

## 2.0 REGULATORY STANDARDS

Past NEB decisions indicate that the regulatory standards to be considered and applied in applications for leave to transfer facilities include the public interest, economic efficiency, “used and useful,” “no acquired rights,” firm contracts as the measure of the level of remaining capacity, and the appropriate transfer price.

The fundamental, overarching decision to be made by the Board is whether a transfer of facilities from gas service to oil service would be in the Canadian public interest.

### 2.1 THE PUBLIC INTEREST STANDARD APPLIES TO TRANSFER APPLICATIONS

The Board is an independent federal agency established by the Parliament of Canada to regulate international and interprovincial aspects of the oil, gas and electric utility industries. It states that *its purpose is to regulate pipelines, energy development and trade in the public interest*.<sup>1</sup>

The Board’s public interest purpose is founded in its statutory mandate. Several sections of the NEB Act make specific reference to the public interest, but it is clear that the Board takes the view that consideration of the public interest is applicable to all Board decisions.

In the Filing Manual, Guide R relates to Transfer of Ownership, Lease or Amalgamation pursuant to section 74. It confirms that the public interest standard applies, stating:

When the pipeline is already regulated by the Board an Order or a Certificate of Public Convenience and Necessity would have been issued once the Board had determined that the facilities:

- would be constructed and operated in a safe and an environmentally sound manner
- were required for the present and future public convenience and necessity

As a result, when a transaction involving the sale, conveyance, lease, purchase or amalgamation of an NEB-regulated pipeline is to occur, the Board needs assurance that, notwithstanding any changes in operation or configuration that are expected to occur, *it would continue to be in the public interest to operate the facilities. (emphasis added)*

The applicability of the public interest standard to transfer applications under section 74 has been clearly established by the Board. The question was specifically litigated in the last case to deal with transfer of facilities from gas service to oil

<sup>1</sup> National Energy Board Home Page “Who We Are and Our Governance”: [www.neb.gc.ca](http://www.neb.gc.ca).

service—the Keystone transfer case held pursuant to NEB hearing order held that the regulatory standard is the public interest. The Board also held that, in deciding a transfer application, it must consider all factors relevant to the public interest, including but not limited to the interests of gas shippers and oil shippers, producers and consumers.<sup>2</sup>

In the MH-1-2006 Decision, the Board stated:

The Board is of the view that Parliament has provided it with explicit guidance in the Act as to the test it should apply to requests for relief under section 74. Part I of the NEB Act establishes the Board and sets out the Board's powers. The Board is of the view that section 12, when considered in accordance with the principles of legislative interpretation suggested by Driedger and the Supreme Court, requires the Board to assess the Transfer Application on the basis of the public interest. To achieve this mandate, it is therefore necessary for the Board to consider matters beyond adverse results to gas pipeline shippers.<sup>3</sup>

Also in the MH-1-2006 Decision, the Board found that the relevant consideration for determining adequate remaining capacity for the Mainline is the pipeline's ability to meet anticipated requests for *firm* service.<sup>4</sup> The Board considered what Mainline facilities continued to be used and useful in gas transmission service, but were no longer necessary to provide that service in respect of firm contracts. The Board found that it would be wasteful and an inefficient use of resources to require that capacity be retained for peak requirements for which shippers had declined to contract.<sup>5</sup>

The Board further held that the standard is not “no harm” to shippers.<sup>6</sup> It also reiterated that shippers on pipelines have no acquired rights<sup>7</sup> to be protected from cost increases or any entitlement to ongoing availability of spare capacity. Shippers are entitled to receive the service for which they have contracted: they are not entitled to specific facilities.<sup>8</sup>

The Board went on to express its belief that regulation should emulate competition and should encourage actions and decisions that would enhance efficiency, improve competition and respond to market needs, but in doing so, should be in keeping with the public interest.<sup>9</sup>

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<sup>2</sup> MH-1-2006 Decision, page 55.

<sup>3</sup> MH-1-2006 Decision, pages 15–16.

<sup>4</sup> MH-1-2006 Decision, page 48.

<sup>5</sup> MH-1-2006 Decision, pages 51 and 55.

<sup>6</sup> MH-1-2006 Decision, page 16: “...adopting the proposed no harm test would be contrary to the long list of Board and Court authorities that have decided that the Board has wide discretion to determine what is relevant to the exercise of its mandate.”

<sup>7</sup> MH-1-2006 Decision, page 51.

<sup>8</sup> MH-1-2006 Decision, page 55.

<sup>9</sup> MH-1-2006 Decision, page 58.

It is clear that consideration of the Canadian public interest is the overriding standard to be applied by the NEB in the determination of whether the Transfer Application should be approved. The issues before the Board on this Application, therefore, include the identification of the best practical balance between the benefits that will be realized by converting Mainline assets to oil service and the potential impacts of that conversion on Mainline gas shippers.

The evidence of TransCanada and Energy East in this application fully justifies conclusions by the Board that approval of the transfer of the Facilities from TransCanada to Energy East is in the Canadian public interest, and that it would continue to be in the public interest to operate the transferred facilities in oil service.

## 2.2 ECONOMIC EFFICIENCY

The Board has stated that one of its purposes is to promote economic efficiency in the public interest.<sup>10</sup>

The concept of economic efficiency has been a part of the NEB's strategic goals for many years and has been applied in both tolls cases and facilities cases.

In the context of regulated tolls, economic efficiency generally means that tolls should promote proper price signals to maximize utilization of the pipeline system and thus reduce costs.<sup>11</sup>

In the context of Canadian long-distance gas transmission pipelines, "economic efficiency" has been described by the NEB to mean

...promotion of the development of an efficient natural gas transmission system that meets shippers' needs and benefits gas users.

More specifically, it means that, to the extent possible, prices reflect the competitive market value of services; a mix of service options is provided that meets shippers' needs; and that adequate pipeline capacity is in place over time.

The Board also strives:

...to ensure that pipeline customers are treated fairly (no undue discrimination) and that service providers have a fair opportunity to recover their invested capital.<sup>12</sup>

<sup>10</sup> Filing Manual, Section 1.1.

<sup>11</sup> National Energy Board Reasons for Decision, TransCanada PipeLines Limited, RH-1-2007, RH-1-2007 Receipt Point Application, July 2007 (RH-1-2007 Decision), page 22.

<sup>12</sup> The Future of Natural Gas Pipeline Regulation in Canada, presented to Industrial Gas Users Association, 2000 Natural Gas Conference, Toronto, Ontario by Jean-Paul Théorêt, Board Member, National Energy Board, November 14 and 15, 2000, page 3.

In the MH-1-2006 Decision relating to the transfer to oil service of facilities that continued to be used and useful in natural gas service, but were no longer necessary for the provision of gas service, the Board considered and applied its judgment on the efficient use of resources. It held that it would be wasteful and an inefficient use of resources to require that capacity be retained for peak requirements for which shippers had declined to contract.<sup>13</sup> It held that it would be in the public interest to provide a productive alternative use of underutilized assets.<sup>14</sup> Further, it stated that economically efficient outcomes are achieved when producers are able to maximize the value received for the commodity they produce while consumers obtain the lowest-cost alternative to meet their requirements.<sup>15</sup>

TransCanada and Energy East believe that the proposed transfer of facilities, the subsequent operation of the transferred facilities in the provision of oil service, and the construction of the Eastern Mainline Project to meet firm capacity requirements in the Eastern Triangle will provide an economically efficient result.

### **2.3 USED AND USEFUL**

The “used and useful” concept is employed by the Board in evaluating the plant in service portion of the rate base. Specifically, the Board asks: 1) is the plant used and useful in providing service to the public? and 2) has the investment in the plant been prudently incurred for the purpose of servicing the public?<sup>16</sup> If the answer to each of the questions is “yes,” the cost of the plant remains in rate base and earns a return on capital.

TransCanada’s position is that its entire investment in all Mainline facilities has been prudently incurred for the purpose of providing service to the public, and pursuant to NEB approvals. All Mainline plant, including the Conversion Facilities, remains used and useful in providing service to the public.

As noted above in the MH-1-2006 Decision, the NEB approved the transfer to oil service of TransCanada Mainline facilities that were in fact used and useful in gas transportation service but were no longer necessary to provide that service.<sup>17</sup> Two reasons for its finding that the transfer was in the public interest included the need for additional oil pipeline capacity, and the provision of a productive alternate use of underutilized assets.<sup>18</sup> The NEB found that it would not be in the public interest to direct TransCanada to continue to keep facilities in gas service when it had been

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<sup>13</sup> MH-1-2006 Decision, page 51.

<sup>14</sup> MH-1-2006 Decision, page 58.

<sup>15</sup> MH-1-2006 Decision, page 55.

<sup>16</sup> Interprovincial Pipe Line Ltd., Rate Application, Reasons for Decision, December 1977 (IPL Rate Application), page 3-8.

<sup>17</sup> See MH-1-2006 Decision page 55, citing Chapter 3 and Chapter 4.

<sup>18</sup> MH-1-2006 Decision, page 58.

demonstrated that they are not necessary and where TransCanada had proposed an alternative use for the facilities that the Board had found to be in the public interest.<sup>19</sup>

The used and useful standard also was the subject of much discussion in the Mainline RH-003-2011 case where it, along with prudence, was accepted by the Board as a criterion that determines the opportunity for cost recovery.<sup>20</sup>

It is the position of the Applicants that in the circumstances of this case, it is in the public interest to transfer the currently used and useful Conversion Facilities from gas service to oil service. The Conversion Facilities will be converted to a higher and better use in oil service, while Mainline gas shippers receive economic benefits.

## 2.4 NO ACQUIRED RIGHTS

The NEB has accepted and adopted the principle of “no acquired rights,” by which it is meant that customers do not gain proprietary rights to services or facilities of a pipeline, or entitlement to a degree of toll protection, simply because of their past patronage, absent a current firm contractual right. When contracting with a pipeline, shippers purchase a service from the pipeline (e.g., transportation or storage service) and not an ownership interest in the facilities. As a result, by purchasing service from a pipeline, shippers are in no way granted an entitlement to future protection of toll levels or availability of capacity.

Recent examples of the application of the “no acquired rights” principle include the RH-003-2011 Decision on the TransCanada Mainline Restructuring, where the Board held that shippers’ costs and benefits do not extend beyond a contract under which service was requested and made available,<sup>21</sup> and the MH-1-2006 Decision on the initial transfer of TransCanada Mainline facilities from gas service to oil service.<sup>22</sup>

The “no acquired rights” principle means that Mainline gas shippers do not have any proprietary rights to existing Mainline capacity that is not currently contracted, or to the facilities that could provide that ~~contracted~~ capacity.

## 2.5 FIRM SERVICE IS THE MEASURE OF POST-TRANSFER REMAINING MAINLINE CAPACITY

Among the factors to be weighed in the assessment of the public interest of the proposed facilities transfer is the anticipated demand for gas transportation capacity on the Mainline, and the impact that the transfer of the Facilities could have on the ability of the Mainline to meet that demand.

<sup>19</sup> Ibid.

<sup>20</sup> RH-003-2011 Decision, pages 37–40.

<sup>21</sup> RH-003-2011 Decision, page 2.

<sup>22</sup> MH-1-2006 Decision, page 5

The logical converse of the “no acquired rights” principal is the conclusion that, to the extent that shippers have contracted on a firm annual basis for capacity on the Mainline, those shippers do have a right to that capacity and the pipeline has an obligation to retain sufficient capacity to serve those rights.

In the MH-1-2006 Decision, the Board found that the relevant consideration for determining adequate remaining capacity for the Mainline—is the pipeline’s ability to meet anticipated requests for *firm* service.<sup>23</sup> The Board considered what Mainline facilities continued to be used and useful in gas transmission service, but were no longer necessary to provide that service in respect of firm contracts. The Board found that it would be wasteful and an inefficient use of resources to require that capacity be retained for peak requirements for which shippers had declined to contract.<sup>24</sup> Accordingly, contracts for firm service are the appropriate measure to determine the capacity TransCanada is required to maintain in gas service after the transfer of facilities to Energy East, unless there are extenuating circumstances that inform a different result.

In this case, one of the concerns of the Eastern LDCs has been to ensure that there is adequate capacity to serve their markets, even though that would involve construction of capacity in excess of that supported by current firm requirements and contracts. To address this concern, TransCanada agreed to include 50 TJ/d of uncontracted capacity in the Eastern Mainline Project. The 50 TJ/d will be available for discretionary service unless and until a party contracts for it on a firm basis. The 50 TJ/d is one of the terms of the LDC Agreement by which the LDCs removed their opposition to the Project.

## 2.6 TRANSFER PRICE

A transfer of facilities requires regulatory consideration of the transfer price and the manner in which it will be accounted for by the seller and the buyer.

The OPUARs and the GPUARs<sup>25</sup> stipulate that transfers between affiliated companies should be recorded at net book value (NBV), unless the Board grants an exemption from the requirement to do so.<sup>26</sup> Various inter-affiliate transfers have been approved at NBV.<sup>27</sup> The Board has also granted an exemption that permitted a transfer at what was effectively replacement cost.<sup>28</sup>

<sup>23</sup> MH-1-2006 Decision, page 48.

<sup>24</sup> MH-1-2006 Decision, pages 51 and 55.

<sup>25</sup> MH-1-2006 Decision, Chapter 5: The Transfer at Net Book Value, pages 53–54.

<sup>26</sup> Sections 129 (1.1) of the Act and 15(4) of the OPUAR and GPUAR.

<sup>27</sup> See MH-1-2006, National Energy Board Reasons for Decision, Intercoastal and Interprovincial Pipe Line Inc., GH-4-93, National Energy Board Reasons for Decision, Interprovincial Pipe Line Inc. (Line 9 Reversal), OH-2-97

<sup>28</sup> National Energy Board Reasons for Decision, Enbridge Southern Lights GP on behalf of Enbridge Southern Lights LP and Enbridge Pipelines Inc., OH-3-2007, page 42-43

In the MH-1-2006 case, the Board approved NBV as the appropriate transfer price for the facilities sold by TransCanada to Keystone for conversion from gas service to oil service. While the NBV transfer price was uncontested, the NEB found it to be appropriate since it accorded with existing practices and principles, and with the OPUARs and the GPUARs.<sup>29</sup>

In the case of the Mainline and Energy East, the Asset Transfer is between affiliated corporations at a price of approximately \$1.5 billion (Transfer Price) that exceeds the NBV of the Conversion Facilities by \$500 734 million. TransCanada proposes to provide additional economic benefit to Mainline shippers by allocating the acquisition premium (\$500 734 million) as a reduction of Eastern Triangle rate base to be amortized ~~over a 15-year period~~ to 2030. The Board has recognized that where there is an Acquisition Premium, its disposition is at the discretion of the pipeline.<sup>30</sup>

In recognition of the fact that TransCanada has committed to assign the full amount of the Acquisition Premium to the benefit of Mainline shippers, TransCanada and Energy East submit that the Board should find that the negotiated Transfer Price is just and reasonable and provides no undue benefit to either affiliated company. Accordingly, the Board should approve the Applicants' requests for exemptions from the GPUAR and OPUAR to permit the Asset Transfer at the negotiated Transfer Price, to credit the Acquisition Premium to the Eastern Triangle rate base and to amortize the Acquisition Premium to 2030.

## 2.7 CONCLUSION

TransCanada's Canadian federally regulated pipeline systems exist and operate within the legal framework established by the NEB Act and the regulatory standards and principles recognized and applied by the Board. These standards continue to be applicable and should inform and govern the decision of the Board on the Application. The overarching regulatory standard applicable to this Transfer Application is the public interest.

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<sup>29</sup> MH-1-2006 Decision, Chapter 5: The Transfer at Net Book Value, pages 53–54.

<sup>30</sup> *Atco Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2006 S.C.J. No. 4.

