LIGHT-HANDED REGULATION

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This article examines the regulations of pipeline tolls and tariffs. In particular, concepts of fairness, economic rationale, selected Canadian and American case law and the discretion of regulators like the National Energy Board are discussed. The author presents key aspects of the Westcoast Energy Inc. "Framework for Light-Handed Regulation," explains the light-handed regulation of pipeline in Texas and by the Federal Energy Regulatory Commission, and concludes with future developments in Canada.

Le présent article examine les règlements relatifs aux taxes et tarifs, et se penche sur les concepts d'impartialité, la justification économique, certaines décisions canadiennes et américaines et le pouvoir discrétionnaire d'organismes de réglementation tels l'Office national de l'énergie. L'auteur présente les aspects clés du Cadre de réglementation léger de Westcoast Energy Inc., explique la réglementation souple des pipelines au Texas et par la Federal Energy Regulatory Commission, et envisage les progrès à venir au Canada.

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I. INTRODUCTION

The cost and inflexibility of traditional cost of service pipeline regulation has sparked a drive for "lighter-handed" regulation. The pressure for change is growing as competition in North American energy markets continues to evolve. A key question is whether, and to what extent, existing regulatory institutions are able, given their statutory mandates, to move to light-handed regulation. This is the question that is addressed in this article.

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The approach taken to addressing the question is purposive. The core regulatory concepts of "unjust discrimination" and "just and reasonable" rates are discussed in light of the purpose of regulation. The inherent flexibility of these concepts, and the judicial acceptance of that flexibility, are noted. It is then argued that light-handed regulation is consistent with the core regulatory concepts.

The National Energy Board ("NEB"), at the time this article was prepared for the June 1998 Canadian Petroleum Law Foundation Seminar, had before it a proposal by Westcoast Energy Inc. ("Westcoast") for a new approach to regulating Westcoast's raw gas gathering and processing services, the "Framework for Light-handed Regulation." The NEB subsequently approved the Framework in a brief letter decision dated June 25, 1998.[1] The Framework contemplates that prices and terms of service would be set through negotiations between individual shippers and Westcoast. This would be subject to requirements for fair dealing and subject to oversight by the NEB through a complaint mechanism. The Framework provides a useful, concrete focus for discussion.

What is "light-handed regulation"? It is plain that this is a relative term since it implies something lighter than the traditional approach to regulation. It is, however, still a form of regulation. It is not deregulation. Various initiatives have already been undertaken to reduce the burden of regulation, including the adoption of formulae to set costs instead of case-by-case adjudication[2] and the acceptance of negotiated, multi-year incentive agreements among customers, or their representatives, and pipelines.[3] These are all lighter approaches to regulation. Indeed, the acceptance of negotiated agreements is a critical breakthrough in the evolution of light-handed regulation. The breakthrough was the recognition that the consensus of the affected parties as to what was fair and reasonable did not need to be subjected to further scrutiny in accordance with some higher ideal of the public interest that existed in the eye of the regulator. In other words, the consensus of the affected parties was a good measure of the public interest.

It is the next step in negotiated agreements that is the preoccupation of this article; namely, negotiated agreements between individual shippers and pipelines. In this

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1 Key documents related to the National Energy Board's decision on the Framework for Light-Handed Regulation (June 1998) (N.E.B.), National Energy Board File 4200-W005-10-1, Westcoast Energy Inc., Framework for Light-handed Regulation [hereinafter Framework]. Letter decision addressed to Westcoast Energy Inc. dated 25 June 1998. The decision notes the broad industry support for the Framework, observes that it is not possible to anticipate the issues that may arise as the Framework is implemented and indicates that the complaints procedure will permit the NEB to address issues if they arise.

2 N.E.B., *In the Matter of TransCanada PipeLines Limited*, No. RH-2-94 (March 1995).

3 Letter of J.S. Richardson, application to the National Energy Board by Interprovincial Pipe Line Inc. dated 16 February 1995 for orders pursuant to Part IV of the *National Energy Board Act* approving a negotiated Toll Settlement, to B.T. Vaasjo (24 March 1996) File: 4200-J001-6. Letter of J.S. Richardson, TransCanada PipeLines Limited application dated 5 July 1995 for 1996 Tolls Reasons for Decision Regarding Phase 2, to J.M. Murray (22 February 1996) File: 4200-T001-10. TransCanada PipeLines Limited (February 1996) No. Rh-2-95 (N.E.B.). Westcoast Energy Inc. (August 1997) No. RH-2-97 Part I (N.E.B.). Westcoast Energy Inc. (August 1997) No. RH-2-97 Part II (N.E.B.).

context, light-handed regulation refers to any regulatory model that provides the freedom for individuals, customer and pipeline, to agree on an individual basis on the price or terms of service. The consequence of such a regulatory model is the potential, and the probability, for greater differences in service arrangements than would be contemplated by traditional approaches to cost of service regulation. This leads to the questions of reasonableness and fairness that lie at the heart of economic regulation and are the subject of this article.

II. FAIRNESS AND EFFICIENCY

Fairness is a fundamental value in all social institutions, including regulatory institutions. Indeed, "probably some variant of equity has motivated most regulation."[4] Price regulation in Western societies traces its origins to the "just price" doctrine of early Christian thought.[5] The just price was contrasted to the "natural price" which, under Roman law, was the price agreed to by willing buyers and willing sellers. The natural price was considered to be unjust because economic necessity (*e.g.*, shortage of supply as might arise in a famine) could coerce the "willing" buyer and lead to unjust enrichment. The just price doctrine contemplated the trader paying a "just price" to the producer and, on resale, adding only as much as was by custom sufficient for the trader's economic support.[6]

One might, with the perspective of the late twentieth century, characterize the just price doctrine as an early attempt to correct for market failure by substituting a regulated price based on a normal cost of production plus a normal profit. The doctrine, however, was based on an ethic that was opposed to "natural" markets and led to a much more pervasive form of price control and wealth distribution. During the decline of the Roman Empire, and with the support of the church, maximum prices were fixed for some 800 commodities.[7]

The just price doctrine was firmly in place by the Middle Ages when the doctrine was integrated into the operation of craft guilds. The guilds maintained monopolies and were closely regulated. Known as "common carriers," "common innkeepers," "common tailors," *etc.*, guild members were obligated to provide service to all who wanted it and to do so at a reasonable price. Later, companies operating under royal charter emerged. They also enjoyed a monopoly with a franchise to carry out a public objective. The monopoly provided the incentive to invest the capital and assume the risks.[8]

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4 J.C. Bonbright, A.L. Danielson & D.R. Kamerschen, *Principles of Public Utility Rates*, 2d ed. (Arlington: Public Utilities Reports, Inc., 1988) at 35, citing D.J. Devey, "An Introduction to the Issues" in H.J. Goldschmidt, H.M. Mann, & J.F. Weston, eds., *Industrial Concentration: The New Learning* (Boston: Little Brown, 1974) at 35-37.

5 P.J. Garfield & W.F. Lovejoy, *Public Utility Economics* (New Jersey: Prentice Hall, 1964) at 3.

6 C.F. Phillips, Jr., *The Regulation of Public Utilities: Theory and Practice* (Arlington: Public Utilities Reports, Inc., 1988) at 81-82, citing M.G. Glaeser, *Public Utilities in American Capitalism* (New York: The Macmillan Co., 1957) at 196.

7 *Ibid.* at 82.

8 *Ibid.* at 82-83.

The themes of economic regulation — the "just" or "reasonable" price embodying some idea of customary or normal profitability, the obligation to serve, the need to attract capital, the recognition of risk and reward, restrictions on entry and exclusivity — have long roots. The idea of justice and a suspicion of free markets have the longest roots.

The idea of the just price survived the displacement of the regulatory role of the guilds, manorial courts and town authorities by the common law courts. The common law recognized some occupations as "common callings," in that they were, in the words of Lord Chief Justice Hale from about 1670, "affected by a public interest,"[9] and so subject to special rights and obligations. The common occupations included bakers, brewers, cab drivers, ferrymen, innkeepers, millers, smiths, surgeons, tailors and wharfingers and carried with them the obligation to provide adequate services and facilities to all and at reasonable prices.[10]

In the eighteenth century, utilitarian theory[11] emerged to challenge the approach to social welfare reflected in existing social institutions. Utilitarianism is an ethically based theory. Among the early utilitarians was Adam Smith who, in 1776 in *An Inquiry into the Wealth of Nations*, criticized the economic foundations of mercantilism[12] and laid the foundation for a market economy driven by individual initiative in a free society with the invisible hand of competition ensuring social justice.[13]

The growing support for individual freedom and an economy based on individual initiative, particularly in the United States, did not displace the idea that some occupations were "affected by a public interest." Rather, American courts struggled for over a century to articulate a rationale for regulation in the face of constitutional protection of life, liberty and property. Regulation in early America was pervasive and extended not only to what would now be recognized as natural monopolies but also to the prices of all kinds of commodities, including basic necessities such as bread and milk.[14]

The struggle in the American courts to articulate a coherent theory is a mirror of a debate that continues today. The utilitarian thinking that underlies competition theory continues to rub against other ideas of fairness. This is reflected in commonly made observations that efficient outcomes are not necessarily equitable outcomes.[15] John Rawls, sought, from the perspective of a philosopher, to formulate a coherent theory

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9 The phrase is from "De Portibus Maris" and quoted by the U.S. Supreme Court in *Munn* v. *Illinois*, 94 U.S. 113 at 127 (1876).

10 Phillips, *supra* note 6 at 83.

11 The earliest formulation of the principle of utility in 1725 is that "that action is best, which procures the greatest happiness for the greatest numbers; and that, worst, which, in like manner, occasions misery." See J. Rawls, *A Theory of Justice* (Cambridge: Harvard University Press, 1973) at 22 n.

12 Garfield & Lovejoy, *supra* note 5 at 4.

13 Rawls, *supra* note 11 at 57.

14 Phillips, *supra* note 6 at 76-81, 85-109; Garfield & Lovejoy, *supra* note 5 at 4-11.

15 Rawls, *supra* note 11 at 71.

as an alternative to utilitarianism (which he rejected as unjust), that would provide the moral foundation for a libertarian, democratic, open market society in which, among other things, outcomes would be both efficient and just.[16] William Baumol, from the perspective of an economist, has also sought to develop methods by which efficient outcomes may be determined to be fair.[17]

Given the long history of concepts of fairness, it is not surprising that there is tension with modern competition theory. The present objective is not to debate that tension. Rather, it is sufficient to note that it exists and should be taken into account by any model of regulation. What is required is a standard of fairness that can co-exist with free market institutions. At the same time, it should also be recognized that changes have occurred in the underlying economic conditions and concerns that gave rise to the just price doctrine in the early Christian era and its subsequent emanations through to the judicial concept of the reasonable price. Liberal democratic societies with free market economies bear no resemblance to the social and economic conditions of the late Roman Empire, the Middle Ages or mercantile England. The idea that market outcomes are unjust has no place in a modern society that gives primacy to competition with regulation as the exception to the rule of the market.

In light of the tension between fairness and efficiency and the power of arguments based on fairness, it will be helpful to explore the idea of fairness a little further.

A. FAIRNESS AS EQUALITY

Fairness as equality is the easiest to grasp and most powerful of notions. Rawls, who argues for a contract theory of justice, defines the "original position," or the starting point of the hypothetical negotiation of the social and political contract, in terms of equality.[18] As appears from the discussion, equality means uniformity of attributes, knowledge (or lack of it) and bargaining rights. However, while equality defines the starting point, inequality is the reality of the society Rawls seeks to justify. Rawls devotes considerable effort to defining the fairness conditions that would justify social and economic inequality.[19] His solution is to focus on institutions, not on the justice of individual cases. Rawls argues that it is the justice of the institutions that is of greatest concern and that it would be too complex to define principles to govern the justice of the endless variety of circumstances and the changing relative positions of particular persons.[20] Inequality is seen as inevitable. Rawls develops what might be considered an institutional conception of equality. Equality is seen to encompass equality of opportunity,[21] equality of access to fair procedures (*i.e.*, procedural justice),[22] and equality of application and interpretation of rules (*i.e.*, treating similar

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16 *Ibid.*
17 W.J. Baumol, *Superfairness* (Cambridge: The MIT Press, 1987).
18 Rawls, *supra* note 11 at 19.
19 *Ibid.*, see *e.g.* at 60-61.
20 *Ibid.* at 87-88.
21 *Ibid.* at 83.
22 *Ibid.* at 86.

cases similarly).[23] Even then, there is no guarantee that single transactions viewed in isolation will be just. The institutional conception of fairness may, therefore, lead in the economic sphere to outcomes that may not satisfy the just price standard of earlier times.

When this theory of justice is applied to the question of whether, for example, free trade is good, Rawls' principles of fairness permit the decision to be made in favour of free trade even if some specific interests suffer because of an inability to compete without tariff protection. "There is no way to guarantee the protection of everyone's interests over each period of time...."[24] As a result, appeals to equality, however simple to grasp, lead very quickly into considerable complexity and, at times, the inevitability of disadvantage to some.

The problem of inequality in a public utility context came before the Supreme Court of Canada in 1893 in respect of the reasonableness of a municipal bylaw that set water rates but discriminated between the property of the federal Crown and other users. The bylaw was held unreasonable and invalid. Apart from constitutional considerations, the judgment of the court refers in strong language to a requirement for "uniformity" of water rates.[25] The attraction of fairness as equality was plainly strong and uncomplicated in that case.

The principle of uniformity was followed in 1907 in another water rates case where the municipality sought to discriminate between users who paid general taxes (and so bore the risks of underwriting the water system) and users who did not. The bylaw was held invalid.[26]

The Supreme Court of Canada was, however, by 1928 more sensitive to the complexities of running municipal water systems. In that case, the municipality sought to charge a special levy to cover the cost of extensions. The court redefined "uniformity" and found the bylaw to be valid. Newcombe, J. said that when the court spoke of uniformity it meant "...uniformity, not in the sense of precise arithmetical equality, but as excluding arbitrary or unjust discrimination."[27] It was observed that account needed to be taken of "diversity of circumstances" and "different considerations."[28] In other words, what was required were reasonable distinctions applied uniformly (*i.e.*, treating similar cases similarly).

In England, the issue of municipal authorities charging discriminatory rates arose in the context of electricity service. The municipality had classified customers based on light and on light and power use. The scheme of rates was held to be valid by the Court of Appeal with the following rationale:

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23 *Ibid.* at 504-505.

24 *Ibid.* at 99.

25 *Canada (A.G.)* v. *Toronto (City)*, [1893] 23 S.C.R. 514.

26 *Hamilton (City of)* v. *Hamilton Distilling Co.*, [1907] 38 S.C.R. 239.

27 *Halifax (City of)* v. *Read*, [1928] S.C.R. 605 at 612.

28 *Ibid.*

> Therefore any differentiation fairly arrived at between classes of customers or between customers in any one class inter se may be made by the undertaking, provided differentiation is not made between customers taking or entitled to supplies which correspond under similar circumstances, which is the only thing prohibited by s. 19.[29]

The court noted that differences might include load factor, diversity factor, quantity of units purchased or any benefit conferred on the electricity undertaking by the customer. Where circumstances differed between customers, bargains could be made with individual customers.[30]

In a later case, a customer learned that other customers had different electricity rates although their circumstances appeared similar. Notwithstanding a lengthy correspondence which purported to explain the rationale for the difference and notwithstanding evidence given on discovery in the subsequent action in which a rationale was given, the actual basis for the distinction did not emerge until the chief engineer was in the witness box at trial. Not surprisingly, the court was unconvinced by the rationale and had no confidence that the rationale was applied consistently. The rate was held to be unduly preferential because the distinction was arbitrary.[31]

Fairness as equality is a powerful, pervasive concept that is easy to grasp. As has been seen, however, the application of the concept quickly devolves into more subtle concepts, in particular, the concept of treating similar cases similarly. The converse is that distinctions in circumstances justify differences in treatment. The differences must be reasonable but, as is discussed further below, that is a matter of judgment. Even the initial question of what distinctions may be recognized is a matter of judgment. The hair colour of a utility customer would not be expected to count as an acceptable difference but other circumstances might or might not count, for example, age, economic circumstances, distance from the source of supply or point of delivery, volume of use and usage characteristics. A lot depends on the facts of the case. As Rawls recognized, the principles of fairness, in the case of economic and social matters, cannot be expected to cope with the enormous detail of individual circumstances. At this level, justice depends on the facts and the judgment applied to those facts. Principles and laws do not dictate the outcomes because, as a practical matter, they cannot — but they do impose general standards of fairness. The modern rationale for regulation is, however, based on economics.

III. THE ECONOMIC RATIONALE FOR REGULATION

The law countenances a wider scope for regulation than does economics. As discussed above, American courts have struggled for over a century to articulate a rationale for economic regulation. Two thousand years of ideas justifying intervention

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[29] *United Kingdom (A.G.)* v. *Hackney Corporation*, [1918] 1 Ch 372 at 379 (C.A.). The section referred to, s. 19, related to the supply of electricity on the "same terms ... under similar circumstances to a corresponding supply."

[30] *Ibid.* at 378.

[31] *United Kingdom (A.G.)* v. *Wimbledon Corporation*, [1940] 1 Ch. 180.

in markets is not easily shaken. The rationales articulated in the various cases go well beyond regulation that could be justified on economic grounds. The American law was crystallized by the U.S. Supreme Court judgment in *Nebbia* v. *New York*,[32] a case involving state legislated controls on milk production, distribution and prices. The law was held (in a 5 to 4 decision) to be valid and not to offend constitutional due process requirements that regulation not be unreasonable or arbitrary. The court noted that milk producers and distributors were not dependent on public franchises or other grants to carry out their businesses. The court also accepted that the dairy industry was not in the accepted sense, a "public utility," and agreed that there was no suggestion of any monopoly or monopolistic practice.[33] Justice Roberts opined that "...a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare ... and the laws giving effect to the policy will be valid if they ...have a reasonable relation to a proper legislative purpose and are neither arbitrary or discriminatory...."[34]

The *Nebbia* case is noteworthy because, although Canadian legislatures are not constrained by the substantive due process requirements of American legislatures, American regulatory concepts and theories have, as noted below, had considerable influence in Canada. It is significant, in that light, to recognize that American regulatory models are not necessarily confined to pursuing objectives justifiable from a purely economic perspective. However, as is discussed in more detail later, a broadly framed legislative mandate does not dictate the means employed by the regulator. So where the law, for example, requires prices to be just but leaves the regulator to choose the means to achieve that end then, depending on the facts, the regulator might choose an approach founded on economic principles. One important fact would be the prevailing public policy framework.[35]

The currently prevailing economic policy framework in North America is strongly reliant on competition, the operation of market forces and free trade. In every area, from telecommunications to electricity, regulation is redefining itself in light of these policies. The economic rationale for regulation has achieved primacy.

The economic rationale for the regulation of pipelines rests on the belief that they are natural monopolies. This natural monopoly derives from economies of scale primarily in the technology employed to provide service[36] and subadditivity of costs.[37] Economies of scale exist where average unit costs decrease as output increases such that it is more efficient for one firm to provide the service.[38] For economies of

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32 291 U.S. 502 (1934) [hereinafter *Nebbia*]. See the discussion of this case in Phillips, *supra* note 6 at 105-109.

33 *Nebbia*, *ibid.* at 531-32.

34 *Ibid.* at 536-37.

35 Government policy may be a relevant consideration in setting rates. See *e.g.*, *The Canadian Pacific Railway Company* v. *The Board of Trade of the City of Regina* (1911), 45 S.C.R. 321 [hereinafter *Regina Rates Case*].

36 Bonbright, *supra* note 4 at 17.

37 *Ibid.* at 22-23.

38 Garfield & Lovejoy, *supra* note 5 at 15-17. The inefficiencies include costly duplication of facilities.

scale to be fully achieved, the plant must be of optimum size and generally of large scale. This requires a large fixed and non-liquid investment.[39] Subadditivity of costs leads to a natural monopoly where the total demand for service can be produced most efficiently by a single firm.[40] Subadditivity of costs may exist even when economies of scale do not exist, *i.e.* where long-run average costs are rising.[41] The localized nature of the markets served and the necessary close physical connection between the customer and the utility also can contribute to a natural monopoly.[42]

The fact, however, that a single firm dominates the market may not be natural. Legislative policies may have contributed to this situation.[43] Market growth may lead to opportunities for new entry.[44] Technological change may lead to smaller optimum-sized plants.[45] Other costs incurred by the utility may offset any economies.[46] Economies of scale are a function of the scale of plant and may be exhausted at a certain point. Professor Kahn described the limitations on pipeline economies of scale as follows:

> The main potential economies of scale are to be found in employing pipe of the maximum diameter available and, to a lesser extent, of further increasing capacity, within limits, by increasing pressure and by "looping," that is, by constructing parallel lines running through the same compressor stations. But these economies taper off sharply once the largest possible pipe available is used and even more sharply when the limits of further expanding capacity in the manner indicated are reached. Once the market has expanded to sufficient size, as a result, there is often room, consistent with maximum efficiency, for more than one transmission line traversing roughly the same territory.[47]

Moreover, the gains achieved by competition may exceed the benefit from regulatory protection of a utility.[48] Nor is regulation cost free: there may be benefits but the costs should also be considered.[49]

Where a natural monopoly exists, competition is said to be inefficient and regulation is generally considered to be of benefit to society. One problem is destructive

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39 Phillips, *supra* note 6 at 47-48; Garfield & Lovejoy, *supra* note 5 at 17-18.

40 Bonbright, *supra* note 4 at 22-23.

41 *Ibid.* at 24.

42 *Ibid.* at 20-21.

43 Phillips, *supra* note 6 at 45.

44 *Ibid.* at 45; Bonbright *supra* note 4 at 43, "if the minimum efficient scale of plant is less than total market demand, there is obviously room for competition."

45 *Ibid.* at 45.

46 R.W. Crandell, *After the Breakup: US Telecommunications in a More Competitive Era* (Brookings Institution: International Book Distributors, 1991) at 63-71 and 155-56 shows the huge costs shed by AT&T in the face of competition and contrasts this with an earlier non-competitive period (1950s and early 1960s) when productivity was unchanged in the face of technological changes that might have been thought to yield productivity improvements.

47 A. Kahn, *The Economics of Regulation*, vol. II (Cambridge: The MIT Press, 1995) at 153-54.

48 Bonbright, *supra* note 4 at 22.

49 J.R. Baldwin, *Regulatory Failure and Renewal: The Evolution of the Natural Monopoly Contract, A Study prepared for the Economic Council of Canada* (Ottawa: Minister of Supply and Services, 1989) at 3.

competition,[50] although it has been said that, while some spectacular rate wars did occur, this problem is overstated.[51] "Few lovers of efficiency or logic would be sad to see the cutthroat competition rationale expunged from the regulatory handbooks."[52]

The problem of price discrimination is more serious. Price discrimination makes it possible to add to profits.[53] Railways were particularly successful in price discrimination by conferring practical monopolies on particular customers supplying a commodity from a particular locale. These practical monopolies were enforced by charging preferential rates to favoured dealers and higher rates to those not favoured.[54]

Regulation does not, however, prohibit discrimination; rather, it controls it.[55] What is prohibited is "undue" discrimination[56] or, in other words, unfair discrimination. Not surprisingly, given the judgmental character of fairness when applied to particular fact situations, many kinds of discrimination have been considered to be fair: pricing based on elasticity of demand or value;[57] pricing to address a competitive factor[58] (*e.g.*, substitute commodities or service); intentional creation of cross-subsidies to extend service, increase utilization, or promote regional development;[59] or cross-subsidies that result from rate or service classifications[60] or problems in allocating joint and common costs.[61]

Transaction failure is another factor which is said to support regulation of natural monopolies. The commitment of long-term large fixed resources by the utility has been said to make the utility the hostage of the customers and so expose the utility to opportunistic behaviour during recontracting. This behaviour may be manifested through the state. Similarly, customers making long-term fixed investments in reliance on the utility may become the hostages of the utility and so be exposed to opportunistic behaviour during recontracting. Quasi-judicial regulatory agencies have been said to be a successful means to address this problem provided legal constraints are placed on the possibility of opportunistic behaviour by the regulator.[62] Canadian law, drawing on the American example, does provide that constraint.

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50 Garfield & Lovejoy, *supra* note 5 at 15-16.

51 Phillips, *supra* note 6 at 62.

52 Bonbright, *supra* note 4 at 40.

53 Phillips, *supra* note 6 at 62.

54 *Ibid.* at 62-63.

55 *Ibid.* at 63.

56 Bonbright, *supra* note 4 at 35.

57 *Ibid.* at 526-27; Phillips *supra* note 6 at 412; Garfield & Lovejoy, *supra* note 5 at 137.

58 American Gas Association Rate Committee, *Gas Rate Fundamentals*, 4th ed. (Arlington: American Gas Association, 1987) at 159 [hereinafter *Gas Rate Fundamentals*].

59 Phillips, *supra* note 6 at 414-15.

60 *Ibid.* at 63. Classifying customers simplifies the problem of designing rates for smaller groupings of customers or even for individual customers.

61 *Ibid.* at 414.

62 Baldwin, *supra* note 49 at 6-9.

In the United States, the seminal legal direction to agencies charged with setting just and reasonable rates are the *Bluefield Waterworks*[63] and *Hope Natural Gas*[64] cases where the Supreme Court stated as follows:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally."[65]

> The rate-making process under the Act, *i.e.*, the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests. Thus we stated in the Natural Gas Pipeline Co. case that 'regulation does not insure that the business shall produce net revenues.' 315 at U.S. page 590.... But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rate are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. Cf. *Chicago and Grand Trunk Ry. Co.* v. *Wellman*, 143 U.S. 339, 345-346. By that standard the return to the equity owners should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital.[66]

The American case law, including *Bluefield Waterworks*, was cited with approval by Locke, J. in the Supreme Court of Canada as reflecting an approach to establishing fair and reasonable rates that had "been followed universally."[67] In that case, the regulator determined the fair return for the company and then explicitly set rates that were designed to achieve a lower return in light of the economic circumstances of the customers. (This, it might be noted, has the appearance of the opportunism discussed in the transactions failure literature). The rates were struck down by the Supreme Court. The court followed its earlier judgment in the first *Northwestern Utilities* case where Lamont J. stated as follows:

> The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company

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63 *Bluefield Waterworks and Improvement Company* v. *West Virginia (Public Service Commission)*, 262 U.S. 679 (1922) [hereinafter *Bluefield Waterworks*].

64 *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1943) [hereinafter *Hope Natural Gas*].

65 *Supra* note 63 at 692.

66 *Supra* note 64 at 603.

67 *British Columbia Electric Railway Co. Ltd.* v. *British Columbia (Public Utilities Commission)*, [1960] S.C.R. 837 at 844 [hereinafter *BC Electric Railway*].

> a fair return for the capital invested. By a fair return it is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise.[68]

The various appeals in *Northwestern Utilities*, however, were dismissed in that there was no error of jurisdiction and the decision as to the appropriate rate base and rate of return were not questions of law. This contrasts with the *BC Electric Railway* case where the regulator refused to exercise its jurisdiction to design rates that would permit the company to earn the return the regulator had found to be fair.

Statutory requirements that rates be just and reasonable as interpreted by the judiciary thus place a constraint on opportunistic behaviour. The discipline and professionalism of regulators are also important factors.

One should not, however, be left with the impression that the economic characteristics used to explain why utilities are regulated are absolutes. They are a matter of degree. Economies of scale, high fixed costs and non-liquidity of capital, demand inelasticity, price discrimination, and subadditivity of costs are found in many unregulated industries.[69] Buyers and sellers may be equally matched and also committed to doing business with each other (there is, for example, only one buyer and one seller of nuclear aircraft carriers in the United States) with the result that bargaining may be hard but not opportunistic so as to cause the relationship to fail. The transaction failure literature offers an imprecise standard.[70]

The extent to which competition may exist is also a matter of degree. A utility may not present a model of efficient competition but that is not to say that it is subject to no competitive forces. Competitive forces operate to constrain a service provider's ability to maximize profits and to be responsive to customers. Regulation aspires to similar ends. Michael Porter has provided a useful framework for assessing the degree of competitiveness of an industry by understanding competitive forces that include forces other than the actual rivalry that is at the core of the classic model of competition.[71] The availability of substitute products or services has always been a factor for local distribution service to *e.g.*, industrial customers. The continuing integration of the North American pipeline grid with various new pipeline proposals and increasing pipeline to pipeline competition will also affect the competitive dynamic. In addition, electricity deregulation with the emergence of innovative marketing strategies by the new energy marketers — marketing various forms of energy — is putting some pressure on the boundaries between industries. The impact of such factors on any pipeline should be considered in fashioning the approach to regulation. The

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68 *Northwestern Utilities, Limited* v. *Edmonton (City of)*, [1929] S.C.R. 186 at 192-93 [hereinafter *Northwestern Utilities*].

69 Phillips, *supra* note 6 at 65.

70 Baldwin, *supra* note 49 at 9.

71 M. Porter, *Competitive Strategy: Techniques for Analyzing Industries* (New York: The Free Press, 1980).

presence or absence of significant, if imperfect, competitive forces can and should be taken into account when deciding the particular approach to regulation.

To justify or explain the existence of regulation on economic grounds is only the first step. The next step is to fashion an approach to regulation that is appropriate for the circumstances of the regulated entity and its customers. The ability of the regulator to fashion the means of regulation to the facts of the case in light of other factors, such as public policy, depends on the degree of discretion conferred by the law.

IV. THE SCOPE FOR DISCRETION IN APPLYING REGULATORY STANDARDS

Two key concepts in economic regulation are the requirement that rates be "just and reasonable" (or "fair and reasonable") and the prohibition against "undue discrimination" (or "unjust discrimination") with its corollary prohibition against "undue preference."

As discussed above, there is considerable room for judgment as to what is or is not undue discrimination and a great many forms of discrimination have been authorized. What is or is not permissible discrimination and what are or are not similar circumstances are very much dependent on the facts, the goals and objectives of the particular regulatory model, and the judgment and opinion of the regulator. It is not surprising, therefore, to find that regulatory legislation, such as the *National Energy Board Act*, expressly says that questions of undue discrimination and the similarity of circumstances are questions of fact.[72] Such provisions render regulatory decisions on these questions virtually inviolate on judicial review or appeal.[73] The *NEB Act* toll and tariff provisions derive from railway legislation and the Supreme Court of Canada has confirmed that questions of undue discrimination and similar circumstances are questions of fact that are not open to argument before the court under an appeal provision limited to questions of law or of jurisdiction.[74]

The recognition in cases involving railways that economic regulatory decisions involve considerable fact-dependent judgment set the stage for a similar recognition in pipeline regulation.

In *Canadian National Railway* v. *Bell Telephone Company*, the Supreme Court of Canada had the following to say on an appeal from an order requiring the Canadian National Railway to pay Bell Telephone Company's cost of removing telephone facilities in relation to work undertaken by the railway in replacing a level crossing in Montreal with a below grade crossing pursuant to an order of the Board:

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72 *National Energy Board Act*, R.S.C. 1985 c. N-7, s. 63 [hereinafter *NEB Act*]. This provision does not deem a question of law or jurisdiction to be a question of fact. Rather, it recognizes and confirms that these are questions of fact.

73 *Ibid.*, s. 22, for example, limits appeals to questions of law or of jurisdiction.

74 *Regina Rates Case*, *supra* note 35.

> The law dictates neither the order to be made in a given case nor the considerations by which the Board is to be guided in arriving at the conclusion that an order, or what order, is necessary or proper in a given case ... in exercising an administrative discretion entrusted to it, the Board itself is to be the final arbiter as to the order to be made.[75]

The determination of "public convenience and necessity" is likewise a matter of opinion.[76] The Supreme Court of Canada had previously determined in the first *Northwestern Utilities* case that the determination of rate base and rate of return did not raise questions of law or jurisdiction.[77]

These authorities were followed by the Federal Court of Appeal on an appeal from a decision by the NEB concerning the rates of the Westcoast pipeline. The court said that the NEB has been given "authority in the broadest terms to make orders in respect of... traffic, tolls, and tariffs.[78] The court endorsed the reasoning in an earlier case arising from the NEB involving the rates of the Trans Mountain Pipe Line Company Ltd. pipeline where the court said:

> Whether or not tolls are just and reasonable is clearly a question of opinion which, under the Act, must be answered by the Board and not by the Court. The meaning of the words "just and reasonable" in section 52 is obviously a question of law, but that question is very easily resolved since those words are not used in any special technical sense and cannot be said to be obscure and need interpretation. What makes difficulty is the method to be used by the Board and the factors to be considered by it in assessing the justness and reasonableness of tolls. The statute is silent on these questions. In my view, they must be left to the discretion of the Board which possesses in that field an expertise that judges to not normally have. If, as it has clearly done in this case, the Board addresses its mind to the right question, namely, the justness and reasonableness of the tolls, and does not base its decision on clearly irrelevant considerations, it does not commit an error of law merely because it assesses the justness and reasonableness of the tolls in a manner different from what the Court would have adopted.[79]

A similar view had been expressed by the court in a 1974 case involving the determination of whether export prices for electricity were just and reasonable.

> Section 83(b) calls for a determination by the board as to whether the price to be charged is "just and reasonable" in relation to the public interest. Generally speaking, as it seems to me, where Parliament leaves it to a tribunal to decide "fair and reasonable" or "just and reasonable" rates or prices or public convenience and necessity, the tribunal has a discretion to decide in what manner it will obtain information and the courts have no right to review the board's opinion based on the facts established before it. See *Northwest Utilities* v. *The City of Edmonton*, [1929] S.C.R. 186, *Union Gas Company of Canada, Limited* v. *Sydenham Gas and Petroleum Company, Limited*, [1957] S.C.R. 185, and

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75 [1939] S.C.R. 308 at 315 [hereinafter *CNR* v. *Bell Canada*].

76 *Memorial Gardens Association* v. *Colwood Cemetery*, [1958] S.C.R. 353 [hereinafter *Memorial Gardens*]; *Committee for Justice and Liberty Foundation* v. *IPL Norman Wells*, [1982] 1 F.C. 619.

77 *Supra* note 68 at 196.

78 *British Columbia Hydro and Power Authority* v. *Westcoast Transmission Company* (1981), 36 N.R. 32 at 40 (F.C.A.) [hereinafter *B.C. Hydro and Power Authority*].

79 *Ibid.* at 41, citing *Trans Mountain Pipe Line Company* v. *Canada (National Energy Board)*, [1979] 2 F.C. 118 at 121 (C.A.) [hereinafter *Trans Mountain*].

> *Memorial Gardens Association (Canada) Limited* v. *Colwood Cemetery Company, et al.*, [1958] S.C.R. 353. Furthermore, where a tribunal adopts a rule of practice to guide it in the exercise of its statutory functions, the question whether it properly appreciates its own rule cannot be a question of law. Nor "can the question whether in a given case the board has properly appreciated the facts for the purpose of applying the rule be such a question. This is so because ... there is no statutory rule and there is no rule of law that prescribes the considerations by which the board is to be governed in exercising its administrative discretion...." See *Bell Telephone Co.* v. *Canadian National Railways*, [1939] C.R.T.C. 10, per Duff, C.J.C. (giving the judgment of the Supreme Court of Canada) at page 21. As it seems to me, before this application can be granted, the court must be able to see a specific question of law or jurisdiction the answer to which may lead to the setting aside of the decision or order attacked. That may be a question as to whether the decision or order was made by the board in disregard of a statutory provision or other rule of law. It may be that the decision or order was based on a finding of fact that cannot be sustained having regard to the board's statutory mandate. It may fall in some other area that does not occur to me. In any event, as already indicated, I fail to recognize any such specific question of law in the paragraph of the applicant's supporting submissions set out above.[80]

The NEB, in a nutshell, is given the broadest authority to make orders in respect of any matter relating to traffic, tolls and tariffs.[81]

These cases do not rest on a general doctrine of judicial deference. The *Regina Rates Case*, the first *Northwestern Utilities* case, *CNR* v. *Bell Canada* and *Memorial Gardens* predate any general doctrine of deference. The authorities cited above reflect the simple fact that it is, as Rawls recognized, too complex to define principles (or laws) to govern the justice of individual cases. It is not that decision-making is unprincipled.[82] Rather, it is that one cannot take a set of principles and apply them invariably to all possible fact situations and derive a just result by simple deduction. The process requires judgment and a balancing of interests in light of the circumstances of the case. These are matters of fact and opinion that the judiciary has been quite content to leave to regulators, intervening only in the clearest of cases (*e.g.*, the *BC Electric Railway* case).

The general doctrine of judicial deference[83] that has emerged in the last two decades only reinforces the authority and discretion of economic regulators that was acknowledged by earlier authorities. In accordance with the doctrine of deference, errors of law made within the jurisdiction and expertise of an expert tribunal are subject to

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[80] *Ibid.* at 42-43, citing *Consumers' Association of Canada* v. *Ontario (Hydro Electric Power Commission)* (1974), 2 N.R. 467 at 471 (F.C.A.) [hereinafter *Consumers' Association*].

[81] *Ibid.* See also *TransCanada PipeLines Limited* v. *Canada (National Energy Board)*, [1987] 2 W.W.R. 253 (F.C.A.) In its very first rates case, the NEB recognized that "[j]ust and reasonable rates are matters of fact to be determined from the circumstances and conditions existing from time to time.": N.E.B., *Reasons for Decision in the Matter of the Application Under Part IV of the National Energy Board Act (Rates Application Phase II) of TransCanada PipeLines Ltd.* No. RH-1-72 at 3-16 (May 1973).

[82] The NEB in its first rates case took great pains to discuss the principles that should apply to fixing rates. N.E.B., *Reasons for Decision in the Matter of the Application Under Part IV of the National Energy Board Act (Rates Application - Phase I) of TransCanada PipeLines Ltd.* (December 1971), c. 6 and Phase II Decision, *ibid.* c. 3.

[83] See *Canada (A.G.)* v. *Public Service Alliance of Canada*, [1993] 1 S.C.R. 941; *Pezim* v. *British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557.

be set aside by a reviewing court only when patently unreasonable.[84] Such expert tribunals may, in respect of non-jurisdictional aspects, adopt reasonable interpretations of their home legislation, define the scope of the relevant statutory concepts and develop tests for their application.[85] Plainly, this should be done in a principled manner having regard to the objects and purposes of the legislation. However, that is no more than economic regulators have done for decades.[86] The doctrine of judicial deference is more than a defence to an appeal. It confers positive authority on the regulator to fashion the means of regulation to achieve the goals and purposes of regulation and to interpret the home legislation accordingly.

It has also been long recognized that it is not every element in the build-up of a decision that must be fair. Rather it is the overall result that should meet the just and reasonable standard.[87]

Nor is regulation static. Even when over-arching public policies and fundamental economic circumstances remain the same, the facts underlying particular decisions are constantly changing. However, public policies do change and regulators can take these new policies into account and modify the approach to regulation accordingly.[88] Moreover, fundamental economic conditions also change. Technological advancement is changing the face of the telecommunications industry and sweeping away not only old assumptions about the existence of natural monopolies but also the boundaries between the telecommunication, broadcasting and computer industries. In the face of these changes, the Canadian Radio-television and Telecommunications Commission ("CRTC") has been changing its approach to regulation to address and foster the emergence of competition. It is entirely proper to shape regulatory requirements in light of competition so long as this does not result in deregulation (unless the power of forbearance is provided by statute).[89]

With one notable exception, the NEB has taken the broad view of its jurisdiction reflected in the above noted jurisprudence. The notable exception occurred in 1988 when the NEB relied on the "equality" provision of the *NEB Act* to find that this provision "precludes" an incremental toll approach for facilities that form part of the integrated TransCanada PipeLines Limited ("TransCanada") system.[90] The section in question is s. 62 (then s. 52) and provides as follows:

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84 *Canadian Broadcasting Corporation* v. *Canada (Labour Relations Board)* (1995), 121 D.L.R. (4th) 385 (S.C.C.).

85 *Ibid.* Where the Labour Relations Board was required to apply the statutory concepts of "administration" and "representation" by the union of its members.

86 See *Memorial Gardens, supra* note 76, where the court noted that public convenience and necessity were determined by reference to the context, objects and purpose of the statute as a matter for the tribunal. The same may be said for similar economic regulatory concepts found in legislation.

87 *Gas Rate Fundamentals, supra* note 58 at 87, citing *Hope Natural Gas, supra* note 64.

88 *Regina Rates Case, supra* note 35; *Re Board of Railway Commissioners*, [1930] S.C.R. 288.

89 *Telecommunications Workers Union* v. *Canada (Canadian Radio-television and Telecommunications Commission)* (1989), 98 N.R. 93 (F.C.A.).

90 N.E.B., *In the Matter of Applications for Facilities and Approvals of Tall Methodology and Regulated Tariff Matters*, No. GH-2-87 (July 1998) at 73 [hereinafter GH-2-87].

> All tolls shall be just and reasonable, and shall always, under substantially similar circumstances and conditions with respect to all traffic of the same description carried over the same route, be charged equally to all persons at the same rate.[91]

The NEB also referred to the prohibition against unjust discrimination in s. 67 (then s. 55).

While the NEB, citing the *B.C. Hydro and Power Authority*, *Trans Mountain* and *Consumers' Association* cases, said that it had a wide discretion in choosing the toll methodology that would result in just and reasonable tolls, it went on to say that "this discretion is fettered by the requirement (in sections 52 and 55) that tolls not be unjustly discriminatory."[92] The provision of the *Act* (now s. 63) that states that such questions are questions of fact and the *Regina Rates Case* which confirmed that these are questions of fact are not referred to in the decision. The NEB went on to parse the language of s. 62 (then s. 52) and concluded that "traffic" referred to the commodity being transported by the pipeline, in that case, natural gas.[93] The NEB then concluded that:

> the phrase "circumstances and conditions" may be regarded as referring to the circumstances and conditions of transportation of the gas such as the nature and character of the service provided (*i.e.* FS or IS) and not to the business motives either of the shipper or the carrier nor to circumstances and conditions created by contract (such as the terms of gas sales or purchase contracts), or by government policy (for example, pre- and post-31 October 1985).[94]

It might also be noted that the NEB had little legal argument on the point. On the whole, counsel for the various parties appeared to share the view expressed by counsel for the Canadian Petroleum Association that the NEB had a "plenary jurisdiction" on toll issues and that toll methodology was a question of fact and a matter of discretion.[95] Counsel for The Consumers' Gas Company Ltd., however, did argue that "traffic" referred to the commodity transported and that the equality provisions of the *NEB Act* presented an impediment to incremental tolls.[96]

When the issue next arose, there was ample legal argument.[97] In fact, the NEB invited legal argument on a series of questions.[98] The hearing lasted 105 days with six very full days of argument. The hearing concluded with the Chairman of the NEB, Roland Priddle, saying that he was troubled by the length and cost of the hearing and reading the following passage from Dickens' *Bleak House*:

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91 *NEB Act*, *supra* note 72, s. 62 (then s. 52).

92 GH-2-87, *supra* note 90 at 72.

93 *Ibid.* at 72.

94 *Ibid.* at 73.

95 *Ibid.*, C.K. Yates for the Canadian Petroleum Association, Transcript Volume 42 at 6705.

96 *Ibid.*, J.H. Farrell for The Consumers' Gas Company, Transcript Volume 44 at 7086-88.

97 N.E.B., *In the Matter of TransCanada PipeLines Ltd.*, No. RH-1-88 (June 1989) [hereinafter RH-1-88].

98 *Ibid.*, Exhibit A-91, letter dated 29 March 1989.

> some score of members of the High Court of Chancery bar ought to be — as here they are — mistily engaged in one of the ten thousand stages of an endless case, tripping one another up on slippery precedents, groping knee-deep in technicalities ... and making a pretence of equity with serious faces, as players might. On such an afternoon, the various solicitors in the cause, some two or three of whom have inherited it from their fathers, who made a fortune by it, ought to be — as are they not? — ranged in a line ... between the registrar's red table and the silk gowns, with bills, cross-bills, answers, rejoinders, injunctions, affidavits, issues, references to masters, masters' reports, mountains of costly nonsense, piled before them.[99]

In the result, the majority of the board rejected the reasoning of the GH-2-87 decision. The dissenting member, A.D. Hunt, sat on the GH-2-97 hearing and maintained, with some modification, the views expressed in that decision.[100] The majority view was as follows:

> Thus, the Board now views "traffic" as referring not only to the commodity that is being transported but also to the activity of transportation and other associated dealings in that commodity. In view of the foregoing, the Board considers that the phrase "all traffic of the same description" in section 62 of the NEB Act can have a broad meaning, depending upon the particular traffic characteristics manifested in the transportation of the commodity.
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> Similarly, the phrase "under substantially similar circumstances and conditions with respect to all traffic of the same description," should no longer be considered as applying solely to the circumstances and conditions of transportation such as the nature and character of the service provided as was held in the GH-2-87 Decision. Rather, the circumstances and conditions which the Board must consider under section 62 are "with respect to ... traffic .....which, given the Board's expanded definition of "traffic," would require that it consider all relevant matters affecting the traffic of the commodity by a pipeline.
>
> Furthermore, under section 63 of the NEB Act, the Board is given the exclusive authority to determine, as a question of fact, what matter or traffic characteristics are relevant, and what weight should be assigned to each in determining whether or not traffic is or has been carried under substantially similar circumstances and conditions and whether such carriage has resulted in unjust discrimination in tolls, service or facilities against any person or locality. In so doing, while the Board may take into account the business motives of the parties or the circumstances and conditions created by contract or any other matter that the Board considers relevant, it is for the Board alone to determine what weight should be given to such matters.[101]

This approach reflects the breadth of the NEB's authority as reflected in the jurisprudence and as supported by the nature and purpose of the NEB's economic regulatory role.[102]

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99 *Ibid.*, Phase II, TransCanada PipeLines Limited, Transcript Volume 105 at 18278.

100 *Ibid.* at 73-76.

101 *Ibid.* at 47-48.

102 The change in approach is reflected in the next decision to consider incremental tolling in which the NEB based its decision on a number of economic and fairness considerations. See: "Tolling and Economic Feasibility," *TransCanada PipeLines Limited*, GH-5-89, vol. 1 (November 1990). The broad, practical approach has been reflected in other decisions where, for example, term-

The law thus confers a broad discretion to fashion the approach to regulation that achieves the objects and purposes of the legislation, having regard to the facts including public policy and fundamental economic circumstances. The degree and nature of the means adopted — heavy or light-handed — thus becomes a matter of judgment for the regulator. Light-handed regulation has been proposed for Westcoast's gathering and processing facilities. This proposal provides a concrete focus for discussion of the factors which may support light-handed regulation and the nature of such regulation.

V. THE WESTCOAST FRAMEWORK FOR LIGHT-HANDED REGULATION

The Framework for Light-handed Regulation[103] proposes to replace cost of service regulation of Westcoast's gathering and processing services with arrangements arrived at through individual negotiations subject to requirements for fair dealing and NEB oversight through a complaint mechanism.

The Westcoast pipeline system owes its birth in 1957 to the natural gas reserves of the Peace River district straddling the border between Alberta and British Columbia. These reserves were too far from the reserves in southern Alberta that were driving the competing pipeline projects which would ultimately be merged to become TransCanada. A market opportunity lay in the Pacific Northwest and the Westcoast pipeline was conceived as the means to connect supply to market. It involved raw gas gathering lines feeding into a gas processing plant (the McMahon Plant named after Frank McMahon, the entrepreneurial spirit behind Westcoast) located near Fort St. John, B.C. and a transmission line through the mountains into the B.C. lower mainland and on to the U.S. border near Sumas, Washington. The entire undertaking received federal authorization (some of the gathering lines crossed the border into Alberta and the undertaking continued to the international border) and fell under the NEB when the NEB was created in 1959.

By the early 1990s, Westcoast's raw gas gathering facilities had expanded and fed a number of plants — principally, three very large plants — McMahon, Fort Nelson and Pine River (located near the Grizzly Valley) — with further expansions contemplated. These facilities were regulated by the NEB under a rolled-in toll methodology (*i.e.*, all costs of all facilities were put in one pot for toll purposes with the result that tolls were based on the average of all costs). Domestic gas users, led by the major B.C. local distribution company, BC Gas Utility Ltd. ("BC Gas"), were concerned that the approach to regulation gave the wrong price signals for expansion suggesting that averaging costs resulted in high cost expansions being subsidized by lower cost existing facilities. This resulted in a hard-fought hearing, in which the jurisdiction over the NEB was challenged, and a subsequent appeal. The Supreme Court of Canada finally resolved the jurisdictional issue in favour of NEB jurisdiction on

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differentiated tolls have been approved in light of the different sharing of risks with the pipeline by long and short-term shippers and the fact that all parties were given an equal opportunity to contract for long-term transportation. See *Express Pipeline Ltd.*, OH-1-95 (June 1996) at 23, 27 [hereinafter *Express Pipeline*].

[103] *Supra* note 1.

March 19, 1998 on an appeal by BC Gas from an earlier Federal Court of Appeal decision.[104]

The British Columbia government, in response to these concerns, established in 1995 a consultative group, the "Core Group," to examine the issue of regulatory reform of Westcoast's raw gas gathering and processing services. This process led to a December 15, 1995 report, "Upstream Regulatory Reform Project."[105] The report found no unambiguous evidence of economies of scale in raw gas gathering and processing in B.C. and identified government policy prior to 1985 as a major factor in the concentration of the industry in Westcoast's hands.[106] In short, the report suggested Westcoast was an unnatural monopoly with the consequence that a different approach to regulation was appropriate. Not all stakeholders shared that view at that time.[107] However, there is now a consensus that a new approach to regulation is appropriate and, on January 23, 1998, all major stakeholder representatives entered into, with Westcoast, the Framework for Light-handed Regulation.[108]

The Framework contemplates one-on-one negotiation between individual shippers and Westcoast to establish terms of and prices for gathering and processing services. The consensus of the stakeholders was that reasonable prices and terms of service can be set by individual negotiations, thereby satisfying the "just and reasonable" standard. (Shippers may negotiate or purchase service in groups to increase their bargaining position.) A number of factors support the view that, although Westcoast is the dominant service provider with over 80 percent of the market in northeastern British Columbia served by the NEB-regulated business plus a non-NEB-regulated affiliate, Westcoast would not be able to exercise market power. These factors are as follows:

(1) The absence of unambiguous evidence of economies of scale.

(2) The role of government policy prior to 1985 as a major factor in the concentration of the industry.

(3) New technologies are being employed that change minimum scale of plant, reduce costs, or increase efficiency and reliability with a resulting increase in value and reduced barriers to entry.

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104 *BC Gas Utility Ltd.* v. *Westcoast Energy Inc.*, Supreme Court of Canada File 25259 (19 March 1998).

105 Province of British Columbia, Ministry of Energy, Mines and Petroleum Resources, Upstream Regulatory Reform Project, Report of the Core Group, submitted by P.L. Miles Consulting Inc. with the assistance of Peter Milne & Associates Inc. and Dr. R.W. Durie, Ph.D., P.Eng. (15 December 1995).

106 *Ibid.* at 7, 12, 15, 20.

107 *Ibid.* at 32-37.

108 The signatories are Westcoast Energy Inc., Canadian Association of Petroleum Producers, Council of Forest Industries and Methanex Corporation, BC Gas Utility Ltd., and the Export Users Group. Other stakeholders were consulted in the development of the Framework and the Framework passed through the Westcoast Tolls and Tariff Task Force by unanimous resolution.

(4) New construction techniques (skid-mounted, modular construction) are being used that reduce risks and costs and thereby lower barriers to entry.

(5) Raw gas gathering and processing are heterogeneous services; that is, different customers have different service needs, creating opportunities to enter based on service customization.

(6) Increasing actual rivalry, as noted in the Upstream Regulatory Reform Project, since 1985 (when government policy changed) although, as noted above, Westcoast and its affiliate still have over 80 percent of the market.

(7) The uncertainty created by the BC Gas jurisdictional challenge led Westcoast to compete for new business (and so with its NEB-regulated self) via a separate non-NEB-regulated subsidiary.

(8) All new processing capacity in recent years has been built outside the NEB-regulated company.

(9) A small number of customers hold the bulk of the service. They are knowledgeable and often self-provide these services in other areas. In other words, they have some power as buyers of the services that can be exerted in negotiating with Westcoast.

(10) British Columbia is generally a high cost area in which to operate with producers on average facing constant challenges to profitability. As a result, there is limited room for Westcoast to squeeze excess profit from producer economic opportunities and there is considerable pressure on Westcoast from customers to become more cost efficient and provide greater value.

(11) Northeastern B.C. is geographically close to Alberta and the NOVA Gas Transmission Ltd. ("NGTL") transmission system. A number of producers, both large and small, already have connections into Alberta or are in close proximity to the NGTL system in Alberta.

(12) NGTL's subsidiary, Novagas Clearinghouse Ltd., is one of the more vigorous new entrants in B.C. It has competed for several new plants and is proceeding with a new plant in the West Stoddart region, in the heart of Westcoast's Fort St. John gathering area.

(13) Light-handed, complaints-based regulatory regimes for raw gas gathering and processing are common in North America.

There are, therefore, a number of forces that combine to make market-based arrangements practical and reasonable.

As discussed previously, the law does not dictate the method by which just and reasonable rates are to be determined. The regulator may determine, as a matter of fact,

that a market-based pricing mechanism is appropriate. In the United States, after natural gas prices were deregulated, the Federal Energy Regulatory Commission ("FERC") was left with the problem of regulating the price of sales by pipelines themselves. This was against the backdrop of a functioning unregulated commodity market for natural gas involving numerous parties, including the pipelines themselves. As a result, the FERC allowed the pipelines to adopt a market-based pricing mechanism. The FERC made it clear this was not "deregulation." It was market-based regulation.[109]

The Framework likewise contemplates market-based regulation. The underlying economic conditions are different from those in the FERC case but, in the judgment of all stakeholders, including Westcoast, the forces operating in this market area are sufficient to lead to just and reasonable results.

The Framework addresses the issue of unjust discrimination by requiring that Westcoast will charge similar tolls to "similarly situated" customers, a phrase which is expressly intended to capture the requirements of sections 62, 63 and 67 of the *NEB Act*.[110] The phrase captures the essence of the equality provisions and prohibitions on unjust discrimination, namely, the basic fairness criterion that similar cases be treated similarly.

The goal of the Framework is to permit negotiations to include any item of value that could be the subject of bargaining in a competitive market.[111] For example, different lengths of terms of contract offer different value to the service provider in that longer contracts may confer a greater benefit while also reflecting a greater "give" on the part of the customer which may be reflected in a lower price.[112] The same may be said of the other parameters such as contract volume, dedication of land or reserves, drilling commitments, renewal rights, extent of compensation for non-performance, gas composition, length of haul, creditworthiness, *etc.* Supply and demand conditions at the time of contracting may be relevant as, for example, a significantly under-utilized service might be marketed at a discount from what might be the price under different conditions. The opportunity a customer may have to switch to a competing service provider may also be a factor. All of these parameters may distinguish one shipper's service from another in a free market and the Framework contemplates that all of these are negotiable.[113]

It has been said that each customer of a utility might theoretically represent a separate market[114] and it is possible (although unlikely) in the small Westcoast

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109 Order 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Wellhead Decontrol* (8 April 1992), FERC Statutes and Regulations, Regulations Preambles, §30,939 at 30,440.

110 Framework, *supra* note 1 at 2, s. A.1.

111 *Ibid.* at 6, s. C.2.

112 The NEB has already approved term-differentiated tolls; see *Express Pipeline*, *supra* note 102.

113 Framework, *supra* note 1 at 6, s. C.2.

114 Phillips, *supra* note 6 at 62. The implied criticism in the observation appears to be that the utility might discriminate down to the individual level but this would not, given everything else Phillips and others say, be objectionable unless the discrimination was unjust. The real objections for many

universe that no two contracts for service would be exactly the same. The market will, however, set the bounds and will establish a range within those bounds of various mixes of prices and other terms. The application of the principle of treating similar cases similarly does not require an exact match. Rather, it involves a comparison to determine points of similarity and then situating the service in question in relation to those contracts to which it is similar (but not necessarily identical).

To be workable, this requires that there be the ability to make the comparison. This leads into the difficult issue of balancing the desire of contracting parties in a competitive climate to maintain the confidentiality of their commercial arrangements with the need for information. The Framework addresses this explicitly in several respects. It is, however, important to note that Westcoast's customers are generally knowledgeable with respect to the provision of the services in question. Many, elsewhere, self-provide or acquire these services from third parties. A number have considered competitive alternatives to the NEB-regulated services of Westcoast and some have contracted with service providers competing with the NEB-regulated services. The Framework also contemplates that competition will increase. This general background is relevant to the information question.

The Framework provides that Westcoast will issue periodic reports providing summary data of contracts by area, acid range, volume, term and distance with high, low, and weighted average tolls.[115] Shippers entering into negotiations may request an update to these market reports.[116]

In the event the parties desire the assistance of a mediator in resolving their differences, the mediator will be given, on a confidential basis, a spreadsheet summarizing the significant components of all contracts. The mediator may then request, on a confidential basis, any contracts.[117] The purpose is to give mediators information to assist them in carrying out the mediation. The mediator may not give the information to the shipper, but the mediator will be able to have the information necessary to assist the parties in resolving the matter.

Should the matter proceed to a formal adjudication by the NEB, the Framework contemplates that the NEB will adopt procedures that will give Westcoast and the shipper access to contract information in accordance with procedures designed to ensure confidentiality.[118] In that regard, the NEB has the power to ensure confidentiality in accordance with section 16.1 of the *NEB Act*.[119]

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utilities against pricing on an individual basis are practical — too much effort for too fine distinctions — and customer acceptability — the differences may not be easily perceptible by customers. However, modern technology makes more complex pricing schemes practical and, in the case of Westcoast, the service is heterogeneous leading to great potential for customization and the stakeholders not only accept this, they want it.

115 Framework, *supra* note 1 at 9-11, ss. D.1(e) and D.2(e).

116 *Ibid.*

117 *Ibid.* at 13, s. E.6(e).

118 *Ibid.* at 14, s. E.8(c).

119 *NEB Act*, *supra* note 72, s. 16.1.

The Framework contemplates that there will be an increase in competition and fosters that development through an interconnection policy. The interconnection policy permits the use of Westcoast facilities for access to the facilities of a competitor to Westcoast.[120] The interconnection policy reduces barriers to competitive entry and so increases the bargaining power of shippers.

Additional guidance as to how the Framework is to be applied is given through statements of principle. The express intention is that the Framework not be applied so as to result in the revaluation of Westcoast's rate base for existing facilities to Westcoast's replacement cost.[121] Prices, in particular for small volume captive shippers, are to be consistent with service provided to shippers with greater bargaining power and, during the transition, the Framework is not intended to be applied so as to result in the premature shutting-in of reserves currently connected to Westcoast.[122]

The Framework thus is a combination of a market-based and a rules-based approach to establishing prices and terms of service subject to the supervision of a regulator. The availability of regulatory intervention to resolve disputes is the ultimate assurance that outcomes will be just and reasonable and not unduly discriminatory. This may operate directly in the form of case-specific regulatory action. It also operates indirectly since the threat of regulatory intervention acts as a force potentially constraining the behaviour of the parties.[123] This is not only because of the uncertainty of recourse to the regulator but also because the Framework rests on the desire of all stakeholders to rely on negotiated, commercial arrangements instead of regulatory oversight.[124]

The Framework provides for "fair dealing" in respect of tariff and contract administration and enforcement, opportunity to negotiate for service and processing of requests for service. The similar treatment rule applies.[125] The fair dealing policy also provides for publication of available capacity, protection of customer confidentiality, the prohibition of any preference based on a customer using a Westcoast affiliate's services or service or Westcoast's transmission services, and the structural separation of Westcoast's affiliate activities, including the prohibition on disclosure of information to affiliates of requests for service from third party service providers.[126] Westcoast is required to advise its employees of the conduct expected under fair dealing policy and is required to take corrective action in the event of non-compliance.[127]

As noted, a wide range of items are negotiable. However, standard contracts are available in which only the volume, receipt and delivery point, acid content, price for service, and renewal terms are to be negotiated.[128] Westcoast is committed to offer

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120 Framework, *supra* note 1 at 3, s. A.3, 17-19, s. G.
121 *Ibid.* at 3, s. A.5.
122 *Ibid.* at 3, s. A.6.
123 Porter, *supra* note 71 at 53.
124 Framework, *supra* note 1 at 2, ss. A.2(a) and (b).
125 *Ibid.* at 4, s. B.1.
126 *Ibid.* at 4-5, s. B.1 - B.5.
127 *Ibid.* at 5, s. B.7.
128 *Ibid.* at 7, s. C.3(a).

renewal rights.[129] It is the terms of renewal that are to be negotiated. There are also provisions related to the safe and reliable provision of service that will be standard for all service and, in that regard, it is not possible to negotiate a higher priority or reliability of service than that provided in fully firm service.[130]

The interconnection policy, as noted above, reduces barriers to entry by permitting access through Westcoast's facilities to a competing service provider. The interconnection policy requires the establishment, in accordance with the Framework's rules, of an unbundled price for use of the portion of Westcoast facilities in question.[131] An individual shipper or the competitor may request such unbundled service. An interconnection agreement with the interconnecting service provider is required which will enable Westcoast to maintain its physical and operational integrity and reliability, allow Westcoast to honour its contractual commitments, and provide for the payment by the interconnecting party of all of Westcoast's incremental capital, owning and administrative costs net of any benefits that may result from interconnection.[132] (An interconnection may, for example, benefit the system by removing a constraint on service.) Interconnection, it may be noted, provides access to a competitor's services not only by direct physical flow but also by displacement, which in a raw gas system adds to the complexity of the arrangements to be negotiated since the streams of gas in various locations are not uniform as to gas composition.

As noted, the Framework is premised on an increasingly competitive environment. Westcoast is provided with flexibility to respond to the competitive needs of shippers. It thus has the opportunity to maximize its profits but also the responsibility for its decisions. As such, the Framework provides that Westcoast is fully responsible for the utilization of its gathering and processing assets and for the stranding of any of those assets.[133] Disposition of assets to affiliates must be done by competitive bidding.[134] This contrasts sharply with the traditional cost of service approach in which under-utilization typically falls on the shoulders of the remaining shippers. The Framework thus establishes a new point of reference for risk and reward issues.

Any violation of the Framework or any failure to reach a satisfactory contractual arrangement with Westcoast may be resolved by complaint to the NEB.[135] The complainant has the option of requiring Westcoast to submit to mediation prior to formal adjudication.[136] This is optional and simply involves one last attempt at arriving at a negotiated solution with the assistance of a mediator. It is no more an impediment to the NEB's jurisdiction than negotiations without the assistance of a mediator. The NEB could, of course, choose to involve itself in mediation as many courts are doing. The timeframes and process for mediation are laid out and reference

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129 *Ibid.*
130 *Ibid.* at 8, s. C.4.
131 *Ibid.* at 17, s. G.1.
132 *Ibid.* at 17-19, ss. G.2 - G.5.
133 *Ibid.* at 15, s. F.2.
134 *Ibid.* at 15, s. F.3.
135 *Ibid.* at 12, s. E.1.
136 *Ibid.* at 12, s. E.6.

is made to the assistance available through the British Columbia International Commercial Arbitration Centre or the Canadian Foundation for Dispute Resolution.[137] Access to mediation is seen to be of benefit in reducing the cost and increasing the effectiveness of the complaints process.

If the parties agree, they may decide to go to arbitration, including final offer arbitration. This requires a written arbitration agreement and, again, reference is made to the assistance available through the above-noted centre and foundation.[138] Arbitration is optional and simply involves another way in which the parties might seek to resolve their dispute without adjudication by the NEB. Even after arbitration, the matter might still proceed to NEB adjudication. The intention of the Framework is that the NEB would take the fact that the parties had gone to arbitration into account and could consider the arbitration decision or positions taken by the parties in arbitration.[139]

As noted, it is contemplated that the NEB, in its adjudication of the complaint, would take steps to protect the confidentiality of commercial information. This might involve an *in camera* hearing with appropriate restrictions on participation, confidentiality orders or confidentiality agreements.[140] The Framework also proposes an option modeled on the procedures of the Canadian International Trade Tribunal.[141]

Even in the absence of a specific confidentiality provision in the *NEB Act*, the NEB would have the authority to make orders to protect confidential information. The general rule with regard to the openness of the judicial process was laid down in *Scott* v. *Scott*.[142] There is some authority that administrative tribunals are in a different position from courts and might have a discretion whether to hold a proceeding in public or private.[143] The NEB is, however, a court of record with all of the procedural powers of a superior court of record.[144] It will be assumed, therefore, for the sake of discussion, that the rule in *Scott* v. *Scott* applies. The rule is, however, subject to exceptions if justice cannot be administered other than *in camera*; in special cases such as lunacy or secret process, and generally where disclosure would destroy the subject matter of the litigation.[145] In such cases, the court will make the order necessary to ensure that the interests of justice are protected. This might go so far as to restrict

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137 *Ibid.*

138 *Ibid.* at 13-14, s. E.7.

139 *Ibid.* at 4, s. E.8(a).

140 *Ibid.* at 14, s. E.8(c)(i).

141 *Ibid.* at 14, s. E.8(c)(ii), Appendix D.

142 [1913] A.C. 417 [hereinafter *Scott* v. *Scott*].

143 *Millward* v. *Canada (Public Service Commission)* (1974), 49 D.L.R. (3d) 295 (Fed. T.D.) [hereinafter *Millward*], a case involving an Appeal Board under the *Public Service Employment Act*, R.S.C. 1985 c. P-32.

144 *NEB Act*, *supra* note 72, s. 11.

145 *Millward*, *supra* note 143; *Samuel Moore & Co.* v. *Patent Commissioner*, [1980] 2 F.C. 350, 45 C.P.R. (2d) 185 (C.A.).

access to counsel only, and to exclude the clients.[146] Another approach would be to limit access to counsel and specified employees of the client who were considered trustworthy and capable of maintaining confidentiality.[147] The purpose of the confidentiality order is to permit the exchange of information between the parties.[148] Where the reasons for judgment refer to confidential information, these may be sealed.[149]

In the case of the NEB, the judicial exceptions to the rule in *Scott* v. *Scott* have been replaced by a statutory provision that confers a broader discretion consistent with the NEB's regulatory mandate. Section 16.1 of the *NEB Act* provides as follows:

> 16.1 In any proceedings under this Act, the Board may take any measures and make any order that it considers necessary to ensure the confidentiality of any information likely to be disclosed in the proceedings if the Board is satisfied that
>
> (a) disclosure of the information could reasonably be expected to result in a material loss or gain to a person directly affected by the proceedings, or could reasonably be expected to prejudice the person's competitive position; or
>
> (b) the information is financial, commercial, scientific, or technical information that is confidential information supplied to the Board and
>
> (i) the information has been consistently treated as confidential information by a person directly affected by the proceedings, and
>
> (ii) the Board considers that the person's interest in confidentiality outweighs the public interest in disclosure of the proceedings.[150]

The contracts to be negotiated under the Framework plainly meet this standard and the NEB is given wide authority to "take any measures and make any order that it considers necessary to ensure"[151] confidentiality.

The order must be in a "proceeding." As such, the section appears to contemplate some activity before the board.[152] If so, then the section would apply to a complaint proceeding as contemplated by the Framework. However, it may be that the simple act of filing a tariff (in the absence of an objection or step taken by the board itself) would

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146 *Maislin Industries Ltd.* v. *Canada (Minister for Industry, Trade and Commerce)*, [1984] 1 F.C. 939, 80 C.P.R. (2d) 253 (T.D.). See also *Hunter* v. *Canada (Consumer and Corporate Affairs)*, [1991] 3 F.C. 186, 35 C.P.R. (3d) 492 (C.A.).

147 *Pfizer Canada Inc.* v. *Novopharm Ltd.* (1996), 70 C.P.R. (3d) 176 (Fed. T.D.).

148 *Proctor & Gamble Co.* v. *Kimberley-Clark of Canada Ltd.* (1989), 25 C.P.R. (3d) 12 (Fed. C.A.).

149 *Proctor & Gamble Co.* v. *Kimberley-Clark of Canada Ltd.* (1990), 28 C.P.R. (3d) 564 (Fed. T.D.).

150 *NEB Act*, *supra* note 72, s. 16.1.

151 *Ibid.*

152 *Black's Law Dictionary*, 5th ed. (St. Paul: West Publishing Company, 1979); D. Dukelow & B. Nuse, *The Dictionary of Canadian Law*, 2d ed. (Toronto: Carswell, 1995).

not constitute a proceeding.[153] By contrast, the CRTC, under the *Telecommunications Act*, has a more general confidentiality provision that applies to the "submission of information" and so would permit tariff filings to be made in confidence.[154]

If this is correct, then Westcoast's tariff would continue to be a public document and, as required by the *NEB Act*, would also contain the tolls.[155] The Framework addresses this by proposing a tariff which would contain a range of tolls which would be the maximum and minimum tolls to be charged by Westcoast.[156] These would be the tolls actually being charged under the Framework with all other actual tolls being charged to shippers falling within the range. The parties to the Framework were prepared to file each contract as an individual tariff if confidentiality were assured but, as noted, that would not seem possible at this time.[157]

Westcoast has an existing tariff in place for its gathering and processing services with a fixed schedule of tolls that will remain in place until December 31, 2001. Shippers may negotiate individual arrangements immediately or they may continue to receive service under the existing tariff at the already established tolls and wait before negotiating new arrangements. As such, there is a transition period of several years for shippers to adjust to the new world.

VI. THE TEXAN APPROACH TO LIGHT-HANDED REGULATION

Texas has had virtually no barriers to pipeline entry and very little economic regulation of pipelines generally. The Texas model has been studied and the literature indicates no unexploited scale economies due to excessive entry and no evidence of monopolistic exploitation.[158]

The Railroad Commission of Texas ("RCT") has jurisdiction over intra-state pipelines including gas gathering lines. Non-discrimination standards date from the 1920s. Gas gathering operations in or within the "vicinity" of where the gas is produced are exempt from cost of service regulation but are subject to non-discrimination standards under common purchaser legislation. The term "vicinity" has been taken by some companies to mean within three counties.[159]

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153 *Words and Phrases*, vol. 34 (St. Paul: West Publishing Company, 1957) at 141, 144.

154 S.C. 1993, c. 38, s. 39.

155 *NEB Act*, *supra* note 72, s. 60(1)(a).

156 Framework, *supra* note 1 at 9, s. D.1(a).

157 *Ibid.* at 10, s. D.2(a). The *Access to Information Act*, R.S.C. 1985, c. A-1 applies to the NEB and, in s. 20, does protect confidential information. The difficulty lies in the apparent *NEB Act* requirement that a tariff when filed is a public document.

158 J. Ellig, "Intrastate Pipeline Regulation: Lessons from the Texas Experience" in J. Ellig & J. Kalt, eds., *New Horizons in Natural Gas Deregulation* (Westport: Praeger, 1996) at 159-73.

159 Interview by the author, in the company of J. Peverett, Vice President, Regulatory and Accounting Services, Westcoast Energy Inc., with RCT staff, M.R. McDonald, Deputy General Counsel, R. Kitchens, Division Director, Gas Services Division, & W. Geise, Senior Project Director, Gas Services Division (10 October 1997) [hereinafter Interview]. The legislation is the *Common Purchaser Act*, Tex. Nat. Res. Code, § 111.081 *et seq.*

A company can declare itself to be a utility but it must comply with the *Gas Utility Regulation Act*.[160] The *GURA* contains "just and reasonable" rate standards. However, section 5.02(b) contains an exemption allowing negotiated rates where one of three conditions is met:

> (1) neither the gas utility nor the customer had an unfair advantage during the negotiations;
>
> (2) the rates are substantially the same as rates between the gas utility and two or more customers under the same or similar conditions of service; or
>
> (3) competition does or did exist either with another gas utility, another supplier of natural gas, or with a supplier of an alternative form of energy.[161]

The parties to the arrangement must certify that one of these conditions was met on a simple one-page form and the rate is accepted for filing without further examination by the RCT. Negotiated rates exist in circumstances that do not fit the classic model of competition.[162]

As of December 1996, there were sixty-four gatherers (representing 35 percent of volumes transported) regulated under the *GURA*, twenty-four interstate gatherers under FERC jurisdiction, and 683 gatherers exempt from *GURA* rate regulation (being within the vicinity of where the gas is produced) but subject to non-discrimination standards. Complaints may be made to the RCT. The system has worked well and the RCT has not had to get involved very often. In practice, there is industry self-regulation.[163]

On August 18, 1997, the RCT established a code of conduct to help prevent prohibited discrimination for operations exempt from the *GURA* for operations subject to the *GURA*, and for gas distribution utilities. The concept of discrimination is interpreted broadly and includes preferences generally as well as dealings with affiliates. Discrimination is defined as "material differences" in rates or terms of service which "unreasonably disadvantages or prejudices similarly situated shippers."[164] Preference is defined conversely, that is, as an unreasonable advantage and includes the dissemination or provision of information.[165]

The concept of the "similarly situated shipper" is determined by reference to the physical, regulatory and economic conditions of service having regard to a broad range of parameters: service requirements, location of facilities, receipt and delivery points, length of haul, quality of service, quantity, swing requirements, credit-worthiness, gas quality, pressure, duration of service, connect requirements, and conditions and circumstances existing at the time of agreement or negotiation.[166]

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160 *Gas Utility Regulation Act*, Texas Civil Statutes, Art. 1446e [hereinafter *GURA*].
161 *Ibid.*, s. 5.02(b).
162 Interview, *supra* note 159.
163 *Ibid.*
164 Railroad Commission of Texas, Substantive Rule 7.59 (18 August 1998) at 9.
165 *Ibid.* at 10.
166 *Ibid.* at 10-11.

The code applies the similar treatment for similarly situated shippers rule to tariff and contract administration and enforcement, provision of service, and processing requests for service.[167]

It had been proposed that companies be required to file price information with a view to price transparency and, hence, the promotion of non-discrimination. However, both gas gatherers and producers were opposed to filing the proposed information (billing information five days after billing). The RCT rejected this proposal and, instead, the code provides for an audit of rates and all terms and conditions under which service is provided.[168]

A complaint to the RCT could involve an audit, informal resolution or formal resolution. Under the informal process, a complainant may make a complaint orally but, if the complaint is to be pursued, the complaint must be put in writing. A copy is then sent to the complainant with a copy to the respondent who has fourteen days to reply in writing. A special project director ("SPD") is assigned to the case. If, after thirty days from the date of complaint, the parties fail to resolve the matter, the SPD invites the parties to an informal meeting. The parties may attend the meeting with legal counsel. Each side states its case and the SPD will ask questions and seek to facilitate a resolution.[169] Oral statements made at the meeting are not recorded. Parties may show documents to substantiate a point and then take the document away (thus preserving confidentiality). The details of any resolution reached informally would be confidential.[170]

Informal resolution encourages free, open and candid discussion. It would appear to work best in private with confidentiality preserved. RCT staff have considerable industry background and this allows them, without disclosing any confidences, to assist the parties. The response to this process has been positive. The key is to get the right people at the table talking to each other. Of about thirty complaints received by the fall of 1997, over twenty had been settled or withdrawn. Only two proceeded to formal RCT adjudication.[171]

The complaints process is an adjunct to facilitate a market-based scheme of regulation consistent with the RCT's basic, light-handed, approach to regulation. The Texas approach, like the Westcoast Framework, allows market forces to operate within a rules-based structure that embodies a basic concept of fairness and subject to regulatory intervention in the event of a problem.

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167 *Ibid.* at 11-12.

168 *Ibid.* at 4, 12-13; Interview, *supra* note 159.

169 Railroad Commission of Texas, "Informal Procedure for Responding to Complaints About Gas Transportation Service" (26 November 1996).

170 Interview, *supra* note 159.

171 *Ibid.*

VII. DEVELOPMENTS AT THE U.S. FEDERAL ENERGY REGULATORY COMMISSION

The U.S. FERC has adopted a practice of permitting FERC-regulated natural gas pipelines to spin off to third parties or spin down to affiliates gas gathering and processing facilities.[172] The effect of this is to take these facilities out of the federal regulatory sphere and to effectively deregulate these facilities.[173] The FERC requires as a condition of its order permitting spin off or spin down that the company provide for a two-year period a default contract to customers as "a transitional mechanism to protect the reasonable expectations of a jurisdictional pipeline's existing customers while they consider their options in an unregulated environment. The default contract ... is not meant to meet the just and reasonable standard.... The sole purpose of the default contract is to provide a pipeline's existing customers with some minimum protection that their gathering service will not be terminated."[174]

On January 31, 1996, the FERC issued a policy statement establishing criteria for market-based rates and incentive cost of service rates for interstate natural gas pipelines. Additional comments were requested on some aspects of the policy. The policy statement applies to all FERC-regulated pipelines.[175] The adoption of market-based rates turns on an assessment of the service and geographic market and the measurement of firm size and market concentration using the Hirschman-Herfindahl Index. The FERC will also consider other factors such as ease of entry, the sophistication, knowledge and purchasing power of the buyer, the availability of substitutes or alternatives that would discipline price increases, and any changes the applicant would propose to mitigate any potential exercise of market power.[176]

The FERC also indicated that shipper-specific, negotiated rates could be permitted where the pipeline continued to provide its existing cost of service rates as a recourse for shippers in the event negotiations were unsuccessful. Such arrangements were seen by the FERC as offering increased market responsiveness in services without protracted disputes about market power. The FERC, however, had a number of concerns, including concerns about the potential for discrimination, the impact of special deals on other customers (*e.g.*, as to priority or flexibility) and the viability of the recourse rate as negotiated arrangements emerge. Comments on these issues were requested.[177]

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172 *Arkla Gathering Services Co. (Arkla I)*, 67 FERC §61,257 (1994); *Arkla Gathering Services Co. (Arkla II)*, 69 FERC §61,280 (1995); *Mid Louisiana Gas Co. and Fairbanks Gathering Co.*, 67 FERC §61,255 (1994); *El Paso Natural Gas Co.*, 72 FERC §61,220 (1995).

173 As noted above, Texas has a light-handed regulatory approach that would apply to such facilities after spin off or spin down. It is understood that a number of states have no regulation process to handle spun off/spun down operations.

174 *El Paso Natural Gas Co.*, *supra* note 172 at §62,019-62,020.

175 "Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines, Statement of Policy and Request for Comments," 74 FERC §61,076 (1996).

176 *Ibid.*

177 *Ibid.*

VIII. FUTURE DEVELOPMENTS IN CANADA

It is probable that within a year of this writing (June 1998) some degree of negotiating flexibility will be achieved by major Canadian transmission systems. In April 1998, an agreement was reached with the two largest gas transmission companies in Canada which, on the one hand, endorsed competition, in particular pipeline-to-pipeline competition, while also recognizing that existing pipelines should be given flexibility to compete. The parties to the agreement have committed to negotiate the changes required for flexibility by the end of 1998.[178]

XI. CONCLUSION

In conclusion, economic regulators are given a broad discretion to fashion the regulatory means to achieve the goals and purposes of regulation. The means to achieve the goals and purposes is a matter for the judgment and opinion of the regulator in light of the facts. Where negotiated arrangements between individual customers and a pipeline are seen by the regulator, having regard to the facts and circumstances of the case, as being capable of producing a reasonable result, then the statutory requirement of "just and reasonable" rates will be satisfied. The problem of discrimination can be addressed by a rules-based approach founded on the basic idea of fairness — treating similar cases similarly. This satisfies the statutory prohibition against unjust discrimination. The light-handed approach is subject to regulatory oversight through a complaints mechanism, ensuring that any problems which arise will be remedied. In short, the light-handed model allows market forces to operate within a rules-based structure that captures a basic concept of fairness with the whole subject to regulatory intervention if required. The well-developed, and fundamentally sound, conception of fairness as treating similar cases similarly is thus found to co-exist with and support a market-based approach to regulation.

[178] The 7 April 1998 "Agreement on Natural Gas Pipeline Regulations, Competition and Change, to Promote a Competitive Environment and Greater Customer Choice" among Canadian Association of Petroleum Producers, NOVA Corporation, NOVA Gas Transmission Ltd., Small Explorers and Producers Association of Canada, and TransCanada PipeLines Limited contemplates the emergence of pipeline-to-pipeline competition and changes in regulatory practices to provide all pipelines an equal opportunity to compete.