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INTRODUCTION

This is Lawson Lundell's energy law newsletter, published quarterly and designed to inform readers of recent events in Western Canada's energy sector. It is written by Lawson Lundell lawyers who practice in the energy field, and indeed a number of the stories reported in the newsletter are matters in which Lawson Lundell is actively engaged. Please call Chris Sanderson, Q.C. in Vancouver at 604-631-9183 for more information about the issues discussed in this newsletter, or about Lawson Lundell.

REGIONAL

Resolved: TransCanada - NEB Dispute Re: Cost of Capital Methodology

In April the Federal Court of Appeal dismissed an appeal brought by TransCanada Pipelines arising from the NEB's 2002 and 2003 decisions affirming its 1995 cost of capital methodology (see *TransCanada Pipelines Ltd. v. Canada (National Energy Board)*, 2004 FCA 149). TransCanada alleged that the NEB erred in dismissing its application for review and variance by inappropriately considering customer interests in determining TransCanada's cost of capital, and by fettering its discretion in requiring TransCanada to demonstrate that the 1995 methodology should be abandoned.

In dismissing TransCanada's first argument the Court noted that the NEB has an unfettered discretion to choose a rate-setting methodology, but that having chosen a cost of service model the NEB must faithfully determine what the appropriate cost of capital is, regardless of its rate impact. The Court went on to dismiss TransCanada's submissions that references to rate impacts in the impugned decision were indicative of an implicit and inappropriate consideration by the NEB of rate impacts in its determination of TransCanada's cost of capital, or its determination of the cost of capital methodology.

In dismissing the second argument, the Court decided that it was appropriate that TransCanada bear the burden of demonstrating that its proposed methodology was superior to the 1995 methodology in light of the fact that the 1995 methodology was enshrined in a final order of the NEB.

In a related matter, the NEB ordered TransCanada on June 30 to revise its current cost of capital application (Phase 2 of TransCanada's 2004 Mainline Toll application) to reflect the Court's findings. That application which will now focus solely on the appropriate capital structure of TransCanada, is scheduled to go to public hearing in October.

Alaska Highway Pipeline Projects

Two companies have recently filed applications with the State of Alaska under the *Alaska Stranded Gas Development Act* (the "Act"). Enbridge Inc. announced its application under the Act on May 4, 2004, and TransCanada Corporation and its wholly owned subsidiary, Alaskan Northwest Natural Gas Transportation Company (ANNGTC) submitted an application on June 1, 2004.

The Enbridge application proposes a 36-inch pipeline that would have an initial capacity of 2.6 Bcf/d (billion cubic feet per day) of gas. The system could be expanded through additional compression and looping to more than 5 Bcf/d as dictated by exploration and market demand. The Alaska segment of the pipeline would follow the existing Trans Alaskan Pipeline System right-of-way from Prudhoe Bay to Fairbanks, Alaska, and then mostly follow the Alaska Highway to the Canadian border. The initial cost for the Alaska segment is estimated at $3.3 billion (US) with an eventual cost of $6 billion (US) with expanded capacity. In order to complete the Project, Enbridge will also have to file an application with the National Energy Board and other Canadian regulatory bodies with jurisdiction over aspects of the Canada segment of the pipeline, which would follow the Alaska Highway to Fort Nelson, British Columbia and then on to Gordondale, Alberta where it would interconnect with existing pipeline infrastructure. In its application Enbridge states, "an in-service pipeline within 9 years of the project kicked-off is a reasonable expectation."

The TransCanada application proposes a 48-inch pipeline that would have an initial capacity of 4.5 Bcf/d that could be expanded to approximately 5.9 Bcf/d by adding incremental compressor units. The estimated capital cost for the Alaska segment is $6.8 billion (US). TransCanada proposes to construct a 1,710 mile natural gas pipeline from Prudhoe Bay, Alaska to a point at Boundary Lake, Alberta. The selection of Boundary Lake is consistent with the original routing of the Alaska Natural Gas Transportation System ("ANGTS") first proposed in the 1970's. TransCanada, through its subsidiaries ANNGTC in Alaska and Foothills Pipe Lines Ltd. in Canada, claims to hold valid certificates and permits issued by the Federal Energy Regulatory Commission in the US and the Northern Pipeline Agency in Canada, which were issued in relation to the ANGTS project. In April 2004, TransCanada signed a memorandum of understanding with the State of Alaska saying that the company would file an application under the Act and the State would resume processing TransCanada's application for a right-of-way lease. In the application, TransCanada states that it believes the pipeline could be in-service by the first quarter of 2012 if shipping contracts for the full pipeline capacity are executed by mid-2005.

ALBERTA

AEUB Orders Permanent Shut-in of Wabiskaw-McMurray Gas Wells

In a decision issued May 31, 2004, the Alberta Energy and Utilities Board (AEUB) issued interim orders to shut-in a total of 280 billion cubic feet of gas in the Athabasca Oil Sands Area, effective July 1, 2004. As previously reported in our newsletters, the AEUB, believing that the production of associated gas presents an unacceptable risk to bitumen recovery using steam assisted gravity drainage, initiated Bitumen Conservation proceedings early in 2003 to address the risk posed to the ultimate recovery of bitumen in the Wabiskaw-McMurray area. The May 31 decision arose from an interim public hearing held from March 10 to April 1, 2004 in which gas and bitumen producers who disagreed with AEUB staff shut-in recommendations made submissions regarding where gas was associated with potentially recoverable bitumen. The resulting order to permanently shut-in 1021 natural gas wells represents the shut-in of approximately 0.7% of Alberta's remaining natural gas reserves, representing about 3 weeks of gas production in Alberta. The bitumen conserved as a result of the shut-in order is estimated at 14.6% of the province's remaining bitumen reserves, or 70 years of bitumen production in Alberta. The AEUB has scheduled a pre-hearing meeting for September 15, 2004 to determine the scope and participants of a final public hearing on the matter. The hearing is expected to proceed this fall.

AEUB Sets Generic Rate of Return and Deemed Capital Structures for Gas and Electric Utilities

On July 2, 2004, the AEUB issued a decision instituting a standardized approach for setting the return on common equity (ROE) for all electric and natural gas utilities regulated by it. Saying it was improving regulatory efficiency, reducing costs and providing fair returns to

utility shareholders at a fair cost to customers, the AEUB determined that a common ROE should apply to all provincially-regulated gas and electric utilities, and that differences in business risk could be appropriately reflected in different capital structures. The common ROE has been established at 9.6% for 2004. For 2005 and beyond, the AEUB established a formula to adjust the ROE each year. The formula will be reviewed in 2009 (or earlier if the adjustment formula results in an ROE that is less than 7.6% or greater than 11.6%) to ensure that the adjustment mechanism continues to yield a fair ROE. The July 2 decision also established a deemed capital structure for each utility regulated by the AEUB. The capital structures were based on an assessment of business risks, previous AEUB approvals, awards by other regulators, interest coverage ratios, bond ratings and other factors. The capital structure for each utility will remain in place unless a utility can demonstrate at a future individual rate proceeding that a material change has occurred requiring adjustment to the deemed capital structure.

AESO Applies to Reinforce Alberta Transmission System

On May 20, 2004 the Alberta Electric System Operator (AESO) applied to the AEUB for approval to reinforce the North-South transmission corridor between Edmonton and Calgary. Intended to provide generation growth opportunities in the Edmonton area and improve reliability in the Calgary and Southern Alberta area, the proposal is divided into two parts. The first phase, anticipated to be in service by 2006, seeks to convert the existing Keephills/Genesee and Genesee/Ellerslie transmission lines from 240kV to 500kV. The second phase consists of building a new 330km 500kV transmission line from Genesee to Langdon. The anticipated in-service date for the new line is 2009.

The AESO made a similar application for reinforcement in respect of the Pincher-Creek – Lethbridge area transmission system in Southwest Alberta on April 5, 2004. The region, having the highest wind energy potential in the province, has seen 220 MW of generating capacity installed to date, and is expecting a further 600 MW of new wind generation to develop in the area by the end of 2005. The proposed development, also divided into two parts, consists of the construction and operation of new 240kV transmission lines between existing substations, as well as numerous alterations and upgrades to associated facilities. The in-service date for the Southwest project has been set for April 1, 2006.

Alberta Court of Appeal Clarifies Role of AEUB in Negotiated Settlements

The Alberta Court of Appeal recently clarified the scope of the AEUB's regulatory role relating to negotiated settlements (see 2004 ABCA 215.) The negotiated settlement process allows regulated utilities and interested parties to contractually agree to settle issues in dispute relating to a rate application, subject to compliance with AEUB guidelines. In 1999 and 2000, ATCO Electric Ltd. (ATCO) applied to the AEUB for approval of certain negotiated settlements establishing utility rates payable to it for electricity services. The AEUB approved the negotiated settlements as submitted. When a subsequent disagreement arose between the parties in respect of deferral account balances and carrying costs for those balances, the AEUB interpreted the settlements as denying ATCO any carrying costs with respect to certain deferral accounts and awarding ATCO a smaller total of carrying costs than claimed with respect to other deferral accounts. ATCO appealed the AEUB's conclusion that the negotiated settlements did not entitle ATCO to the claimed carrying costs, and further argued that if the AEUB's interpretation was correct and ATCO was not in fact entitled to recover carrying costs, then the AEUB breached its statutory obligation to set just and reasonable rates by approving the negotiated settlements in the first place, as they did not allow ATCO a reasonable opportunity to recover all its costs. On July 13, 2004, the Alberta Court of Appeal dismissed ATCO's appeal. Concluding that the AEUB did not breach its statutory duties in approving the negotiated settlements, the Court confirmed that when the AEUB is presented with a "package deal" negotiated settlement agreed to by a utility, the public interest to be considered by the AEUB in determining whether or not to approve the settlement is

that of the consuming public generally – the AEUB is under no obligation to consider the utility's economic interests. While the AEUB has the jurisdiction (and obligation) to conduct an independent review of a negotiated settlement to determine if it is in the "public interest", the AEUB may take it as a given that the negotiated settlement is in the best interests of the utility, and is not required to intervene where a negotiated settlement does not allow a utility to recover its financing costs. In the words of the Court, consideration of the public interest in the context of negotiated settlements does not require the AEUB to save the utility from itself.

BRITISH COLUMBIA

BC Hydro and BCTC Applications to the BCUC

The evidentiary phase of BC Hydro's first revenue requirement hearing in 10 years concluded in Vancouver on June 10. BC Hydro, having revised its December 15 application at the end of March, seeks an across-the-board rate increase for fiscal 2005 of 8.9%, and no further increase for fiscal 2006. BC Hydro also seeks approval of certain deferral accounts, a reduction in wholesale transmission rates, and approval of capital expenditure plans. Parties to the hearing have filed written arguments, and oral arguments will be on August 17. A decision is expected in the fall.

BCTC filed an application with the BCUC on May 31, 2004 for approval of BCTC's Transmission System Capital Plan. The 150-page application lists virtually every capital project BCTC plans to undertake over the next 10 years, at a total proposed cost of $2.8 billion. Under the agreements and legislation establishing BCTC, BC Hydro will continue to own and finance the transmission system, while BCTC will operate, manage, maintain and plan it as well as seek regulatory approval for system expansions. A written hearing into the application is currently underway.

BCUC Approves Fortis Acquisition of Aquila (BC)

On April 30, 2004 the BCUC approved the purchase of Aquila (BC) by Fortis in a share-purchase transaction. On the strength of commitments by Fortis to re-establish Aquila (BC) on a stand-alone basis, headquartered and run from its Trail, BC operations centre, and to not seek recovery from ratepayers of any of the premium over book value paid for the company, the BCUC approved the transaction virtually without conditions. This is in sharp contrast to the purchase of what was then West Kootenay Power in 1987 by Aquila, which was approved only in the wake of a controversial application and emotionally charged hearing, and on 11 reasonably stringent BCUC-imposed conditions. In related proceedings, the AEUB approved the sale of Aquila (Alberta) to Fortis in April, and regulators in Kansas – Aquila's home state - approved the transaction in May.

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