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INTRODUCTION

This is Lawson Lundell LLP's energy law newsletter, a quarterly publication meant to inform readers of energy developments in Western and Northern Canada. Drawing on our firm's experience in advising energy clients, it focuses on new and evolving legal and regulatory issues. For more information about Lawson Lundell LLP's energy law practice please contact Chris Sanderson at (604) 631-9183, in Vancouver; Jerry Schramm at (403) 781-9475, in Calgary, or Geoffrey Wiest at (867) 669 5544, in Yellowknife. Back copies of this newsletter may be found at www.lawsonlundell.com in the Energy Law Practice Group section.

NATIONAL

NEB Unveils New Electricity Cost Recovery Model

In a 2 hour session in Toronto on January 19, the National Energy Board (NEB) explained the concepts that are to underpin its new cost recovery (electricity) regulations. At the current time the NEB costs associated with electricity regulating are recovered largely through exporters, and are based on export volumes. Under the new concept, which has been almost 2 years in the making, a fee will be imposed on newly regulated international power line companies. The new fee will be payable upon approval of new NEB international power certificates or permits, and will be set at 0.2% of the capital cost of the project, as estimated by the NEB.

In addition, the balance of NEB costs related to electricity regulation will now be

recovered from international power line operators, rather than exporters. Large operators, those transmitting more than 50,000 MWh per year, will pay on the basis of the ratio of their import and export activity to the total import and export activity of all NEB-regulated international power lines in Canada. Small operators, those transmitting less than 50,000 MWh per year, will pay a fixed fee. How the operators will recover their costs will then become a matter, in most cases, for provincial tariffs or regulations.

Interested parties have until February 20 to provide comments on the proposal, which can be found at http://www.neb-one.gc.ca/actsregulations/nebact/electricitycostrecovery/2004/index_e.htm

REGIONAL

Mackenzie Gas Project Hearings Get Underway

On January 25, 2006, the NEB hearings got underway in respect of the Mackenzie Gas Project (MGP). The MGP involves five inter related applications: one for the Mackenzie Valley Pipeline between Inuvik and northern Alberta, one for a gas gathering system, and three applications for the development of onshore natural gas fields known as Taglu, Parsons Lake and Niglintgak. The Taglu natural gas field was discovered in 1971, followed by the Parsons Lake and the Niglintgak in 1972.

The commencement of the NEB hearings marks the beginning of a new chapter in the effort to bring northern gas to southern markets. A variety of pipeline proposals

were put forward in the mid-1970's. At the time, northern aboriginal groups were strongly opposed to pipeline development. In his 1977 report on the Mackenzie Valley Pipeline Inquiry, Mr. Justice Thomas R. Berger opined that a period of ten years would be required to settle native land claims and that no pipeline should be built until that had been achieved.

The mood in the North is quite different now. At the opening session in Inuvik, the NEB heard from a Gwich'in Chief, Charlie Furlong, who stated his view that the progress on land claims during the last thirty years "have brought the people a long ways from the days of Thomas Berger." In fact, three of the four aboriginal groups along the proposed route of the pipeline have settled land claims—Inuvialuit (1984), Gwich'in (1992) and Sahtu (1993). The Aboriginal Pipeline Group (APG) is one of the proponents of the Mackenzie Valley Pipeline, along with Imperial Oil, ConocoPhillips, ExxonMobil and Shell Canada. The APG has the support of the three groups with settled land claims. The only aboriginal group along the proposed pipeline route that does not support the project, the Deh Cho First Nation, does not have a settled land claim.

The project still has a long way to go before it becomes a reality. The NEB has scheduled another 55 days of hearings during 2006 to take place in a number of communities in the Northwest Territories. In addition, the Joint Review Panel (JRP), which is tasked

with reviewing the environmental and socioeconomic impacts of the project, will begin its hearing in Inuvik on February 14. The JRP has scheduled 73 days of hearings in numerous communities throughout the North. The project proponents do not anticipate receiving regulatory approvals before the third quarter of 2007, at which time they will then be faced with making a final decision to construct. Assuming the regulatory and construction schedules proceed as planned, commissioning and start up is not anticipated until 2011.

Kinder Morgan to Sell Terasen's Water and Utility Services Subs

On January 17, 2006 Kinder Morgan announced the sale of Terasen's water and utility service subsidiaries to a consortium of buyers including CAI Capital Management and the Terasen subsidiaries' management team. The sale price of \$125 million is a small fraction of the \$6.9 billion purchase price Kinder Morgan paid for Terasen in a transaction that was approved by the BC Utilities Commission and Investment Canada in the fall. The Terasen subsidiaries provide water, waste water and related utility services primarily on contract to municipalities, which is a business outside of Kinder Morgan's main pipeline business. The transaction is scheduled to close in April.

BRITISH COLUMBIA

EnCana Gas Plant Approval

EnCana Corporation has received approval from the BC Oil & Gas Commission for the \$60 million Steeprock natural gas processing

plant, which would be built 50 kilometres south of Dawson Creek, British Columbia. The plant would process natural gas from EnCana's wells in the Kelly Lake, Cutbank Ridge and Bisette areas.

The plant has a planned capacity of 198 million cubic feet of natural gas per day and would provide about 15 permanent jobs. Construction is scheduled to begin in February.

BCTC Opts Out of Grid West

British Columbia Transmission Corporation (BCTC) announced in January that it will discontinue its funding of the next development phase of Grid West (formerly RTO West). The decision follows on a recent decision by the Bonneville Power Administration (BPA) to withdraw from Grid West, and the subsequent completion of a cost-benefit study that showed minimal benefit to British Columbia from continued participation. The decision allowed BCTC to avoid committing \$3.2 million to Grid West over the next 18 months, and spending an additional \$1.5 million per year on internal costs related to Grid West development. The decision also effectively ends BC's 6 year involvement in the development of a cross-border regional transmission operator.

Vancouver Island Transmission Projects

On February 6, 2006 concurrent CPCN hearings for Vancouver Island transmission projects commenced before the BCUC. BCTC's application is for approval of a 230



kV transmission line, with a projected cost of \$245 million. Sea Breeze Pacific Regional Transmission System Inc. (Sea Breeze) is advocating its HVDC Light proprietary technology in a competing application. The BCUC ordered the two applications to be heard together at a November 10 pre-hearing conference. Further information on the two projects is provided in our Fall 2005 Newsletter.

Meanwhile, Sea Breeze Victoria Converter Corp (Sea Breeze) filed an application with the NEB on December 1, 2005 for a CPCN for an international power line between Vancouver Island and the Olympic Peninsula in Washington State. The Canadian portion of the project includes 19 kilometers of submarine cable beneath the Strait of Juan de Fuca, 12 kilometers of underground line and 500 meters of overhead lines, as well as a converter station. The United States portion includes a further 16 kilometers of cable and associated facilities. The project is proposed to be a merchant transmission line employing HVDC Light proprietary technology, and would complement Sea Breeze's proposed Vancouver Island transmission project. If successful, the Juan de Fuca project would be incorporated into the high-voltage electricity grid of the Pacific Northwest and would be operated by either or both of BCTC and BPA.

The NEB issued a hearing order on January 18, setting Sea Breeze's application down for an oral public hearing commencing April 24, 2006, at a location still to be determined.

The deadline for interventions is February 13, 2006.

ALBERTA

Final Bitumen Conservation Decision Released

The Alberta Energy and Utilities Board (AEUB) has ordered approximately 920 Wabiskaw-McMurray natural gas wells producing from certain Wabiskaw-McMurray gas zones in the Athabasca Oil Sands Area of north east Alberta to be shut-in on a final basis. AEUB Decision 2005-122, released November 12, 2005, is the result of a public hearing held last summer addressing the risk that natural gas production poses to the ultimate recovery of bitumen in the area. Two previous AEUB hearings on the bitumen conservation issue were held in 2004, and resulted in the interim shutting-in of the wells effective July 1, 2004 due to concerns that the production of associated gas presents an unacceptable risk to bitumen recovery using steam assisted gravity drainage. While detailed reasons for the final rulings (initially scheduled for release by the end of November, 2005) are yet to be issued, the final decision represents no significant change from the gas estimated to be affected by the 2004 interim decisions.

Calgary-Area Critical Sour Gas Project Application Closed

The AEUB recently closed Compton Petroleum Corporation's (Compton) application for licences to drill six

critical sour gas wells 1.1 km east of the Calgary city limits due to Compton's failure to file its Emergency Response Plan with the AEUB. As reported in our previous newsletter, the AEUB issued Decision 2005-060 on June 22, 2005 conditionally approving Compton's application to drill the wells. In that decision the AEUB agreed with Compton that it was possible to safely drill and complete four of the six proposed wells, and confirmed that if Compton can gain the AEUB's approval of its Emergency Response Plan (ERP), the AEUB would issue licences for the four wells. On December 14, 2005, Compton requested an eight-month extension to the deadline to file a revised ERP, stating that Compton was unable to finalize an updated ERP due to a lack of cooperation by the City of Calgary and the Calgary Health Region. The Board denied Compton's extension request on the basis that Compton did not demonstrate that it had explored all possible opportunities to work with the various parties in advance of the deadline imposed, and that in any event, Compton did not complete all tasks that did not require cooperation with other groups. The application was closed without prejudice to Compton's ability to re-apply for approval of the proposed project. At this time Compton is not expected to re-apply for approval to construct the 6 wells.



Alberta Court of Appeal Clarifies Provincial Taxing Authority Over Pipelines Under Construction

The Alberta Court of Appeal recently confirmed the Alberta government has no ability to tax a pipeline under construction until it is capable of being used for its intended purpose. Alliance Pipeline Ltd. (Alliance) sought to appeal a series of 2001 municipal tax assessments dealing with the value of the Alberta portion of a pipeline it was constructing from northern British Columbia and Alberta to Chicago, Illinois. Alliance objected to the assessment on the basis that the pipeline was entitled to a statutory exemption from taxation for the 2001 tax year because the pipeline was neither complete nor capable of being used for the transmission of gas on the date of the assessment. On appeal, the Municipal Government Board (MGB) dismissed the complaint, finding that although construction was not complete, the pipeline was still capable of being used for gas transmission. On an application for judicial review of the MGB decision, the Alberta Court of Queen's Bench concluded that the MGB's interpretation, namely that assessability merely required capacity to carry out the transmitting function rather than commissioning, constant flow or even actual use, was not unreasonable. Alliance appealed this decision to the Alberta Court of Appeal. In *Alliance Pipelines Ltd. v. Alberta (Minister of Municipal Affairs)*, 2006 ABCA 9 issued January 11, 2006, the Court confirmed that only once a pipeline is capable of being used for its intended purpose – that is the safe, commercial transmission of gas – is it assessable under

the legislation. The fact that a significant amount of test gas can be sent and received through the line is insufficient, particularly where that flow of gas is well below the pipeline's minimum commercial design capacity. Most importantly, the pipeline must be demonstrated to have completed the basic safety and systems testing to ensure that the public and the environment are not at risk. Not having been pressure tested nor commissioned on the relevant date, the pipeline was exempt from taxation.

SASKATCHEWAN

Saskatchewan Issues First Oil Sands Exploration Permit in 35 years

Saskatchewan regulators recently approved the province's first commercial drilling program in over three decades to investigate the extent of bitumen deposits in northwest Saskatchewan. Oilsands Quest Inc., 70% owned by CanWest Petroleum Corporation, is conducting Saskatchewan's first oilsands exploration program since Shell and Gulf Canada completed limited core drilling in the area in the mid-1970s. The first phase of the Oilsands Quest drilling program, which started earlier this winter, is anticipated to drill 25 core holes. A second phase is scheduled to proceed later this winter, pending regulatory approval. Since the mid-1990s, there has been a gradual eastward expansion from the proven oilsands areas of northeastern Alberta towards the Alberta-Saskatchewan border. Given the renewed interest in investigating the virtually unexplored territory, Saskatchewan regulators are working to streamline and update the application process.

VANCOUVER

1600 Cathedral Place
925 West Georgia Street
Vancouver, British Columbia
Canada V6C 3L2
Telephone 604.685.3456
Facsimile 604.669.1620

CALGARY

3700, 205 – 5th Avenue SW
Bow Valley Square 2
Calgary, Alberta
Canada T2P 2V7
Telephone 403.269.6900
Facsimile 403.269.9494

YELLOWKNIFE

P.O. Box 818
4908 - 49th Street
Yellowknife, NWT
Canada X1A 2N6
Telephone 867.669.5500
Toll Free 1.888.465.7608
Facsimile 867.920.2206

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