



LAWSON LUNDELL

BARRISTERS AND SOLICITORS

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WESTERN CANADIAN BUSINESS LAW

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INTRODUCTION

Welcome to the Lawson Lundell Energy Law Newsletter, a quarterly publication dedicated to keeping our readers abreast of energy issues in Western Canada. For further information about this newsletter or Lawson Lundell, please contact one of our lawyers identified on the back page, or visit our web-site at www.lawsonlundell.com.

EDITORIAL COMMENT: U.S. POWER INVESTIGATIONS (II)

On March 26, 2003, the FERC issued its most significant order yet arising out of the California energy crisis. While Chairman Woods and Commissioner Brownell had previously made many public statements about the need for the industry to put the California crisis behind it and set about the business of renewing the infrastructure for the delivery of electricity throughout the United States, there is significant reason to worry that, in fact, the FERC will permit a backward focus to dominate the industry for some years to come, and cause a resultant chill on those who would otherwise wish to participate enthusiastically in electricity markets in the future.

FERC's order named only Enron, BP Energy and Reliant as those who must immediately show cause why their power marketing authorization should not be removed by reason of inappropriate trading practices during 2000-2001. However, the FERC also released a staff

report that recommended that suppliers be responsible to refund very large sums of money. FERC staff reached this recommendation by interpreting very broadly defined provisions in the California tariffs prohibiting "gaming" to effectively mean that in times of undersupply, suppliers will not be able to rely on market conditions to determine the price. It is widely expected that the FERC will accept many of the staff recommendations.

The transparent flaw in this approach is that customer groups are not prepared to guarantee the survival of an unregulated supply sector in times when supply exceeds demand. Unlike utilities, participants in the unregulated generating sector have no guarantee that they will ever recover their fixed costs. Typically, in commodity markets, fixed costs are recovered in those brief periods of time when demand significantly exceeds supply. Those periods are limited because the high prices that result lead to the construction of new capacity and usually a significant decline in price. Thus, thin margins which make little contribution to the financial costs associated with construction of projects in most years are compensated for by significant profits in high-price years.

The FERC's willingness to even contemplate the expropriation of the profits made by these suppliers in high-price years must worry not just potential participants in the industry, but financial institutions who work with them, as well. The spectacular bankruptcies in the electric industry and the erosion of the earning capacity and creditworthiness of the survivors should be a significant concern to

lenders and other financial market participants. Assessment of business prospects and credit risk becomes exceedingly difficult when the fortunes of the suppliers are subject to the retroactive whim of regulators. It is our view that the FERC would do well to consider the impact of its orders on the ability of the industry to finance for the future if it is really concerned with renewing the electric infrastructure in the United States and beyond.

REGIONAL

TransCanada Pipelines 2003 Tolls and Tariff Application

The hearing into TransCanada's September 16, 2002 application for approval of 2003 mainline tolls reconvene on April 7.

TransCanada Pipelines 2001/02 Fair Return Application

In February the NEB rejected an application by TransCanada to review and vary the NEB's June 2002 decision in which it rejected an application for a variance of the NEB cost of capital methodology (employed since 1994, and described in RH-2-94). Refusing to quit the fight, TransCanada is seeking a review of the decision in Federal Court.

Potential Northern Pipelines

The Aboriginal Pipeline Group (APG) and TransCanada Pipeline announced on February 24 the tentative financing of the portion of the APG's 1/3 stake in the proposed Mackenzie Valley Pipeline.

BRITISH COLUMBIA

B.C. Hydro "Heritage Contract", Stepped Rates and Transmission Access

As promised in its recent Energy Policy, the provincial government has ordered the BCUC to enquire into and make recommendations regarding three components of that policy: a "heritage contract" (to secure for BC ratepayers the benefits of BC Hydro's low embedded cost generation resources); stepped rates (to provide price signals to industrial customers on their incremental demand); and access principles (to provide a framework within which industrial customers can take their load to market).

The Terms of Reference were issued on March 25, 2003. They require the BCUC to order BC Hydro to file proposed recommendations on each of the three components by April 30, 2003. The BC Hydro proposal is to be followed by a public hearing process, and will culminate in a report to government by the BCUC by October 17, 2003. That report is to recommend specific changes to legislation and regulations necessary in the BCUC's view to effect the elements of the Energy Policy captured in the Terms of Reference. The public hearing process will commence with a workshop on May 13, and conclude with a public hearing to commence July 28 in Vancouver.

The Terms of Reference and proceeding schedule may be obtained at www.bcuc.com/Current_Info/BCH_Heritage.html.

Georgia Strait Crossing Pipeline and Vancouver Island Generation Project

The NEB/CEAA Joint Review Panel (JRP) conducted a public hearing into the application for approval of the Georgia Strait Crossing Pipeline (GSX) between February 24 and March 19, 2003, in Sidney British Columbia. A significant issue in the hearing was the extent to which the JRP ought to consider environmental effects of downstream combustion of gas, including the environmental effects of the Vancouver Island Generation Project (VIGP). VIGP is a proposed 265 MW combined cycle gas turbine generation plant at Duke Point, near Nanaimo, that will depend in part on GSX for its gas supply. The application for approval of the VIGP was filed with the BCUC by Vancouver Island Energy Corp., a subsidiary of BC Hydro, on March 12.

Duke's Southern Mainline Expansion Project

On January 28 the NEB approved Duke's application for an expansion of its Southern Mainline, which would see the construction of six loop segments paralleling the route of the existing mainline for about 55 kilometers. The \$270 million project will provide an estimated 200 million cubic feet per day of additional capacity, and is expected to be in-service by November. It was opposed by an intervenor group established to oppose the GSX project, GSX Concerned Citizen Coalition, which sought NEB orders rescinding the approval and setting the matter down for re-hearing.



to address end-use issues. The application to rescind the approval was dismissed by the NEB on March 28.

BC Gas Acquires Express Pipeline System, Considers Name Change to "Terasen"

In January BC Gas and other parties purchased the Express Pipeline System from EnCana for \$1,175 million. The Express system and BC Gas' subsidiary Trans Mountain Pipelines have been re-named Terasen. At its AGM on April 25 BC Gas shareholders will consider a management proposal to re-name BC Gas itself Terasen. It is unclear whether BC Gas will also change the names of its Centra Gas subsidiaries.

Accenture – BC Hydro Close Outsourcing Transaction

On February 28, BC Hydro and Accenture Ltd signed a customer service, purchasing, IT and financial systems outsourcing arrangement that is said to be worth nearly \$1 billion over the next 10 years. Meanwhile, the provincial legislature passed Bill 10, effective February 17. Bill 10 allows the provincial government to designate BC Hydro outsourcing agreements and thereby confirm the corporate ability of BC Hydro to enter into such transactions. It also confirms that the BCUC's role in such transactions is to review them in a revenue requirements context only. The arrangement has attracted a fair amount of public opposition, spearheaded by an organization called BC Citizens for Public Power, which

has launched a class action against BC Hydro and the government in a bid to defeat the arrangement.

ALBERTA

ISO Transition

The transition towards an Independent System Operator ("ISO") is nearly complete. On March 27, 2003, the Alberta Legislature passed the new *Electric Utilities Act* (Bill 3), establishing the Alberta Electric System Operator ("AESO") as the new ISO. AESO is poised to assume responsibility for market operations, incorporating the Power Pool, system control, long-term transmission system planning and load settlement functions. Other features of the new legislation include an expanded role for the Market Surveillance Administrator, a more independent Balancing Pool to be governed by a board of professional members, and a flow-through default rate option (to be known as a Regulated Default Supply) to provide customers with an electric energy charge connected to the Power Pool wholesale price.

Amendments to Gas Utilities Statutes

On March 27, 2003, the Alberta Legislature passed Bill 19: *Gas Utilities Statutes Amendment Act*. Seeking to improve the ability of natural gas consumers to buy natural gas and other related services from the supplier of their choice, the legislation allows companies other than natural gas utility companies to provide gas supply

service at rates regulated by the AEUB. The proposed changes to the *Gas Utilities Act*, the *Gas Distribution Act* and the *Rural Utilities Act*, provide for regulated supply rates based on a flow-through of Alberta spot prices. Consumers buying natural gas from retailers will receive a single utility bill for both gas supply and delivery costs. Natural gas utilities will continue to have the exclusive right to provide regulated delivery service however. Bill 19 is not yet in force.

Glacier Power Hydroelectric Project Denied

On March 25, 2003 a joint AEUB/NRCB review panel issued Decision 2003-020 denying Glacier Power's proposal for an 80 megawatt hydroelectric plant on the Peace River upstream of the Dunvegan Bridge. The panel found that significant uncertainty remained concerning the potential benefits and costs of the project. Although the project would provide employment opportunities and likely benefit the local economy, impacts on the flooding risk to the Town of Peace River and the Shaftesbury crossing remained uncertain. Further safety concerns included increased risks to boaters on the Peace River due to the hydraulics of the weir, and to vehicles using the Dunvegan Bridge due to increased winter fog and ice. The panel concluded that while each of these potential negative effects of the project, if they were to occur, were substantive on their own, their cumulative effect clearly outweighed the social and economic benefits of



the project to the local community, as well as to Albertans in general. Not being convinced that there were reasonable opportunities to offset or mitigate these potential negative effects, and finding that there was little evidence that the project would have an effect, positive or negative, on the reliability of local electricity supply, the panel denied approval of the project.

ATCO Electric Applies to Construct a 3rd Transmission Line From Fort McMurray

ATCO Electric has applied to construct a 240 kV transmission line from Dover to Deerland in northeastern Alberta. The AEUB convened a hearing on April 1, 2003 in Smoky Lake, Alberta to hear Phase 1 of ATCO's application. The purpose of the hearing was to determine the need for the project, the general routing of the transmission line, and the technical and financial impacts of the proposed route and possible alternatives on the Alberta Interconnected Electric System (AIES). Alternatives presented included several routes running parallel to the proposed Dover Deerland route, as well as some east west alternatives starting at Dover, but ending in the Peace River area of northwestern Alberta. The Transmission Administrator of Alberta and several cogenerators and oil sands developers in the Fort McMurray area gave evidence in support of ATCO's application. Numerous landowners objected to the project, citing concerns with the proposed routing for the line, as well as the degree of consultation undertaken by ATCO in preparing the applications. A decision in the matter is expected by the end of April.

NORTHWEST TERRITORIES

Inuvik Gas Ltd. Rate Proceeding

Inuvik Gas Ltd., a subsidiary of Ikhil Resources, Enbridge and AltaGas, filed notice on February 28 that it would be increasing natural gas rates in Inuvik by 45%, effective May 1. The Town of Inuvik has complained to the NWT Public Utilities Board, which has indicated it will enquire into the complaint.

NTPC GRA Phase II Hearing in April 2003

The NTPC's rate design was held April 9 – 11 in Yellowknife and April 13 in Inuvik. Eight intervenors participated in a lively hearing that attracted considerable community attention.

YUKON TERRITORIES

Devolution Takes Effect in the Yukon

On April 1, 2003, the Yukon government assumed responsibility for lands, waters, and mineral resources in the Yukon from the federal Department of Indian Affairs and Northern Development. The Yukon government now manages and administers land, water and mineral dispositions in the territory. As part of the transfer of responsibilities, most DIAND employees working in those areas have been transferred to positions with the Yukon government.

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**FEATURE ARTICLE:
NEW BC LEGISLATION RE: COALBED METHANE RIGHTS**

Spring 2003

On April 10, 2003, *Coalbed Gas Act* (the “Act”) was passed into law enshrining what has been the policy of the British Columbia Ministry of Energy and Mines for the past 20 years – coalbed gas (primarily methane or natural gas) belongs to the owner of the natural gas rights and not to the owner of the coal rights. The Act applies retroactively to Crown and freehold minerals.

The Act has the potential to affect rights between parties who may have proceeded on the basis that coalbed gas belonged to the coal owner. Section 6 of the Act, however, bars claims for compensation against the Government arising from the operation of the Act.

Causes of action that might otherwise arise out of the extraction, production or removal of coalbed gas by a non-owner prior to the Act becoming effective are excluded by virtue of section 6(3). The Minister is also empowered under section 7 to authorize coal owners to vent or dispose of coalbed gas not owned by them for safety reasons.

In recognition of the increasing interest in coalbed gas, the British Columbia Government had already taken several other steps to align regulations with the different circumstances applying to the extraction of natural gas from coalbeds.

- ▶ Crown dispositions of coalbed gas are by public tender or auction, as with conventional oil and gas. The Ministry, however, examines posting requests for potential overlaps with existing coal rights.
- ▶ A recent amendment to the *Petroleum and Natural Gas Drilling Licence Regulation* has extended the terms of licences for the development and production of coalbed gas. The normal terms of drilling licences of three, four, or five years, plus one extension year, have been amended to provide for a maximum of five extensions after the normal term and extension period have elapsed.
- ▶ The new *Petroleum and Natural Gas Royalty and Freehold Production Tax Regulation* provides a unique royalty regime for coalbed gas, for example, making allowance for costs of handling produced water, and providing royalty credit incentives for coalbed gas drilling.
- ▶ Extraction of coalbed gas has the potential to cause injury to associated coal rights. The Ministry and the Oil and Gas Commission (which regulates drilling and production operations) manage coalbed gas projects on a case-by-case basis, with recognition of these conflicting interests. As such, disposition and management of the resource is dependent on the situation in which coalbed gas is encountered in the coalbed.



While the passage of the Coalbed Gas Act will not be welcomed by all interested parties (i.e. private owners of coalbeds), it at least brings some certainty to the industry. We view it as an evolutionary step toward a comprehensive strategy for appropriate economic development of coalbed gas, of which there are tremendous reserves in western Canada.

In Alberta, Informational Letter IL 91-11 (issued in 1991) sets out Government policy (mirroring the British Columbia position) that in most cases coalbed gas will be treated as natural gas, and no legislative or regulatory changes have been deemed necessary to reflect that view. A coalbed advisory committee commissioned by the Alberta Department of Energy issued its report in 2002, identifying a number of further requirements to foster sustainable growth, some of which remain relevant to British Columbia: a tenure system granting larger contiguous parcels of land, new regulations to ensure technical data is made publicly available on a timely basis, additional work on fiscal and economic frameworks, and perhaps most notable, comprehensive policies relating to water use and disposal consistent with Alberta's new *Water for Life* strategy.

With 25 pilot projects in Alberta alone, there will be pressure to address these issues sooner rather than later.

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