NATURAL GAS PRICING IN CANADA

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Setting out the historical developments which led to government control of natural gas pricing, this paper reviews the current legislative mechanisms and regulatory issues. It includes an examination of net-back pricing under the Petroleum Administration Act and Alberta's Natural Gas Pricing Agreement Act. Issues raised in the Alberta Public Utilities Board's Cost of Service Inquiry are analyzed, along with the special position of Alberta Gas Trunk Line Company.

I. INTRODUCTION

Until 1971 the pricing of natural gas in Canada had been a relatively uncomplicated matter. During the past eight years, and particularly the past five, many dramatic changes have taken place. These changes have been caused by social and economic events, and have resulted in increased involvement in the pricing process by both the provincial and federal governments. Government involvement has created a body of legislation and regulations designed to meet current conditions and to regulate and control the price of natural gas.

Because of the rapidity of the changes and the necessity of swift government action, much of the legislation was hurriedly drafted. Consequently, it was sometimes confusing and incomplete. The oil and gas industry is beginning to learn to live under these new rules and regulations, and the inevitable problem areas are beginning to surface. Recent hearings of the National Energy Board, the Alberta Public Utilities Board and the newly formed Alberta Petroleum Marketing Commission have served to underscore the problems. Undoubtedly, many of the difficulties will be resolved over time. In the meanwhile, the industry should understand the problem areas that exist, while participating in the changed pricing environment.

It is the purpose of this paper to briefly trace the historical events which have given rise to the existing pricing machinery, to examine the existing legislation and the problems it has created, to identify some of the more important and unresolved problem areas and to review current matters pending before regulatory boards which could have a significant impact on the pricing machinery.

II. HISTORY

Natural gas has nearly always been purchased from the producer under long term contracts commonly referred to as gas purchase contracts. These contracts have evolved over the years and contain many interesting features such as prepayment clauses, favoured nation clauses and take or pay provisions.[1] The price paid under such contracts depended upon many factors resulting from the negotiations of the purchaser and the producer. The price arrived at for the initial period of the contract was referred to as the base price. Most gas purchase contracts contained price escalation provisions, and many contained price re-determination provisions and favoured nation

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1. *See* Holland, *Comparative Analysis of Gas Purchase Contracts*, (1971) 9 Alta. L. Rev. 479.

clauses. All these were designed to increase the base price to the producer during the long period of the contract. The strongest influence on the amount of the base price for Canadian gas was the regulated field price in the United States. Those were the days of relatively cheap gas for Canadian customers.

The number of purchasers of gas from Canadian producers has always been small. Aside from the local utility companies which buy some of their requirements in the field as well as acquiring reserves, the major purchaser has always been Trans Canada Pipelines Limited, purchasing for sale to Eastern Canadian customers and to the export market in the U.S. In the early years, and until 1958, Trans Canada was the only purchaser of gas for removal from Alberta. At that time, the base price was about 10 cents per Mcf. In 1958, Alberta and Southern Gas Co. Ltd. began purchasing gas for removal, and the price increased by approximately 3.5 cents per Mcf. Because the two companies were buying in different areas of Alberta, the base prices remained fairly constant in the range of 13 to 14 cents per Mcf. This lasted until around 1969 when Consolidated Natural Gas Limited commenced contracting for larger volumes of gas in the expectancy that it would receive an export permit from the National Energy Board. This forced the base price up rather markedly: by 1972, Trans Canada's base price had increased to a provincial average of 16 cents per Mcf. The N.E.B.'s refusal of the Consolidated export application in 1971 removed the competitive element. Although it might have been expected that prices would level off, certain events, initiated by the Alberta and federal governments, caused further increases and added a new dimension to pricing considerations. The end result is that government has replaced private industry in the pricing of natural gas.

The Alberta government initiated an inquiry by the Alberta Energy Resources Board into the field price of natural gas. As a result of this inquiry, in August, 1972, the Board recommended that the field price of natural gas in Alberta be based on commodity value. On November 16, 1972, the Alberta government adopted this recommendation. In January, 1973, forthcoming amendments to the Alberta Arbitration Act[2] were announced with the intention of ensuring that prices fixed under price redetermination clauses in gas purchase contracts would be based on commodity value. The amendments were made in December, 1973 by passage of the Alberta Arbitration Amendment Act,[3] which became effective January 3, 1974. This Act provided that in any price re-determination under gas purchase contracts, the arbitrators would be required to use commodity value as the basis for determining the field price. In addition, it stipulated the new price would be effective at the earliest date under the contract, unless specifically excluded by the contract.

In 1972, Pan Alberta Gas Ltd. commenced purchasing natural gas in Alberta, thus increasing competition. Pan Alberta was offering 40 cents per Mcf., approximately double the amount then offered by the other purchasers. By 1973 it was becoming clear that the field prices

2. R.S.A. 1970, c. 21.
3. S.A. 1973, c. 88.

being paid were unsatisfactory to the government. In July, 1973, the E.R.C.B. reviewed the matter of field pricing again. It concluded that the 1973 average field price in Alberta was approximately 20 cents per Mcf., an increase of 3.5 cents over 1972, but 7-18 cents per Mcf. below the Board's estimate of a proper field price based on commodity value. Also during 1973, the government announced that there would be no further gas export permits until the price paid had increased to its proper value.

During 1973 and while, with the support of the government, natural gas pricing was moving toward commodity value pricing, the Organization of Petroleum Exporting Countries (O.P.E.C.) began a rapid escalation in petroleum prices. The jump in prices caused the Canadian and U.S. governments to take steps to control domestic prices. On September 4, 1973, Canada froze the average price of Alberta crude at $3.80 per barrel. The N.E.B. refused applications for crude oil exports to the U.S. because the export price, based on the frozen price, was too low. The Federal government then announced a federal export tax in an amount equal to the differential established by the N.E.B. This step touched off the well-known row between Alberta and Ottawa over control of provincial oil and gas resources and resulting revenues. In December, 1973, Alberta convened a special session of the Legislature to deal with the many energy-related problems which had arisen during the preceding years, particularly the constitutional question of Alberta's right to control its resources.

Several important pieces of legislation were enacted at this session of the Legislature, which became known as the "Energy Session". One of the major purposes of the session was to provide the machinery to keep control of the marketing and pricing of Alberta's petroleum resources within the constitutional framework of the B.N.A. Act.[4] The Petroleum Marketing Act[5] was enacted, amendments were made to the Mines and Minerals Act,[6] and the Freehold Minerals Taxation Act[7] was passed. It is not within the ambit of this paper to review the constitutional aspects and justification for this legislation. What is significant, however, is the passage of the Petroleum Marketing Act which provided for the establishment of the Alberta Petroleum Marketing Commission (A.P.M.C.). That commission was given the power to set prices, to sell and to set the terms of sale for all petroleum produced from Crown lands. Because of the preponderance of production of petroleum from Crown lands in Alberta (approximately 80%), the price and terms set by A.P.M.C. effectively control the pricing and marketing of freehold petroleum.

Throughout 1974 world petroleum prices continued to escalate. The dispute between Alberta and Ottawa also continued, with the main emphasis being the price for Alberta petroleum products. Each government seemed to agree that there should be one domestic price, but the price level was a continued source of contention. In April,

4. R.S.C. 1970, Appendices.
5. S.A. 1973, c. 96.
6. R.S.A. 1970, c. 238, as amended by the Mines and Minerals Amendment Act 1973, S.A. 1973, c. 94.
7. S.A. 1973, c. 89.

1974, the Federal government introduced Bill C-18, the Petroleum Administration Act. Passage of this Act did not take place until June 19, 1975, because of the intervening federal election in July, 1974. Part III of the Petroleum Administration Act[8] deals with natural gas pricing and is significant to any discussion of the subject.

The Act made provision to regulate the price of crude oil and natural gas in interprovincial and export trade. In brief, it provides the legislative authority for the Minister to enter into agreements with individual provinces to establish a price for gas delivered outside that province. Failing such agreement, the federal government has the authority, upon the coming into force of s. 51, to unilaterally establish the price. Section 53 prohibits the sale or purchase of gas outside the province of production at a sale other than the prescribed price, that is, approved by the National Energy Board. In addition, s. 64 provides for the flowback to producers of certain amounts resulting from the sale of gas outside Canada.

The legislative groundwork was now in place for the federal government to establish a domestic and export price for natural gas. In the June 23, 1975, budget speech, the federal government announced that as of November 1, 1975, the price for natural gas in Alberta would be established on the basis of an increase at the Toronto City Gate from the current price of approximately 82 cents to $1.25 per 1000 cubic feet. On October 17, 1975, the Alberta and federal governments entered into a letter agreement which provided for the establishment of an imputed Alberta border price for natural gas removed from Alberta. To provide legislative sanction for the letter agreement, on November 25, 1975, the Alberta government passed the Natural Gas Pricing Agreement Act.[9] The legislation was effective November 1, 1975, the date when the Toronto City Gate price had been established. The new government-imposed price replaced all previous considerations. During the past two years, the industry has been trying to cope with the new environment and the new laws and regulations stimulated by it. Predictably, many difficulties have arisen.

It is hoped that this historical background will provide a framework for the discussion which follows, and that it has shown how matters originally the subject of private contract have now become matters of public policy almost fully regulated by government.

III. NET-BACK PRICING[10]

The phrase "net-back pricing" is commonly used in the oil and gas industry. It describes, quite succinctly, the mechanism used for determining the wellhead price of natural gas since November 1, 1975. The Alberta producer now receives a wellhead price arrived at by deducting from the Toronto City Gate price (established by agreement between

8. S.C. 1974-75, c. 47, hereinafter referred to as the "Petroleum Administration Act".
9. S.A. 1975, c. 38, as amended, hereinafter referred to as the "Natural Gas Pricing Agreement Act".
10. For a more detailed discussion of the issues raised in this section, *see* Edie, *Natural Gas Pricing in Canada*, (1976) 14 Alta. L. Rev. 455, and Saville, *The New Regime in Natural Gas Pricing in Alberta*, (1977) 15 Alta. L. Rev. 538.

the Alberta and federal governments) the cost of service of moving the gas from the wellhead to the Toronto City Gate.

The legislative foundation for net-back pricing is contained in two statutes and a letter agreement between the federal and Alberta governments dated October 17, 1975.

A. The Petroleum Administration Act

The first of these statutes to be enacted was the Petroleum Administration Act, passed on June 19, 1975, with retroactive effect to April 1, 1974. Part III of that Act deals specifically with natural gas and is entitled "Domestic Gas Price Restraint". Sections 48 and 49 set out the application, purpose and methods of the Act:

> s. 48. Application. This Part applies to gas that enters into interprovincial or international trade.
>
> s. 49. Purpose. The purpose of this Part is to provide legislative authority for measures that will, so far as may be practicable, enable the Government of Canada
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> (a) to achieve a uniform price, exclusive of transportation and services costs, for gas used in Canada outside its province of production;
>
> (b) to achieve a balance in Canada between the interests of consumers and producers in Canada;
>
> (c) to protect consumers in Canada from instability of prices for gas and to preserve a reasonable balance between the prices of alternative fuels in Canada; and
>
> (d) to encourage the discovery, development and production of a supply of gas adequate to the self-sufficiency of Canada.

Few statutes provide such a clear expression of the intention of the legislators. Section 48 makes it clear that the government of Canada is confining its jurisdiction to the pricing of natural gas that enters into interprovincial or international trade. The Act provides the machinery for the establishment of the "prescribed price". Section 50 authorizes the Minister, with the approval of the Governor-in-Council, to enter into an agreement with a producer-province to establish a mutually acceptable price for various kinds of gas produced, extracted, recovered or manufactured in that province. Once an agreement is entered into, s. 51(1) enables the Governor-in-Council, by regulation, to prescribe prices at which such gas is to be sold on or for delivery in Canada outside that province or at any points on the international boundary of Canada. Although the Act does not specifically say so, presumably the agreed price with the producer-province becomes the 'prescribed price'. That is the procedure which has been followed to date. Section 51(2) provides the main criteria to be followed in establishing the prescribed price:

> s. 51(2). For the purpose of establishing prices pursuant to subsection (1), the Governor-in-Council shall have regard to such matters as he deems requisite from time to time to achieve the purpose of this Part including
>
> (a) transportation and other costs applicable to the movement of gas;
>
> (b) the kinds of gas produced, extracted, recovered or manufactured in Canada;
>
> (c) the prices of alternative fuels in interprovincial markets; and
>
> (d) the probable effect on the producers and consumers in Canada of establishing prescribed prices for the various kinds of gas.

The combined effect of these sections is to permit the federal government to prescribe the price to be paid for natural gas provided there is an agreement with a producer-province. In the absence of such an agreement, or if any such agreement is terminated or not capable of being effective, s. 52(1) permits the Governor-in-Council to prescribe prices for various kinds of gas. Although s. 52(1) only comes into force upon proclamation, and no such proclamation has been made, ss. 52(2) (3) (4) and (5) set up the machinery for a rapid debate by the House of Commons on any proclamation. Accordingly, if no agreement is signed with a producer-province, Parliament can readily give the Governor-in-Council authority to prescribe the appropriate price.

Section 53(1) also prohibits certain transactions which would violate the clear intention of the Act:

s.53(1) No person shall . . .

. . . (c) sell or purchase any kind of gas outside its province of production unless the price paid therefor is the prescribed price for that kind of gas.

(2) Paragraph (1)(c) does not apply in respect of a sale of gas in a province for consumption therein if the gas is purchased in that province otherwise than from a person who brought the gas out of its province of production or caused it to be brought therefrom.

Section 53(2) is designed to avoid any constitutional problem with the legislation, and s. 53(1)(c) makes the prescribed price a mandatory price for the sale or purchase of gas outside its province of production.

The Act also establishes very serious penalties for any contravention of s. 53. Under s. 58, the Crown can proceed by way of indictment or summary conviction. On summary conviction a person is liable to a fine of up to $20,000 or to six months imprisonment or to both. A conviction upon indictment permits imprisonment only for a term not exceeding two years. It should be noted that s. 58(2) provides that any officer, director or agent of the corporation who directed, authorized, assented to, acquiesced in or participated in the commission of the offence is a party to and guilty of the offence and liable to the same penalty whether or not the corporation has been convicted or not. Furthermore, where an offence is committed on more than one day, it shall be deemed to be a separate offence for each day. Reference is made to these sections to alert industry to the danger of entering into agreements which may accidentally and unintentionally violate any of the s. 53 prohibitions.

Section 64, sometimes referred to as the "flowback provision", has probably given rise to the most comment. Under existing circumstances, its only practical application would appear to be in respect to export sales, although the wording of the section has equal application to domestic sales outside the province of production. Section 64(1) provides that where gas is purchased and transported and resold by the purchaser outside its province of production (including any point on the international boundary), the purchaser shall distribute to the producers, on a monthly basis in accordance with the regulations, any excess revenue received by the purchaser for its monthly gas sales over its cost of service for that month, as determined by the N.E.B., including its cost of gas. The cost of gas is computed by using the wellhead price if approved by the Board or by such other means as the Board prescribes. Section 64(2) treats the same subject in reference to gas purchased and transported by a person other than its purchaser. In that case, the purchaser distributes to the producer the excess of the total value, as determined by the N.E.B., of the purchaser's cost, also determined by the Board, in respect to the acquisition and transportation of that gas to its points of delivery.

Section 64 is designed to return to the producers certain excess funds in the hands of gas purchasers, and to stimulate further exploration in the province of origin. This seems to flow from one of the purposes of the Act found in s. 49(d), namely, to encourage the discovery, development and production of a supply of gas adequate to the self-sufficiency of Canada.

B. *The Letter Agreement*

Following the enactment of the Petroleum Administration Act, an agreement pursuant to ss. 50 and 51 was reached between the Alberta and federal governments. This took the form of an exchange of letters between the federal Minister of Energy and Natural Resources and the Alberta Minister of Energy and Natural Resources, dated October 17, 1975. The letters are contained in Alberta Regulation 318/75 and amendments thereto, passed pursuant to the Natural Gas Pricing Agreement Act. They create a nexus between the Petroleum Administration Act and Alberta's Natural Gas Pricing Agreement Act.

The purpose of the letter agreement was to establish a regulated price for Alberta gas while avoiding any constitutional conflict between the Alberta and federal governments over the question of jurisdiction. The price originally established as the Toronto reference price was $1.25 per Mcf. This has been amended several times. The latest amendment, on August 31, 1977, establishes the Toronto reference price as 185 cents per million B.T.U.'s commencing February 1st, 1978 and ending July 31st, 1978.

It should be noted that paragraph 8 of the letter agreement states it can be terminated prior to its expiration upon 90 clear days' notice by either party. Paragraph 9 reads as follows:

> 9. Each Government acknowledges that this proposal and your Government's acceptance thereof shall not affect or prejudice the constitutional rights and powers of either Government.

The governments have left in abeyance any question of constitutional jurisdiction. As long as suitable agreements can be worked out, the legislation will not be challenged in the courts. However, a confrontation between the validity of the Petroleum Administration Act, Part III, and the Alberta Natural Gas Price Administration Act could occur if an agreement cannot be concluded in the future. Such a confrontation seems to be unlikely as long as the federal government moves domestic oil prices towards international levels and keeps the price of gas at an appropriate competitive relationship with oil. But the following remarks made by Premier Lougheed to the Canadian Petroleum Association on April 20th, 1978, are indicative of storm clouds on the horizon:

> I am bothered by the over-building that we have had in Central Canada of refinery capacity relying upon inexpensive imported foreign oil. It is creating an unfortunate situation by backing residual fuel oil into a natural market for Alberta natural gas production. I am concerned about this in a number of ways. Concerned first of all because it involves crude oil coming in on a subsidized basis and affecting domestic energy exploration. There must be an all-out effort by all of us involved for a reversal of this situation. It's going to be difficult. One of the difficulties, of course, is the price insensitivity of the residual fuel oils to adjustments that we might make in our natural gas pricing position. One of the other difficulties — this is one that really gets me angry, but I will say it with restrained emotion tonight — not only have they built Petrosar — 170,000 barrels a day of Alberta crude, to the detriment of jobs for Albertans in the petrochemical industry. That's kicking us in one shin. They now kick us in the second shin because the residual fuel production coming out of that operation is significantly aggravating our domestic natural gas market in central Canada. I have never seen any sound

energy policy connected with the Petrosar project. I would hope that this would be the best lesson to illustrate the need to recognize that a "federal" energy policy must in the future be a "national" energy policy.

In addition to the Toronto reference price discussed above, the letter introduced the concept of an imputed Alberta border price. This means the Toronto reference price less the cost of all transmission and metering and all other costs associated with the movement from the Alberta-Saskatchewan border to Toronto, as determined by the N.E.B. The concept is used to determine an Alberta border price so that prices and costs relating to that gas can be established from that point.

In order to provide producers with the benefit of higher prices for export gas, which are established by the N.E.B., the letter agreement provided for distribution to producers of an amount referred to as the "export differential". The export differential, in summary, is the proceeds of sale at the international border price for gas delivered at the border point less the transmission costs from the Alberta border as determined by the N.E.B. and less the amount which would have been received if sold at the imputed Alberta border price at the Alberta border.

C. *The Natural Gas Pricing Agreement Act*

The Natural Gas Pricing Agreement Act completes the legislative package of gas pricing. It gives effect to the letter agreement which had pre-dated the legislation; it also provides the machinery to determine the field price received by the Alberta producer and to flowback excess money resulting from U.S. export sales to the producers.

Section 10 provides for two different prices to be paid to producers, depending upon the destination of the gas. First, for the gas intended to be removed from Alberta, the price shall be the Alberta border price (which is the same as the imputed Alberta border price referred to in the letter agreement) plus the price adjustment less the Alberta cost of service. The latter is defined in the Act and will be discussed later. Secondly, the price for gas sold for consumption in Alberta shall be the lesser of: (a) the Alberta border price plus the price adjustment, less the amount estimated by the Alberta Petroleum Marketing Commission for the Alberta cost of service to move the gas from the contract delivery point to a point on the Alberta border specified by the Minister, assuming the gas were to be moved to that point and pipeline facilities were available; *or* (b) an amount equal to the contract field price (defined by the Act) plus the price adjustment. These prices are defined to be the "regulated field price" under the Act.

It should be noted that under s. 10(3.1), the above pricing provisions do not apply where raw gas is delivered under a gas sales contract, processed in a processing plant by the original buyer, and the marketable gas recovered sold by him in Alberta. Specific provision is made for the price in these circumstances by ss. 10(3.1)(b) and (c).

It should also be noted that s. 11 effectively removes the possibility that renegotiation or arbitration or price redetermination with respect to the contract price can be used to raise regulated field price. The contract field price becomes the regulated field price and is then restricted by s. 11.

The Act also provides for the compulsory purchase and resale of gas by owners and the price to be paid therefor. Section 14 provides:

14. (1) The Commission (A.P.M.C.) may by order direct that any owner of gas in Alberta shall deliver the gas to the Commission at the point within Alberta prescribed in the order.

Section 14(3) specifies how the owner will be compensated by the Commission. The compensation differs depending upon the destination of the gas. In the case of gas intended to be removed from Alberta, the price is the Alberta border price less the Alberta cost of service. In the case of gas intended for consumption in Alberta, the price is equal to the *lesser* of the contract field price plus the Alberta cost of service from the contract delivery point to the delivery point specified by the Commission *or* the Alberta border price minus the amount estimated by the Commission as the Alberta cost of service from the delivery point specified to a point on the Alberta border.

The vast majority of the gas produced in Alberta is purchased in this manner, as is all gas which is sold to the U.S. export market. The Commission purchases and takes ownership of the gas and instructs the owner to deliver it at a certain point. The gas is then sold back to the party from whom it was purchased at the price determined under s. 14(5). If the gas was intended for consumption outside Canada, the resale price is the international border price, less the Canadian and Alberta cost of service. Because the price paid by the Commission was only the Alberta border price less the Alberta cost of service, the Commission has received an excess on the transaction. This excess is held by the Commission in a fund established by s. 16 and entitled the "Natural Gas Pricing Agreement Act Fund". All gas other than gas intended for export is purchased and resold by the Commission at the same price.

The Commission determines monthly the excess funds received in this manner. After dividing the total amount by the gas produced in the province during that month, it establishes and publishes a monthly price adjustment figure for the gas delivered that month. This amount is distributed to all producers.

The foregoing illustrates that significant factors in the price to be paid to any producer are the Alberta cost of service and the Canadian cost of service. Under the existing machinery, the amount of these costs has a direct bearing on the net-back to the producer at the well-head. During the past two years, there have been vigorous efforts by producers to deal with these costs. The next portion of the paper deals with this problem.

IV. COST OF SERVICE

Alberta cost of service is defined in the Natural Gas Pricing Agreement Act as follows:

s. 1. 1(b) "Alberta cost of service" with respect to any gas or the movement of any gas means the costs and charges, wherever incurred,

(i) that are attributable to the acquisition of the gas by the original buyer, except the contract field price or the regulated field price, whichever applies,

(ii) that are associated with the movement and metering of the gas in Alberta,

(iii) that are related to any processing required to cause the gas to become marketable gas or that are otherwise related to the supply of the gas, and

(iv) that consist of interest or other costs or charges which, under a contract entered into prior to November 1, 1975, were recoverable by the original buyer from the price at which he sold the gas, or any portion of those costs or charges, as determined by the Commission.

One of the responsibilities the Minister delegated to the Commission was the determination of the Alberta cost of service described in the Act. Because the Commission experienced difficulties in trying to work out a policy concerning what should be included in the Alberta cost of service, it met with various representatives of producer organizations in trying to establish guidelines. A consensus could not be reached, so the Commission recommended that the Public Utilities Board conduct an inquiry into the Alberta cost of service.

The Public Utilities Board was designated by Order-in-Council 1016/76, dated September 21, 1976 to:

> . . . conduct an inquiry into the principles and methods which should apply to the determination of the Alberta cost of service . . .

Public hearings were held for 43 days during 1977. All parties affected by the Alberta cost of service were given an opportunity to make submissions and present evidence relating to the principles and methods which they considered appropriate.

Because the charges of Alberta Gas Trunk Line Company Limited (A.G.T.L.) formed the largest element of the Alberta cost of service, it was only natural that the principles and methods used by A.G.T.L. in establishing those charges became the central issue in the Inquiry. The Commission did not believe it had jurisdiction to question the charges of A.G.T.L. under the Natural Gas Pricing Agreement Act, and simply allowed them in the Alberta cost of service which it approved. As a result, considerable time in the inquiry was given to the question of placing some control over the A.G.T.L. charges.

Final arguments were filed with the Public Utilities Board in the Cost of Service Inquiry in February, 1978, but to date no report has been released. The industry is anxiously awaiting the report and recommendations.

There are still many uncertainties which will not be resolved until the P.U.B.'s findings are made known. The Commission continues to determine and approve the Alberta cost of service pursuant to the Natural Gas Pricing Agreement Act and the regulations passed thereunder. Section 7 of the Natural Gas Pricing Agreement Act provides for an appeal to the P.U.B. from any determination or estimation of the Alberta cost of service by the Commission. The procedure for appeal is set out in ss. 6 and 7 of the Regulations. Appeals are available to producers or original buyers. In recent months the Commission approved an application to include take or pay payments in the Alberta cost of service and this decision has been appealed by a group of producers. The appeal has not yet been heard.

Because the largest element in the Alberta cost of service is the A.G.T.L. and the Commission has no jurisdiction to determine those charges, any party who has a complaint against those charges must complain to the P.U.B. pursuant to ss. 30(1) and (3) of the Alberta Gas Trunk Line Act.[11] This section will be referred to later, and was the

11. S.A. 1954, c. 37, as amended, hereinafter referred to as the "Alberta Gas Trunk Line Act".

subject of considerable comment at the Cost of Service Inquiry. Until July 1977, there had only been one complaint filed against A.G.T.L. under that procedure. In July 1977, a group of producers launched a complaint against A.G.T.L. in respect to certain increases in its charges on July 1, 1976, resulting from changed depreciation rates and a change in its method of treatment of income taxes. This complaint was heard in April, 1978, but no decision has yet been reached.

Unquestionably, in future, there will be ever increasing vigilance on the charges of all transmission companies. It can be expected that producers will be taking an active part in any rate applications before the N.E.B. in respect to Trans Canada Pipelines Limited and Westcoast Transmission Company Limited. The procedures for regulating the charges of the transmission companies under its jurisdiction are well established by the N.E.B., however, in the case of A.G.T.L., there appears to be a regulatory gap which has been magnified by the advent of net-back pricing. Whether or not this gap is satisfied by the existing complaint procedure is a matter of considerable debate. The situation of A.G.T.L. in the existing scheme of things deserves special attention.

V. ALBERTA GAS TRUNK LINE CHARGES

Alberta Gas Trunk Line Company Limited (A.G.T.L.) was incorporated by special act of the Alberta legislature primarily for the purpose of acting as a carrier of natural gas located within Alberta destined for removal from Alberta. It serves as a contract carrier within the province, gathering and transporting natural gas, both for delivery within the province and to Alberta border points to connect up with extra-provincial transmission lines. It occupies a virtual monopoly position for the transmission of gas.

Before November 1st, 1975, A.G.T.L. charges were recovered from shippers with whom it had negotiated transportation agreements. Those shippers in turn passed the charges along to the ultimate consumer. The shippers, mainly Trans Canada Pipelines Limited, were subject to public scrutiny and regulatory control and thus had a direct financial interest in the amount of A.G.T.L. charges. If the charges did not stand up to regulatory control, the shipper would be at risk. This element of downstream control disappeared with the introduction of net-back pricing. The result is that, theoretically at least, shippers have no financial risk in negotiating the A.G.T.L. charges under the transportation agreements, because payment of the charges simply results in a reduced net-back to the producer. In view of the fact that s. 30 of the Alberta Gas Trunk Line Act gives A.G.T.L. the power to set its own charges, and that s. 16 excludes it from the provisions of the Gas Utilities Act,[12] it is not surprising that the A.G.T.L. charges, in the absence of regulatory control, can become suspect by the producers who bear their impact.

This concern was expressed at the Cost of Service Inquiry. Although there were divergent views, it was generally considered that some form of regulatory control is necessary. A.G.T.L.'s position was that the present complaint procedure is adequate. It remains to be seen what the P.U.B.'s recommendations will be.

12. S.A. 1970, c. 158, as amended.

Because the complaint procedure is still in place, some consideration should be given to it and its possible defects.

Under the Act, A.G.T.L. is empowered to fix and vary the rates, tolls and other charges for its services. No other legislation derogates from that right. Sections 30(2), (3) and (4) provide for a complaint procedure:

s. 30(2) Upon complaint in writing of an interested party Public Utilities Board may, or upon the direction of the Lieutenant Governor in Council shall, after notice to and hearing of the parties interested, determine the justness and reasonableness of the rates, tolls or other charges fixed or varied by the company and by order in writing may vary or confirm the rates, tolls or other charges.

(3) Where the Public Utilities Board varies a rate, toll or other charge fixed or varied by the company, its order shall specify that the variation shall remain in full force and effect until a specified date or until the date of the happening of a specified event but in no case shall the period involved exceed 12 months.

(4) The provisions of Part 1 of The Public Utilities Board Act apply with respect to matters within the jurisdiction of the Public Utilities Board under this section in so far as they do not conflict with the provisions of this section.

A reading of the section points out several areas of uncertainty. These are:

1. The complaint is *after* the event. This is the reverse of normal regulatory approval.
2. No time limit is specified for filing the complaint.
3. The hearing of the complaint is discretionary.
4. The operative date of any order made is uncertain. Is it the date the rate is established, the date the complaint is filed, or the date of any order made?
5. Any order made is effective for only 12 months.

All these matters remain to be dealt with and determined. Possibly the P.U.B. Inquiry will initiate some legislative clarification. For the moment, the operative date of any order is arguable and may require future court determination.

VI. COST OF SERVICE INQUIRY – ISSUES

In addition to possible regulatory control of A.G.T.L., several other issues which impact on the Alberta cost of service in a material way were fully reviewed by the P.U.B. at the Inquiry. This paper can do little more than note several of them:

1. Normalized v.s. flow-through treatment of income taxes
2. Methods of depreciation
3. Take or pay payments
4. Carrying charges on advance and take or pay payments
5. Rate of return
6. Return to companies with zero rate base-brokerage fee
7. Allocation of A.G.T.L. costs – postage stamp, zone, etc.

Perhaps some of these issues will be resolved in the next few months. Some of the principles, at least, are presently under review in a factual context. A group of producers, utilizing the complaint procedure in the A.G.T.L. Act, have raised the issues of proper income tax treatment and depreciation rates used by A.G.T.L. In addition, the P.U.B. convened a hearing for the purpose of developing a position paper on the question of normalized versus flow-through tax treatment for utility companies in Alberta. This hearing was recently concluded, with arguments filed in July, 1978.

At the moment, therefore, there are three panels of the P.U.B. dealing with the question of whether the normalized or flow-through method of income tax treatment should be adopted for regulatory purposes. The decisions of the Board in these matters will have considerable impact on all producers in the oil and gas industry.

In a recent decision of the N.E.B. released on or about May 26, 1978, Westcoast Transmission Company Limited was permitted to adopt normalized treatment for income tax purposes and to collect past deferred taxes. This is a significant decision because in the past the Board refused permission to Trans Canada Pipelines Limited to do the same thing. It will be interesting to see the position adopted by the Board in the present Trans Canada Pipelines Limited hearing concerning the same matter.

VII. CONCLUSION

It is now clearly established that the pricing of natural gas in Canada is almost purely a matter of government regulation. It is unlikely that such regulation will be removed in the future. It also seems that commodity value pricing is likely to be continued. However, depending upon the relationships between Alberta and the federal government, the constitutional justification for the legislative machinery now in place could give rise to further confrontations and possibly to court determinations.