

Tolling Methodologies On Federally Regulated Pipelines In Northeast British Columbia

By: Nigel Bankes

Matters Commented On: (1) National Energy Board (NEB), [Letter decision on the Application of Westcoast Energy Inc](#) for Review of the Decision of Members Ballem and Lytle, in Report GH-003-2015 ([Towerbirch Report](#)), Respecting the Toll Treatment of the Tower Lake Section (TLS), and (2) NEB letter to NOVA Gas Transmission Ltd (NGTL), Westcoast Energy Inc (Westcoast) and Alliance Pipeline Ltd (Alliance), re [Examination to Determine Whether to Undertake an Inquiry of the Tolling Methodologies, Tariff Provisions and Competition in Northeast BC](#), 16 March 2017 (the Tolling Methodology Process Letter).

Northeast British Columbia is an area of expanding natural gas production due to a number of significant shale gas plays in the area including [Horn River, Liard, and Montney](#).

Historically this area of the province was first served for conventional sour gas production by Westcoast Transmission. Westcoast offered producers a bundled service including sour gas processing as well as mainline transmission down to the lower mainland and on to serve markets in the Pacific Northwest. This entire system has long been federally regulated by the National Energy Board (NEB), a practice that was legally and constitutionally confirmed by the majority judgement of the Supreme Court of Canada in *Westcoast Energy Inc. v. Canada (National Energy Board)*, [1998] 1 SCR 322, [1998 CanLII 813](#) (SCC). More recently the area has also come to be served by Alliance's "bullet pipeline" and by extension of the NGTL system from Alberta into BC. The [Alliance Pipeline](#) is a point-to-point pipeline which transports liquids rich gas from this area and northwest Alberta to the Chicago market hub. Alliance came on stream in 2000. Its construction was backed by 15 year contracts. Few shippers elected to renew and "accordingly, Alliance developed its New Services Offering (NSO), which incorporated new services and tolling methodologies on the pipeline. Alliance applied for Board approval of the NSO in 2014." The Board's Reasons for Decision on that matter (RH-002-2014) are available [here](#). The NGTL system is the old NOVA *intraprovincial* transmission system which began life in the 1950s under the name Alberta Gas Trunk Line (AGTL) and subsequently morphed into NOVA before merging with TransCanada PipeLines (TCPL) in 1998. Historically, AGTL and NOVA were provincially regulated until brought under federal regulation in 2009: see ABlawg post [here](#). The AGTL\NOVA business model was quite different from that of Westcoast. NOVA focused its attention on the transmission system and left the producers to assume responsibility for owning and constructing in-field processing facilities to produce pipeline quality gas for delivery to the AGTL\NOVA system.

The result of these developments is that the natural gas transmission scene in northeast BC no longer looks like a natural monopoly, and has not for some long time. Instead, there is competition for natural gas production and competition to fill transmission systems with gas. No pipeline system feels this more acutely than the NGTL system and its sister, the TCPL mainline,

which needs additional volumes of gas to make up for the declines in conventional gas production in the western Canadian Sedimentary Basin (WCSB).

NGTL's expansion into northeast BC has met with opposition from a number of players including in particular Westcoast. Westcoast has long argued that NGTL's expansion is supported by NGTL's tolling scheme which cross subsidizes the NGTL extensions into this area thereby improving the netback to producers who tie in to the NGTL system. In Westcoast's view this results in unfair competition since these producers are not paying the full cost of this new infrastructure. The NGTL tolling system sets its tolls on the basis of receipt and delivery points and by reference to pipe diameter. The toll is therefore distance based but the tolls are subject to caps or ceilings as a result of which, for some receipt points, the toll fails to track the distance carried. NGTL justifies this tolling practice, including the ceilings, on the basis that the NGTL system is a highly integrated trading system (rather than a bullet line) and that there are overall system benefits from these geographical extensions.

Westcoast has raised its concerns in a number of NGTL extension applications, specifically the [Chinchaga and Komie North](#) application, [North Montney](#) and, most recently, [Towerbirch](#), also the subject of this most recent Letter Decision on an Application for Review referenced above.

Chinchaga and Komie North

Westcoast was partially successful on both procedural and substantive grounds in opposing NGTL's Chinchaga and Komie North application, GH-001-2012. On the procedural issues the Board noted that while it had previously denied Westcoast's application for a general inquiry (letter of October 2, 2011) with respect to tolling, it had acceded (at 17) to Westcoast's request to expand the list of issues associated with NGTL's Part III application (for a certificate of public convenience and necessity) to include Part IV tolling matters. On the merits, Westcoast succeeded in demonstrating that NGTL's tolling proposal would not result in a set of just and reasonable tolls for the Komie North part of the application. Accordingly, since NGTL had not proposed any alternative tolling procedures the Board recommended rejection of the NGTL's application for a certificate of public convenience and necessity under the new version of s.52 of *NEBA*. The NEB considered that the tolls would not be just and reasonable because of the operation of ceilings in NGTL's tolling approach. The Board commented as follows (at 27):

The Board acknowledges NGTL's view that there is some inherent cross-subsidization in many rate designs. However, the Board considers the extent and impact of the cross-subsidization as important factors in its decision making. ...

NGTL asserts that the toll ceiling is justified because only three per cent of the entire Alberta System revenue is impacted by the rate ceiling. In the case of the Komie North Section, the Board finds this observation unpersuasive. Differences in rates or prices that are small relative to NGTL's large system and large revenue can still have a significantly disruptive impact on choices made in specific locations. As a result, cost causation for the Komie North Section remains an important consideration for the Board.

All parties submitted that netbacks (market prices less the rates charged for transportation) will determine the choices made by producers in northeast BC. In this context, the Board finds user-pay to be particularly important. Portions of NGTL's rate design methodology are distance-based, which normally would take into account user-

pay or cost causation to a significant degree. However, the ceiling on receipt rates limits the cost causation reflected in the rate design.

The evidence shows that any shipper on the Komie North Section would be receiving a significant subsidy. This cross-subsidization exceeds the Board's tolerance for departures from the user-pay principle. Therefore, the Board finds that NGTL's proposed toll treatment for the Komie North Section would not produce just and reasonable tolls.

It is clear that the Board was particularly concerned about the degree of cross-subsidization because of the competitive environment within which NGTL was operating and in its concluding comments noted that (at 30) "The proposed rate design would unreasonably subsidize the extension of the NGTL Alberta System into an area where it would compete with infrastructure already in place."

North Montney

NGTL's North Montney Project (GH-001-2014) is in many respects the most complex of the three projects discussed here because of the potential for part of the applied for facilities (the Aitken Creek lateral) to serve two very different purposes: (1) the NGTL system, and (2) the liquefied natural gas (LNG) export market and in particular the proposed Prince Rupert Gas Transmission Pipeline (PRGT). For the first number of years (until the PRGT project becomes operational) all of the gas on the North Montney system would enter the NOVA Inventory Transfer (NIT) market and supply markets accessed by the existing NGTL System. Once PRGT is operational gas would be able to go in either direction.

In its decision, the Board identified two relevant periods for setting just and reasonable tolls: the Transition Period and the Long-Term Phase. The Transition Period ends when gas is first delivered to the PRGT. The Board was clearly concerned that even during the Transition Period there would, as in Komie North, be an unacceptable degree of cross subsidization of the extension by other shippers on the NGTL system. But in this case, rather than recommend rejection as in Komie North, the Board concluded instead that it would establish terms and conditions in the recommendation to the Governor in Council that would, if adopted, result in just and reasonable tolls. In particular, the Board directed that while NGTL could charge tolls based on NGTL existing tolling methodology during the Transition Period it (at 31) "must accumulate in a deferral account that portion of the Project's [Cost of Service] not recovered by incremental revenue from Project-related transportation contracts for disposition in a future tolls application." By this technique the Board aimed to limit (at 31) "the amount of cross-subsidization by the accumulation of unrecovered North Montney [cost of service]" For the Long-Term Phase, the Board indicated (at 31 – 32) that "NGTL may develop and seek Board approval for a new tolling methodology applicable to the Project facilities, which will better satisfy the principal (*sic*) of cost causation and the goal of economic efficiency. If NGTL does not develop a replacement methodology that is approved by the Board by the end of the Transition Period, the Board requires NGTL to implement stand-alone tolling for the Project until an approved long-term methodology is in place."

The Board justified its decision to propose stand-alone tolling as the default position in the Long-Term Phase largely on the basis (at 32) "that the Project, as presented, is not meaningfully integrated with the existing NGTL System during the Long-Term Phase." The Board elaborated (at 32):

Although the Project is at all times physically connected with the existing NGTL System, a mere physical connection is not sufficient to find that meaningful integration exists. In this case, Project facilities are geographically separated from the footprint of the existing NGTL System. As a result, none of the Project's facilities parallel or share the route of the existing System. Further, the Project's pipeline will be connected to a single point at an extremity of the existing NGTL System, which precludes the Project from affecting the capacity of the existing System, as further discussed below.

The Board finds that in the Long-Term Phase, the Project can be used separately and largely independently of the existing NGTL System and the gas flows between the two sets of facilities will be minimal and intermittent.

The Board again emphasized the importance of cost-based tolls where pipelines are operating in a competitive environment (at 40)

In the case of competition amongst regulated pipelines, the Board finds that adherence to the principle of cost causation lays the foundation for fair competition. Given the competitive environment in Northeastern BC, the vast potential of the resource and potential to benefit Canadians, the Board is mindful of the need to prevent competitors from gaining a regulatory advantage as a result of its tolling decisions.

On March 20, 2017 NGTL [applied to the Board](#) to have it vary condition 4 of the certificate of public convenience and necessity. That condition required NGTL to confirm with the Board prior to commencing construction of the North Montney mainline that Progress Energy had made a final investment decision with respect to the PRGT pipeline and that TransCanada is proceeding with that project. In this variance application NGTL explains that the PRGT project has been delayed, but in the meantime gas producers in the area have continued to advance development plans and thus need incremental firm access to the NGTL system. Accordingly, NGTL has applied to have the Board waive the application of condition 4 so as to allow it to proceed with certain of the applied for facilities. It argues that the additional contractual arrangements it has concluded "provide further evidence of long-term market demand for North Montney gas supply independent of west coast LNG."

Towerbirch

In Towerbirch the majority was prepared to approve NGTL's tolling treatment for both the proposed mainline expansion (the Groundbirch Main Line Loop (GBML) and an extension referred to as the Tower Lake Section (TLS). With respect to the GBML portion the Board noted (at 71) that "the GBML Loop will be fully integrated with the existing NGTL System because the Project will not be used separately and independently of the NGTL System. Upon entering the GBML Loop, gas will be commingled with existing gas streams on the Groundbirch Mainline. Furthermore, it is the demand of both existing and new shippers which has created the need for service. This high degree of physical and operational integration supports utilizing the same toll methodology already in place on the Groundbirch Mainline." The majority concluded that there was no cross-subsidization with respect to the GBML. The minority was of the view that any cross-subsidization was acceptable because of the high degree of integration. The majority and minority diverged more significantly with respect to the TLS lateral. The majority was still persuaded that there was no cross-subsidization even though (at 73) it seemed to accept that "the incremental toll will not cover the incremental costs of the TLS". That was too narrow a view of cross-subsidization for the majority who preferred to view the matter "in the

context of the entire NGTL System”. In that broader context the TLS lateral offered system benefits which respected the user-pay principle and precluded a finding of cross-subsidization. This conclusion with respect to system benefits was however conditional upon the gas continuing to serve the NGTL system. Should the gas be used to serve other markets such as the LNG export market the majority was of the view that the tolling treatment of the TLS should be revisited.

The majority went on to conclude (at 74) that any other tolling treatment of TLS such as stand-alone or incremental tolling “would unjustly discriminate against shippers on the TLS as compared to shippers on other laterals on the NGTL System” and would effectively “confer acquired rights to existing shippers on the NGTL System because those shippers would benefit from additional gas on the NGTL System and associated increased throughput without bearing any additional costs of the TLS facilities.” Finally, the majority (at 75) was not persuaded that TLS would have significant negative competitive impacts on Westcoast. Instead the majority considered that the competitive take-away capacity that the TLS would offer to Montney producers was positive and not duplicative.

The Phase I Letter Decision on the Review of the Towerbirch Decision

Westcoast filed an application under s.21(1) of the *National Energy Board Act*, [RSC 1985 c. N-7](#) (NEBA) and under the NEB Rules of Practice and Procedure, [SOR/95-208](#) (Rules) for a review of the Towerbirch tolling decision.

Section 45 of the Board’s Rules provides for what is a two-step procedure much like that articulated in [Rule 16](#) of the Alberta Utilities Commission. At the first stage the rules make it clear that the Board may dismiss an application for review “if the Board is of the view that the applicant has not raised a doubt as to the *correctness* of the Board’s decision or order” (emphasis added). The onus is evidently on the applicant. The applicant must also show “the nature of the prejudice or damage that has resulted or will result from the decision or order”. It is only if the applicant can satisfy these tests that the Board will proceed to conduct the review (phase 2). In this case the Board Panel considering the matter concluded that Westcoast had not met its onus. In its Review Decision the Review Panel emphasized that while the standard of review is correctness (according to the Board’s own Rules quoted above), that which is being reviewed for correctness in this case (just and reasonable tolls) (at 4) “is largely a matter of informed judgment and opinion.” In doing so the Review Panel confirmed that “there is a high threshold for reviews of its decisions” but also concluded that its correctness review was not confined to the matters referenced in s. 44(2)(b) of its Rules (i.e. error of law or jurisdiction, a change in circumstances, or new evidence).

The Review Panel’s decision addresses four substantive issues: (1) the question of cross-subsidization, (2) the economic efficiency issue, (3) the acquired rights\discrimination issue and (4) the nature of any prejudice suffered by Westcoast. While these are described as separate issues there is considerable overlap between them.

Cross-subsidization

As noted above, the majority in the original decision (hereafter the Board) had rather perversely reached the conclusion that that there was no cross-subsidization associated with either the mainline loop or the TLS lateral because of the overall system benefits. The Review Panel reinterpreted this conclusion somewhat noting that when read as a whole (at 7) “it is clear that

the Board did not fail to consider the evidence that the revenue from the FT-R tolls would not fully cover the costs of both the TLS and the existing NGTL System. Rather, consistent with Westcoast's interpretation, the Board found it appropriate that NGTL System shippers bear financial responsibility for some of the costs of the TLS." That sounds more like a finding that any cross-subsidization was reasonable in light of system benefits (rather than a finding of no cross-subsidization). Nevertheless, the Review Panel also went on to confirm that the Board had not erred in finding no cross-subsidization because of the Board's finding that the TLS tolling did not depart from the cost-causation principle and (at 8) "since there was no departure from the cost-causation or user-pay principle, the Board did not err in finding that there was no cross-subsidization." With respect this seems equally perverse since a conclusion that a lateral offers system benefits is hardly the same as the conclusion that there is no departure from the cost-causation principle.

Economic efficiency

Economic efficiency refers to the optimum allocation of resources. Resource allocation will be sub-optimal if goods and services are priced inappropriately (i.e. do not cover the full cost of production including social costs). In such a case consumers will consume more of that good or service than they would if it were priced more appropriately. In this context economic efficiency means that "tolls should promote proper price signals". Westcoast argued that this was manifestly not the case here since in its view the proposed toll of 0.9 c/Mcf was not even close to the cost of transportation of 9.2 c/Mcf on the TLS. In effect, Westcoast was arguing that while the Board had identified economic efficiency as a relevant consideration in setting just and reasonable tolls, the result demonstrated that it had in fact ignored the principle.

The Review Panel was not convinced that this was an error (at 9 – 10). It noted that the legislation did not require the Board to consider economic efficiency and certainly did not prescribe the weight to be accorded to this factor. The Review Panel noted that the Board's decision did refer to this factor and that seems to have been enough for the Review panel. Certainly there is no searching analysis of the quality of the Board's original reasons on this point.

No acquired rights and no unjust discrimination

While Westcoast argued that the no-acquired rights principle could not apply since existing shippers would make no use of the TLS the Review Panel (at 11) agreed with the Board – existing shippers would make effective "use" of the TLS lateral because of the system benefits it conferred. Furthermore, the Board was entitled (at 12) to reach the factual conclusion that anything other than rolled-in treatment of the TLS would result in unjust discrimination.

Prejudice

For Westcoast the prejudice was obvious. The low TLS toll would permit NGTL to engage in unfair competition. NGTL however pointed out that the Board had concluded that the TLS toll would not have "any significant offloading impacts on Westcoast" and that absent evidence to doubt the correctness of that decision that should be the end of the matter. The Review Panel evidently agreed (at 13) with that assessment. But is this not too narrow a view of prejudice? Both the Board and the Review Panel evidently focus on de-contracting or offloading but presumably Westcoast is equally concerned that it will not be competitive in competing for *new* volumes of gas.

A final glitch – is it a glitch and if it is, is it just a glitch?

The 14 page Letter Decision concludes by recalling that the matter of tolling methodology in Northeast BC had already been referred by the Board Chair for review by a single Board member under s.15 of NEBA. The Review Panel reports that this occurred on 26 January 2017 but the only public announcement of this seems to be the letter discussed in the next section which is dated 16 March 2017, the same date as the Review Panel’s own decision. I am not quite sure what to make of this. Was the referenced “examination” part of the Review Panel’s record? Was the Review Panel operating behind a Chinese wall? Did the Chair’s decision to initiate a process to assess whether an inquiry should be called, influence the Review Panel’s assessment in any way, and if so how?

The Tolling Methodology Process Letter

As noted in the last paragraph, on the same date that the Review Panel’s decision was released the Secretary of the Board wrote to each of NGTL, Alliance and Westcoast indicating that the Board’s chair had decided, under s.15 of *NEBA*, to appoint a single Board member, Lyn Mercier, to conduct an examination to determine whether it would be warranted to conduct an Inquiry into “the tolling methodologies or tariff provisions” of one or more of the three companies and if so, to advise as the scope of any such Inquiry. The companies were directed to serve the letter on shippers, stakeholders and interested parties. Parties have until 21 April 2017 to respond. In effect this is an inquiry into whether or not an inquiry should be held, or, in the argot of the Board, an “Examination” to determine if there should be an “Inquiry”. Westcoast may not yet have the Inquiry that it was looking for in 2011 but it is inching towards it, and it now has the record of three contested hearings to help it make its submissions.

Tolling matters do not appear to be part of the mandate of the [NEB Modernization Panel’s](#) inquiries – perhaps they should be!

This post may be cited as: Nigel Bankes “Tolling Methodologies On Federally Regulated Pipelines In Northeast British Columbia” (27 march, 2017), online: ABlawg, http://ablawg.ca/wp-content/uploads/2017/03/Blog_NB_Tolling_NortheastBC.pdf

To subscribe to ABlawg by email or RSS feed, please go to <http://ablawg.ca>
Follow us on Twitter [@ABlawg](#)

