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BARRISTERS & SOLICITORS

WESTERN CANADIAN BUSINESS LAW

ENERGY LAW NEWSLETTER

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INTRODUCTION

Welcome to Lawson Lundell LLP's energy law newsletter. This quarterly publication is intended to keep readers informed about developments in the energy sector in Western and Northern Canada, with a focus 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, or the "guest editor" of this edition of the newsletter, Keith Bergner, at 604-631-9119 in BC, or Jerry Schramm in Alberta at (403)781-9475. Back copies of this newsletter may be found at www.lawsonlundell.com in the Energy Law Group section.

REGIONAL

Kinder Morgan Acquisition of Terasen

On August 1, 2005 Kinder Morgan Inc. (Kinder Morgan) announced a $7 billion deal to acquire Terasen Inc. (Terasen) in a cash, share and debt deal. Kinder Morgan is a Houston based energy transportation and storage company with no current holding in Canada. Terasen's business is primarily natural gas distribution in British Columbia and oil pipelines connecting Alberta and British Columbia. Terasen shareholders voted to approve the transaction on October 18. Because the transaction will result in a change of indirect control of a number of regulated Terasen utilities in British Columbia, approval is required from the British Columbia Utilities Commission (BCUC). Despite persistent and vocal public opposition to the transaction, and calls for a full, oral hearing into the approval application, the BCUC has ordered a written hearing process, and has said it anticipates rendering a decision on the application by November 10, 2005.

Update on Alberta Intertie Conduct

The Alberta Market Surveillance Administrator (MSA) had an active September, issuing a review of the Trading Practices Guideline on September 15, an update on the Alberta – B.C. interconnection on September 23 and holding its annual stakeholder meeting on September 28.

In the September 23 Update on Economic Use of the BC Interconnection, the MSA advised that periods of undesirable conduct on the AB – BC intertie continued in 2005, although the data indicates a favourable trend in sustained uneconomic import sequences, and improved participant behavior. The MSA had determined in its July 28, 2005 Notice to Market Participants Regarding Intertie Conduct that conduct having as its primary intent the management of the Pool price to suit the market participant's portfolio would, in the MSA's view, be a breach of the Electric Utilities Act. Such conduct can create distortion in the Pool price, reducing fidelity of the market price signal and, therefore, has a negative effect on the fair, efficient, and openly competitive operation of the market.

While the economics of imports to Alberta across the AB – B.C. intertie are of particular concern to the MSA, it emphasized that it will be applying an equal level of scrutiny to export practices on the BC intertie and to practices on the Saskatchewan – Alberta intertie.

The MSA has modified and refined its approach to monitoring and analyzing conduct on the tie lines, identifying uneconomic flows by imputing economics to the various participants. The MSA attributes the inability for importers to price into the Alberta market as a substantial obstacle to success and encourages market design adjustments to address the issue. The MSA report is available at http://www.albertamsa.ca/msahome.html.

BRITISH COLUMBIA

BCUC Approves Negotiated Settlement of BC Hydro Resource Expenditure and Acquisition Plan

By application dated March 7, 2005 BC Hydro filed for BCUC approval of its 2005 Resource Expenditure and Acquisition Plan (REAP). The REAP was comprised of three essential components, namely (i) F2006 and F2007 capital expenditure plans; (ii) F2006 and F2007 demand side management expenditure plans; and (iii) a plan to acquire 2400 GWh/yr of firm electrical energy from the private sector through an open call for energy. The call for energy component of the REAP attracted significant intervenor and industry interest over the course of the summer, and culminated in a 4 day negotiation session in September that was facilitated by BCUC staff. The settlement that came out of that session, and which addressed all elements of the REAP, was approved by BCUC Order No. G 103 05 on October 11, 2005.

Significant elements of the call for energy, which is expected to be issued imminently, are as follows:

1. the call will target 2400 GWh/yr of firm electrical energy from projects greater than 10 MW, and associated non firm energy, and 200 GWh/yr of electrical energy from projects less than 10 MW;

2. contract awards will take into account BC Hydro's need for approximately 800 GWh/yr of firm energy in 2009-10 and approximately 1600 GWh/yr more firm energy in 2010-11, with a commercial operation date between October 1, 2007 and November 1, 2010.

Vancouver Island Transmission Applications

On July 7, 2005 British Columbia Transmission Corporation (BCTC) applied to the BCUC for approvals to build a proposed 67 kilometre 230 kV transmission line between South Delta (on the mainland south of Vancouver) and North Cowichan on Vancouver Island. The proposed line would replace an existing 138 kV transmission line, and be in service by October 2008. Including upgrades to a second existing 138 kV line, total project costs are projected to be $245 million. The application has attracted significant public interest and opposition, primarily from affected residents and environmental groups. Over 50 intervenors have registered to participate.

Meanwhile, Sea Breeze Pacific Regional Transmission System Inc. (Sea Breeze) filed an application with the BCUC on September 30, 2005 for approvals to build a competing direct current transmission line between the mainland and Vancouver Island with the land portions of the line located underground. Sea Breeze estimates the cost of its line at $302 million, with an in service date of March 2008. In its application Sea Breeze claims that while the direct costs of its project would be greater than those of BCTC's project, its project avoids the need for a number of costly transmission reinforcements that would otherwise be necessary. On this basis, Sea Breeze's project is said to cost $127 million less than BCTC's proposal. Sea Breeze also cites numerous other advantages of its direct current transmission line, including fewer environmental issues, no visual impact, and minimal electromagnetic field radiation.

Sea Breeze brought a motion to consolidate the hearings of the competing applications, and the BCUC on October 27, 2005 ordered (Order No. G 109 05) that a decision on consolidation should be deferred until after a pre-hearing conference to be held on November 10, 2005.

New Wind Power Policy for B.C.

On October 14, 2005 the B.C. government announced a new participation rent policy for wind power projects located on Crown land. The government stated that the new policy will offer flexibility and incentives for wind power producers with respect to capital investment. Under the new policy, there will be no participation rents for the first 10 years of commercial operations. From year 11 on, a variable rent scheme will be in effect. In 2010 a review of the rent-free phase will be conducted, however, any changes that are made to the rent scheme at that time will not affect projects that are already in operation. The Honourable Richard Neufeld, B.C.'s Minister of Energy, Mines and Petroleum Resources noted that B.C.'s 2002 Energy Plan gave the government a path forward in having industry develop new power supplies, including from wind or other sources. Currently, there are 169 tenure applications for wind energy development in B.C. and over 2,000 MW of wind energy projects in various stages of the development process throughout the province. The detailed operational policy document will be made available in the near future at www.em.gov.bc.ca/AlternativeEnergy/windpower.

ALBERTA

AESO Releases Wind Penetration System Impact Study – Phase I

In September 2005 the Alberta Electric System Operator (AESO) released Phase I of its Wind Penetration System Impact Study. Seeking to gauge the effects of increased wind penetration on the safe and reliable operation of the Alberta integrated electric system, the study uses existing (2004) wind generation capacity of 254 MW as a benchmark to model incremental effects of several growth scenarios, representing wind power penetration of 10%, 15% and 20% of total Alberta peak load. Study findings reveal that all three growth scenarios result in one or more system performance violations, indicating that mitigating measures are needed. The AESO anticipates finalizing Phase II of the study, including recommendations to address the introduction of increased wind generation and settlement of the operational requirements for wind power facilities, by next summer.

The AESO has already initiated stakeholder consultation to assess the need for reinforcement and expansion of the Southeast Alberta transmission system, an area of significant prospective wind generation, and has identified a preliminary range of options to address future transmission needs. Screening of alternatives is expected to conclude before the end of the year, with transmission development recommendations for the area to be finalized early in 2006.

Compton Signals Intention to Proceed with Calgary-Area Critical Sour Gas Project Despite Regulatory Uncertainty

On October 25, 2005 Compton Petroleum Corporation advised the Alberta Energy and Utilities Board (AEUB) of its intention to proceed with its proposed project to drill four critical sour gas wells from a single well pad located 1.1 km east of the Calgary city limits. The announcement was made on the same day that the Alberta Court of Appeal granted the City of Calgary leave to appeal the AEUB's decision to extend the time for Compton to notify the Board of its intentions in respect of the Calgary-area critical sour gas project from August 15, 2005 to November 1, 2005. As previously reported in our newsletter, the AEUB issued Decision 2005-060 on June 22, 2005 conditionally approving the proposed project. In order to obtain final authorization to proceed, Compton must gain the Board's approval of its Emergency

Response Plan which is currently incomplete. Having decided that a 4 km Emergency Planning Zone (EPZ) was not sufficiently protective of public safety, the Board directed Compton to use an EPZ of 9.7 km in developing any revised Emergency Response Plan.

The City's appeal is not the only appeal being sought in respect of the controversial project. Earlier this summer, the Calgary Health Region applied to the Court for leave to appeal the AEUB's conditional approval of the project on the basis that the Board failed to consider site-specific health risks in making its initial decision, and exceeded its jurisdiction by establishing an EPZ other than that applied for by Compton. The Health Region's application for leave to appeal has not yet been heard by the Court. Both the Calgary Health Region and the City of Calgary have also filed applications with the AEUB for review and variance of the Board decisions.

SASKATCHEWAN

SaskEnergy Revises Rate Application Upwards

SaskEnergy, Saskatchewan's Crown-owned natural gas distribution company, has a commodity rate request currently before the Saskatchewan Rate Review Panel. SaskEnergy recently revised its commodity rate request upwards, applying to increase the current rate of $6.97/GJ to $10.88/GJ effective November 1, 2005. The new rate represents a system wide average bill increase of some 41%, or about $475 per year for the average residential customer. Citing sky-high natural gas cost forecasts arising out of the serious damage caused to energy infrastructure by recent hurricane activity in the Gulf of Mexico, SaskEnergy is asking for a higher rate increase to recover the cost it pays for gas, which is passed through directly to customers.

NUNAVUT

Qulliq Energy Corporation: Examining Hydro-Electric Potential in Nunavut

In July 2005 the Qulliq Energy Corporation (QEC), which serves the territory of Nunavut, issued a Request for Proposals (RFP) related to possible hydroelectric developments in Nunavut. QEC currently operates twenty-six diesel generation plants in Nunavut, burning 39 million litres of diesel fuel annually. QEC is investigating alternative energy sources due to increasing fuel costs and after considering the impending impact of the Kyoto Protocol. The RFP was to develop a report that would identify the top five feasible sites in the Iqaluit area for hydroelectric generation, including a study of the watersheds, their economic viability and the associated risks. On October 13 the Government of Nunavut announced that QEC had awarded the site survey contract to Knights Piésold Ltd. The survey is scheduled to be completed by mid-January 2006.

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