export sales.

I foresee two, equally serious, potential ramifications of these decisions. First, it would appear that the disallowed portion of export demand tolls would now be recovered from commodity-related export revenues. In such an instance, producers could bear the risk of under-recovery. Second, where the importer has no firm obligation to purchase a minimum volume, nor to provide a minimum revenue stream, there is the possibility that export revenues accrued at the international border would be insufficient to cover the licence holder's fixed costs, much less ensure an adequate return to producers. Clearly, a situation in which Canadian producers are put at undue risk for transportation investments made to provide service to U.S. consumers raises grave concerns for the Government of Canada, the producing provinces and the producing industry.

I would accordingly ask that the NEB review amendments to existing contracts and all new contractual arrangements underpinning gas export licences and advise me on whether or not negotiated pricing provisions meet the criterion of recovering the appropriate share of the costs incurred.

Specifically, pursuant to Section 22, Part II of the *National Energy Board Act*, I am requesting that the National Energy Board in addition to the information requested in ray letter of 29 October 1986;

(1) provide me with information on an on-going basis on new or amended contractual arrangements underpinning natural gas export licences;

(2) prepare and provide me with an annual report that indicates whether Criterion 1 contained in Clause 18 of the Agreement on Natural Gas Markets and Prices is being met for every export licence; and if it is not being met, that indicates the reasons why that is the case and provides

advice as to what action is appropriate in any such circumstances. For purposes of this report, Criterion 1 should be interpreted to mean that the revenue generated by each export licence on an annual basis is sufficient to cover the intraprovincial and interprovincial transportation costs in Canada and netback a price that is acceptable to the producers supplying the natural gas, as demonstrated by their support for the arrangement (Criterion 5).

In the past, our export industry has shown great ingenuity in-devising flexible, competitive, market-oriented export arrangements that are consistent with the Government of Canada's Criteria for Acceptability. I am confident that, with clear guidance on our policy framework and regulatory procedures, they will continue to do so.

I greatly appreciate the Board's assistance in implementation of Canada's natural gas export pricing policy.

Sincerely,

Marcel Masse

c.c. The Honourable Jack Davis
The Honourable Neil Webber
The Honourable Patricia Smith

Appendix III
(iii) Addendum, dated 27 July 1987, to the NEB Memorandum of Guidance on NEB Regulatory Procedures and Information Requirements for Applicants Filing for Short-term Gas Export Orders and Long-term Export Licences

File No.: 1537-1

27 July 1987

TO: ALL INTERESTED PARTIES

SUBJECT: Addendum to the National Energy Board Memorandum of Guidance on National Energy Board Regulatory Procedures and Information Requirements for Applicants Filing for:

A. Short-term Gas Export Orders; and,

B. Long-term Gas Export Licences dated 14 November 1986

As a result of the Agreement on Natural Gas Markets and Prices between the federal government and the producing provinces, the federal government announced certain policy changes with respect to short-term gas export orders and long-term gas export licences. To implement these changes, which became effective on I November 1986, the National Energy Board amended its regulations and on 14 November 1986 issued its Memorandum of Guidance on information requirements for applicants filing for short-term orders and long-term licences. With respect to long-term licences the Minister removed the requirement that exporters seek prior Board approval of the price for natural gas. As a result the Board removed the requirement for applicants to provide information on Criteria 1 and 2 as set out in the 1985 federal/ provincial Agreement on Natural Gas Markets and Prices.

On 24 June 1987, the Minister of Energy, Mines and Resources in a letter to the Board (copy attached) highlighted his concern regarding the recent U.S. Federal Energy Regulatory Commission (FERC) decision to disallow the as-billed pass-through of Canadian demand charges by U.S. importers. As a result the Minister requested that "the NEB review amendments to existing contracts and all new contractual arrangements underpinning gas export licences and advise me on whether or not negotiated price provisions meet the criterion of recovering the appropriate share of the costs incurred". Accordingly, the Board is reinstating Criterion 1 and requests that all applicants seeking Board approval of new or amended export sales contracts file information as follows:

(1) "the price of exported natural gas must recover its appropriate share of the costs incurred."

As stated in the Minister’s letter "Criterion 1 should be interpreted to mean that the revenue generated by each export licence on an annual basis is sufficient to cover the intraprovincial and interprovincial transportation costs in Canada and [to] netback a price that is acceptable to the producers supplying the natural gas, as demonstrated by their support for the arrangement (Criterion 5)".

Yours truly,

J.S. Klenavic
Secretary
Encl.