NATURAL GAS DEREGULATION: REVIEW AND PERSPECTIVE

ALLAN L. McLARTY AND DAVID A. HOLGATE*

This paper presents a review of the development of the statutory framework for implementing natural gas regulation in Canada and the steps in the process of "deregulation" followed by a discussion of some of the major outstanding issues arising directly from the process of deregulation. Some of the issues discussed in the context of deregulation include the federal and Alberta surplus tests, the pressure on existing long-term gas contracts being exerted by consumer provinces, the bypass option and Alberta gas removal permit procedures.

I. INTRODUCTION

The deregulation of natural gas pricing in Canada, for both the domestic and export markets, has been a popular topic for debate among lawyers for some time now. Initially, there was a flurry of discussion about why governments should get out of the gas pricing business. When the governments finally came to the same conclusion, there was a new flurry of discussion about how the deregulation process should occur. Now that the initiatives taken by the federal and provincial levels of government to deregulate gas pricing are in place, the new debate centres on the efficacy of the steps taken to move the natural gas industry towards a competitive and market-sensitive pricing regime untrammeled by restrictions on access to pipelines and markets.

To deal with the extent to which gas price deregulation has occurred requires some understanding of how regulation of gas pricing was implemented, how the statutes and regulations dealing with gas pricing have changed over the years and what has happened to those statutes and regulations since 31 October 1985, the acknowledged deregulation date. With an understanding of this background it is easier to assess how far deregulation has proceeded and how far it has yet to go.

In reviewing the history of regulation and the process of deregulation, this paper emphasizes *what* has occurred on the domestic scene rather than *why* it has occurred. As most of the steps towards deregulation relate to domestic pricing, transportation and market access this paper also provides little in respect of export pricing beyond the historical review.

Finally, the competition between the federal and provincial governments for the right to influence or control gas prices, both during the period of regulation and since deregulation, raises several important constitutional issues. Although some of these issues are identified they are not discussed in detail.

II. GAS PRICING AND REGULATION

A. GENERAL

Before dealing with the mechanics of how, in spite of the jurisdictional claims of the Federal and provincial governments, the system was implemented and then dismantled, it is important to stress that gas pricing

* Partners, Fenerty, Robertson, Fraser & Hatch, Calgary, Alberta.

regulation and deregulation in Canada has only occurred by intergovernmental agreement. The myriad of statutes and regulations at the federal and provincial levels were put in place to provide the framework for implementing principles already agreed upon.

B. REGULATED GAS PRICING AGREEMENTS

Prior to the conclusion of the first Agreement between the Government of Canada and the Government of the Province of Alberta, in November 1975,[1] the price of Canadian gas was largely determined by contract. In Canadian domestic markets, the price was determined by adding together the amount paid by the ex-Alberta buyer to the gas producer in Alberta and the cost of service incurred in transporting the gas to market.

The 1975 Agreement introduced the concept of "netback pricing" thereby negating the pricing provisions of all ex-Alberta gas contracts. A Toronto City Gate Price was set by agreement and the Federal Government set the export price which was common for all export points (with one minor exception). The Alberta Border Price was determined by deducting from the Toronto City Gate Price the cost of service incurred by the transmission company in transporting the gas to market from the Alberta border. The price paid to the Alberta producer was determined by further deduction from the Alberta Border Price of the cost of service incurred in gathering and moving the gas within Alberta. As a consequence of this arrangement, the Alberta producers, although benefiting from higher prices, became responsible for any increase in the cost of service of the transmission companies, both inside and outside Alberta, whether the gas was destined for domestic or export markets.

The 1975 Agreement also created the concept of "export flowback", by which two prices for natural gas were established: the domestic price and the export price. Simplistically, the difference between the two prices was allowed to flow back to all Alberta producers. Consequently, no matter with whom an Alberta producer contracted to sell gas, the price received per unit of gas sold was the same, being comprised of the Alberta Border Price plus the export flowback less the Alberta cost of service relating to the gas. The export flowback was determined by deducting from export revenues the cost of service involved in transporting the gas to the Canadian border.

This regulated gas pricing regime was altered with the National Energy Program in October, 1980 and the subsequent Canada/Alberta Agreement on Energy Pricing and Taxation of September 1, 1981 and the Canada/Alberta Agreement Respecting Gas Pricing and Market Development Incentive Payments of November 25, 1981.[2] The two Agreements operated so as to minimize the Alberta producers' responsibility for transportation costs by moving the pricing point from the Toronto City Gate to the Alberta border. Additionally, the "flowback" system was confirmed and Alberta agreed to a discount of 30 percent on new sales to fund a federally administered program for transmission and distribution system expansions.

1. *See* Alberta O.C. 1499/75, incorporated in Alta. Reg. 318/75; Canada P.C. 1975-2439.
2. Incorporated in Alta. Reg. 412/81.

The Agreements additionally provided for a fixed schedule of annual price increases of 50 cents/Mcf at the Alberta border over the term of the Agreement, being to January 31, 1987. Concurrently, the Federal Government committed to keep the price for Alberta gas in Eastern Canada at 65 percent of the price of crude oil. The commitment was, for some time, maintained by the Federal Government through downward adjustment of the Federal excise tax on natural gas, pursuant to the Natural Gas and Gas Liquids Tax ("NGGLT").[3] However, with the subsequent decline in the world price of oil occurring at the same time as the agreed increases in the Alberta Border Price of natural gas, it became increasingly difficult for the Federal Government to maintain the 65 percent gas/oil price ratio. This difficulty resulted in an Amending Agreement, dated June 30, 1983, between the Government of Canada and the Government of Alberta. The Amending Agreement was for a term of 18 months and focused on the retention of the price of natural gas in Canada at a level no higher than 65 percent of the price of oil. To effect this goal, the Federal Government agreed to continue to reduce the NGGLT to zero, if necessary. Once that tax reached zero, the Alberta Government agreed that the Alberta Border Price of gas would be adjusted to maintain the 65 percent gas/oil price ratio. Additionally, the Federal Government agreed to subsidize transmission tolls to ensure that from the period August 1, 1983 to January 31, 1985, the toll increases would not exceed five percent of the June 30, 1983 toll level. The June 30, 1983 Agreement included a formula for calculation of the Alberta Border Price as 65 percent of the Toronto Refinery Acquisition Cost ("TRAC") less the transmission company tolls, the Canadian Ownership Special Charge ("COSC"), and the Federal excise tax, if any. During the period February 1, 1984 to August 1, 1984, the Alberta Border Price would only change by the lesser of the previously agreed increase or 65 percent of TRAC less transmission tolls less COSC less the previously prevailing Alberta Border Price.

C. FEDERAL REGULATION OF GAS PRICING

The Federal legislation which provides the framework for these agreements on natural gas pricing is found in Part III of the Energy Administration Act (EAA).[4] Pursuant to section 48 of the EAA, Part III, gas that "enters into interprovincial or international trade" is made subject to federal jurisdiction. Section 50 empowers the Minister of Energy, Mines and Resources of Canada to enter into an agreement with the Government of a "producer-province", defined in section 47 as:

> a province in which the quantities of gas ordinarily produced, extracted, recovered or manufactured in that province in a month are such that a significant quantity of that gas is normally available for use outside that province in each month

for the purpose of establishing mutually acceptable prices for the gas during such period as may be agreed upon. Section 51(1) provides:

> Where an agreement is entered into with a producer-province under section 50, the Governor in Council may, by regulation, prescribe prices at which the various kinds of gas

3. Excise Tax Act, R.S.C. 1970, c. E-13; Part IV.1 enacting the Natural Gas and Gas Liquids Tax was added by S.C. 1980-81-82-83, c. 68, s. 43, as am. by S.C. 1980-81-82-83, c. 104, and S.C. 1985, c. 3.
4. S.C. 1974-75-76, c. 47, Part III am. by S.C. 1980-81-82-83, c. 114, ss. 20 to 28.

> to which this Part applies that are produced, extracted, recovered or manufactured in that province are to be sold on or for delivery in any areas or zones in Canada and outside that province or at any points of export from Canada.

Section 52.1 confers on the Governor in Council companion authority to establish regulations "to prescribe prices for gas when there is no agreement with a producer-province".

Section 51(2) of the EAA sets out the factors to be considered by the Governor in Council in establishing gas prices, as follows:

> (2) For the purpose of establishing prices pursuant to subsection (1) or section 52.1, 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
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> (a) transportation and other costs applicable to the movement of gas;
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> (b) the kinds of gas produced, extracted, recovered or manufactured in Canada;
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> (c) the prices of alternative fuels in inter-provincial markets; and
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> (d) the probable effect on the producers and consumers in Canada of establishing prescribed prices for the various kinds of gas.

Following the Canada/Alberta Agreement of November 25, 1981,[5] the Natural Gas Prices Regulations, 1981,[6] were promulgated pursuant to section 51(1) of what was then the Petroleum Administration Act,[7] now the EAA. Those Regulations refer to the Agreement with Alberta under section 50, and go on to provide for the actual price determination in section 3 and the Schedule to the Regulations. Prior to the October 31, 1985 Agreement, the Natural Gas Prices Regulations were periodically amended to track the Alberta Border Price prescribed by the current Canada/Alberta Agreement.

D. ALBERTA REGULATION OF GAS PRICING

The provincial statute established as the framework to govern natural gas pricing is the Natural Gas Pricing Agreement Act[8] (NGPAA) as amended by the Natural Gas Pricing Agreement Amendment Act, 1986.[9] Section 4 of the NGPAA empowers the Minister of Energy and Natural Resources of Alberta to enter into an agreement on behalf of the Government of Alberta with the Government of Canada for the purpose of establishing prices for gas. By section 4(2), a federal-provincial agreement may provide for the determination of an amount as the "Alberta border price" for the term of the agreement. Section 1(1)(a) of the NGPAA provides:

> "Alberta border price" means, with respect to the term of a federal-provincial agreement or any period during that term, the amount determined as the Alberta border price for the term or that period, as the case may be, under the federal-provincial agreement.

Alberta Regulation 412/81 filed on November 20, 1981, approved the entry into an agreement in the form of the November 25, 1981 Canada/ Alberta Agreement by the Minister of Energy and Natural Resources on behalf of the Government of Alberta. Alberta Regulation 28/84 gives

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5. *Supra* n. 2.
6. SOR/81-973, as am.; revoked by SOR/86-838.
7. *Supra* n. 4; title of statute changed by S.C. 1980-81-82-83, c. 114, s. 2.
8. R.S.A. 1980, c. N-4, as am.
9. S.A. 1986, c. 26.

approval to enter into the Amending Agreement in the form attached thereto, which form effectively consolidates the September 1, 1981, November 25, 1981 and June 30, 1983 Agreements. Similarly, subsequent amendments to the Canada/ Alberta Agreement have been incorporated by Regulation.[10] As a result of these amendments, for the twenty-seven month period commencing August 1, 1984 and ending October 31, 1986, the Alberta Border Price, as prescribed by Regulation, was $2.79804 per gigajoule (GJ).

Since 1975, Alberta, like the Federal Government, has maintained legislation which would allow it to implement regulated pricing in the absence of a federal-provincial agreement. The Natural Gas Price Administration Act (NGPAdA)[11] empowers the provincial Minister of Energy and Natural Resources, pursuant to section 10, to prescribe by regulation, for any month, the price of any gas:

(a) at the point of production, extraction or recovery of the gas,

(b) at the contract delivery point of the gas, or

(c) at any other point in Alberta.

Section 15 of the NGPAdA allows the Alberta Petroleum Marketing Commission ("APMC") to determine for any month an amount called the "Alberta Border Price" with respect to gas intended to be removed from Alberta.

Both the NGPAA and the NGPAdA impose the regulated price on producers by means of the imposition of a compulsory buy-sell arrangement with the APMC. By section 15 of the NGPAA (s. 16 NGPAdA), the APMC may order any owner to deliver its gas to the APMC. The APMC is obliged to compensate the owner in an amount equal to the Alberta Border Price less the Alberta Cost of Service to move the gas from the APMC delivery point to the Alberta border. The APMC is then obliged to offer the gas for resale to the original owner at an amount equal to the compensation paid by the APMC. If the owner elects not to repurchase the gas, the APMC may sell the gas to any other person.

The net effect of this buy-sell arrangement is nominally to create at the Alberta border a cost of gas equal to the prescribed Alberta Border Price for gas destined for removal from the province.

III. AGREEMENTS LEADING TO DEREGULATION OF GAS PRICING

A. GENERAL

In the same manner that gas pricing was a function of inter-governmental agreement so was deregulation similarly a function of agreement. Unlike the regulated regime, however, the agreements to achieve deregulation established concepts as opposed to principles with the task of establishing the principles and scope of deregulation being left to the legislators and regulators.

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10. Alta. Regs. 331/84, 31/85, 134/85, 356/85 and 396/85.

11. R.S.A. 1980, c. N-3, as am. S.A. 1981, c. 57, s. 9.

B. THE WESTERN ACCORD

On 27 March, 1985, the Agreement Among the Governments of Canada, Alberta, British Columbia and Saskatchewan on Energy Pricing and Taxation, known as the Western Accord, was signed. By this Agreement the parties agreed "... a more flexible and market-oriented pricing mechanism is required for the domestic pricing of natural gas". However, the parties recognized that the problems in reaching the goal of a market-oriented pricing system were many and a consultation process involving all interested parties was required. That process was initiated by the Western Accord and was to terminate with a deregulated natural gas pricing system on 1 November, 1985.

Following the Western Accord, the producing provinces and the Federal Government embarked upon the series of discussions that would ultimately culminate, although 30 days later than forecast, in the agreement initiating natural gas price deregulation.

C. THE OCTOBER 31, 1985 AGREEMENT

On October 31, 1985, the Agreement among the Governments of Canada, Alberta, British Columbia and Saskatchewan on Natural Gas Markets and Prices (the "1985 Agreement") was concluded.[12] By this Agreement, the parties committed themselves to the implementation of a market-oriented pricing regime for the domestic pricing of natural gas.

Effective November 1, 1986, the price of gas in interprovincial trade was to be determined by negotiation between buyer and seller. In the transition period from October 31, 1985 to November 1, 1986, consumers could purchase gas from producers at negotiated prices provided contract carriage arrangements were available. The availability of contract carriage was, from Alberta's perspective, an integral element to deregulation. In most Canadian gas market jurisdictions, local distribution companies (LDCs) held a monopoly on gas transportation systems and on gas supply within a franchise area. Similarly, for markets east of Alberta, TransCanada PipeLines Limited ("TCPL") held a monopoly on the transmission system and gas supply. Provision exists under section 59(2) of the National Energy Board Act[13] to order an inter-provincial transporter to carry gas for others. Similar provision did not exist with respect to the systems of the provincial LDCs.

To ensure the opportunity and benefit of negotiated prices flowed through to direct purchasers, contract carriage on LDC systems was integral. That requirement for contract carriage gave rise to transportation proceedings in British Columbia, Manitoba, Ontario and Quebec.

Under the October 31, 1985 Agreement, consumers seeking release from existing contractual arrangements with LDCs would be eligible to purchase gas at negotiated prices only if producers supplying gas under the existing

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12. "Agreement Among the Governments of Canada, Alberta, British Columbia and Saskatchewan on Natural Gas Markets and Prices", 31 October 1985, reproduced in *Canada Energy Law Service*, Hunt et al Editors, Canadian Institute of Resources Law, Richard De Boo Publishers, Volume II at 30-1806 *et. seq.*
13. R.S.C. 1970, c. N-6, s. 59 am. by S.C. 1980-81-82-83, c. 116, s. 18.

contractual arrangements agreed to such a release. Substantially, these are producers under contracts to TCPL.

The 1985 Agreement also contemplated negotiation, between buyers and sellers under existing contracts, for the price to be paid for gas to be delivered after November 1, 1986.

Following the transition period from October 31, 1985 to November 1, 1986, prices were to be no longer prescribed. Paragraph 11 of the 1985 Agreement provided that the price of gas delivered under existing shipper-distributor contracts was to remain at $2.79804/GJ at the Alberta border for the transition period. Paragraph 14 of the 1985 Agreement provided that in the absence of a negotiated agreement between a shipper and a distributor, or a producer and a shipper, as to the price to be paid for gas under existing contracts on November 1, 1986, and thereafter, the price was to be determined by arbitration.

Paragraphs 21 to 23 attempted to preserve the respective federal and provincial constitutional powers of the signatories. While reiterating the provincial right to condition the removal of natural gas from the province so as to protect provincial public interest, paragraph 23(ii) committed Alberta to a review of s. 5(3)(c) of the Gas Resources Preservation Act[14] (GRPA) to ensure that it did not require new sales to be incremental to existing sales prior to November 1, 1986.

D. CURRENT LEGISLATION AND REGULATORY POSITIONS

To effect deregulation, the regulated pricing regimes established at both federal and provincial levels had to be dismantled to some extent. Additionally, transitional provisions and new provisions were necessary to give effect to the 1985 Agreement.

1. Federal Legislation

Following the 1985 Agreement, the Natural Gas Prices Regulations, 1981 were revoked and replaced by the Alberta Natural Gas Prices Regulations, 1986, which only lasted until 31 October, 1986.[15]

The 1981 Regulations had prescribed the price as the aggregate of the Alberta Border Price (which price was defined so as to track the Alberta Border Price set in the most current federal-provincial Agreement) and the cost of the transportation of that gas to its market. The 1986 Regulations were designed to take into account the deregulation of the natural gas market by providing that the prescribed price was the aggregate of the Alberta border price and the domestic cost of transportation, unless the price to be paid for the gas had been amended, in which case the prescribed price would be the aggregate of the domestic costs of transportation and any amounts charged in connection with the sale or delivery of the gas to a maximum of $25.00 per gigajoule.

Amendments to the Energy Administration Act assented to June 27, 1986[16] provided in section 52(1.1) that:

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14. S.A. 1984, c. G-3.1; *see* complete citation, *infra* n. 28.

15. *Supra* n. 6.

16. S.C. 1986, c. 39, s. 5.

Sections 53 to 65 do not apply in respect of a producer-province during any period in which an Order of the Governor in Council that declares those provisions to be non-applicable in respect of the province remains in effect.

A major function of sections 53 to 65 of the EAA is to prohibit the movement, purchase or acquisition of gas from a producer-province for consumption outside that province unless the price paid therefor is a price approved by special or general orders of the National Energy Board or is a prescribed price for that gas.

By Regulation SOR/86-1049 dated 30 October, 1986, made pursuant to the EAA, sections 53 to 65 were declared not to apply with respect to any producer-province. By SOR/86-1050, under the same Act, and also dated 30 October, 1986, the Alberta Natural Gas Prices Regulations, 1986,[17] and the Energy Administration Act, Part III Regulations,[18] were revoked. The combined effect of these measures was the elimination of price prescription at the federal level and suspension of those sections of the EAA which would have prohibited the movement, purchase, sale or acquisition of gas at other than prescribed prices. It is important to note, however, that the pricing and regulatory provisions in the EAA have not been revoked but only set aside. Those provisions may again be made applicable in the same manner they were made inapplicable, by Order of the Governor in Council. The machinery for price prescription, at the federal level, continues to exist and may be made operable at any time.

2. Alberta Legislation

Alberta has implemented new legislation and amended existing legislation to give effect to the 1985 Agreement. However, as with the Government of Canada, Alberta has retained the regulatory framework necessary to establish a regulated price for natural gas.

Pricing prescription was effectively eliminated by section 3 of Alberta Regulation 356/85 which established the termination date for the Agreement on pricing as being October 31, 1986. With the termination of the Agreement, the Alberta Border Price, and hence regulated pricing, ceased to exist.

Amendments[19] were made to Section 11 of the NGPAA which now establishes the price of gas to be at the Alberta border price, *if* a federal-provincial agreement establishes an Alberta border price in respect of a month. This may be contrasted with the previous wording which established the price of gas to be at the Alberta border price *when* a federal-provincial agreement is in effect during any month. These amendments appear to contemplate the situation envisioned by the October 1985 Agreement in which a federal-provincial agreement is in effect but where the agreement does not establish an Alberta border price. However, those involved in drafting the amendments suggest the change from "when" to "if" was simply to correct what had long been recognized as a drafting error.

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17. *Supra* n. 6.

18. C.R.C. 1978, c. 1261, as am.

19. *Supra* n. 9 s. 6.

Although amended on November 1, 1986,[20] Part II of the NGPAA continues to allow for the acquisition and resale of gas by the APMC. As a result of these amendments, the buy-sell price is now to be set at a price per gigajoule prescribed by, or determined under, regulation instead of by reference to the previous formula where the Alberta cost of service was subtracted from the Alberta Border Price. Pursuant to section 15 of the NGPAA, the Alberta Government retains the power to impose a buy-sell arrangement on any owner of gas at a prescribed price.

Similar buy-sell provisions exist under the NGPAdA and these remain intact and in force. The NGPAdA empowers the Minister of Energy and Natural Resources to prescribe a regulated field price.[21]

To give effect to the objectives established by the 1985 Agreement, Alberta has established various other transitional measures.

The 1985 Agreement contemplated that, for contracts entered into in the transition period, or in situations where the price under a pre-November 1, 1986 contract was voluntarily renegotiated during the transition period, price was to be a negotiated contract term. For contracts entered into before November 1, 1985, the Agreement contemplated that, during the transition period, parties to existing contracts would be able to renegotiate price for delivery subsequent to November 1, 1986. Pending this redetermination, however, prices were fixed at the October, 1986 Alberta Border Price of $2.79804/GJ. The Agreement further contemplated that, absent voluntary renegotiation prior to November 1, 1986, prices thereafter would be determined by arbitration. Alberta has implemented legislation to give effect to these transition provisions.

The most significant of the Alberta transitional legislation is the Natural Gas Marketing Act (NGMA)[22] which deals essentially with four subjects:

(a) services relating to price components;

(b) producers' support for downstream pricing;

(c) price arbitration; and

(d) records and information.

The significant pricing deregulation aspects of the NGMA pertain to producers' support for downstream pricing and with respect to price arbitration.

The producers' support requirement is to reflect the fact that most Alberta gas, destined to ex-Alberta markets, is under contract to shippers like TCPL, Pan-Alberta Gas Limited and Alberta and Southern Gas Limited. It is the shipper resale contracts that determine price and the netback to the producer. Hence, effective November 1, 1986, section 9(1) of the NGMA came into force to prohibit a shipper of "netback gas" from removing the gas from Alberta for domestic or export sale, or delivering that gas in Alberta for resale to another person, unless there is an APMC finding of producer support in relation to that netback gas. Netback gas is exempted from this requirement if deliveries under the downstream

20. *Id.* s. 7.

21. *Supra* n. 11 s. 10.

22. S.A. 1986, c. N-2.8.

contract commenced prior to October 31, 1986, however, subsequent price, volume or term changes to the contract will cause the exemption to expire.

Netback gas is defined in section 8(1)(b) and although not readily capable of being summarized, generally includes gas sold by a producer to other than an end-user, where the price is established by a formula relating to the resale price, and where no consent has been given to the price or prices used in the formula. A sale, for example, by a producer directly to an end-user consumer would not be within the definition of netback gas.

If gas is shipped without producer support, a penalty may be imposed on the gas which penalty revenues are to be distributed to producers who may have suffered a loss.

A grandfathering provision is established in section 9(7) of the NGMA which exempts the application of this part from net-back sales after November 1, 1986 if there was a previous APMC determination of producer consent to price, prior to November 1, 1986.

The 1985 Agreement contemplated arbitration of contract pricing provisions which could not be resolved by negotiation. Section 12 of the NGMA provides a mechanism for price determination where the price is "unascertainable" after November 1, 1986. To effect the determination mechanism, either the buyer or the seller *must* provide written notice to the other by January 15, 1987 (extended by Ministerial Order No. E 01/87, dated January 9, 1987 to June 15, 1987 and again by AR 250/87 to 15 January, 1988), that the price is to be re-determined by arbitration under the Arbitration Act.[23] Failure to provide written notice within the prescribed time will result in termination of the contract.

By clause 15 of the 1985 Agreement, the Alberta Government agreed to amend section 17 of the Alberta Arbitration Act. According to judicial interpretation[24] section 17, as it existed in November of 1985, precluded an arbitrator in a gas pricing matter from considering the price of alternative sources of natural gas. The old section 17 was replaced with a new provision[25] allowing the arbitrator more freedom of action. In particular, the arbitrator was authorized to have regard for the price of competing gas as well as competing fuels in the end use market and to competing netback pricing arrangements. The amended provisions of the Arbitration Act have undoubtedly contributed to the relative ease with which the pricing provisions of the major shipper/producer contracts have or may be renegotiated.

These provisions for arbitration of contract pricing are, however, by necessary implication, limited to contracts subject to Alberta law. The absence of comparable legislation at the federal level or in the consuming provinces, leaves open to considerable question the effect of the 1985 Agreement on non-Alberta contracts, for example, as between shippers and LDCs in provinces other than Alberta.

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23. R.S.A. 1980, c. A-43, as am. *see infra* n. 25.

24. *Shell Canada Resources Limited* v. *Canadian Western Natural Gas Company Limited* (1980) 13 Alta. L.R. (2d) 176, 118 D.L.R. (3d) 607 (Alta. C.A.).

25. Arbitration Amendment Act, 1986, S.A. 1986, c. 10.

The absence of a price re-determination mechanism has given rise to considerable controversy, particularly in Manitoba and Ontario. In both jurisdictions the regulatory authorities have reacted unfavourably to prices negotiated as between the LDCs and TCPL in light of substantially greater discounts being available by way of direct purchase.

In the result, the alternative to negotiated pricing under these ex-Alberta supply contracts may be limited to a claim of contract termination as advanced in the Manitoba proceeding, discussed in Part IV.E below. Termination of a shipper/LDC contract would likely generate some significant implications for the shipper and Alberta producers. Such a termination would not automatically relieve a shipper of its producer contract obligations which could lead the shipper to incur take or pay costs.

With respect to take or pay costs, some attention needs to be addressed to the Take-or-Pay Costs Sharing Act.[26] This legislation is designed to implement the National Energy Board's recommendations in its Decision RH-5-85[27] to facilitate recovery of take-or-pay carrying costs lost as a result of displacement sales, for example, LDC industrial customers who opt for direct purchase.

Not all Alberta legislative enactments have been made in a manner that would enhance market sensitive pricing. Insofar as the exact amount of the take-or-pay levy is prescribed by Alberta Regulation, the Alberta Government retains the power to indirectly influence the price of direct sale, non-system gas shipped on TCPL by increasing or decreasing this levy. While not a price regulation mechanism per se, the Take-or-Pay Costs Sharing Act effectively enables the Alberta Government to impose an additional price restraint on some sellers in the form of increased levy costs.

The Government of Alberta has retained an additional powerful tool, in influencing price, in the power it has to grant or withhold approval to remove gas from Alberta. Because of the importance of this issue it is dealt with in some detail. After all, freedom to sell gas, for example in Ontario, at negotiated prices is of little value if the seller is prevented from removing the gas from Alberta. Additionally, the authority of Alberta to restrain removals from the province is a critical aspect of concern in the consuming provinces.

To appreciate the authority held by the Province it is necessary to review to some extent the background to the Gas Resources Preservation Act (GRPA).

(a) Historical Development of the GRPA

Gas may only be removed from Alberta under the authority of a gas removal permit granted pursuant to the provisions of the GRPA as

26. S.A. 1986, c. T-0.1.

27. National Energy Board, "Reasons for Decision, In the Matter of TransCanada Pipelines Limited, Availability of Services" May 1986, published by Minister of Supply and Services Canada, 1986, as Cat. No. NE22-1/1986-7E.

amended.[28] Section 19 of the GRPA provides that removal of gas produced in Alberta to a place elsewhere than in Alberta without a permit granted pursuant to the Act is an offence. By section 4, a permit may be granted or amended by the Energy Resources Conservation Board (the "ERCB"), with the approval of the Lieutenant Governor in Council, subject to such terms and conditions as may be prescribed by the Board. By section 6, for volumes not exceeding 3 billion cubic meters of gas or 160,000 cubic meters of propane and terms not exceeding two years, permits or amendments thereof may be made by the ERCB without approval of the Lieutenant Governor in Council, but with the approval of the Minister of Energy.

The GRPA precludes the ERCB from granting a permit unless, in its opinion, the granting of the permit is in the "public interest". Prior to 1984, the GRPA required the ERCB, in determining the public interest, to have regard to:

> (a) the present and future needs of persons in Alberta, and
>
> (b) the established reserves and the trends in growth and discovery of reserves of gas or propane in Alberta.

The GRPA was amended in 1984 and, in addition to the above provisions, the following was added to what then became section 5(3) of the amended GRPA:

> (c) the expected economic costs and benefits to Alberta of the removal of the gas or propane from Alberta.

The first two of the above considerations have for some time been implemented by the ERCB by determining whether the gas proposed for removal from Alberta was surplus to Alberta's requirements. Alberta requirements to date have been established on the basis of a surplus test formula. The formula initially provided protection for 30 times Alberta's first year annual requirements (30 A_1). In more recent times this formula has been revised to provide protection for 25 times Alberta's first year annual requirements (25 A_1), and more recently still to provide protection for 15 times Alberta's first year core customer requirements (15C_1), as discussed in Part IV.C.1 below.

In the context of gas pricing the ERCB, in Decision 85-9,[29] considered the "economic costs and benefits to Alberta" as provided by section 5(3)(c). The Board concluded the "fundamental question" to be considered when determining the Alberta public interest, was whether or not the proposed removals would represent additional deliveries of Alberta gas rather than the replacement of one Alberta producer by another as the seller of the gas.

This decision introduced the "incrementality" test to the determination of gas removal permit applications. The ERCB stated at page 4 of the decision:

> The Board agrees with the contention that unless the gas to be removed from the Province under an applied-for permit will serve a market that is incremental to markets already

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28. R.S.A. 1980, c. G-3, as am. R.S.A. 1980, c. 10 (Supp.); repealed and replaced by S.A. 1984, c. G-3.1, assented to 13 November 1984; as am. S.A. 1986, c. 17, assented to 18 September 1986 and proclaimed in force 30 October 1986, and SA 1987, c. 23, assented to 17 July 1987, discussed in Addendum, *infra*.

29. Energy Resources Conservation Board, "Decision D 85-9, Application No. 840886 by Consoligas Management Ltd. for a Gas Removal Permit" 7 May 1985.

being supplied by Alberta gas, approval of the application will not provide net economic benefits to Alberta. If the markets are incremental, then total revenues would increase and the revenues to other producers would not be affected...

As the Board sees it, the basic question that needs to be addressed respecting net benefits is whether the proposed sales would be incremental. The Board believes that for a sale to be incremental it must represent a delivery that would not otherwise occur. The definition would include both the delivery to a totally new market and the retention of an existing market that would otherwise be lost.

This incrementality test represented a major hurdle to gas price deregulation in that the test precluded competitive sales and the essence of deregulation was competition. In a later decision,[30] the ERCB expanded the parameters of subsection (3)(c) but consistently held that the key questions to be addressed in assessing the matter of economic costs and benefits were:

1. Whether the proposed sale would be incremental and would result in an increase in the total sales of Alberta gas;
2. Whether the gas would be priced competitively with respect to competing fuels; and
3. Whether the netback to the Alberta border (the market price less transmission and other costs) would be reasonable in comparison to netbacks resulting from sales to other markets, with suitable transportation arrangements having been made.

Not until after the 1985 Agreement was signed and the Alberta Government announced its intention to amend the GRPA did the ERCB modify this approach.

(b) The GRPA in the Context of Deregulation

The 1985 Agreement specifically referred to the incrementality test applied by the Board under the GRPA, as follows:

23(ii) Alberta will review the wording of the Gas Resources Preservation Act, specifically section 5(3)(c), and as necessary, intends to amend the legislation to ensure that it does not require new sales to be incremental to existing sales prior to November 1, 1986.

In a letter dated December 2, 1985, the Minister of Energy and Natural Resources advised the ERCB of the Agreement and stated that the parties had agreed that the current incrementality test was not in the public interest or consistent with the intent of the Agreement and it should be discontinued. He also advised that he intended to introduce legislation to achieve the objective of removing the incrementality test.

The ERCB in turn issued Informational Letter IL85-17 on December 4, 1985, which appended the letter from the Minister of Energy and Natural Resources and stated as follows:

As a result of the Minister's letter and his indication that the Gas Resources Preservation Act will be amended at the first opportunity, the ERCB is immediately dispensing with the incrementality test in assessing the public interest of removal applications. The ERCB will accept that pricing arrangements for proposed removals are in the Alberta public interest if they are generally in accordance with the provisions of the Agreement.

The GRPA was amended on October 30, 1986 to fulfill the commitment made by the Government of Alberta in the Agreement. One of the amendments resulted in a replacement of section 5(3). The comparable section is now section 8 and prescribes that:

8. The Board shall not grant a permit unless in its opinion it is in the public interest of Alberta to do so having regard to

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30. Energy Resources Conservation Board, "Decision D 85-29, Application No. 850382 by Northridge Petroleum Marketing Inc. for a Gas Removal Permit" 8 July 1985.

(a) the present and future needs of persons in Alberta,
(b) the established reserves and the trends in growth and discovery of reserves of gas or propane in Alberta, and
(c) any other matters considered relevant by the Board.

While the amended GRPA no longer specifically includes the economic cost and benefit criteria, the replacement provision wording --- *i.e.* "other matters considered relevant by the Board" --- is arguably broader in its scope than was the section replaced.

In introducing the amendment to the GRPA in the Alberta Legislature, the Minister of Energy and Natural Resources indicated that this discretionary power will be used by the ERCB and that the Minister and the Provincial Cabinet will also have regard to similar matters in approving decisions of the ERCB. He stated:[31]

> Mr. Speaker, I hope the concern of all of us would be that we are not going to allow gas from Alberta to be removed at fire-sale prices or at prices below market value. In this respect, the ERCB have the criteria to look at addressing the question of whether or not a gas permit should be approved. In addition to that, all gas removal permits in this province have to be approved by Order in Council or by Ministerial approval, and in that regard there does not have to be any reason given with respect to why a permit may be turned down. So for those who are concerned that gas can leave the Province of Alberta not to the benefit of Albertans and this Province, there are safe-guards in place where we can prevent the new permits for gas removal from actually occurring.

The Minister went on to state during debate on September 11, 1986 that the GRPA directs the ERCB not to grant a permit unless it is in the public interest of Alberta to do so. He stated that "this gives the Board the power to refuse to grant a permit if the price is at a wasteful level or, in other words, is not in the public interest".[32]

To date, the ERCB has not purported to exercise this power. However, the ERCB in Decision 86-19,[33] suggested the price to be paid for gas to be removed from the Province may continue to be a relevant factor to be considered in determining whether to grant a removal permit for that gas. The ERCB, in reference to section 8, concluded that a number of questions were "relevant", one of which was "whether a fair and equitable price would be obtained for the gas". The ERCB expressed its views on the question of price as follows:[34]

> The Act as recently amended directs the Board to include in its assessment of the public interest "... any other matters considered relevant by the Board".
>
> The Board considers the price that would flow back to the Province from an extra-provincial sale of gas to be a matter relevant to the Alberta public interest. It therefore believes it must be in a position to assess this aspect of a removal application before deciding the matter.
>
> The most definitive manner in which this could be done would be to require the filing of the contract or at least the detailed pricing provisions. This would, however, result in the information being publicly available, and the Board believes that such an action would be contrary to the public interest and to efforts to foster a competitive industry. In the Board's judgement, the negative aspects of requiring the public filing of pricing details would be so substantial that it would not in normal circumstances ask for such information. ***Rather it will ask applicants, as it did in the case of PSR, to provide as much information as possible respecting the principles on which the pricing arrangements are based.***

31. Alberta Hansard, 1st Sess., 21st Leg. 35 Eliz. II, 10 September 1986 at 1593.
32. *Id.* 11 September 1986 at 1622.
33. Energy Resources Conservation Board, "Decision D 86-19, Application No. 860997 by PSR Gas Ventures Inc. for a Gas Removal Permit" 9 December 1986.
34. *Id.* at 3.

> The type of information the Board has in mind would include an indication of the basis for the initial price (e.g. competitive with gas or a particular competing fuel in the marketplace), the timing and conditions of price renegotiations, and the charges that would be made to the market price to move the gas from Alberta to the market place. The Board will then evaluate those principles and draw its conclusions as to whether they appear to be such that the sale of gas would be in the public interest.
>
> With respect to the PSR application currently before it, the Board is satisfied that the principles upon which the price would be determined are such that *the price would be generally consistent with the public interest, in that it would be competitive with prevailing prices and would be responsive to changing market conditions.* [Emphasis added]

This decision suggests the ERCB has already formulated criteria to be applied in lieu of the incrementality test. Given that the price to be paid for exported gas appears to still be a matter relevant to the public interest of Alberta, it appears that the ERCB could refuse to grant a permit to facilitate a sale to an out-of-province market on the basis that the price to be paid for the gas is not in the public interest.

The scope of the powers conferred on the Board to grant a permit subject to terms and conditions, may similarly be utilized to influence a minimum price for gas removed from Alberta. Alternatively, conditions imposed directly by the Lieutenant Governor in Council, may be effective to the same end. Section 13(2) of the GRPA provides:

> An approval of the Lieutenant Governor in Council or the Minister under this Act may be made subject to any terms or conditions that the Lieutenant Governor in Council or the Minister respectively prescribes.

A specific pricing condition imposed by the ERCB or Lieutenant Governor in Council would, however, tend at minimum to be at odds with the objective of market-sensitive pricing established by the 1985 Agreement to which the Province of Alberta is a signatory.

Specific permit conditions may be designed so as not to impact directly on pricing, but rather to give the Board the authority to review pricing provisions. The Board in past has imposed the condition that:

> The Permittee shall satisfy the Board throughout the term of the Permit that the price to be paid for gas continues to be in the public interest of Alberta.

Such a condition would enable the Board to implement remedial action should the Board consider the price to be paid for gas to be inappropriate and not in the public interest.

The ability to grant a permit subject to terms and conditions may be one approach to influencing the prices to be paid for gas removed from the province. However, it should be noted that, with respect to the Order in Council required for a long term permit or Ministerial Approval of a short term permit, no time constraint exists which would require government approval, even upon the recommendation of the ERCB. This discretionary authority in the Lieutenant Governor in Council and Minister of Energy provides the Alberta Government with effective control over not only the terms and conditions under which gas may be removed but whether gas may be removed from the province at all. Clearly, unless the Alberta Government is satisfied as to all aspects of a removal permit, it would be within the prerogative of the Lieutenant Governor in Council or the Minister to simply withhold the approval and thereby preclude a particular removal pending other more satisfactory arrangements being established.

It is additionally noteworthy that, in respect of existing permits, the ERCB is authorized by section 11 of the GRPA to suspend a permit if it appears to the Board that there has been or is a contravention of

(a) any term or condition of a permit;

(b) any term or condition of the Lieutenant Governor in Council or the Minister; or

(c) the Act or Regulations.

If a permit is suspended, the Board must conduct an inquiry at the request of the permit holder following which it may reinstate the permit, subject to terms and conditions; continue the suspension; or, with the approval of the Lieutenant Governor in Council, cancel the permit.

By section 13.1 recently added to the GRPA,[35] the Lieutenant Governor in Council may direct the Board to reconsider a permit or an application for a permit, which may potentially lead to an amendment or cancellation of a permit.

No public proceeding has yet arisen or ERCB decision issued which would reveal the circumstances under which the extensive review provisions reserved to the Board may be utilized. However, non-compliance with either an explicit or implicit term or condition of a permit, which may include "the fair and equitable price obtained for the gas" would seem to be a potential issue which might cause a permit authorization to be put in jeopardy.

A particular condition which may in future result in proceedings being either taken by the Board or directed by the Lieutenant Governor in Council, relates to the identification of the purchaser/end-user contemplated by a removal permit. Most permit applications identify the purchaser/end-user market to be served. ERCB application requirements in fact specify that the application shall contain a general description of the nature of the markets to be served. Most removal permits are specifically stated to be granted in accordance with the application for the permit. As such, it would seem to be arguable that a change in market for permitted gas would constitute an alteration of the implicit terms and conditions under which the permit was granted. To date, the position of the ERCB has been to require the holder of an existing permit to apply for a permit amendment to allow deliveries under the permit to an alternative market.

It should also be noted that a decision of the ERCB is, by section 44 of the Alberta Energy Resources Conservation Act,[36] subject to appeal only on questions of law or jurisdiction to the Alberta Court of Appeal. No appeal exists with respect to an approval or denial by either the Lieutenant Governor in Council or the Minister of Energy.

E. SUMMARY

Although the Federal Government has eliminated prescribed pricing in accordance with the terms of the 1985 Agreement, it has retained in place

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35. *Supra* n. 28 added by S.A. 1986, c. 17, s. 5.

36. R.S.A. 1980, c. E-11, as am.

the Federal legislation necessary to implement pricing regulation. Pricing regulation may be re-established by agreement or unilaterally.

In like manner, Alberta legislation has been amended or promulgated to put into effect the objectives of the 1985 Agreement. In so doing, however, the Alberta Government has preserved all of the regulatory mechanisms to also re-establish regulated pricing, either by agreement or unilaterally.

Although gas pricing deregulation has been legislatively effected, the extent of that deregulation is both tentative and uncertain. Not only has the legislative machinery for regulation been fully maintained, but the scope and objective of deregulation is itself at issue. Federally, as well as in the consuming and producing provinces, numerous critical details have yet to be resolved, not the least of which is Alberta's policy position that:[37]

> . . . ensures that respect for existing shipper-distributor contracts is maintained, as intended in the Agreement. Removal of natural gas from Alberta for sale to a distributor will only be allowed if a distributor is taking full volumes, on a daily basis, under all natural gas purchaser contracts entered into by the distributor and in force on October 31, 1985, adjusted to take into account operational demand volume levels set by the National Energy Board in connection with direct sales to end users.

The practical implications of deregulation of gas pricing, as have been discovered, are limited to the elimination of a prescribed price. The regulated pricing structure had been incorporated into gas marketing stretching from the wellhead to the burner tip. To the extent that "netback pricing" had been ingrained and was to be continued, a mechanism for producer protection was required. Transportation on the TCPL system for supply to domestic markets had the effect of displacing TCPL system supplies and markets. This, in turn, gave rise to issues of access and to availability of transportation, the TCPL toll structure and the recovery of take-or-pay financing costs under the TOPGAS I and II and TOPCON Agreements.

Within the consuming provinces, regulators were faced with new issues brought on by "contract carriage", price differentials resulting from Competitive Marketing Programs (CMP's) and buy/sell arrangements referred to in Part IV.D below, and the push towards a competitive market. The traditional monopoly position of the provincial utilities as both suppliers and transporters of product was questioned as constituting an impediment to that competition.

What has become obvious is that gas pricing deregulation goes to the very heart of the manner in which natural gas is marketed and regulated in Canada. Deregulation, consequently, has become an evolving and growing process, including governments, regulators, producers, LDCs and consumers, all with a substantial interest in the outcome.

The detail and eventual extent of deregulation and its implementation have, in large measure, been left to various regulatory tribunals working within the context of either perceived or stated government policy. A review of the considerations of these regulatory bodies is less than encouraging, but enlightening in disclosing how far deregulation has come and how far it yet has to go.

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37. Manitoba Public Utilities Board, "Report on the Impact on Manitoba Consumers of Deregulation of Natural Gas Pricing in Canada" April 1987 at 26.

IV. REGULATORY ISSUES IN THE CONTEXT OF DEREGULATION

A. GENERAL COMMENTS

The inter-governmental Agreements, which led to both regulation and deregulation, were the result of hard bargaining where the stakes were high and each party claimed the right to the biggest piece of the pie. There were no right or wrong solutions, only a choice between a number of different policy options each of which would have a different impact (positive or negative) on the interests of those involved. Each party was required to give something up before agreement could be reached.

The terms of the inter-governmental Agreements and the intention of the parties to those Agreements is open to interpretation. Even now, after deregulation has been legislatively effected, disagreement exists among Alberta, the consuming provinces and the Federal Government as to what the intention behind the 1985 Agreement actually was and how far deregulation should go. This uncertainty has overflowed into proceedings before a number of administrative tribunals charged, to varying degrees, with jurisdiction over matters that are affected by deregulation.

The regulatory agencies at the federal and provincial levels have been required to deal with a number of issues raised by the general move towards a more competitive market system. The move towards a competitive market and the issues required to be addressed, however, did not come as a complete surprise. The Pipeline Review Panel, established pursuant to clause 25 of the 1985 Agreement, was to investigate "the role and operations of interprovincial and international pipelines engaged in the buying, selling and transmission of gas".[38] The Panel, after reviewing written submissions, set out in extensive detail the issues to be tackled and resolved not only at the interprovincial pipeline level but with respect to distribution systems and within consuming provinces. In so doing, the Panel identified far more deregulation issues than potential solutions.

The Panel observed that changes were required[39]

> . . . in private sector practices, regulation and legislation if a more flexible and market oriented regime is to come into effect smoothly and quickly.

The Panel additionally concluded that the ". . . changes needed are extensive" and range ". . . from the field to the burner tip".[40]

Significant among the issues addressed by the Panel were:

(a) The need for multiple buyers and sellers at each level of transaction from producer to consumer, *except for the sale of gas by a franchise distributor to its "core" market*,[41] a position which seems not to be shared by Ontario and Manitoba.

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38. Pipeline Review Panel, "Review of the Role and Operations of Interprovincial and International Pipelines in Canada Engaged in the Buying, Selling and Transmission of Natural Gas" June 1986 at 1. The Pipeline Review Panel was established pursuant to para. 25 of the 31 October 1985 Agreement, *supra* n. 12.

39. *Id.* at 3.

40. *Id.* at 31.

41. *Id.* at 6.

(b) The need for separation between transportation and marketing functions of both pipeline and distribution companies,[42] a concept adopted by TCPL in the establishment of its marketing arm, Western Gas Marketing, and recently endorsed by the Ontario Energy Board (OEB) in respect of the Ontario distributors.

(c) The need for open, non-discriminatory access to transportation service on both interprovincial pipeline and local distribution company systems, a need so far responded to only in Ontario and Alberta.[43]

(d) The need for the bypass option to be available, an option ostensibly concurred in by Ontario but currently mired in a jurisdictional dispute in the courts.[44]

The blueprint for change drawn up by the Pipeline Review Panel represented a comprehensive analysis, but in retrospect, seems to have omitted consideration of the extent to which the perspective of the players would be influenced by the advantages or disadvantages available to them from deregulation.

The following review of the manner in which the regulatory agencies have addressed these issues shows that complete deregulation of the natural gas markets in Canada is not likely to occur for some considerable time in the future. The interest of the producing provinces, particularly Alberta, in the long-term contracts between the producers and the shippers and between the shippers and the LDCs in the consuming provinces, is contrary to the interest of the consuming provinces in obtaining short term and spot market pricing for *all consumers*, thus ensuring that the debate will continue for some time before all issues are resolved.

B. FEDERAL ISSUES

1. Availability of Transportation Services on the TransCanada PipeLine System

Arising out of the Western Accord, the National Energy Board ("NEB") was requested to review the availability and appropriateness of transportation services on the TCPL system. The proceeding designated as RH-5-85 was completed in April 1986 and included an extensive review of TCPL's tariffs and services in the context of making transportation services available to direct purchasers.

In its Reasons for Decision, dated May 1986,[45] the NEB considered the displacement proviso contained in the TCPL toll schedules, which the NEB concluded prevented transportation services from being made available to direct purchasers when those direct purchasers would displace volumes previously supplied by the TCPL. The Board directed the displacement proviso be removed.[46]

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42. *Id.* at 12.
43. *Id.* at 3.
44. *Id.* at 14.
45. *Supra* n. 27.
46. *Id.* at 6.

The NEB additionally determined as inappropriate[47] the duplication of demand charges, which resulted when a customer, who previously purchased gas through an LDC, arranged an alternative supply through a direct purchase. This caused the direct purchaser to pay the demand charges twice; once to TCPL for the transportation service and once to its LDC to indemnify the LDC for the damand charges paid to TCPL for the volumes which, because of the displacement, were no longer required.

To resolve the double demand charge problem, the Board implemented a new system of toll design which included the establishment of an operational demand volume for the purpose of determining demand tolls. For purposes of implementing the operational demand volume solution to the double demand charge problem, the NEB defined displacement volumes as:[48]

> the volume of gas contracted under a direct purchase, firm service contract is to be considered a displacement volume for fixed cost allocation purposes, if assuming the absence of such direct purchase, the distributor could supply the account on a firm contract basis without itself contracting for additional firm volumes to accommodate the resulting demand.

The effect of the operating demand solution was to provide relief to the LDCs under their long-term contracts with TCPL, by reducing those demand obligations to the extent of any firm direct sales arrangements made by customers served by those LDCs.

The operating demand approach potentially opened an opportunity for LDCs themselves to enter into direct purchase arrangements with other suppliers and thereby reduce their demand charge obligations to TCPL, in an effort to make lower priced gas available to all end-users. The NEB concluded "... the concept of self-displacement is not within the intent of the Agreement. The Board does not consider it appropriate to order tariff changes which would accommodate self-displacement."[49]

In its decision, the NEB expressed disagreement with TCPL that the operational demand solution was beyond the Board's jurisdiction in that it had the effect of altering sales contracts. In the Board's view, the fact that the method it chose to establish tolls had an incidental effect on contracts negotiated by TCPL and its LDCs did not oust the Board's jurisdiction.[50]

TCPL, in subsequent appeal proceedings before the Federal Court of Appeal, argued the Board's decision was beyond its jurisdiction. In giving the reasons of the Court for dismissing the appeal, Uric J. indicated:[51]

> I think it unassailable to say that the operating demand volume method of calculating "tolls" is *a matter relating to* "tolls" or "tariffs" and thus falls within the ambit of the board's jurisdiction ... [emphasis in the original text]

47. *Id.* at 8.

48. *Id.* at 10.

49. *Id.* at 34.

50. *Id.* at 9.

51. *TransCanada Pipelines Limited* v. *National Energy Board* (1986) 72 N.R. 172, [1987] 2 W.W.R. 253 at 266 (Fed. C.A.).

2. Bypass

The National Energy Board in its Proceeding GH-3-86, was faced with an issue as a result of an application made to the Board for a certificate of public convenience and necessity to construct a bypass pipeline located wholly in the Province of Ontario. Cyanamid Canada Inc. was at the time served by a pipeline of an Ontario LDC which Cyanamid proposed to bypass to save considerable transportation costs. The bypass pipeline, to be constructed and operated by Cyanamid, would connect the TCPL system and the Cyanamid plant directly and would convey gas volumes purchased directly in Alberta by Cyanamid. The National Energy Board, after considering the Cyanamid application in a jurisdictional context and as to its merits, by decision dated December 1986[52] decided the application fell within the federal sphere of authority and that the balance of the public interest rested in the applicant's favour. Although the Board did not consider a redundant pipeline represented the optimum use of resources, it concluded that a need existed to allow market signals to flow directly through to the OEB and to the Ontario local distribution companies. The Board concluded that if it did not approve the application it would be suppressing those signals.

3. Surplus Test

The National Energy Board, by decision dated April 1986,[53] in respect of the Surplus Determination Procedures Phase of the Gas Export Omnibus Hearing, 1985, established a new "reserves to production ratio procedure" for determining gas reserves available for export. The new procedure was to protect Canadian needs while at the same time allowing natural gas producers freer access to export markets. The calculation of the maximum potential surplus is based on maintaining a ratio of 15 between reserves and total production.

As a result of criticisms of that test being excessively stringent, particularly in the context of gas pricing deregulation, the National Energy Board is currently conducting a further review of its surplus test procedures.

C. ALBERTA ISSUES

1. Surplus Test

In January, 1987, the ERCB conducted a review of its existing surplus determination procedures at the request of the Alberta Minister of Energy and in response to clause 23(i) of the 1985 Agreement which reads as follows:

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52. National Energy Board, "Reasons for Decision, In the Matter of an Application Under Section 49 and Subsection 59(3) of the National Energy Board Act of Cyanamid Canada Pipeline Inc." December 1986, published by the Minister of Supply and Services Canada, 1986, as Cat. No. NE22-1/1986-14E.

53. National Energy Board, "Reasons for Decision, In the Matter of Phase 1 of The Surplus Determination Procedures Phase of the Gas Export Omnibus Hearing, 1985" April 1986, published by the Minister of Supply and Services Canada, 1986, as Cat. No. NE22-1/1986-6E.

> Alberta and British Columbia will initiate a review of their respective surplus tests to ensure that the tests will contribute to the achievement of the market-oriented pricing system contemplated in this Agreement.

Alberta producers had often complained that the maintenance of a large gas reserve base, which they had spent the money to discover, placed an undue financial burden on them. The cost of maintaining this large "inventory" is high and has a major impact on cash flows. The Alberta surplus requirements were viewed as an impediment to market access and market competition in a deregulated environment.

The issue before the ERCB was whether a regulated surplus requirement, referred to by the ERCB as a "mandated surplus", was consistent with deregulation; whether it was required in spite of deregulation; and, if it was required, to what extent, for whose protection, and who should bear the cost.

For many years, Alberta has had a gas surplus test designed to ensure that the reasonably foreseeable needs of all Alberta consumers can be met before gas will be allowed to be removed from the province. From 1979 until the ERCB decision in March 1987,[54] the surplus test in effect in Alberta required that reserves sufficient to satisfy total Alberta requirements for a period of 25 years be maintained. This was referred to as the $25A_1$ test.

The March 1987 decision of the ERCB entitled "Gas Supply Protection for Alberta: Policies and Procedures" set out a new surplus test which is essentially a middle ground between the range of positions put in evidence before the Board. The spectrum ran from no surplus test at all to one at least as stringent as the existing 25-year requirement.

The new Alberta surplus test, referred to as the $15C_1$ test, protects the needs of the Alberta core market, defined as the commercial and residential customers of the Alberta gas utilities, for a period of 15 years. The new test requires that reserves equal to the forecast core requirements for the current year times a factor of 15 be maintained before gas will be available for removal from the province. Large industrial consumers are no longer to be protected and instead are to be responsible for contracting their own long term supplies. The Board found comfort in its decision from the evidence of the Alberta LDCs which indicated they had approximately a 13 year supply already under contract.

The ERCB determined that the needs of the Alberta core market required public protection as those customer classes would be unable to protect a reasonable security of supply by direct contract with producers. The needs of the industrial end-users were excluded from the surplus test as the Board determined they were in a position, because of their size and sophistication, to protect their own security of supply through contracts with producers or other suppliers.

It is interesting to note that the surplus test determined by the ERCB tends to mirror in many respects the policy earlier enunciated by the Minister of Energy for Alberta. The policy is in fact referred to numerous times in, and is attached as an appendix to, the Board's decision.

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54. Energy Resources Conservation Board, "Report 87-1: Gas Supply Protection for Alberta: Policies and Procedures" March 1987.

Arguably, in a competitive market environment, all gas users would be responsible for ensuring their own protection. The LDCs serving the core markets would be responsible for ensuring security of supply for the reasonably foreseeable needs of their customers in order to stay in business. The ERCB decision recognizes that a mandated surplus test is not as consistent with deregulation as is the other major alternative where all parties would be required to protect their security of supply by contractual arrangements with producers ("contracting approach"). At page 11 of the Board's decision, where this factor is considered, the Board said:

> The contracting approach would be *entirely consistent with the Government policy of moving towards deregulation.* [emphasis added]

However, the Board used somewhat more ambiguous language when dealing with the mandated surplus when it went on to say, on page 11:

> Elimination of the mandated surplus *would also be a strong signal that the Alberta Government is fully committed to reliance on market forces in terms of the gas industry.* [emphasis added]

The distinction in wording tends to indicate that the Board recognizes the mandated surplus may be less consistent with deregulation, a fact recognized by the Board at page 12 of its decision in indicating that "the mandated surplus could be at odds with the move to deregulation and could interfere with market forces . . ."

The Board appears to have been swayed towards the mandated surplus test, in part, because it was persuaded by the view that ". . . with the major markets for Alberta gas thousands of miles away, such market forces would not necessarily coincide with the Alberta public interest".

The new Alberta surplus test is important in that it represents the first tangible evidence of a defensive line drawn against deregulation. Whether this delineation of the extent to which deregulation may be allowed to go will result in a further withdrawal from deregulation by Alberta only time will reveal.

2. Producer Transportation Service for Direct Sale Gas on Alberta Utility Systems

The Alberta Public Utilities Board ("PUB") issued its Decision Report No. E86110[55] on the Natural Gas Transportation Rates Inquiry in January 1987. Through that decision, the PUB ordered Northwestern Utilities Limited ("NUL") and Canadian Western Natural Gas Limited ("CWNG") to apply for a new "menu" of rates and services allowing for short-term transportation on their respective transmission systems. The transportation service was to be restricted to gas producers and industrial customers or brokers. The PUB decision does not extend to core market customers.

The impetus behind the Board's decision appears to be its regard for the direction in the 1985 Agreement that the direct purchase of gas from producers by consumers be facilitated.

It is likely that large groups of commercial or even residential customers will attempt to obtain transportation service on the LDC systems in order

55. Public Utilities Board of Alberta, "Report No. E86110: Natural Gas Transportation Rates Inquiry" 30 December 1986.

to purchase gas directly from producers thereby reducing their gas costs. The PUB will then be faced squarely with an application attacking the core market which the LDCs view as the financial underpinning for their systems.

The issue before the Board was whether the transmission systems of NUL and CWNG should be opened up to direct sellers or direct buyers of gas. In other words, whether the LDCs should be converted into transporters of direct sale gas in addition to their combined function as sellers and transporters of system gas. Prior to issuing its decision report with respect to the transportation inquiry, the PUB had issued interim orders to certain gas producers requiring the LDCs to provide interim short-term transportation service pending the outcome of the inquiry.

In its decision, the PUB appears to have assumed it had a duty to facilitate implementation of a deregulated market for natural gas within the Province of Alberta. This appears to have been a major driving force behind the Board's decision to require short-term transportation service. This could be interpreted as a complete acceptance of a move towards deregulation if the Board had not qualified its decision. At page 91 of the decision the Board said:

> The Board notes that, except for CWNG/NUL, all of the participants including ICG support the position that short-term T-Service should be provided. The Board agrees with most of the participants on this issue, *on condition that there would be no significant impact on the core customers*. [emphasis added]

It appears that if the PUB had been convinced there would be adverse impact on the core customers short-term transportation would not have been provided at all or, if it was, it would be on substantially different terms and conditions. The Board indicated, however, it was not convinced that core customers would be adversely impacted.

In light of the qualification placed on its decision by the PUB, it can only be assumed that deregulation of the transportation service on Alberta LDCs would not be as attractive a prospect where impacts adverse to the Alberta public interest were the result. This position is consistent with that taken by the ERCB with respect to the surplus test.

D. ONTARIO

Ontario, essentially a non-producing province views itself, as indicated by the Honourable Vincent Kerrio when speaking at a recent Canadian Petroleum Association Annual Meeting, to be Alberta's biggest and best customer. Ontario was not a participant in the 1985 Agreement.

The Ontario Government was, however, quick to respond to deregulation in an effort to obtain lower priced gas supplies for its consumers. The OEB, at the request of the Ontario Minister of Energy, conducted a proceeding in January and February of 1986 which jointly involved the 3 major Ontario LDCs, to consider interim contract carriage arrangements on the Ontario LDC systems.[56] The position of Ontario as reflected in a

56. Ontario Energy Board, "Reasons for Decision, In the Matter of a Hearing Respecting Interim Contract Carriage Arrangements on The Consumers' Gas Company Ltd.'s, Northern and Central Gas Corporation Limited's and Union Gas Limited's Ontario Distribution Systems: E.B.R.O. 410, 411 and 412" 4 April 1986.

statement of the Honourable Mr. Kerrio, dated December 3, 1985 is that ". . . a market oriented pricing system should result in lower natural gas prices to Ontario", and further that "Ontario believes that lower-priced gas can be negotiated through direct purchase".

In the proceedings before the OEB, the Ontario distributors expressed great reservation both as to the need for and benefit to be obtained from contract carriage. It was argued that contract carriage would adversely impact optimum system operation and reduce flexibility in the ability of the LDCs to minimize gas purchase costs. It was further argued that contract carriage would benefit only the large industrial consumer to the detriment of residential and commercial consumers.

In the alternative, the Ontario LDCs supported the Competitive Marketing Programs offered by TCPL and the system gas producers and advocated the buy-sell arrangement to facilitate direct purchase. The buy-sell arrangement contemplated a direct purchase made from a producer or other supplier at "market price" and re-sold to the LDC at the Ontario border at the average cost of gas. Thereafter, the direct purchaser would be supplied by the LDC, at LDC rates, like any other sales customer.

The buy-sell proposal represented an early attractive option but had the effect of diluting the benefits available from direct purchase and of maintaining markets as the exclusive enclave of the LDCs.

In the face of the strong objections from the Ontario LDCs, the OEB, in its Reasons for Decision in EBRO 410, 411 and 412, dated 4 April, 1986, ordered the establishment of "interim contract carriage" arrangements and set out the terms, conditions and rates at which transportation service would be available on the Ontario LDC systems. In so doing the Board concluded that it:[57]

> . . . believes that the free market for gas-on-gas competition will bring benefits to end-users in Ontario and therefore the Board finds that contract carriage will be offered by the Ontario utilities.

In ordering interim contract carriage, the OEB endorsed the stated Ontario Government policy position that contract carriage should be available so as not to adversely impact existing customers. That position, however, gave rise to allegations of cross-subsidization in the distributors' rates. That issue spawned, in turn, further issues as to the appropriateness of the LDC rates and extended the deregulation argument to the distributors' monopoly position over gas supply.

In September through December of 1986, the OEB conducted a subsequent proceeding in which it considered in detail the manner in which natural gas would be sold and transported in Ontario. In its Reasons for Decision in EBRO 410-II, 411-II and 412-II, dated March 23, 1987,[58] the Board endorsed the establishment of a competitive market in Ontario where all consumers would have the opportunity to purchase on equal

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57. *Id.* at 131.

58. Ontario Energy Board, "Reasons for Decision, In the Matter of the Ontario Energy Board Act Subsection 13(5) and Section 19, And In the Matter of a Hearing to Determine Certain Matters Relating to Contract Carriage Arrangements on The Consumers' Gas Company Ltd.'s, ICG Utilities (Ontario) Ltd.'s and Union Gas Limited's Ontario Distribution Systems: E.B.R.O. 410-II, 411-II and 412-II" 23 March 1987.

terms. To achieve that objective, the OEB found in favour of allowing brokers to market gas in Ontario, found in favour of a larger menu of individual services to be offered to transportation customers and determined the Ontario LDCs should segregate their gas supply function from their gas transportation function.

What had started out before the OEB as a proceeding to consider if and under what conditions contract carriage should be offered, resulted in a substantial adjustment to the manner in which natural gas is to be marketed in Ontario. Not only has the monopoly position of the LDCs in gas supply been eroded, but the LDCs will be required to operate their systems on an open, non-discriminatory basis. Competition in gas supply is to be achieved by separate distributor marketing arms.

Later this year, the LDCs are required to file cost based rates designed on the basis of a fully allocated cost study. These rates are likely to have a significant negative impact on residential and commercial customers.

It is hardly surprising in result that Ontario has expressed serious concern at the TCPL/LDC renegotiated contracts, which provide for modest price reductions to low volume, low load factor customers and reserve the most significant discounts for large volume, high load factor customers. To Ontario, deregulation of gas pricing provides the opportunity to minimize gas costs to both industry *and* core markets. The approach being followed by Ontario is to make available lower cost gas to as broad a segment of the consuming public as possible. In view of the constraints resulting from the Ontario LDC's long term contracts with TCPL, the OEB has opted for the next best alternative to open direct sales to all Ontario gas consumers.

Two significant issues resulting from the decisions of the Ontario Energy Board deserve special mention:

(a) The intention of Ontario in putting into place the mechanisms necessary to make direct purchase available to all Ontario consumers including the core customers of the LDCs, seems to be in direct conflict with the position of the Province of Alberta, that gas will not be sold at fire sale prices. Alberta's position is that the direct purchase option is to be available only to large industrial customers. Remaining customers are to continue to obtain their gas supply from the Ontario LDCs, thereby enabling the Ontario LDCs to maintain their contractual obligations to TCPL and the continued purchase of system gas. The Ontario Energy Board proposal which opens the Ontario marketplace to brokers, when combined with the National Energy Board operating demand calculation, has the potential effect of seriously impacting and minimizing system gas purchases.

(b) The OEB, in light of the proposal by Cyanamid Canada Limited for a bypass pipeline, investigated the generic issue of bypass pipelines in Ontario[59] and concluded that it has exclusive jurisdiction over such pipelines constructed wholly within the Province of Ontario. The OEB

59. Ontario Energy Board, "Reasons for Decision, In the Matter of the Ontario Energy Board Act and In the Matter of Potential Bypass of Local Gas Distribution Systems: E.B.R.O. 410-I, 411-I and 412-I" 12 December 1986.

referred the bypass pipeline issue to the Divisional Court of the Supreme Court of Ontario on a stated case and the Ontario Court upheld the OEB's claim to exclusive jurisdiction.[60] The position of the OEB and of the Ontario Divisional Court is in direct conflict with the determination made by the National Energy Board in the Cyanamid case proper, where the National Energy Board concluded that the Cyanamid facility, notwithstanding that it was wholly located within the Province of Ontario, was within federal jurisdiction under the National Energy Board Act.[61] The decision of the Ontario Divisional Court has been referred to the Ontario Court of Appeal by the Government of Ontario.

E. MANITOBA

The Manitoba Public Utilities Board, early on, declined the opportunity to establish contract carriage arrangements in the Province of Manitoba and instead left the distribution of gas in Manitoba to the exclusive jurisdiction of the Manitoba LDCs, principally ICG Utilities (Manitoba) Ltd.

In October 1986, ICG Utilities (Manitoba) Ltd. (ICG) and TCPL reached an agreement on gas pricing for a two-year term, subject to approval of the pricing arrangement by the Manitoba Public Utilities Board. The Manitoba Minister of Consumer and Corporate Affairs considered the pricing arrangement to be unacceptable and requested the Manitoba Public Utilities Board to publicly review the application made by ICG.

In proceedings before the Manitoba Public Utilities Board in February and March of 1987, the Manitoba Department of Energy and Mines took the position that, as at November 1, 1986, when regulated pricing ceased to exist, ICG's long-term contracts with TCPL became unenforceable due to the absence of a price, being a fundamental term. It was argued, consequently, that ICG was not bound by its long-term contractual obligations to TCPL and that it was, therefore, open to Manitoba consumers to arrange direct purchases for their future gas supply requirements. It was contemplated that a Manitoba Crown corporation would arrange for the direct purchase and supply of gas to Manitoba customers, including core customers, to be served over the Manitoba LDC systems.

The recent decision of the Manitoba Public Utilities Board,[62] provides a rather concise summary of the state of gas pricing deregulation in Canada and the issues yet to be faced.

The Manitoba Board, like the OEB before it, concluded that:[63]

> . . . at the present time there is no perfect competitive market for gas supplied to gas distributors for resale to core customers in Canada. As was noted by several witnesses at

60. *Ontario Energy Board* v. *The Consumers' Gas Company et al* unreported 26 March 1987, Toronto Divisional Court Action No. 1243/86 (Ont. S.C.).

61. *Supra* n. 52.

62. *Supra* n. 37. *See also*, The Public Utilities Board of Manitoba, "Order No. 89/87: "Public Hearing To Inquire Into The Applications of Greater Winnipeg Gas Company and ICG Utilities (Manitoba) Ltd. for An Order or Orders Approving a Change in Rates And Other Matters" 13 May 1987, discussed in Addendum, *infra*.

63. *Supra* n. 37 at 10.

the hearing, the process of deregulation has just begun and many issues need to be resolved before a truly competitive market for natural gas is realized.

The Manitoba Board found "a number of regulatory, contractual, administrative and institutional arrangements" which it collectively termed as *constraints*, "that prevent Manitoba consumers from receiving gas at competitive prices". The constraints identified included Alberta removal permits, the sanctity of the long-term distributor contracts, double demand charges, transportation tolls and streaming of gas to provide discounts to large volume customers. The principal issue for Manitoba, however, appears to be that "... there does not appear to be an avenue at present by which core customers can obtain cheaper gas".

Notwithstanding the urging of some parties to the proceeding, the Manitoba PUB recognized the impracticality of acceding to the argument of termination of the long-term contracts. The PUB realized such action would achieve little more than precipitate a direct conflict with the Alberta Government. Instead, the Manitoba PUB urged a resolution negotiated between the Governments of the two provinces.

F. QUEBEC

Little direct response is available from Quebec, however, the Régie de l'Électricité et du Gaz for the Province of Quebec, by Board Order G-441, addressed certain tariff structure matters pertaining to Gaz Métropolitain, inc. and issues pertaining to the deregulation of natural gas pricing.[64] In the proceeding, Gaz Métropolitain objected to the implementation of contract carriage and alternatively proposed a buy/sell arrangement. The Régie rejected that proposal and instead directed on a provisional basis that both the buy/sell alternative and contract carriage be made available. The Régie, however, approved of a contract carriage rate and attached to the service a civil liability obligation which together rendered the service largely unattractive.

The Régie additionally prescribed that contract carriage rates should not adversely impact other customers and that to the extent cross-subsidization existed in Gaz Métro's rates, such should be continued.

G. JURISDICTIONAL ISSUES

The purported reservation of unilateral authority by both Alberta and the Federal Government to regulate gas pricing may potentially give rise to some interesting constitutional debates. It is obvious, for example, that a potential for direct conflict exists as between the unilateral pricing provisions in the EAA and the NGPAdA.

The prescription of an Alberta border price or other regulated price for the purposes of an APMC buy-sell may be a purely intra-provincial transaction. However, the intent of the NGPAdA would seem to be to regulate the price of gas destined for sale outside Alberta, as well as for intra-Alberta transactions. Even though the buy-sell may itself be intra-provincial, it may be construed as effectively regulating a price for gas

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64. Régie De L'Électricité Et Du Gaz, "Ordonnance Partielle et Provisoire G-441: Dossier 3081-85: Gas Métropolitain, inc." 24 March 1986.

which has already entered the flow of interprovincial trade. This constitutional question may be rendered even more difficult if the Alberta Government were to establish a wellhead price for gas under section 10 of the NGPAdA, pursuant to its constitutional powers under section 92A of the Constitution Act, 1982.[65]

The "resource amendment" to the Constitution Act, 1982 as part of the constitutional amendment package, gave the producing provinces concurrent legislative jurisdiction with the Parliament of Canada in relation to the export of resource production from the Province when that production is destined for "another part of Canada". For the purposes of this discussion, the key to the amendment is subsection (2) which prescribes that:

> (2) In each province, the legislature may make laws in relation to the export from the province to another part of Canada of the primary production from non-renewable natural resources and forestry resources in the province and the production from facilities in the province for the generation of electrical energy, but such laws may not authorize or provide for discrimination in prices or in supplies exported to another part of Canada.

Subsection (2) appears to have the intent of allowing a producing province to venture into interprovincial trade. In an article entitled "Natural Resources: Provincial Proprietary Rights, The Supreme Court of Canada, and the Resource Amendment to the Constitution", William Moull stated at pp. 486-87:[66]

> Before the introduction of section 92A, only Parliament could legislate in relation to the export of resource production from a province.
>
> Now, under subsection 92A(2), the producing provinces have a concurrent legislative jurisdiction with Parliament in relation to the export of resource production from the province when that production is destined for "another part of Canada". In recent years, almost all of Alberta's oil has gone to markets in Eastern Canada, and so to that extent at least Alberta's petroleum marketing system would be saved by subsection 92A(2) even if it intruded upon an area formerly reserved exclusively to Parliament. Any such provincial "export" legislation under subsection 92A(2) would still be subject to overriding federal legislation by virtue of subsection 92A(3), but in the absence of any contradictory federal legislation the concurrent field is clear for provincial legislation.

A not dissimilar question may also exist in terms of whether the 92A(2) prohibition against provincial export laws that discriminate extra-provincially in prices or supplies may preclude regulatory bodies, such as the ERCB, from discriminating when authorizing removal of a resource from a province for sale in another part of Canada.

V. CONCLUSION

The manner in which the various producing and consuming provinces and the Federal Government interpret "deregulation" seems to depend, to a considerable extent, on the perspective from which the impacts are viewed. To the consuming provinces, deregulation means cheaper gas prices. To Alberta, a producing province, deregulation has the effect of reducing producer and provincial revenues with, however, the prospect for future higher prices as competition for security of supply leads to longer

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65. The Constitution Act, 1982, Schedule B to The Canada Act 1982, (U.K.) 1982, c. 11.

66. W. Moull, "Natural Resources: Provincial Proprietary Rights, The Supreme Court of Canada, and the Resources Amendment to the Constitution" (1983) XXI *Alta. L. Rev.* 472 at 486-487.

term contracts and higher prices. The consuming provinces want cheaper gas "competitively priced" for all customers. Alberta, currently enjoying a large supply inventory, is faced with minimizing sales at "fire sale prices". All parties are able to point to the 1985 Agreement to generate some support for their position that competition is to be beneficial.

Alberta's position that it was never the intention that core market customers be permitted to enter into direct sales with Alberta producers or that long-term contracts between shippers and provincial LDCs be renegotiated to reflect spot sale prices or short-term commitments, seems destined to ensure the debate continues. This is particularly true in view of the position of the consuming provinces, who interpret "deregulation" as meaning not only lower prices but access by all customers, including core customers, to that lower cost.

The Federal Government wisely appears to be staying out of this fray to the greatest extent possible.

Although many issues have yet to be resolved, probably the most contentious issue is what will happen to the existing long-term contracts between the LDCs in the consuming provinces and Western Gas Marketing Limited. The recent decisions of both the OEB and the Manitoba PUB have identified the long-term contracts as being a constraint to deregulation and the establishment of a competitive market. The Alberta Government, on the other hand, has made its position clear that, if those long-term contracts are jeopardized, steps will be taken to protect Alberta's interests. Those steps seem clearly to rest on the Alberta Government's authority under the GRPA to control volumes of gas removed from the province.

It seems clear that the divergence of opinion as to how far deregulation may be allowed to go must necessarily lead to a new round of intergovernmental negotiations. These negotiations, however, will most certainly include consuming provinces as principal participants.

The alternative to a negotiated resolution may be a constitutional challenge to the authority of Alberta by the consuming provinces or the Federal Government. The likely issues would be the authority of the Province of Alberta to unilaterally set gas prices directly, through the provisions of the NGPAdA, or indirectly, through the provisions of the GRPA. If these challenges were successful and price deregulation continued, the consuming provinces would have much greater potential, through LDC rate regulation, to determine the market price for gas even to the extent of interfering with shipper/LDC long-term contracts.

If the Ontario response to the bypass issue is an example, that province, at least, may not be shy in attempting to assert or expand its constitutional jurisdiction through the Courts. When the NEB issued its decision on the Cyanamid bypass application, it was immediately appealed to the Federal Court of Appeal by the Ontario distributors and the Ontario Government. However, before the matter could be heard by the Federal Court, the OEB had conducted its own generic bypass proceeding in which it had determined that bypass within Ontario was a matter of exclusive Ontario jurisdiction. On a Stated Case to the Divisional Court of the Supreme Court of Ontario, the OEB jurisdictional view was confirmed.

As soon as the Ontario Divisional Court decision was rendered, the Federal Court appeal of the NEB decision in the Cyanamid case by the Ontario LDCs and the Ontario Government was immediately discontinued. Then, by Order in Council of the Lieutenant Governor of Ontario, the decision of the Divisional Court was referred for review and consideration to the Ontario Court of Appeal.

Although the bypass issue may not be typical, it at least represents an indication of the lengths to which the parties affected by deregulation can be expected to go in the future to protect their interests. Unfortunately, it also represents a style of issue resolution that usually results in the merits of the matter being lost in the shuffle. For Cyanamid, the initiator of the bypass issue at the National Energy Board level, the objective was to minimize its gas purchase costs consistent with a deregulated gas pricing environment. Instead, Cyanamid, like other consumers and producers, has been caught in a complicated web it did not weave.

Looking to the future, it is interesting to speculate what the positions of the various parties will be if the circumstances pertaining to supply of or demand for natural gas change as they are expected to do in the 1990's. The reduced supply availability or increased demand, in a market sensitive environment, would likely prompt an increase in price. Depending on the degree of change in the supply or demand of natural gas, that price increase could be substantial. Will Alberta, in that circumstance, be as adamant about the enforcement of existing long-term contracts? Will Manitoba and Ontario be as anxious to ensure that *competitive prices* are available for all consumers, including core customers? Will direct purchasers be as anxious to be responsible for their own supply requirements? And, perhaps most critically, will governments be able to resist the temptation to again regulate natural gas pricing in Canada to protect what they perceive to be the interest of Canadians or any provincial segment of the Canadian population?

ADDENDUM

Since this paper was printed, some significant events have occurred. In Alberta, the Gas Resources Preservation Amendment Act, 1987, received Royal Assent on 17 June, 1987. This amending Act gave the Alberta Government the authority to retroactively amend existing gas removal permits to add terms and conditions that are typically present in the more recently issued permits.

On 25 June, 1987, Alberta Regulation 271/87, the Permit Conditions Regulation, was established. This Regulation, which codifies the practice currently followed by the Minister of Energy in considering gas removal permit applications, requires the filing of information about prices, volumes, customers and other matters referred to as "downstream arrangements". The new Regulation applies both retroactively and prospectively to all gas removal permits and applications for permits.

The Regulation has been held out by the Alberta Government and the Department of Energy as being necessary to allow all sellers of gas to compete on an equal footing. Some short-term, small-volume permits issued in the first few months of deregulation do not contain the same

restrictions as do the later permits. For example, the holder of a non-restricted permit may not be required to advise the Minister of changes in the end-users to whom it sells, volumes of gas sold or prices paid over the life of the permit. The holder of a restricted permit, on the other hand, is required to file with the Minister any changes in the sale arrangement. For spot sales, the holder of a restricted permit has been required to get ERCB and Ministerial approval for all changes including substituting or adding customers, amending the price or amending the volumes sold. Because of the nature of spot sales, these changes could be required on a monthly, or even weekly, basis. This situation provided such an unfair advantage to the holder of the unrestricted permit that these permits came to be known as "hunting licences".

In addition to conditions ensuring equal information filing requirements, the Regulation enshrines two further conditions in all short-term, small-volume permits. These are as follows:

(a) No gas can be removed for sale to a distributor unless, as required by section 6(1)(a), the distributor is taking all the gas it ". . . is *entitled* to take delivery of . . ." under its contract that existed at 31 October, 1985 (emphasis added).

The choice of "entitled" rather than "required" is interesting. There are some distributor contracts that do not contain minimum take provisions. In such a case the distributor would not be *required* to take any gas under the contract but would, obviously, be *entitled* to take full contract volumes.

(b) No gas can be removed pursuant to any short-term permit after 1 September, 1987, unless the Minister of Energy has given written notice to the ERCB that the Minister is satisfied with the surplus test that results from the most recent National Energy Board surplus determination hearing GHR-1-87. The National Energy Board decision is expected to be released sometime in September, 1987.

As might have been anticipated, subsequent to the Alberta Public Utilities Board Decision Report No. E86110 on the Natural Gas Transportation Rates Inquiry, wherein the Board recommended that short-term T-Service should be provided by Northwestern Utilities and Canadian Western Natural Gas Limited "on the condition that there would be no significant impact on core customers", some 15 applications for orders compelling the provision of T-Service to "core customers" were received by the PUB. The Board responded by issuing a Notice of Hearing set for August 10, 1987, where it would entertain these applications and address a number of issues including the definition of "core market" customers.

The core market issue impacts directly on the Alberta Government's policy on natural gas supply protection procedures. External to Alberta, the Government of Alberta has taken the position that the sanctity of long-term contracts between TCPL and the LDCs in the consuming provinces (which serve the "core markets" in those provinces) must be preserved.

The core market issue before the PUB obviously had the potential for serious ramifications on the Government of Alberta policy with respect to removal of gas from the Province. As a result, the Province of Alberta aborted the PUB proceeding and issued Order in Council 484/87 directing

a joint PUB/ERCB inquiry for the purpose of reporting to the Government on the core market issue.

It seems that the Province of Alberta, in initiating the joint PUB/ERCB core market inquiry, intends to develop a definition of core market, as well as policies respecting the Alberta core market, which will be consistent with the position Alberta has taken on the interprovincial level.

In Manitoba, the Public Utilities Board, by Order 89/87, dated May 13, 1987, rendered its decision in respect of applications by Greater Winnipeg Gas Company and ICG Utilities (Manitoba) Ltd. for orders approving a change in rates for the sale of gas in that Province, due to agreements concluded as between the LDCs and their supplier, TCPL.

At page 15 of Order 89/87, the Board expressed concern that it was:

> ... being asked to approve rates which are based on criteria to which it was not a party and which may effectively require it to abandon a part of its jurisdiction to others and may lead to rates that are unduly discriminatory.

In addition, at page 17 of Order 89/87, the Board reiterated its view, which it had earlier set out in its Report on the Impact on Manitoba Consumers of Deregulation of Natural Gas Pricing, dated April, 1987, that:

> ... due to a number of constraints, there is not a free competitive market for natural gas sales to distributors for resale to core customers in Manitoba.

The Board additionally noted that it had no jurisdiction over many of these constraints and that it considered those constraints not to be within the spirit of a deregulated gas market.

For the reason that the Board considered it was left without a responsible alternative, it decided to accept the prices as established by the LDCs and TransCanada PipeLines in the gas pricing agreement, but only until October 31, 1987, so that the parties would receive the discounts stemming from November 1, 1986. The Board further advised the LDCs to prepare and to report to the Board with a detailed gas purchasing plan by July 30, 1987.

In early June of 1987, the Manitoba Government introduced Bill 68 in the Manitoba Legislature, being "An Act to Govern the Supply of Natural Gas in Manitoba and to Amend the Public Utilities Board Act". The Bill was assented to on July 17, 1987 and will come into force on Proclamation, for which no date has been fixed. The Act would establish the Manitoba Consumers Gas Corporation as agent for the Crown in right of Manitoba. The powers conferred upon the Corporation would enable it to participate in the Manitoba market as a supplier of gas.

The Act would considerably enhance the authority of the Manitoba Public Utilities Board. Section 114 thereof provides that the supply of gas in Manitoba may only be made with the approval of the Manitoba Public Utilities Board and that the Board in granting any order approving of the selling, delivery, direct purchase, distribution, storage or transmission of gas within the Province, "shall not be bound to recognize or give effect to the terms of any existing contract".

The Manitoba Government, at the time of initiating the legislation, indicated it intended to require the Manitoba LDCs to ensure that just, reasonable and fair gas prices would be available to all consumers in Manitoba.

The efforts of the Manitoba Government have been denounced by members of the Alberta Government as being a means of regulating gas prices in Manitoba, contrary to the spirit of deregulation.

The dispute between the producing provinces, primarily Alberta, and the consuming provinces is likely to continue for some time. How it will be resolved is still in doubt. Whether negotiation, litigation, or a combination of the two, will be the chosen means of resolution only time will tell. However, the recent legislative action of the Alberta and Manitoba Legislatures described in this addendum are some indication that both sides are preparing for an important struggle in this high-stakes game.