

NATIONAL ENERGY BOARD

IN THE MATTER OF the *National Energy Board Act*, R.S.C. 1985, c. N-7, as amended, (“*NEB Act*”) and the Regulations made thereunder;

AND IN THE MATTER OF an application pursuant to Part IV of the *NEB Act* by Trans Mountain Pipeline ULC as General Partner of Trans Mountain Pipeline L.P. (collectively “Trans Mountain”) for approval of the transportation service to be provided and the toll methodology to be applied on the expanded Trans Mountain Pipeline System.

**APPLICATION BY TRANS MOUNTAIN FOR APPROVAL OF THE
TRANSPORTATION SERVICE AND TOLL METHODOLOGY FOR
THE EXPANDED TRANS MOUNTAIN PIPELINE SYSTEM**

June 29, 2012

Updated with Black Line on January 10, 2013

DIRECT EVIDENCE OF JOHN J. REED

To: The Secretary
National Energy Board
444-7th Avenue S.W.
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1 ***I. INTRODUCTION***

2 **Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A1. My name is John J. Reed. My business address is 293 Boston Post Road West, Suite 500,
4 Marlborough, Massachusetts 01752.

5 **Q2. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?**

6 A2. I am Chairman and Chief Executive Officer of Concentric Energy Advisors, Inc.
7 (“Concentric”). Concentric is a management consulting firm specializing in financial and
8 economic services to the energy industry.

9 **Q3. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND AND**
10 **EXPERIENCE.**

11 A3. I have more than thirty-five years of experience in the North American energy industry.
12 Prior to my current position with Concentric, I have served in executive positions with
13 various consulting firms and as Chief Economist with Southern California Gas Company,
14 North America’s largest gas distribution utility. I have provided expert testimony on
15 financial and economic matters on more than 150 occasions before, the National Energy
16 Board (“NEB” or “Board”), the Federal Energy Regulatory Commission (“FERC”)
17 provincial and state utility regulatory agencies, various state and federal courts, and before
18 arbitration panels in Canada and the United States. A copy of my résumé and a listing of the
19 testimony I have sponsored is included as Attachment A.

20 **Q4. IN WHICH CASES HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE**
21 **BOARD?**

22 A4. I have submitted evidence before the Board on behalf of the following parties in the
23 following proceedings:

- 24 • Alberta-Northeast (GH-1-87)
- 25 • Alberta-Northeast (GH-2-87)
- 26 • Alberta-Northeast (GH-5-89)
- 27 • Independent Petroleum Association of Canada (RH-2-91)
- 28 • The Canadian Association of Petroleum Producers (RH-1-93)

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- 1 • Maritimes & Northeast Pipeline (GH-6-96)
- 2 • Alliance Pipeline (GH-3-97)
- 3 • Maritimes & Northeast Pipeline (GH-3-2002)
- 4 • TransCanada PipeLines (RH-3-2004)
- 5 • Brunswick Pipeline (GH-1-2006)
- 6 • TransCanada PipeLines (RH-1-2007)
- 7 • Repsol Energy Canada (GH-1-2008)
- 8 • Maritimes & Northeast Pipeline (RH-4-2010)
- 9 • TransCanada PipeLines (RH-003-2011)

10 In addition to testifying, I have worked with numerous entities in the Canadian energy
11 industry during my career, assisting them with various strategic, regulatory and toll-related
12 issues.

13 **Q5. ON WHOSE BEHALF ARE YOU SPONSORING EVIDENCE IN THIS**
14 **PROCEEDING?**

15 A5. I am sponsoring evidence on behalf of Trans Mountain Pipeline ULC (“Trans Mountain” or
16 the “Company”).

17 **Q6. WHAT IS TRANS MOUNTAIN PROPOSING IN THIS PROCEEDING?**

18 A6. Trans Mountain pipeline currently has nominal capacity to carry approximately 300,000
19 barrels of oil and petroleum products per day. However, demand for capacity on the Trans
20 Mountain pipeline system has been growing for the past several years. In late 2011 and early
21 2012 Trans Mountain held an Open Season for an expansion which resulted in nine shippers
22 signing binding contracts for long-term firm service of 508,000 bpd. In October, 2012,
23 Trans Mountain held a supplemental round to its Open Season process (Round 3), which
24 resulted in additional committed capacity from three shippers. As of January 10, 2013, the
25 total committed shipper capacity for the Trans Mountain expansion is 708,000 bpd.

26 In this proceeding, Trans Mountain is seeking advanced approval of the commercial terms,
27 services, and tolling structure that would be in effect if its proposed expansion is approved
28 and ultimately constructed. Specific to this application, Trans Mountain is seeking approval
29 of the toll methodology that shippers agreed to in the open seasons, and certain changes to

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1 the terms and tolling structure that would apply for uncommitted services. The
2 implementation of the toll methodology proposed in this application, and the final decision
3 to expand the pipeline, are all conditional on the approval of the Facilities Application, for
4 which the Company expects to seek approval in a future proceeding, and the
5 commencement of service on those facilities.

6 **Q7. WHAT APPROVALS DOES THE COMPANY SEEK IN THIS PROCEEDING?**

7 A7. First, the Company's application is seeking approval to provide long-term contract service
8 for ~~up to~~ approximately 80 percent of the nominal capacity that would be available on the
9 expanded system. Second, the Company is seeking approval for negotiated tolls that will
10 establish its tolls for firm service on the integrated pipeline system during the 20-year period
11 following its contemplated expansion. Third, the Company is seeking approval to set the
12 tolls for uncommitted service at a level that is 10 percent higher than the negotiated tolls for
13 15-year firm service. Fourth, it is seeking approval of a revised set of rules and procedures
14 associated with the expansion of the pipeline.¹

15 **Q8. WHAT IS THE PURPOSE OF YOUR EVIDENCE?**

16 A8. My evidence addresses the following issues: (i) the reasonableness of the proposed tolling
17 methodology and procedures; (ii) the reasonableness of the open season process; and (iii) the
18 appropriateness of the percentage of capacity to be reserved for uncommitted service.

19 **Q9. PLEASE SUMMARIZE WHY THE PROPOSED TOLL METHODOLOGY IS**
20 **JUST AND REASONABLE.**

21 A9. The proposed toll methodology for post-expansion firm service, along with the terms of
22 service and risk-sharing features, provides a negotiated balance of risks that is acceptable to
23 both the committed firm shippers and the pipeline. Moreover, these agreements between
24 highly-sophisticated buyers and Trans Mountain were negotiated in the context of a
25 transparent² and fair open seasons that ~~were~~ conducted at ~~a~~-times when competitive

¹ Tab C of the Application describes the proposed changes to the Rules and Regulations associated with the expanded system firm service offering.

² In this evidence, a transparent Open Season Process means that the process was equitable, that all parties were well informed and had an equal opportunity to participate. This concept was discussed by the Board in NEB, Reasons for Decision, RH-3-2008 and in NEB, Reasons for Decision, OH-3-2007.

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1 alternatives existed and competing projects were being proposed. The outcome is both fair
 2 and efficient. For these reasons the committed firm service tolls should be deemed to be
 3 just and reasonable.

4 In addition, the proposed tolls for uncommitted service are just and reasonable because they
 5 will be tied in a reasonable relationship to the tolls for committed firm service. By tying the
 6 tolls for the two services together, the uncommitted shippers benefit from the negotiating
 7 power and competitive conditions that produced the just and reasonable tolling
 8 methodology for committed firm service. Moreover, the proposed close relationship
 9 between tolls for committed firm service and tolls for uncommitted service is important in
 10 order for the proposed toll methodology to be fair and economically efficient.

11 **Q10. PLEASE SUMMARIZE WHY THE OPEN SEASON PROCESS WAS**
 12 **REASONABLE.**

13 | A10. Trans Mountain provided a transparent, fair and balanced process for shippers, giving them
 14 | sufficient time and information to make an informed decision, and an equal opportunity to
 15 | participate. During the first two rounds of the almost five month binding Open Season
 16 | process, prospective bidders were provided access to all of the proposed terms of service,
 17 | information about the expansion, evaluation criteria, and the ability to ask the Company
 18 | questions at any time. As is common in many Open Season processes and described in the
 19 | Application and the Company's Evidence, the Company negotiated with prospective
 20 | shippers during the Open Season and made many changes to the Facility Support
 21 | Agreement ("FSA")³ and the Transportation Service Agreement ("TSA"). These
 22 | negotiations produced a fair and balanced agreement that was available to all potential
 23 | shippers. The successful result of the Rounds 1 and 2 of the Open Season, with 20-year
 24 | Firm Service Commitments signed by nine shippers for 508,000 bpd, demonstrates that the
 25 | Open Season process was equitable. In October 2012, Trans Mountain announced a Round
 26 | 3 Open Season, which was completed in January, 2013 and resulted in two additional 20 year
 27 | commitments and one 15 year commitment from firm service shippers. These additional

³ A Facility Support Agreement is also sometimes referred to as a Precedent Agreement on other projects.

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1 | commitments led to an expanded project and to lower tolls that have been negotiated
 2 | between Trans Mountain and its shippers.

3 | ~~A10.~~

4 | **Q11. PLEASE DISCUSS THE APPROPRIATENESS OF THE ALLOCATION OF**
 5 | **CAPACITY BETWEEN FIRM CONTRACT SERVICE AND UNCOMMITTED**
 6 | **SERVICE.**

7 | A11. In response to the needs of the market, ~~508708,000~~ bpd, or ~~67.3~~approximately 80.00 percent
 8 | of the ~~755890,000~~ bpd of the pipeline's nominal post-expansion capacity, is currently
 9 | committed on a long-term firm contract basis. In addition, the Company intends to dedicate
 10 | 20 percent of the nominal capacity to uncommitted service. This proportion of capacity
 11 | dedicated to uncommitted service balances the need for long-term contracts to underwrite
 12 | the expansion against the need to continue providing some uncommitted capacity. Because
 13 | the pipeline is committing to ~~151~~approximately 183,000 bpd for non-firm service and
 14 | expanding from 300,000 bpd to ~~755890,000~~ bpd, the amount of apportionment of
 15 | uncommitted service should be greatly reduced or eliminated by the size of the expansion.
 16 | In addition, as discussed later in this testimony, this proportion of nominal capacity available
 17 | for uncommitted service is at the high end of the range of nominal capacity reserved for
 18 | uncommitted transportation service on other major petroleum pipeline projects approved by
 19 | the Board in recent years.

20 | **Q12. WHY IS TRANS MOUNTAIN FILING THIS APPLICATION IN TWO STAGES?**

21 | A12. The commercial tolling application accompanying this testimony is specifically focused on
 22 | obtaining regulatory approval of the commercial terms, toll methodology and the Open
 23 | Seasons process that underlie the planned expansion of the Trans Mountain pipeline. The
 24 | reason for this application is to resolve all commercial concerns before proceeding with a
 25 | Facilities Application. Activities involved in a Facilities Application such as evaluating siting
 26 | alternatives, engineering, licensing, environmental impact assessment, and the approval
 27 | process take multiple years to complete and are very costly. Because the expansion is being
 28 | developed and configured based on the results of the open seasons and the contractual
 29 | agreements negotiated between shippers and the pipeline, it is imperative for all parties to
 30 | know at an early stage whether the commercial agreements will be approved. Early

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1 consideration of the tolling methodology is particularly important for a very large project like
 2 the Trans Mountain expansion which requires new terms and tolling procedures.

3 ***II. OVERVIEW OF PROPOSED TOLLS AND COMMERCIAL TERMS***

4 **Q13. PLEASE BRIEFLY DESCRIBE THE TOLL METHODOLOGY AND**
 5 **COMMERCIAL TERMS FOR WHICH TRANS MOUNTAIN IS SEEKING**
 6 **APPROVAL IN THIS APPLICATION.**

7 A13. In this proceeding, the Company is requesting approval for the tolls and commercial terms
 8 that the Company negotiated with prospective shippers during the Open Seasons process
 9 and finalized in the form of the FSA and TSA. Schedule B of the FSA/TSA provides for,
 10 among other things, a schedule of indicative Firm Service Tolls, an Initial Project Cost
 11 Estimate, and a list of costs that will be capped and uncapped. It also indicates the limits on
 12 the fixed charge component of the toll design which, if exceeded at the time of a Certificate
 13 of Public Convenience and Necessity (CPCN), allows the shipper the option to withdraw its
 14 Open Season commitment. Schedule C describes the Firm Service Toll Methodology that
 15 resulted from the Open Seasons process. The Open Seasons process also established the
 16 amount of nominal capacity to be provided as firm contract service and the amount of
 17 nominal capacity to be provided as uncommitted service, as well as the relationship between
 18 the tolls charged for contract shippers versus the tolls charged for uncommitted shippers.
 19 Further, the agreed upon terms indicate the process to be used to apportion nominations of
 20 uncommitted transportation service between shippers seeking deliveries to land-based
 21 markets (Land Shippers) and those seeking deliveries to the Westridge Dock (Dock
 22 Shippers), should the requirement to apportion ever arise post-expansion, as well as other
 23 allocation procedures such as firm shipper makeup rights.

24 **Q14. PLEASE DESCRIBE THE STRUCTURE OF THE FIRM SERVICE TOLLS**
 25 **PROVIDED IN SCHEDULE B OF THE FSA.**

26 A14. Schedule B includes the following: 1) Indicative Firm Service Tolls for 15- and 20-year
 27 contracts for volumes less than 75,000 barrels per day; 2) Indicative Firm Service Tolls for
 28 15- and 20-year contract volumes greater than or equal to 75,000 barrels per day; 3) Open
 29 Season Toll Limits; and 4) an Initial Project Cost Estimate. The Firm Service Tolls are

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1 comprised of (i) a fixed charge for the reservation of capacity and (ii) a variable charge for
 2 the amount of throughput actually shipped. The level of Indicative Firm Service Toll
 3 components for each receipt and delivery point, as well as for the petroleum type (light vs.
 4 heavy) and contract term (15 or 20 years), are shown in Schedule B. The Firm Service Toll
 5 sheets also indicate the Open Season Toll Limits, which trigger a shipper option to withdraw
 6 if revised cost estimates as of 60 days after issuance of a CPCN indicate that the Open
 7 Season Toll Limit will be exceeded. The toll design also contains features that are designed
 8 to promote fairness and efficiency such as: the tolls for longer distances are greater than the
 9 tolls for shorter distances, the variable tolls for heavy petroleum are greater than the variable
 10 tolls for light petroleum, and the tolls for larger contract volumes receive a discount.
 11 Customers who sign 20-year firm contracts will pay tolls that are 10 percent less than the
 12 tolls for 15-year firm contracts, while uncommitted shippers will pay tolls that are 10 percent
 13 greater than the tolls for 15-year firm contracts. As explained further in Article 3 of the
 14 FSA, the Firm Service Tolls will be updated as the project proceeds.

15 **Q15. PLEASE DESCRIBE THE INITIAL PROJECT COST ESTIMATE AS**
 16 **PROVIDED IN SCHEDULE B.**

17 A15. The Initial Project Cost Estimate, as shown in Schedule B of the FSA provides an itemized
 18 listing of the project costs, including: 1) project management, including regulatory costs; 2)
 19 engineering costs, including survey and environmental; 3) pipeline materials; 4) land or right
 20 of way costs; 5) pipeline construction and inspection; 6) facilities costs, including terminals
 21 and stations; 7) commissioning, including loop reactivation; and 8) all other costs including
 22 consultation and accommodation costs. The costs are presented as an initial estimate and
 23 are broken out by the capped costs and the uncapped costs, which define the portion of
 24 construction cost risks borne by the Company and by the shippers. For example, costs
 25 related to project management, engineering, terminal and station facilities, and
 26 commissioning are all capped. But only portions of the costs of pipeline materials,
 27 construction, and right-of-way are capped. The Initial Project Cost total is estimated at
 28 approximately ~~\$4.25.4~~ billion, of which ~~\$3.34.4~~ billion is capped and only ~~\$900-million~~\$1.1
 29 billion is uncapped. Additionally, the Initial Project Cost Estimate notes that the probability
 30 distribution is deemed to be Class IV, so, in accordance with the Association for the

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1 Advancement of Cost Engineering International recommended practices, the range of the
2 estimate is +35%/-22.5%.

3 **Q16. WHAT IS THE BASIC TOLL METHODOLOGY PRESCRIBED IN SCHEDULE**
4 **C OF THE FSA?**

5 A16. The Toll Methodology, as defined in Schedule C of the FSA, provides a description of the
6 principles to be used in calculating any future adjustments to the Indicative Firm Service
7 tolls. For the fixed charge component of the toll, Schedule C explains how relative distance
8 of haul is incorporated into the tolls, how the fixed charge component of the toll will adjust
9 for changes in costs and expenses, and how the fixed charge component of the toll will
10 increase each year by two and a half percent. For the variable charge component of the toll,
11 Schedule C states what is included in that toll, specifically: 1) the basis for the power costs; 2)
12 a description of the uncommitted service revenue sharing; and 3) other adjustments that may
13 be made for future costs that are uncontrollable.

14 **Q17. HOW WILL THE FIXED CHARGE COMPONENT OF THE TOLLS BE**
15 **ADJUSTED TO REFLECT THE FINAL AMOUNT OF CAPITAL COSTS**
16 **INCURRED FOR THE PROJECT?**

17 A17. The fixed charge component of the toll for the 15-year contract for shipments to Burnaby
18 will be increased or decreased by seven cents (\$0.07) per barrel for every one hundred
19 million dollars of variance in capital costs or portion thereof, and adjustments for distance
20 will be made for tolls to other destinations. However, in computing the variance from the
21 revised cost estimate at the time of the CPCN relative to the final incurred costs for the
22 project, the categories of costs that are capped will not include any costs in excess of the
23 capped amount. This formula significantly limits the amount of potential cost increases that
24 shippers will be required to pay when the expansion is put into service.

25 **III. REASONABLENESS OF THE PROPOSED TOLL METHODOLOGY**

26 **Q18. HOW IS THE CONCEPT OF “JUST AND REASONABLE TOLLS” DEFINED?**

27 A18. The methodology for achieving just and reasonable tolls is not prescribed by law, leaving it
28 up to regulators to apply their judgment, along with statutory requirements and guidance

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1 provided by the courts, in order to determine whether tolls are just and reasonable.⁴
2 However, a regulator may consider many factors in determining whether rates are just and
3 reasonable. In evaluating the Trans Mountain pipeline it is important to consider that the
4 tolling methodology was agreed to by every committed firm shipper. That fact, plus the
5 ability of sophisticated shippers to negotiate more favorable terms during the Open Season
6 process and the existence of competitive alternatives documented in the evidence of Dr.
7 Schink, indicates that Trans Mountain's proposed toll methodology is just and reasonable.

8 **Q19. HOW WERE TOLLS ORIGINALLY ESTABLISHED ON OIL PIPELINES?**

9 A19. Section 62 of the National Energy Board Act (NEBA) states:

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

14 Under the original regulatory and service model, petroleum transportation was provided on
15 an uncommitted basis and tolls generally were based on the carrier's cost-of-service.

16 **Q20. HAVE PIPELINES FOLLOWED THE ORIGINAL REGULATORY AND**
17 **SERVICE MODEL IN RECENT DECADES?**

18 A20. No. In the past two decades, a number of Canadian oil pipelines have implemented
19 alternative tolling and service structures for existing pipeline systems, new construction and
20 expansion projects. These proposals have diverged from the original uncommitted service
21 model with cost-of-service tolls set yearly by the regulator. Instead, these new projects
22 generally have proposed and implemented: 1) negotiated tolls or tolling methodologies
23 which are not based upon a cost of service methodology and (2) the introduction of firm
24 transportation service.

⁴ *Trans Mountain Pipe Line Company v. National Energy Board et al.*, [1979] 2 F.C. 118 at para. 9. For example, in *Trans Mountain Pipe Line Company v. National Energy Board et al.*, the Federal Court of Appeal found that the method to be used and the factors to be considered in assessing the justness and reasonableness of tolls: "... must be left to the discretion of the Board which possesses in that field an expertise that judges do not normally have. If, as it has clearly done in this case, the Board addresses its mind to the right question, namely, the justness and reasonableness of the tolls, and does not base its decision on clearly irrelevant considerations, it does not commit an error of law merely because it assesses the justness and reasonableness of the tolls in a manner different from that which the Court would have adopted."

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1 In addition, existing pipelines such as Enbridge and Trans Mountain have revised their
 2 services and tolling methodology. In the case of Enbridge, tolls generally have departed
 3 from a cost-of-service basis for many years. For example, the Board approved an Incentive
 4 Toll Settlement for Enbridge in 1995.⁵ Most recently, the Board approved a Competitive
 5 Toll Settlement for the Canadian Mainline in June 2011 that established tolls based on
 6 negotiations between Enbridge and its shippers. The Competitive Toll Settlement set tolls
 7 for a ten-year term that were indexed to change by 75 percent of the annual changes in
 8 Canada's Gross Domestic Product.⁶ Further, Trans Mountain has already responded to
 9 market needs by offering some firm service and using market-based auctions to more
 10 efficiently allocate capacity at the Westridge Dock.

11 **A. Distinction Between “Negotiated” and “Market-Based” Tolls**

12 **Q21. WHAT IS THE DISTINCTION BETWEEN “MARKET-BASED” TOLLS AND**
 13 **“NEGOTIATED” TOLLS?**

14 A21. These two terms are often used interchangeably, but in the context of regulation they
 15 generally have different meanings. For example, in the U.S. the FERC regulations make a
 16 clear distinction between these terms. “Market-based” rates are available only to those
 17 companies that are able to demonstrate that they face sufficient competition that they will be
 18 unable to charge excessive rates without losing business to competitors. In contrast, FERC
 19 allows “negotiated” rates, regardless of whether the pipeline has market power, when one or
 20 more customers agree to pay an alternative rate that might include rates or rate components
 21 that are higher than those that would prevail under traditional recourse rates.

22 Throughout this testimony “market-based” means that the regulator has determined that it
 23 does not need to exercise its jurisdiction to set rates because competition is sufficient to
 24 allow the regulator to forbear from further examination of the justness and reasonableness
 25 of rates charged by the regulated company. Regulated companies that are judged to be
 26 eligible for market-based tolls are sometimes required to file their tariff terms and conditions

⁵ NEB, Order TO-1-95, RH-4-95 (1995).

⁶ *Enbridge Pipelines Inc.*, Competitive Toll Settlement, July 1, 2011, p. 15.

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1 or individually-negotiated customer contracts for information purposes, but they are not
 2 required to obtain regulatory approval before placing rates into effect. Moreover, a pipeline
 3 with market-based toll authority is not required to post its rates in a tariff. The settlement
 4 tolling arrangement agreed to in *Westcoast* is an acknowledged case of the Board permitting
 5 market-based rates.⁷ Westcoast proposed a framework of light-handed, complaint-based
 6 regulation of its tolls and service structure, under which it was granted the latitude to
 7 negotiate market-based contracts with its shippers. Trans Mountain is not proposing
 8 market-based tolls for the post-expansion pipeline. Instead, it is proposing negotiated tolls
 9 that reflect the product of arms-length negotiations.

10 Negotiated tolls are arrived at through agreement between the regulated company and its
 11 customers, but those tolls still require the approval of the regulator. In addition, those tolls
 12 often are standardized and posted in the tariff so that the same rates are available to all
 13 similarly situated customers. When negotiated tolls are the result of voluntary commercial
 14 agreements between equally sophisticated and knowledgeable parties, it is common for the
 15 Board to rely on that fact in approving negotiated tolls. In this Application, Trans Mountain
 16 is filing for approval of the negotiated toll methodology that will establish its tolls for
 17 approximately 20 years after the expansion.

18 **Q22. ARE MARKET-BASED TOLLS CURRENTLY IN EFFECT ON THE TRANS**
 19 **MOUNTAIN SYSTEM?**

20 A22. Tolls for deliveries to the Westridge Dock are effectively established on a market-basis in
 21 order to efficiently allocate the available capacity. Since 2002, the non-firm or uncommitted
 22 capacity at the Westridge Dock has been apportioned by using monthly auctions. Similarly,
 23 the “Firm 50” application that was approved by the Board in 2011 (RH-2-2011) adopted
 24 market-based tolls for contracts for firm service at the Westridge Dock. Thus, all shipments
 25 to the Dock pay market-based tolls and it is only the Land shippers who currently pay “cost-
 26 based” tolls. However, in recent years the “cost-based” tolls paid by these shippers have
 27 become extremely distorted as a result of the mechanism whereby most of the proceeds
 28 from the monthly auctions of uncommitted capacity at the Dock are credited to all shippers.

⁷ NEB, Reasons for Decision, RH-2-97 (Part 1); NEB, Framework Summary, RHW-1-98, June 1998.

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1 The amount of those proceeds has grown to the point where, if all of the proceeds from last
 2 year were passed through in 2012, the credit would offset more than 80 percent of the “cost-
 3 based” tolls for uncommitted transportation to all destinations.

4 **Q23. IS THE TOLL METHODOLOGY NEGOTIATED BETWEEN TRANS**
 5 **MOUNTAIN AND THE FIRM SHIPPERS FOR THE EXPANSION THE SAME**
 6 **AS MARKET-BASED TOLLS?**

7 A23. No. Because the same tolls and tolling methodology will be approved by the Board in
 8 advance, posted in the tariff and available for all shippers, they are not “market-based” tolls
 9 in the same sense as an auction or unique individually-negotiated contracts with each
 10 shipper. Instead, the proposed toll methodology is the result of negotiations with
 11 sophisticated firm shippers and the resulting tolls have been made available to everyone who
 12 participated in the Open Season process. As a result, the balance of terms, risks and toll
 13 methodology that was agreed to by all firm shippers is just and reasonable. In addition, Dr.
 14 Schink’s evidence demonstrates that the market structure is competitive, which is another
 15 indicator that the negotiated toll methodology reflects an efficient, competitive market
 16 outcome.

17 **Q24. DO NEGOTIATED TOLLS PROVIDE MARKET PROTECTIONS TO**
 18 **SHIPPERS WHO DO NOT HAVE COMPETITIVE ALTERNATIVES?**

19 A24. Yes. Because negotiated tolls are posted in the tariff and the same terms and conditions are
 20 available to all shippers, those shippers with the fewest competitive alternatives receive the
 21 benefits of the negotiating position of the shipper with the most negotiating leverage and
 22 competitive alternatives. For example, Chevron recently filed a request with the Board to be
 23 designated as a Priority Destination because it claims that it does not have competitive
 24 alternatives to Trans Mountain’s service.- Even if Chevron’s claim is proven to be correct, it
 25 would still be the case that the post-expansion toll proposed in the current application would
 26 be reasonable for Chevron because it is the same as the toll available to shippers that have
 27 negotiating leverage and more competitive alternatives. Similarly, although Dr. Schink’s
 28 evidence indicates that the Kamloops market may be slightly concentrated under some
 29 scenarios, the proposed post-expansion tolls would be reasonable for Kamloops for the
 30 same reason.

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1 It should be noted however that it is only necessary to find that tolls are just and reasonable
2 for a class as a whole and not necessarily for every individual within that class.

3 ***B. Regulation Should Attempt to Emulate a Competitive Outcome***

4 **Q25. WHAT IS THE OBJECTIVE OF REGULATING THE TOLLS AND SERVICES**
5 **OF PUBLIC UTILITIES?**

6 A25. In general, public utilities are subject to regulation for two reasons: (1) the public
7 importance and necessity of the services they provide requires oversight of service quality;
8 and (2) there are special characteristics that render competition infeasible or ineffective in
9 promoting efficient levels of service at rates that are just and reasonable. In addition, there
10 usually is an implicit assumption that regulation will produce a more efficient balance
11 between service quantity, quality and price than arms-length negotiations between buyers
12 and sellers. However, in many instances regulation is a poor substitute for competition or
13 negotiations between buyers and sellers.

14 **Q26. WHY IS REGULATION OFTEN A POOR SUBSTITUTE FOR COMPETITION?**

15 A26. Generally speaking, competition is superior to regulation for determining optimal market
16 outcomes. Competition serves to minimize the costs of providing a service to those
17 consumers willing and able to pay for it. Competition creates efficient markets that allocate
18 resources to those who value them most when no single market participant has the power to
19 set or manipulate prices, but rather prices are set by the market.

20 From an economist's perspective, the ultimate goal of any market is economic efficiency,
21 including allocative and productive efficiency. Allocative efficiency indicates that markets
22 assign resources to their highest valued uses while productive efficiency exists when markets
23 satisfy demand at the lowest possible cost. Competition is the best means of achieving
24 economic efficiency and according to Alfred E. Kahn:

25 [c]ompetition will weed out the inefficient and concentrate
26 production in the efficient; it will determine, by the objective test of
27 market survival, who should be permitted to produce; it will force
28 producers to be progressive and to offer customers the services they
29 want and for which they are willing to pay; it will assure the allocation

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1 of labor and other inputs into the lines of production in which they
2 will make the maximum contribution to total output.”⁸

3 When competition is deemed to be infeasible or ineffective, governments resort to
4 regulation as a means to correct the problem and mirror or mimic the outcomes of a
5 competitive market. Bonbright, Danielsen and Kamerschen provide the following quote
6 from Clair Wilcox explaining why regulation is a poor substitute for competition:

7 Regulation, at best, is a pallid substitute for competition. It cannot
8 prescribe quality, force efficiency, or require innovation, because such
9 action would invade the sphere of management. But when it leaves
10 these matters to the discretion of industry, it denies consumers the
11 protection that competition would afford. Regulation cannot set
12 prices below an industry’s costs however excessive they may be.
13 Competition does so, and the high-cost company is compelled to
14 discover means whereby its costs can be reduced. Regulation does
15 not enlarge consumption by setting prices at the lowest level
16 consistent with a fair return. Competition has this effect. Regulation
17 fails to encourage performance in the public interest by offering
18 rewards and penalties. Competition offers both.⁹

19 Given the shortcomings of regulation, it is important to understand the overall objectives
20 and principles of regulation, and the circumstances under which regulation is, or is not,
21 appropriate.

22 As Alfred Kahn has observed, “...the single most widely accepted rule for governance of the
23 regulated industries is regulate them in a way as to produce the same results as would be
24 produced by effective competition, if it were feasible.”¹⁰ This statement recognizes that rate
25 regulation is clearly intended to be a second best alternative to effective competition, and
26 should attempt to mimic the results that effective competition would produce, not to try to
27 improve upon what would have been a market-based result. In other words, it is
28 inappropriate to apply regulation to approximate a competitive outcome where competition
29 already exists, or where the parties to a transaction are capable of negotiating an efficient
30 outcome on their own.

⁸ Kahn, A. E. (1988). *The Economics of Regulation: Principles and Institutions* (Vol. I). Cambridge, Massachusetts: The MIT Press, p. 18.

⁹ Bonbright, J. C., Danielsen, A. L., & Kamerschen, D. R. (1988). *Principles of Public Utility Rates*. Arlington, Virginia: Public Utility Reports, Inc., p. 30.

¹⁰ *The Economics of Regulation, Principles and Institutions*, Alfred E. Kahn, The MIT Press (1988), Volume I, p. 17.

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1 Another market-oriented objective that is often cited for rate regulation is to ensure that
 2 production and consumption decisions are economically efficient. This objective has been
 3 described as maximizing the level of consumer welfare derived from the consumption of
 4 society's scarce resources. Long-term contracts that underwrite construction of new
 5 facilities for customers who are willing to pay for those facilities, along with complex
 6 provisions that balance risks and toll levels in a manner that is reasonable to both buyers and
 7 sellers, will produce a more efficient outcome than a traditional regulatory model when
 8 major projects designed to serve large, sophisticated customers are proposed.

9 In both rate-regulated markets and competitive markets, prices should provide signals that
 10 promote economic efficiency. The key difference is that in rate-regulated markets, the rate
 11 or price typically reflects embedded costs for a relatively small number of standard services,
 12 and the focus is on achieving non-discriminatory rates for different customers. In
 13 competitive markets, economic efficiency is achieved when companies attempt to outdo
 14 their competitors in providing combinations of services, terms and prices that best balance
 15 the needs of customers. As discussed further in the evidence of Dr. Schink, competitive
 16 bargaining and negotiations will promote a transaction that is mutually beneficial and
 17 economically efficient for all parties. It is not necessary for a market to be perfectly
 18 competitive, as long as it is workably competitive in the sense that there is sufficient
 19 competition that negotiations are likely to produce a more efficient outcome than
 20 regulation.¹¹

21 ***C. Is Trans Mountain's Negotiated Tolling Methodology Just And Reasonable?***

22 **Q27. GIVEN THE OBJECTIVES FOR REGULATION, WHAT ARE THE**
 23 **PRINCIPLES THAT YOU CONSIDER MOST IMPORTANT FOR**
 24 **ESTABLISHING JUST AND REASONABLE TOLLS IN THIS PROCEEDING?**

25 A27. The principles that are most important for determining just and reasonable tolls are:

- 26 1) Ability to attract investment to provide efficient levels and quality of service;
 27 2) Ability to attract willing commitments from sophisticated customers;

¹¹ A workably competitive market is one in which a product or service provider cannot charge a price on a sustained basis that is above the market clearing level and do so profitably. In such a market the necessary checks and balances exist to prevent market manipulation and abuse without the need for regulation.

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- 1 3) Promotion of efficient use of facilities;
2 4) No undue discrimination in the tolls or terms of service; and
3 5) No acquired rights.

4 **Q28. PLEASE DESCRIBE WHY ECONOMIC EFFICIENCY IS AN IMPORTANT**
5 **OBJECTIVE FOR TOLLS.**

6 A28. Economic efficiency is the concept that resources should be employed in their most highly
7 valued use. Most economists agree that voluntary agreements in workably competitive
8 markets promote economic efficiency by providing all parties with incentives to pursue the
9 most efficient production, consumption, and allocation of resources. Similar to workably
10 competitive markets, tolls in a regulated environment should also provide proper price
11 signals in order to promote optimum construction of facilities and to maximize the cost-
12 effective utilization of the system, and thus maximize the benefits to society. The Board has
13 adopted efficiency objectives that are consistent with this concept:

14 ... the following factors are assessed to determine how well NEB-regulated
15 pipelines are working to ensure that the Board's goal "Canadians benefit
16 from efficient energy infrastructure and markets" is being achieved:

- 17
18 • adequacy of pipeline capacity;
19 • pipeline tolls and shipper satisfaction; and
20 • the financial soundness of pipeline companies.

21 In general, an efficient pipeline transportation system will have an ability to
22 respond on a timely basis to changing market conditions. This may entail
23 adjustments to pipeline capacity or enhancement of pipeline services.¹²

¹² Canadian Pipeline Transportation System, Transportation Assessment, National Energy Board, July, 2009, p. 2.

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1 In my opinion, the toll methodology and commercial terms that resulted from the Open
2 Season process are consistent with this concept of economic efficiency because they will
3 bring forth adequate capacity to meet the needs of the market at tolls that are satisfactory to
4 both the shippers and the pipeline. Moreover, because the variable charge component of the
5 toll design will include only the cost of power, the marginal toll paid by firm shippers will
6 match the pipeline's marginal cost of throughput and promote the most efficient utilization
7 of the firm capacity.

8 **Q29. WHAT IS MEANT BY THE PROHIBITION AGAINST UNDUE**
9 **DISCRIMINATION?**

10 A29. An important principle in sound toll making is that tolls should not be unduly
11 discriminatory. The overarching goal is that similar tolls should be assessed for similar
12 services provided under similar conditions. Similar services can be defined to include similar
13 quality of services provided, similar types or nature of services provided, the degree to which
14 similar facilities are utilized, and similar locations and/or markets that can be accessed.
15 When regulated tolls are designed, they should not be developed in a manner such that they
16 grant any undue preference to any particular shipper or group of shippers that places those
17 parties either at a competitive advantage or competitive disadvantage relative to similarly
18 situated shippers. In other words, toll methodologies should not grant "wealth entitlements"
19 to certain shippers at the expense of other similarly-situated shippers. This is not to suggest
20 that differences in tolls should be prohibited or limited in any manner, but rather that
21 differences in tolls should reflect differences in the services being provided or the
22 circumstances under which the services are provided. The term "unduly discriminatory" is
23 open to differing interpretations. Generally, it is understood that tolls cannot be designed
24 perfectly to entirely eliminate all toll discrimination. However, upon consideration of the
25 other tolling principles and the circumstances of each particular case, tolls should, to the
26 greatest extent possible, be designed so as to not be unduly discriminatory.

27 **Q30. IS THE REDUCED TOLL FOR CONTRACT VOLUMES IN EXCESS OF 75,000**
28 **BPD REASONABLE?**

29 A30. Yes. Trans Mountain is offering a 7.5 percent reduction in tolls for shippers who commit to
30 long-term contracts for 75,000 bpd or more. This reduction in the toll is non-discriminatory

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1 because it is available to anyone willing to commit large volumes. Moreover, it is justified by
2 the greater financial commitment, and economic risk these shippers are making to
3 underwrite the expansion.

4 **Q31. WOULD YOU COMMENT ON THE PROPOSAL TO CHARGE LOWER RATES**
5 **TO SHIPPERS WHO SIGN LONGER TERM CONTRACTS?**

6 A31. In its Open Season, Trans Mountain proposed that shippers who sign 20-year contracts
7 would receive a discount of 10 percent below the fixed charge component of the toll for 15-
8 year contracts. Assuming the expanded system goes into service, Trans Mountain also is
9 proposing that the fixed charge component of tolls for uncommitted, service will be set 10
10 percent above the fixed charge component of tolls for 15-years of committed volumes.
11 Lower rates for longer term contracts have been used on several pipelines in recent years.
12 For example, Express, Keystone, Keystone XL, and Southern Lights all recognized the
13 greater financial risks taken on by shippers who sign longer-term contracts by offering lower
14 rates for long-term contracts. These tolling methodologies were approved by the Board.¹³
15 Southern Lights offered shippers the option of contracted service for a 15-year term, or
16 uncommitted service at a toll set to be two-times the contracted toll.¹⁴ The Board approved
17 that tolling methodology in 2008, and reaffirmed its position in a February 2012 decision in
18 response to a shipper complaint regarding the uncommitted toll.¹⁵ In the 2012 decision, the
19 Board cited the risk taken by committed shippers and their agreement to bear the
20 responsibility for the entire revenue requirement during the initial 15-year term as
21 justification for the two-to-one toll ratio. The Board has recognized this consideration in
22 other cases in the past. For example, in Keystone XL, the Board did not take issue with the
23 proposal to charge separate rates to committed and uncommitted shippers, nor with the fact
24 that tolls charged to committed shippers would decrease with the length of the contract
25 term. The Board explained:

26 The Board has considered the proposed toll structure whereby committed
27 tolls would decrease with the length of contract term and uncommitted tolls
28 would be set at a premium of 20 per cent over the 10-year committed toll.

¹³ NEB, Reasons for Decision, OH-1-95, p. 20; NEB, Reasons for Decision, OH-1-2007, p. 16; Keystone XL Pipeline Section 52 Application, Section 5, p. 9-11.

¹⁴ NEB, Reasons for Decision, OH-3-2007, p. 54.

¹⁵ NEB, Reasons for Decision, RH-1-2011, p. 33.

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1 The Board accepts that this is a reflection of shippers having provided
2 differing levels of financial support to the Keystone XL Project and
3 accepting differing levels of risk. Therefore the Board finds that no unjust
4 discrimination would result from this proposed toll structure and that the 20
5 percent premium for uncommitted tolls is just and reasonable.¹⁶

6 ***1. Tolls For Uncommitted Service***

7 **Q32. WHAT IS THE CURRENT TOLL METHODOLOGY FOR UNCOMMITTED**
8 **SERVICE ON THE TRANS MOUNTAIN PIPELINE SYSTEM?**

¹⁶ NEB, Reasons for Decision, OH-1-2009, p. 46.

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1 A32. Uncommitted Dock shippers pay a market-based price that is established in a monthly
 2 auction.¹⁷ In contrast, the current filed tolls for uncommitted Land shippers are based on
 3 “cost of service,” but are modified by substantial credits of market-based revenue collected
 4 from uncommitted Dock shippers each month. The result of this structure is that land-
 5 based shippers have been paying a toll that is significantly below a traditional cost of service,
 6 and far below the toll that uncommitted Dock shippers have voluntarily agreed to pay. For
 7 example, in 2011 Trans Mountain had a total revenue requirement of approximately \$270
 8 million, and it collected \$251 million of monthly bid premiums from uncommitted shippers
 9 at the Dock, even though this service was only eight percent of the throughput on the
 10 pipeline system. Because the bid premiums offset such a large portion of the revenue
 11 requirements, the credit of the 2011 bid premiums is being amortized over several years.
 12 The result is that the average toll for uncommitted service ~~is being~~ was reduced by 41 percent
 13 (from \$2.706/bpd to \$1.609/bpd) during 2012. Under the current circumstances, it is likely
 14 that the tolls for uncommitted service for all destinations will be heavily distorted until an
 15 expansion and the new tolling methodology goes into effect.

16 **Q33. WHAT IS THE DIFFERENCE BETWEEN THE CURRENT TOLL**
 17 **METHODOLOGY FOR UNCOMMITTED SERVICE AND THE PROPOSED**
 18 **POST-EXPANSION TOLL METHODOLOGY FOR THAT SERVICE?**

19 A33. The Company’s shippers currently receive service under a distorted form of “cost-based”
 20 tolls. In addition, Dock shippers pay a bid determined premium to gain access to ship over
 21 the Dock. In its current application before the Board, the Company is seeking to amend
 22 this rate structure to charge all shippers—i.e., Land shippers as well as Dock shippers – tolls
 23 that are based on the negotiated tolls agreed to by committed firm shippers in the Open
 24 Season.

¹⁷ In return for firm capacity rights, Committed Dock shippers currently pay a rate that is equal to the uncommitted toll, plus a market-based premium above the committed toll that was established for each shipper in an Open Season auction. Each of the committed Dock shippers will pay its bid premium for a term of ten years. However, their contracts state that they will pay the applicable toll rate for firm service in the event that an expansion goes into service.

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2. Importance Of A Single Set Of Tolls

Q34. IS IT IMPORTANT TO PRICE ALL SERVICES USING A SINGLE, CONSISTENT TOLLING METHODOLOGY?

A34. Yes. The use of a single approach to tolling is better at addressing the following issues:

- 1) Correct pricing signals
- 2) No undue price discrimination
- 3) No hoarding of existing service, no wealth transfer between shippers

Q35. WHY IS IT IMPORTANT FOR TOLLS TO PROVIDE CORRECT PRICE SIGNALS FOR UNCOMMITTED SERVICE?

A35. Trans Mountain's proposed expansion will add a large amount of capacity and it will involve a very large investment. In order to ensure that the expansion is sized efficiently it is important to have an incentive for as many shippers as possible to sign long-term contracts that help ensure the need for the expansion and underwrite the investment.

The motivation for shippers to commit to firm service on a long-term basis is the expectation that the market value of the service will be greater than the toll for the service. If the toll for uncommitted service had been set too low relative to the toll for committed long-term firm service during the Open Season, the low non-firm toll could have undermined the value of the firm service and discouraged shippers from making these commitments. In other words, if too many shippers expected that they could benefit from increased capacity without making firm commitments or paying the higher tolls, a market failure would have been likely and an efficient level of expansion capacity would not be constructed. In fact, concern about this issue was sufficiently important that the TSA contains a "Most Favoured Nations" provision that grants committed shippers the same rate as uncommitted shippers if Trans Mountain ever sets the uncommitted service toll lower than the toll for firm service. This provision means that the financial viability of an expansion depends on Trans Mountain establishing a reasonable relationship in which the uncommitted toll is at least as high as the committed toll. For these reasons, Trans Mountain is proposing that the tolls for uncommitted service will be priced 10 percent higher than 15-year firm service tolls.

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1 **Q36. IS INEFFICIENT ARBITRAGE LIKELY TO RESULT IF THE**
 2 **UNCOMMITTED TOLL IS SET SIGNIFICANTLY BELOW THE**
 3 **COMMITTED FIRM TOLL?**

4 A36. The “law of one price” states that in efficient markets, all homogenous goods will have a
 5 single price. Under this principle, regardless of the mix of inputs used to produce a good or
 6 service, or regardless of the currency in which it is priced, eventually only one price will
 7 prevail in the market. The corollary of this principle is that if temporary market
 8 inefficiencies develop, arbitrage eventually will drive price convergence for homogenous
 9 goods.

10 Capacity for deliveries to land destinations will continue to be apportioned on a pro rata
 11 basis. However, if there is a need to apportion uncommitted capacity for land deliveries at
 12 some point after the expansion goes into service, many potential shippers will have an
 13 incentive to over-nominate (or “hoard”) non-firm service that they can sell on the secondary
 14 market at a higher price. The result would be that legitimate non-firm shippers would pay
 15 more than the non-firm toll for much of the volume shipped, but third-party middlemen
 16 would collect the difference between the pipeline’s low non-firm toll and the market value of
 17 the capacity. This arbitrage would be inefficient because a portion of the value of capacity
 18 would be diverted from both the pipeline and the shippers, thereby reducing the price
 19 signals and incentive for future expansions.¹⁸

20 **Q37. WHAT IS THE PRINCIPLE OF “NO ACQUIRED RIGHTS?”**

21 A37. Similar to the principle that tolls should not be unduly discriminatory, toll design should also
 22 reflect the principle that customers do not have certain proprietary rights to services or
 23 facilities of a company, or be granted protection from toll increases, simply because of their
 24 past patronage. When contracting with a pipeline, shippers purchase a service from the
 25 pipeline (e.g., transportation or storage service) and not an ownership interest in the
 26 facilities. As a result, by purchasing service from a pipeline, shippers are in no way granted

¹⁸ Because uncommitted capacity for deliveries to the dock will continue to be allocated using a monthly bid premium auction, similar arbitrage opportunities to obtain capacity at less than market value and then re-sell it at a higher price should not be available for dock capacity.

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1 an entitlement to future rate protection. In fact, standard pipeline contracts or service
 2 agreements generally do not specify a particular price for the contract term, but rather refer
 3 to the tariff whereby prices are subject to change at any time throughout the contract term
 4 upon approval by the appropriate regulatory agency. Clearly, in certain circumstances, prices
 5 for services are fixed for a period of time, typically through settlement agreements or
 6 negotiated contract arrangements; however, apart from such agreements, the provision of
 7 service is not a grant of future rate certainty or ownership in the pipeline. Therefore, tolls
 8 should be established on the basis that all shippers, either existing or new, are equally entitled
 9 to service, and that any tolling differences should be made because the services justify such
 10 differences, and not because of shippers' legacy rights to capacity. This principle has been
 11 endorsed by the Board on several occasions. For example, in its Reasons for Decision
 12 regarding TransCanada's Gros Cacouna Receipt Point Application, the Board held that the
 13 payment of tolls in the past conferred no benefit on tollpayers beyond the provision of
 14 services at that time. Put differently, previous tollpayers have no acquired rights and the
 15 Board does not equate tollpayers with those who paid for the facilities. Shippers who have
 16 used the pipeline in the past are not entitled to continue using the existing facilities without
 17 being affected by new circumstances. Therefore, existing shippers should not be exempt
 18 from a toll increase in the future.¹⁹

19 **Q38. ARE THERE OTHER REASONS WHY UNCOMMITTED SHIPPERS SHOULD**
 20 **PAY TOLLS THAT ARE TIED TO THE TOLLS NEGOTIATED BY FIRM**
 21 **SERVICE SHIPPERS?**

22 A38. Yes. Because the demand from every shipper may be considered to be the marginal source
 23 of demand causing the need for additional capacity, the costs of increased capacity may
 24 equitably be attributed to every user. As the Board has noted in several cases, on an
 25 integrated pipeline system it is the aggregate demand of shippers that gives rise to the need

¹⁹ NEB, Reasons for Decision, RH-1-2007, p. 21-23; NEB, Reasons for Decision, GH-2-87, p. 70; NEB, Reasons for Decision – Volume 1 Tolling and Economic Feasibility, GH-5-89, Section 2.3 (no page number listed - mimeo pp. 29 and 31), and ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board), [2006] 1 S.C.R. 140, 2006 SCC 4.

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1 for new facilities, and the costs and cost responsibility of those new facilities are properly
2 charged to all ongoing users of the system.²⁰

3 In addition, Trans Mountain will be assuming even more risk for the provision of non-firm
4 service than it is accepting for the provision of firm service because the non-firm service is a
5 stand-by service that may or may not be used and paid for. If any of the uncommitted
6 capacity goes unused and unpaid for, the effect is to increase the effective cost per unit of
7 providing this “stand-by” service.

8 Moreover, non-firm service poses greater risk to the project because Trans Mountain has
9 agreed that it will not increase its firm service tolls if it is unable to sell the capacity reserved
10 for non-firm service, but it will share with firm shippers 50 percent of any revenues collected
11 from selling more than 85 percent of the available uncommitted capacity. Trans Mountain is
12 voluntarily relinquishing the right for 20 years to come back to the Board to seek a toll
13 increase for firm services and it is taking the risk associated with future fluctuations in the
14 level of uncommitted service revenues. The market has priced and incorporated the risk
15 premium for this commitment in the terms for firm service, and it is reasonable to use this
16 as the basis for establishing non-firm tolls.

17 **Q39. IN CONCLUSION, IS IT REASONABLE TO INCREASE TOLLS FOR**
18 **UNCOMMITTED SERVICE ONCE THE EXPANSION IS COMPLETED?**

19 A39. Yes, for several reasons. First, during the past seven to eight months apportionment has
20 reduced uncommitted shipper nominations to land destinations by approximately 70
21 percent, and the expansion should benefit uncommitted shippers by dramatically reducing
22 the amount of this apportionment. Second, an increase in the toll for non-firm service is
23 required in order to properly gauge the amount of new capacity required and to promote
24 allocative efficiency once the expansion is completed. Third, the open season TSA requires
25 that committed shippers will not pay more than uncommitted shippers. Fourth,
26 continuation of a low toll for uncommitted service would confer on uncommitted shippers a
27 form of property rights to the old tolls to which they are not entitled. Finally, because the
28 toll for uncommitted service will be closely linked to the competitively negotiated firm toll,

²⁰ *TransCanada PipeLines Limited*, GH-5-89, November 1990, Vol. 1, Sec. 2.3.

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1 uncommitted shippers will enjoy benefits similar to the competitive outcome that the
 2 committed firm shippers were able to obtain. This approach undoubtedly mirrors the result
 3 that a competitive, unregulated and efficient market would produce, which should be the
 4 objective of regulated tolls.

D. FSA/TSA Risk-Sharing Features**Q40. WHY IS A FAIR FACILITIES SUPPORT AGREEMENT IMPORTANT?**

7 A40. The purpose of a Facilities Support Agreement (“FSA”) is to allocate the risks associated
 8 with a large infrastructure project among the parties at an early stage before most
 9 development construction costs are incurred. Facilities Support Agreements provide a level
 10 of assurance to developers of new pipeline service that the facilities are required by the
 11 market and that recovery of their significant capital investments is likely to occur. Similarly,
 12 these agreements are also designed to protect the interests of customers by providing the
 13 structure by which prices will be developed, by describing the services that will be supplied
 14 to shippers, and by the inclusion of reasonable terms through which shippers can reduce or
 15 eliminate their financial obligations.

16 Facilities Support Agreements must be drafted carefully in order to meet the needs of both
 17 developers and shippers. As is discussed in some detail by Trans Mountain witness Dr.
 18 Schink, the Open Seasons process under consideration in this proceeding involved
 19 considerable interactions and concessions between the shippers and the Company. The
 20 evolution of the Facility Support Agreement and the Transportation Service Agreement
 21 (“TSA”) that Dr. Schink discusses, and the capacity commitments made by many
 22 sophisticated shippers during the Open Seasons is evidence that shippers were able to
 23 negotiate what they considered to be fair terms for firm capacity.

24 From a regulatory perspective, the fairness of the Open Seasons and the mutual agreement
 25 of sophisticated shippers and the pipeline establish that the agreed upon tolling methodology
 26 and services are just and reasonable. This conclusion is discussed at greater length, below.

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1 **Q41. IN YOUR OPINION ARE THE PROVISIONS IN THE COMPANY'S**
2 **PROPOSED FSA/TSA UNUSUAL?**

3 A41. No. In my experience, none of the individual provisions in the Company's FSA/TSA are
4 unusual for this type of large capital project. However, it should be recognized that the
5 entire negotiated package is intended to provide a balance between various considerations
6 that are unique to the circumstances of the firm shippers and Trans Mountain.

7 **Q42. IN WHAT WAY ARE RISKS GENERALLY SHARED BETWEEN SHIPPERS**
8 **AND THE DEVELOPER IN AN FSA AND TSA?**

9 A42. As discussed above, one of the main purposes of FSAs is to distribute the risk of investment
10 in a large capital project among shippers and the developers. Because these agreements are
11 legally binding, shippers are required to make substantial commitments for capacity, typically
12 for a minimum of ten to 20 years. This required commitment places a portion of the project
13 risk on the shipper.

14 Facilities Support Agreement commitments from shippers apply not only to the term during
15 which service will be available, but also to the development period as well. Facilities Support
16 Agreements typically contain provisions that assign a portion of development cost
17 responsibility to shippers in certain instances of project modification or cancellation.

18 **Q43. PLEASE DESCRIBE THE CONDITIONS PRECEDENT AND TERMINATION**
19 **CLAUSES INCLUDED IN THE TRANS MOUNTAIN FSA.**

20 A43. As with similar agreements, the Company's FSA includes "conditions precedent" clauses
21 that describe future conditions that must be met to activate service and cost obligations.
22 These conditions are designed to provide additional clarity of risk to the Company and
23 shippers because FSA contracts must be signed long before service becomes available. With
24 respect to the developer, conditions precedent often require successful conclusion of the
25 Open Season process, approval of permits and other regulatory requests, and internal
26 corporate approval to proceed with the project. Shippers' conditions precedent are often
27 similar, involving corporate approvals and regulatory approval of tolling mechanisms
28 without material modifications to the tolling methodology or service terms. Section 5.4 of
29 the Company's FSA describes the rights the Company and shippers have with respect to

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1 project termination if conditions precedent are not satisfied. This section also describes the
2 resulting distribution of the development cost burden.

3 Pursuant to Section 5.4, shippers may terminate the agreement if their conditions precedent
4 are not satisfied. In the case of the Company's FSA, project termination conditions
5 apportion development costs between Trans Mountain and shippers in proportion to the
6 capacity for which each shipper has contracted. For purposes of termination cost allocation,
7 Trans Mountain is deemed to be the party holding the uncommitted capacity. If revised
8 development expense forecasts require tolling charge adjustments above the agreed
9 threshold amount, shippers are permitted to terminate the agreement, but must pay pro-rata
10 portions of development costs incurred to that point. If these cost revisions prompt one or
11 more shippers to terminate their agreements, the Company is required to conduct another
12 Open Season to allocate capacity. If this second Open Season is not considered successful,
13 the project is terminated with all shippers responsible for their pro rata share of
14 development costs. In this case, because the election to terminate is at the shippers'
15 discretion, and not Trans Mountain's, the pro rata sharing of costs is among shippers only.

16 These provisions in Trans Mountain's FSA are substantially similar to those found in other
17 Facilities Support Agreements throughout the North American energy industry. These
18 terms require shippers to assume certain risks, and in return shippers are able to attenuate
19 their risk exposure through advantageous pricing options and other contract terms, as is
20 discussed below.

21 **Q44. WHAT ARE THE DEVELOPMENT COSTS THAT WOULD BE SHARED**
22 **AMONG SHIPPERS AND THE COMPANY IN SOME CASES?**

23 A44. As is described in Section 6.1 of the FSA, costs and expenses include:

- 24 1) Predevelopment expenses incurred prior to the Open Season;
- 25 2) Engineering design, environmental studies, stakeholder consultation, and
- 26 commercial and regulatory activities;
- 27 3) Capital expenditures, including those related to material and labor supply; and
- 28 4) Financing costs and all applicable taxes.
- 29

30 However, in accordance with Section 5.4(d)(ii) of the Company's FSA and the NEB Reasons
31 for Decision in RH-2-2011, costs and expenses associated with a terminated project will be

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1 reduced by the Firm Service Fees (i.e., toll premiums) for existing firm dock service on Trans
 2 Mountain, which have been reserved for the purpose of funding future capital expenditures.
 3 In early 2012 Trans Mountain began providing Firm Service for 54,000 bpd of deliveries at
 4 the Westridge Dock. The five shippers who obtained this service in an auction process each
 5 agreed to pay a Firm Service Fee in addition to the posted toll for uncommitted service. The
 6 Firm Service Fees amount to \$28.6 million per year and will be used primarily to reduce the
 7 capital costs of the proposed expansion in accordance with the Board's Order in RH-2-
 8 2011.²¹

9 **Q45. PLEASE COMMENT ON THE RISK ASSOCIATED WITH CONSTRUCTION**
 10 **COST OVERRUNS.**

11 A45. Developers routinely face the risk of construction cost overruns on oil pipeline projects.
 12 Market conditions can change from the time a project is planned to when it is constructed,
 13 which can have a dramatic inflationary effect on the prices of necessary inputs and services.
 14 Enbridge's Southern Lights project—a pipeline to ship diluents from Chicago to
 15 Edmonton—was originally estimated to cost \$384 million in 2006. By the time Southern
 16 Lights was placed in service in 2010, however, the actual capital costs had reached \$559
 17 million,²² an increase of 45 percent. In that case, Southern Lights did not directly bear the
 18 risk of construction cost overruns, but shippers had an option to withdraw from the project
 19 if costs increased by more than 15 percent. Its tolling methodology was cost-based, with a
 20 negotiated return on equity that was tied to how well Southern Lights was able to control its
 21 construction costs. This case illustrates the substantial risk of cost overruns in pipeline
 22 construction projects. It should therefore be noted that Trans Mountain, under its proposed
 23 tolling methodology, has agreed to limit the amount of risk associated with construction cost
 24 overruns, to the benefit of all shippers.

25 **Q46. PLEASE DISCUSS THE RISKS SHIPPERS NORMALLY TAKE ON DURING A**
 26 **NEW OR EXPANSION PIPELINE PROCESS.**

27 A46. Historically, prospective shippers have taken a certain amount of risk associated with
 28 development costs of a new pipeline. Under cost-based rates, shippers assume some, or all,

²¹ NEB, Reasons for Decision, RH-2-2011, p. 38-39.

²² NEB, Reasons for Decision, RH-1-2011, p. 24.

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1 of the risks associated with uncertainties regarding financing costs, as well as capital and
 2 operating costs. They also often assume risks associated with changing contract and
 3 throughput levels. In this case, Trans Mountain is offering a schedule of annual rates for
 4 long-term service that will be known at the beginning of service and remain essentially
 5 invariable during the term of the committed contracts. Thus, the Company is taking many
 6 of the risks associated with future operating and capital costs, and contract levels.

7 Defining the financial risks to be borne by prospective shippers and the carrier early in the
 8 approval process provides both parties with the certainty required to evaluate and justify
 9 major commitments and expenditures.

10 **Q47. HOW DOES THE TOLL METHODOLOGY IN THE COMPANY'S FSA AND**
 11 **TSA INSULATE SHIPPERS FROM RISK?**

12 A47. The Company's firm service toll design includes both Fixed charge and Variable charge
 13 components. Once construction is completed and firm services tolls are locked in, the fixed
 14 charge component of the toll will escalate at 2.5 percent per year, but it will not change in
 15 response to changes in throughput or increases in most types of costs. This essentially fixed
 16 schedule of tolls shields shippers from price volatility during the term of the contracts and
 17 shifts substantial risks from shippers to pipeline owners.

18 While rates that are fixed for the term of the contracts are not universally offered to shippers
 19 on other projects, fixed rates are increasingly common in negotiated contracts between
 20 sophisticated parties. For example, the toll methodologies for contract service proposed by
 21 Keystone and Keystone XL, both of which were approved by the Board, hold the fixed
 22 charge component of the committed toll constant throughout the term of the TSA.²³

23 In addition, the fixed charge component of Trans Mountain's proposed toll insulates
 24 shippers from any volume risks associated with under-subscription or non-performance by
 25 other shippers because the charge is unrelated to the amount of capacity that the pipeline
 26 sells.

²³ NEB, Reasons for Decision, OH-1-2007, p. 15; NEB, Reasons for Decision, OH-1-2009, p. 39.

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1 **Q48. DO SHIPPERS THAT SIGN LONG-TERM CONTRACTS HAVE ANY**
2 **PREFERRED OPTIONS WITH RESPECT TO EXTENDING SERVICE?**

3 A48. Yes. It is common in the pipeline industry to offer shippers subscribing to long term
4 capacity agreements in an initial Open Season process the option to extend service for some
5 period of time beyond the term of the initial contracts. In the Company's FSA, shippers
6 have the right to renew their agreements for a term of five years, provided that written
7 notice is provided to Trans Mountain in a timely manner.

8 **Q49. DO THE TERMS OF THE FSA AND TSA FAIRLY BALANCE THE**
9 **INTERESTS OF THE PARTIES, AND ARE THEY REASONABLE AND**
10 **WITHIN STANDARD INDUSTRY PRACTICES?**

11 A49. Yes, they are fair, balanced, and consistent with industry practices. Both parties have taken a
12 certain amount of risk associated with development costs for the expansion. However, as
13 noted above, Trans Mountain has assumed a considerable amount of the risk associated with
14 construction and operating costs, financing costs, and throughput and contract volumes. In
15 my view the result fairly balances the risks and interests of both parties.

16 **E. *Trans Mountain's Negotiated Tolls Are Preferable to Traditional Cost-of-Service***
17 ***Tolls***

18 **Q50. WHY ARE NEGOTIATED TOLL PRINCIPLES COMMON FOR NEW**
19 **PIPELINES AND MAJOR EXPANSIONS?**

20 A50. In increasingly competitive and dynamic markets, it is difficult, if not impossible, to obtain
21 financing for major pipeline projects without fixed long-term shipper commitments to pay
22 for service. In order to attract investors, pipelines need revenue commitments and expected
23 returns commensurate with the risk they are bearing in making long-term investments. At
24 the same time, in order to attract shippers willing to sign long-term contracts, pipelines often
25 need to offer negotiated toll principles that specifically define and limit the risks that
26 shippers will assume during the life of the contract. Conventional cost-of-service toll
27 principles often do not offer adequate flexibility or certainty to attract both shippers and
28 investors in increasingly competitive oil and oil pipeline markets. In response, oil pipelines
29 have begun to propose more complex negotiated toll principles that balance the various risks

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1 and toll levels to achieve contracts that are mutually-agreeable to both shippers and
2 investors.

3 **Q51. CAN NEGOTIATIONS BE RELIED UPON TO PRODUCE A JUST AND**
4 **REASONABLE TOLL METHODOLOGY FOR TRANS MOUNTAIN?**

5 A51. Yes. There are several reasons that Trans Mountain's negotiated toll methodology is just and
6 reasonable, and in fact is preferable to traditional cost-of-service tolls. First, the regulated
7 cost-of-service model frequently does not provide conditions that are sufficiently flexible to
8 meet the requirements of both shippers and the pipeline with respect to construction of
9 major new facilities. Although the amount of apportionment in recent years indicates that
10 there is strong demand for capacity linking Alberta with the Pacific coast and other markets
11 throughout North America, the market has not been able to bring forth adequate capacity
12 under a regulatory formula based on traditional cost-of-service tolls. That condition is not
13 unusual as the risks associated with developing major projects have required shippers and
14 transporters to negotiate non-standard tolls in many instances in order to meet the capacity
15 requirements of the market. For example, several new pipelines or expansions were
16 constructed using negotiated tolls or toll methodologies that were approved by the Board.

17 Second, the contractual commitment that tolls that will remain largely fixed is important to
18 induce many potential shippers to sign the long-term transportation contracts that are
19 required to justify construction. By signing long-term contracts, shippers take on the risk
20 that market conditions will change during the life of the contract. However, the negotiated
21 toll methodology substantially reduces toll uncertainty, which is an important element of
22 risk, and helps shippers to make informed and efficient decisions concerning the amount of
23 financial commitment that a long-term contract entails. From the pipeline's perspective it is
24 a risky concession to give up its opportunity to increase tolls if costs per unit increase above
25 the level of the negotiated tolls to which the pipeline is committing. Thus, there is a balance
26 between providing shippers with toll certainty and also providing a toll that is at a level at
27 which the pipeline will assume substantial cost and throughput risks.

28 Third, additional capacity is pro-competitive and, as demonstrated by Dr. Schink, adequate
29 and growing levels of competitive alternatives exist. The proposed new facilities will provide

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1 important new competitive options for producers in Alberta as well as additional supplies to
2 consumers, refineries and markets in British Columbia and the Pacific Rim.

3 Fourth, the market has spoken and its preferences are known. Specifically, after extensive
4 discussions and negotiations with potential shippers that resulted in numerous concessions
5 by Trans Mountain, the Open Season's offerings developed to a point where ~~nine-thirteen~~
6 informed, sophisticated shippers and Trans Mountain reached an agreement which included
7 long-term contracts with firm access rights and the balance of risks incorporated into the
8 final negotiated toll methodology. The result was signed contracts for ~~20 years for~~ a total of
9 ~~508708,000~~ bpd. Two of the thirteen shippers signed 15 year contracts and the remaining
10 eleven shippers signed 20 year contracts. Because the same deal was available to all potential
11 shippers on a non-discriminatory basis, all shippers benefited from the negotiating leverage
12 of the shippers with the best competitive options. Those circumstances ensure that the
13 outcome for all shippers reflects the results of a workably competitive market.

14 **Q52. HAS THE COMPANY PROVIDED A COST-OF-SERVICE BASIS FOR ITS**
15 **PROPOSED NEGOTIATED CONTRACT TOLLS?**

16 A52. No, the Company has not provided a cost-of-service basis for its negotiated contract tolls.
17 Instead, the proposed rates reflect a negotiated outcome with significant non-standard terms
18 of service. The Company did provide all prospective shippers with initial estimates of costs
19 associated with various cost categories and an agreed upon method for adjusting the
20 indicative tolls if actual costs vary from the initial estimates. This information was sufficient
21 for ~~nine-thirteen~~ shippers to make large, long-term commitments.²⁴

22 Trans Mountain is taking an agreed-upon portion of the risk of construction cost overruns
23 with certain costs capped and a shipper option to terminate the agreement if tolls exceed a
24 limit set during the Open Season. It also is providing a long-term fixed price with specific
25 annual calculations that prevent it from increasing tolls in response to most increases in
26 operating costs, or in response to declines in throughput or contract volumes. With this
27 division of future toll risks, a traditional cost-of-service calculation is not relevant for
28 shippers to make decisions on the commercial reasonableness of the negotiated toll

²⁴ FSA and TSA Schedules, Schedule B3 Initial Cost Estimate.

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1 methodology. In *Express*, the Board made the following statement regarding the pipeline's
2 negotiated toll proposal, which was not accompanied by a cost-of-service filing:

3 "The Board is also of the view that a cost-of-service benchmark is not
4 necessary to evaluate whether the tolls are just and reasonable."²⁵

5 The same conclusion can be reached for Trans Mountain's proposed post-expansion tolls.
6 As a general matter, we do not know the cost, or the return earned by the seller, of most
7 products we buy in the market. That fact does not prevent us from weighing our
8 alternatives and making informed, efficient decisions. As Dr. Schink discusses, large,
9 sophisticated buyers like the committed firm shippers are able to make thousands of
10 different purchases and contract commitments without knowing the seller's costs, and the
11 lack of that information did not prevent them from committing to the Trans Mountain
12 project.

13 **Q53. WOULD YOU DESCRIBE EXAMPLES OF OTHER PIPELINES THAT HAVE**
14 **RECENTLY IMPLEMENTED NEGOTIATED TOLL METHODOLOGIES?**

15 A53. In *Keystone* and *Keystone XL*, the Board approved toll methodologies that were negotiated
16 with the committed shippers and designed to recover both fixed and variable costs.²⁶ Under
17 the toll methodologies proposed in those cases, the fixed portion of the committed toll was
18 intended to recover the investment in plant and was levelized to provide shippers with lower
19 rates in the early years of their contracts. In addition, the fixed charge component of the toll
20 was lower for longer contract terms, acknowledging the greater financial commitment made
21 by shippers signing longer-term contracts. The variable charge component of the toll for
22 committed service was designed to recover the pipeline's operating costs and would be
23 updated annually. In *Keystone*, the toll charged to uncommitted shippers was the committed
24 toll for a five-year contract plus a twenty percent premium. The uncommitted service toll in
25 *Keystone XL* was set equal to the committed toll for a ten-year contract plus a twenty percent
26 premium.

²⁵ NEB, Reasons for Decision, OH-1-95, p. 23.

²⁶ NEB, Reasons for Decision, OH-1-2007; NEB, Reasons for Decision, OH-1-2009.

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1 *Southern Lights* involved a negotiated tolling methodology where the committed shippers
 2 agreed to pay the pipeline's costs each year, and the shippers took the throughput and
 3 contracting risk. However, tolls were to be based on a negotiated schedule of depreciation
 4 rates that tended to levelize the tolls during the life of the contracts. In addition, the rate of
 5 return on common equity was negotiated to be fixed somewhere between 10 percent and 14
 6 percent, depending on whether the final construction costs were above or below the amount
 7 estimated during the open season.²⁷

8 **Q54. WHAT BASIS HAS THE BOARD PROVIDED FOR APPROVING**
 9 **NEGOTIATED TOLLS IN THE PAST?**

10 A54. Regarding negotiated rates, the Board considers carriers and shippers to be sophisticated
 11 parties, and has typically found that rates agreed upon in a consultative process between such
 12 parties are just and reasonable. For this reason the Board has tended to look to the results
 13 of a pipeline's open season to gauge whether the rates have been set at a competitive level.
 14 In *Express*, the Board cited the fact that 85 percent of the available capacity was contracted
 15 for during the open season process, and the availability of competitive transportation
 16 alternatives, as evidence that the proposed rates were just and reasonable.²⁸

17 In *Keystone XL*, the Board approved the proposed negotiated tolling methodology, stating:

18 The Board finds that the proposed committed toll methodology will produce
 19 tolls that are just and reasonable, given that the methodology resulted from
 20 negotiations between sophisticated parties, and the Board's views above with
 21 regards to the proposed toll differential.²⁹

22 In *Southern Lights* the Board stated that the negotiation process is a give and take process in
 23 which a party might give on an otherwise important issue to gain a favorable overall
 24 outcome. The Board, therefore, accepted the negotiated toll methodology and tariff as a
 25 package.³⁰

²⁷ *Enbridge Southern Lights GP Inc.*, Applications for Line 13 Reversal and Capacity Replacement for the Southern Lights Project, Appendix 4-3, Schedule B, p. 3.

²⁸ NEB, Reasons for Decision, OH-1-95, p. 23.

²⁹ NEB, Reasons for Decision, OH-1-2009, p. 46.

³⁰ NEB, Reasons for Decision, OH-3-2007, p. 56.

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1 **Q55. WHAT DO YOU CONCLUDE CONCERNING THE APPROPRIATENESS OF**
2 **NEGOTIATED RATES FOR THE TRANS MOUNTAIN POST-EXPANSION**
3 **SYSTEM?**

4 A55. The considerations discussed above suggest that the Board does not need to intervene to
5 “protect the market” from its own preferences. Reliance can be placed on the number of
6 contracts and the large volume of commitments negotiated by knowledgeable parties of
7 equal stature. As discussed in the evidence of Dr. Schink, all of the firm shippers are large,
8 sophisticated entities that are capable of negotiating complex contracts that promote their
9 commercial interests. In addition, as demonstrated in the evidence of Dr. Schink, there are
10 sufficiently good alternatives available to conclude that the market is workably competitive.
11 Cost-based tolls do not meet the market need. Negotiated tolls are particularly preferable
12 for a project like Trans Mountain’s expansion because the parties have a negotiated non-
13 standard toll methodology and apportionment of risks that would not be replicated by cost-
14 of-service regulation. For example, Trans Mountain is assuming a substantial portion of the
15 risks of construction cost overruns, and variations in operating costs, financing costs, and
16 throughput for the term of the contracts. It is only willing to assume these risks because the
17 proposed rates and terms of services balance the interests of both shippers and Trans
18 Mountain.

19 **Q56. IS IT NECESSARY FOR A REGULATOR TO BALANCE COMPETING**
20 **PRINCIPLES WHEN SETTING REGULATED TOLLS?**

21 A56. Yes. As noted above, in a workably competitive market as opposed to a regulated market,
22 the market functions efficiently on its own, as appropriate price signals allocate the existing
23 resources to those who most value the resources and indicate the timing and level of need
24 for new facilities (i.e., new entrants or expansions by existing market participants). In a
25 workably competitive market, the necessary checks and balances exist to prevent market
26 manipulation and abuse without the need for regulation. However, in a monopoly market
27 where regulatory oversight as opposed to market forces is utilized to direct the functions of
28 the market, there are policy and economic principles that are components of the overall
29 decision-making process of how best to manage and administer the market.

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1 Due to the complexity of market circumstances, the policies and principles in many cases are
2 conflicting, and thus compromises need to be made. This is recognized in the utility
3 economics literature. For example, in *Principles of Public Utility Rates*, Bonbright, Danielsen
4 and Kamerschen stated:

5 The art of rate making is an art of wise compromise.³¹

6

7 This theme runs to the effect that utility rates, like other prices, are
8 designed to perform multiple functions as instruments of economic
9 control. To a high degree, these functions can be performed in
10 harmony; necessarily so, indeed, since they are partly complementary.
11 But the harmony is far from complete, for the most efficient
12 performance of any one function would require the acceptance of a
13 system of rates not also best designed to perform any of the others.³²

14 Alfred Kahn also acknowledged that compromise within economic principles was also
15 necessary:

16 But all would point out, and correctly so, that even the most
17 sophisticated and conscientious effort to apply these principles
18 inevitably involves large doses of subjective judgment and, at the very
19 best, can achieve only the roughest possible approximation of the
20 desired results.

21

22 Therefore, it is not a matter merely of compromising an economic
23 principle; it is a question of correctly applying the relevant principle
24 or of balancing one principle with another.³³

25 With regard to Tran Mountain's tolling methodology there is little need to compromise any
26 economic principles. Instead, the negotiated outcome provides an efficient balancing of
27 risks. Moreover, the fact that the same toll methodology and structure is available to
28 everyone means that there is no discrimination and that shippers with the least number of

³¹ Bonbright, J. C., Danielsen, A. L., & Kamerschen, D. R. (1988). *Principles of Public Utility Rates*. Arlington, Virginia: Public Utility Reports, Inc., p. 82.

³² Bonbright, James C., (1961). *Principles of Public Utility Rates*. New York, New York: Columbia University Press, p. 386.

³³ Kahn, A. E. (1988). *The Economics Of Regulation: Principles and Institutions* (Vol. I). Cambridge, Massachusetts: MIT Press, p. 182 and 86.

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1 competitive options are able to obtain the benefit of the terms negotiated by the shipper
2 with the most competitive options.³⁴

3 ***IV. TRANS MOUNTAIN'S OPEN SEASON AND RESULTS***

4 ***A. Requirements For A Fair And Reliable Open Season***

5 **Q57. WHAT ARE THE PRINCIPLES AND GUIDELINES OF A FAIR AND**
6 **RELIABLE OPEN SEASON SERVICE OFFERING?**

7 A57. Over the past several decades, a set of well established principles and guidelines have been
8 developed in North America for implementing an open season process for the acquisition of
9 capacity on a pipeline. Those principles and guidelines include: 1) non-discrimination and
10 equal access to participation and information over a reasonable period of time; 2) reasonable
11 access to evaluation criteria; 3) open communication between potential shippers and the
12 carrier; 4) arrangements in place to ensure the confidentiality of information provided to,
13 and received from, Open Season participants; 5) shippers meeting minimum financial
14 criteria; and 6) Facilities Support Agreements in which risks are managed and shared
15 appropriately.

16 **Q58. PLEASE DISCUSS THOSE PRINCIPLES AND GUIDELINES IN MORE**
17 **DETAIL.**

18 A58. An ~~Open-open Season-season~~ process that is non-discriminatory and allows equal access and
19 participation by all interested shippers provides for an even-handed and robust ~~Open~~
20 ~~Season-season~~ process. Shippers must be given the opportunity to participate in all phases
21 of an ~~Open-open Season-season~~ and should be provided all of the information required to
22 make an informed commercial decision, with a reasonable amount of time to make that
23 decision. Next, reasonable evaluation criteria that are known by the carrier should be
24 provided to the shippers. This is necessary for shippers to make informed and binding bids
25 for capacity on the carrier. As a result, carriers will receive better and more defined bids.
26 Another important principle for the success of an ~~Open-open Season-season~~ is the ability for
27 shippers to have meaningful discussions with a carrier. Throughout the process,

³⁴ This concept is also discussed in the Evidence of George R. Schink.

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1 | stakeholders should be adequately consulted and updated about changes in the ~~Open-open~~
 2 | ~~Season-season~~ offering. Ultimately, discussions between a carrier and a shipper will provide
 3 | for an equitable and informed ~~Open-open Season-season~~ process. Finally, shippers are
 4 | required to provide adequate financial and credit information. Prospective shippers must
 5 | demonstrate an ability to satisfy specific creditworthiness provisions in order to allow the
 6 | carrier to finance the project.

7 | **Q59. ARE THE OPEN SEASON PRINCIPLES DISCUSSED ABOVE CONSISTENT**
 8 | **WITH BOARD PRECEDENT?**

9 | A59. Yes. Subsection 71(1) of the NEB Act requires that an oil pipeline company offer service to
 10 | any party wishing to ship oil on its pipeline. Where capacity on a natural gas or oil pipeline is
 11 | contracted, the Board examines the open season process for fairness and transparency. The
 12 | Board has not developed specific rules or guidelines requiring oil and gas pipeline companies
 13 | to conduct open seasons prior to applying for facilities, nor has it specifically outlined how
 14 | such companies must conduct open seasons. However, through prior decisions it has
 15 | provided for the principles and guidelines noted above. In particular, the Board approved
 16 | the ~~o~~Open ~~s~~Season process conducted in 2010 by Trans Mountain in connection with its
 17 | application for Firm Service to the Westridge Marine Terminal.³⁵ In that decision the Board
 18 | stated that:

19 | In this case, the Board is satisfied that the Open Season conducted
 20 | for the Trans Mountain Firm Service offering was adequate. All
 21 | potentially interested shippers had a fair and equal opportunity to
 22 | participate in the different phases of the Open Season. Interested
 23 | parties, all of whom were sophisticated commercial parties, were
 24 | involved in extensive discussions both in group and one-on-one
 25 | settings, prior to commencement of the formal Open Season. These
 26 | parties were further able to choose whether to contract for capacity
 27 | to the Westridge dock on the same terms, based on their own
 28 | economic judgment.³⁶

³⁵ NEB, Reasons for Decision, RH-2-2011, at p. 18.

³⁶ *Ibid*, at 26.

DIRECT EVIDENCE OF JOHN J. REED**B. *Trans Mountain's Open Seasons Met All Criteria For A Fair And Reliable Process***

1 | **B. *Trans Mountain's Open Seasons Met All Criteria For A Fair And Reliable Process***
2 | **Q60. ~~WAS WERE~~ THE TRANS MOUNTAIN OPEN SEASONS CONSISTENT WITH**
3 | **THE PRINCIPLES, GUIDELINES AND PAST PRACTICES OUTLINED**
4 | **ABOVE?**

5 | A60. Yes ~~it was~~they were. As discussed in detail in the Company's evidence, Trans Mountain
6 | provided a fair and balanced process for shippers, giving them an equal opportunity to
7 | participate. Trans Mountain began discussions with shippers in April 2011 with respect to
8 | forecasted demand on the pipeline. In May 2011, Trans Mountain communicated its plans
9 | to a broader group of shippers and realized there was strong support for the expansion.
10 | Trans Mountain focused on developing a series of expansion alternatives as a solution to the
11 | prospects for long-term apportionment on the system and for those shippers seeking firm
12 | capacity. In addition to discussions with potential shippers, the initial Open Season was
13 | advertised in several daily newspapers.

14 | On October 20, 2011, Trans Mountain began its Open Season process. Through the online
15 | posting of the Open Season documentation, shippers were provided non-discriminatory
16 | access to capacity on the carrier. The public section of the Open Season web site included a
17 | brief overview of certain commercial terms, including the scheduled closing date for the
18 | original Open Season of January 19, 2012, which was subsequently extended to February 16,
19 | 2012 and again to April 10, 2012. The online web site included an invitation to interested
20 | parties that had not already done so to execute confidentiality agreements in order to access
21 | the Open Season documents. During ~~the~~ Round 1 of the Open Season in December 2011,
22 | Trans Mountain held a shipper meeting with 17 parties in attendance. The materials
23 | discussed at the meeting were subsequently distributed to all parties that executed a
24 | confidentiality agreement. Trans Mountain's initial Open Season process was open for
25 | approximately five months, which gave interested shippers ample time to examine the Open
26 | Season materials and have discussions with the Company.

27 | Interested shippers were required to stipulate desired volumes, receipt and delivery locations,
28 | petroleum type and the length of the contract they were seeking. The Company also
29 | provided information during the Open Season regarding over-subscription allocations.

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1 Documents that were available publicly to all interested parties on the web site included: 1) a
2 map of the proposed carrier route; 2) proposed receipt and delivery points; 3) size and
3 design capacity; 4) estimated in-service dates; and 5) a rate schedule noting discounts for
4 specific contract lengths. A prospective shipper that signed a confidentiality agreement was
5 further provided with: 1) the FSA; 2) the TSA; and 3) the Rules and Regulations.
6 Throughout ~~the Round 1 of the~~ Open Season time frame, Trans Mountain and the
7 prospective shippers negotiated several revisions to the FSA and the TSA. Shippers received
8 notices of the revisions. Those revisions were provided to shippers through the online web
9 site. The first round of the Open Season was initially closed on February 19, 2012.
10 Subsequent to the close of the Open Season, one shipper failed to demonstrate its
11 creditworthiness. Trans Mountain re-opened the Open Season on March 27, 2012 for two
12 weeks. Finally, following a brief period to confirm shipper creditworthiness and
13 confirmation of the final expansion scope, Trans Mountain announced the successful close
14 of ~~the Round 2~~ Open Season and served the necessary notice to the nine committed
15 shippers.

16 **Q61. PLEASE EXPLAIN WHY THE COMPANY UNDERTOOK A SUPPLEMENTAL**
17 **ROUND 3 OPEN SEASON PROCESS.**

18 **A61. In May, 2012 prior to the filing of Trans Mountain's expansion application, Suncor Energy**
19 **Products Partnership ("SEPP") filed an application with the Board requesting that it direct**
20 **Trans Mountain to refrain from requiring, as a condition of transportation service, that**
21 **shippers waive their rights to challenge the tolls in the associated tolls applications, in other**
22 **words to disallow Trans Mountain from including Section 2.2 in the FSA. Trans Mountain**
23 **and two other parties filed comments disagreeing with SEPP's application and requested that**
24 **the Board dismiss SEPP's application on grounds that it lacks urgency and is redundant with**
25 **Trans Mountain's upcoming toll application. SEPP replied to the Board upholding its**
26 **previous objections to Section 2.2. The Board ultimately agreed with SEPP and disallowed**
27 **Section 2.2 from the FSA, stating: "[T]he Board finds that prospective shippers should be**

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1 free to contract for a service and raise concerns related to the tolls and tariff provisions to be
2 applied to this service.”³⁷

3 As discussed in the Company’s Additional Written Evidence³⁸, the Board’s conclusion
4 prompted Trans Mountain to hold a supplemental Round 3 Open Season. After numerous
5 discussions with the existing nine shippers that executed the FSA and TSA in May, 2012, the
6 Company sent a formal letter to all parties that executed confidentiality agreements with
7 Trans Mountain between October, 2011 and April, 2012 (“Notice to Supplemental
8 Shippers”). The Notice to Supplemental Shippers specifically invited those parties that did
9 not participate in Rounds 1 and 2 of the initial Open Season because of the inclusion of
10 Section 2.2 of the FSA (“Supplemental Shippers”), to participate in the Round 3 Open
11 Season.³⁹ Attachments to the Notice to Supplemental Shippers included an updated FSA
12 with Section 2.2 deleted and a TSA identical to the TSA executed by the Existing Shippers.
13 Thus, the only change to the FSA and TSA was the deleted Section 2.2. Eligible
14 Supplemental Shippers were requested to provide signed and executed FSAs and TSAs to
15 Trans Mountain on November 28, 2012, approximately six weeks from when the Notice was
16 sent. Meetings were held with interested shippers on a one-on-one basis throughout the
17 Round 3 Open Season period. Those meetings generally reviewed the terms of the Round 3
18 Open Season and the commercial documents including the FSA, TSA and Rules and
19 Regulations.

20
21 Trans Mountain received formal requests for firm transportation service from three
22 additional shippers in Round 3. As a follow-up to the to the signed FSAs and TSAs, Trans
23 Mountain received letters from each of the shippers with firm commitments in Round 3
24 confirming that their participation in Round 3 would have occurred if not for the inclusion

³⁷ NEB Letter to Kinder Morgan Canada, Inc. Suncor Energy Products Partnership (SEPP) Application Regarding Trans Mountain Pipeline ULC (Trans Mountain) Open Season National Energy Board (Board) Decision, August 17, 2012.

³⁸ Trans Mountain Pipeline ULC Application Pursuant to Part IV of the National Energy Board Act for Approval of the Toll Methodology to be Applied on the Expanded Trans Mountain Pipeline System (the “Application”), Additional Written Evidence of Trans Mountain Pipeline, LP, October 23, 2012.

³⁹ Notice of Supplemental Open Season – Trans Mountain Pipeline Proposed Expansion, Kinder Morgan, Inc., October 17, 2012.

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1 of Section 2.2 of the FSA and that all necessary approvals were received from their internal
2 boards.

3
4 **Q61-Q62. WHAT WERE THE RESULTS OF THE OPEN SEASON PROCESS?**

5 ~~A61-A62.~~ As noted in more detail in the Company's evidence, ~~the Rounds 1 and 2 of the~~ Open
6 Season process resulted in the qualifying commitments for firm service totaling 508,000 bpd
7 for 20 years from nine shippers. Two additional FSAs were submitted, but one was rejected
8 in the initial round of Open Season because the shipper failed to satisfy Trans Mountain's
9 internal credit policies, while ~~another FSA~~ the SEPP FSA was rejected in the second round
10 because it had been unilaterally amended ~~by the shipper~~ and therefore was deemed invalid.
11 Between the conclusion of Round 2 and in the Round 3 Open Season process additional
12 firm service commitments of 200,000 bpd were contracted for a total firm shipper
13 commitment of 708,000 bpd from all thirteen firm shippers.

14 **Q62-Q63. HOW DID TRANS MOUNTAIN COMMUNICATE TO PROSPECTIVE**
15 **SHIPPERS ITS FINANCIAL ASSURANCE REQUIREMENTS AND ITS**
16 **INTERNAL CREDIT POLICIES?**

17 ~~A62-A63.~~ As part of its notice for Open Season procedures, Trans Mountain included a
18 creditworthiness provision. This provision stated that any shipper that signed an FSA with
19 the Company had to provide, if asked, specific financial information that would satisfy the
20 company's internal credit policies. Accordingly, the financial assurances provision provided
21 in the FSA requires shippers to provide to the Company audited financial statements and
22 information concerning any other business affairs, operations, assets and financial conditions
23 of the shipper that may be reasonable to request from time to time. Furthermore, the FSA
24 states that if the credit rating of a shipper is below investment grade, the Company may
25 request acceptable security from the shipper.

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1 | ~~Q63:Q64.~~ **IS THERE PRECEDENT FROM THE BOARD OR THE FERC**
 2 | **CONCERNING THE CREDITWORTHINESS OF PROSPECTIVE SHIPPERS?**

3 | ~~A63:A64.~~ Yes there is. Since sufficient financial assurances are needed from prospective
 4 | shippers to protect financial commitments to the project, the FERC has recognized that
 5 | there is a:

6 | [N]eed for greater collateral for initial shippers on new pipeline
 7 | systems or on facilities created by major expansion projects on
 8 | existing systems. As we explained in our Creditworthiness Policy
 9 | Statement, the collateral requirements that may be necessary for the
 10 | initial shippers that will use new facilities are not necessarily just and
 11 | reasonable when applied to future shippers on those facilities.⁴⁰

12 | ~~Q64:Q65.~~ **WAS TRANS MOUNTAIN CLEAR WITH SHIPPERS THAT ANY**
 13 | **ALTERED OR INVALID FSA WOULD NOT BE ACCEPTED?**

14 | ~~A64:A65.~~ Yes it was. The Company stated in its notice for Open Season that “FSAs that have
 15 | been altered or amended in any way by the shipper....will be invalid and the shipper’s FSA
 16 | will not be accepted by the Carrier”.⁴¹ That is not to say that over the ~~five-month~~ Open
 17 | Season process, negotiations between the Company and prospective shippers did not update
 18 | and amend the FSA as deemed appropriate by both parties and when amendments were
 19 | negotiated bilaterally those changes were made available to all shippers.

20 | ***C. Shipper Complaints***

21 | ~~Q65:Q66.~~ **WERE ISSUES RAISED BY PROSPECTIVE SHIPPERS DURING THE**
 22 | **OPEN SEASON PROCESS?**

23 | ~~A65:A66.~~ Yes. During ~~Rounds 1 and 2 of~~ the Open Season process, four prospective shippers
 24 | sent letters of complaint to the Board, objecting to the Open Season process that was
 25 | underway.⁴² In their letter to the Board, ~~Suncor Energy Marketing (“SuncorSEPP”)~~ and
 26 | ConocoPhillips Canada Resources Corp. (“ConocoPhillips”) asked the Board to direct Trans

⁴⁰ *Ruby Pipeline, LLC*, 128 FERC ¶ 61,224, p. 31.

⁴¹ Trans Mountain Pipeline Proposed Expansion, Notice of Open Season Procedure for Firm Service Capacity, October 20, 2011, p. 3.

⁴² Suncor Energy Marketing and ConocoPhillips Canada Resources Corp. letter sent to the Board on January 31, 2012; Imperial Oil Limited letter sent to the Board on February 7, 2012; and Chevron Canada Limited letter sent to the Board on February 8, 2012.

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1 Mountain to extend the closing date of the Open Season to allow time for the terms and
 2 conditions of service offered in the Open Season, including the toll methodology, to be
 3 approved by the Board. Subsequently, Chevron Canada Limited and Chevron Canada
 4 Resources (“collectively, “Chevron”) and Imperial Oil agreed with ~~Suncor~~SEPP that the toll
 5 methodology should be approved by the Board before the end of the Open Season. In
 6 addition, Chevron claimed that Trans Mountain was not engaging in sufficient substantive
 7 discussions with its customers, either as a group or one on one, and that prospective
 8 shippers should not be required to adhere to a confidentiality agreement that prevents them
 9 from consulting collectively as a group. In a final letter to the Board, ~~Suncor~~SEPP and
 10 ConocoPhillips complained that the Company did not provide sufficient information for the
 11 prospective shipper or the Board to determine how the indicative tolls proposed by Trans
 12 Mountain compared to the cost of providing the service.⁴³

13 **Q66-Q67. IS IT COMMON PRACTICE TO HAVE A TOLL METHODOLOGY**
 14 **APPROVED BY THE BOARD BEFORE AN OPEN SEASON PROCESS IS**
 15 **CONCLUDED?**

16 ~~A66-A67.~~ No it is not. During the Open Season preliminary or illustrative tolls are developed
 17 and an FSA is executed. When the Open Season closes, the carrier announces the amount
 18 of capacity subscribed by shippers and whether there is adequate support to justify an
 19 expansion or whether the carrier is over-subscribed. At that time, the carrier can determine
 20 if it needs to develop an allocation of the capacity based on the over subscription and then
 21 finally negotiate new tolls based on the newly allocated capacity.

22 As discussed in its letter to the Board in response to ~~Suncor~~SEPP, ConocoPhillips and
 23 Chevron, the Company stated that there is nothing in the Board’s governing legislation or
 24 elsewhere requiring the toll methodology to be reviewed by the Board prior to completion of
 25 the Open Season process. In fact there is precedent to the contrary. In GHW-R-1-2007 the
 26 Board held that such a procedure is not required or recommended:

27 CAPP did not refer to any policy document, Board decision or
 28 direction from the Board setting out the requirement for a Group 1

⁴³ Suncor Energy Marketing and ConocoPhillips Canada Resources Corp. letter sent to the Board on February 9, 2012.

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1 company to apply for new services before offering them to shippers.
 2 Open seasons or service offerings through task force committees or
 3 other means are often held before the company applies for approval
 4 of the service. This enables the company to gauge whether there is
 5 interest in the new service and what the issues are that the company
 6 needs to address.

7 If companies were required to come to the Board before it was
 8 determined whether there was any interest in a service, it would delay
 9 the business process and impose considerable regulatory burden on
 10 all parties. Clearly, a carrier cannot place a new service in operation
 11 without either Board approval or the filing of a tariff pursuant to
 12 paragraph 60(1)(a) of the Act, but the Board expects a company to
 13 determine whether there is an interest in, need for or concerns with
 14 the service before it attempts to place them in operation. The Board
 15 has no interest in, and does not believe it would be in industry's best
 16 interests for it to micro-manage service offerings.⁴⁴

17 In my experience, the Board's reasoning in this matter is consistent with general commercial
 18 and regulatory practices in other jurisdictions.

19 | **Q67.Q68. IS REQUIRING SHIPPERS TO SIGN CONFIDENTIALITY**
 20 | **AGREEMENTS A STANDARD PRACTICE DURING OPEN SEASON**
 21 | **PROCESSES?**

22 | **A67.A68.** Yes, it is quite common for carrier companies to require prospective shippers to
 23 execute a confidentiality agreement in order to obtain commercially sensitive project
 24 development and cost information. A confidentiality agreement allows for full and complete
 25 sharing of information between the shipper and carrier such that the proposed pipeline
 26 project can be designed to meet shippers' needs. A confidentiality agreement is particularly
 27 important in circumstances where the company is in competition with other potential
 28 project developers, as is Trans Mountain, and in the case where some potential shippers may
 29 be aligned with those competing projects, as is clearly the case with this proposal. Requiring
 30 prospective shippers to sign a confidentiality agreement does not limit the shipper from
 31 asking questions of the company. If the proposed toll methodology is not entirely
 32 understood by a prospective shipper, that shipper may contact the carrier and seek

⁴⁴ NEB, Reasons for Decision, GHW-R-1-2007, p. 7-8.

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1 information and guidance in order to make an informed decision about the services being
2 offered.

3 | **Q68:Q69. DOES THE BOARD HAVE SPECIFIC REGULATIONS OR RULES**
4 | **THAT REQUIRE CARRIERS TO CONSULT WITH PROSPECTIVE SHIPPERS**
5 | **COLLECTIVELY?**

6 | ~~A68:A69.~~ No, it does not. Nevertheless, Trans Mountain had substantial one-on-one
7 | conversations with prospective shippers as well as a group shipper meeting with 17 parties in
8 | December, 2011. All materials from this meeting were distributed to shippers that signed
9 | the confidentiality agreement.

10 | **Q69:Q70. IS THE COMPANY REQUIRED TO PROVIDE PROSPECTIVE**
11 | **BIDDERS WITH DETAIL ON THE COST OF THE TRANS MOUNTAIN**
12 | **EXPANSION PROJECT?**

13 | ~~A69:A70.~~ No it is not. The Board has ruled that when instituting negotiated contract rates, a
14 | carrier is not required to provide cost of service information to prospective shippers. In
15 | *Express Pipeline Ltd.*, the Board found the tiered service structure and negotiated rates
16 | proposed by the Company to be just and reasonable. Regarding the fact that the negotiated
17 | contract tolling proposal was not accompanied by cost-of-service information, the Board
18 | clarified that a cost of service benchmark is not necessary to evaluate whether tolls are just
19 | and reasonable. As I discuss elsewhere in this testimony, Trans Mountain's negotiated tolls
20 | are just and reasonable, and nine shippers had sufficient information to make long-term
21 | commercial commitments to the pipeline without needing cost information in the form
22 | requested by the complaining parties. In fact, given the tolling methodology – including
23 | indicative rates, various cost caps, the shipper withdrawal option related to the Open Season
24 | Toll Limit, and the throughput and financing cost risks that Trans Mountain is proposing to
25 | assume – a traditional cost-of-service calculation would not, in my view, improve the ability
26 | of any party to make an informed commercial decision.

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1 | ~~Q70.~~Q71. **DO YOU BELIEVE TRANS MOUNTAIN MET THE BOARD'S**
 2 | **STANDARDS FOR ITS OPEN SEASON PROCESS?**

3 | ~~A70.~~—Yes I do, although the Board disagreed with my opinion by allowing SEPP to delete Section
 4 | 2.2 of the FSA as described further above. In a letter responding to Suncor and
 5 | ConocoPhillips, the Board stated that:

6 | ~~—The Board will consider the Open Season to the extent it is relied upon in support of an~~
 7 | ~~application and Trans Mountain will have the onus of demonstrating that the open season~~
 8 | ~~was conducted in an appropriate manner.~~

9 | Through this evidence and the Company's Application, Trans Mountain has described fully
 10 | its entire Open Season process. The Open Seasons ~~were~~was conducted on a transparent
 11 | basis that was fair to the participants, and the results are fair, market-responsive and reliable.
 12 | Trans Mountain is sizing the project and committing to spend large amounts of capital based
 13 | on these results, and the process and terms of service are economically efficient. With this in
 14 | mind and the changes made to Section 2.2, I continue to believe that the open season
 15 | process was fair and reasonable.

16 | **V. APPROPRIATENESS OF COMMITTED/UNCOMMITTED CAPACITY SPLIT**

17 | **A. *Contract Carrier Service Model And Tolls***

18 | ~~Q71.~~Q72. **PLEASE DESCRIBE HOW SERVICE ON CANADIAN OIL PIPELINES**
 19 | **HAS TRADITIONALLY BEEN PROVIDED.**

20 | A71. Prior to the past two decades most service on Canadian oil pipelines was provided on an
 21 | “uncommitted” basis. While natural gas pipelines typically offer firm transportation service
 22 | on a contractual basis, oil pipelines historically have solicited nominations from interested
 23 | shippers on a monthly, uncommitted basis. As long as the total demand for transportation
 24 | service on a given pipeline in a given month is not greater than the pipeline's physical
 25 | capacity, the carrier is obligated to accept and honor each nomination received. In the
 26 | event that the nominations for service in a given month exceed the physical capacity of a
 27 | pipeline, the pipeline capacity has been apportioned among all interested shippers in
 28 | accordance with the procedures specified in the pipeline's tariff. There are many different
 29 | procedures for allocating pipeline capacity to the interested shippers, including on the basis

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1 of historical volumes shipped over a defined base period (with certain capacity reserved for
2 new shippers) or on the basis of nominated volumes or other methodologies.

3 | **Q72-Q73. PLEASE EXPLAIN THE BASIS FOR THE TREND TOWARDS**
4 **COMMITTED CONTRACT “FIRM” SERVICE.**

5 A72. Long-term committed contracts with shippers are essential for developers to justify major
6 pipeline investments. Offering contract service also provides benefits to shippers and
7 promotes efficiency for those shippers who require reliable service to operate their
8 businesses. Moreover, when long-term shipper contracts are matched with long-term
9 pipeline investments the market is more likely to provide an efficient amount of capacity.
10 Finally, as more petroleum pipelines utilize firm service with “ship-or-pay” commitments
11 from shippers, there is increasing competitive pressure and risk for those pipelines that
12 primarily offer uncommitted service. Pipelines without firm contracts risk becoming swing
13 pipelines that will be the ones most likely to lose business in response to changing market
14 dynamics.

15 | **Q73-Q74. WHAT ARE THE PRECEDENTS FOR OIL PIPELINES OFFERING**
16 **FIRM SERVICE?**

17 A73. Express Pipeline Ltd. was the first oil pipeline to receive approval of firm contract service
18 from the Board. In June 1995, Express filed for a Certificate of Public Convenience and
19 Necessity (“CPCN”) to construct a new oil pipeline from Alberta to Wyoming.⁴⁵ The tariff
20 proposed in *Express* contained four tiers of service—contracted service for terms of 5, 10,
21 and 15 years, as well as monthly apportioned service. Customers willing to sign long-term
22 contracts were offered unapportioned access at tolls lower than those charged to monthly
23 customers. The unapportioned access and lower tolls granted to Firm Contract customers
24 were justified by the support these long-term contracts provided to financing the pipeline.
25 Subsequent to the *Express* decision, the Board has reviewed and approved numerous pipeline
26 applications with proposed service structures that include contracted capacity.

⁴⁵ NEB, Reasons for Decision, OH-1-95.

DIRECT EVIDENCE OF JOHN J. REED**Q74.Q75. WHAT WAS THE BOARD'S RATIONALE IN APPROVING THE FIRM CONTRACT SERVICE AND TOLL STRUCTURE PROPOSED BY EXPRESS?**

A74. In *Express Pipeline Ltd.*, the Board found the tiered firm and uncommitted service structure proposed by the Company to be just and reasonable. Moreover, the Board found that the proposed service structure did not contravene the Company's common carrier obligation because all parties were given an equal opportunity to contract for long-term secure access to the system. The Board also found that the proposed tolls were not unjustly discriminatory, citing the fact that:

...lower tolls, renewal rights, and preferred access for contract shippers are justified by the support those shippers provide for the financing of the pipeline and their sharing with Express of the risks associated with the pipeline.⁴⁶

B. Reasonableness of Trans Mountain's Proposal**Q75.Q76. HOW DOES THE CURRENT ALLOCATION OF CAPACITY ON THE PIPELINE SYSTEM COMPARE WITH THE PROPOSED ALLOCATION?**

A75. Currently, the capacity on the pipeline is approximately 300,000 bpd, with 54,000 bpd committed to contract shippers. All of the contract shippers are Dock shippers. Dock shippers are also allocated another 20,000 bpd of capacity for uncommitted service, and approximately 5,000 bpd for barge shipments at the dock. The remaining approximate 221,000 bpd of capacity is allocated to Land shippers.

The Company is proposing to leave 20 percent of the post-expansion capacity uncontracted in order to maintain a reasonable balance between the portion of the capacity available for uncommitted service and the need to have long-term contracts with shippers in order to manage risks and underwrite construction of the expansion. With nominal post-expansion capacity of approximately ~~755890,000~~ 755,890,000 bpd, and commitments of ~~508708,000~~ 508,708,000 bpd for firm committed capacity, uncommitted shippers could have access ~~initially to as much as 247~~ approximately 183,000 bpd. ~~Assuming that the remaining capacity available for long-term firm service is contracted, they will have access to at least 151,000 bpd of nominal~~

⁴⁶ *Ibid*, p. 23.

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1 | ~~capacity when the expansion is completed.~~ In addition, because committed shippers will be
 2 | allowed to assign their capacity to others, there may be additional capacity available in the
 3 | secondary market. Currently, Land and Dock Shippers combined have access to
 4 | approximately 246,000 bpd of uncommitted service, but some past uncommitted shippers
 5 | will become future firm shippers on the expanded pipeline (either for incremental volumes
 6 | or previous uncommitted volumes). Thus, much, if not all, of the current apportionment of
 7 | uncommitted service should be alleviated by the expansion.

8 | **Q76:Q77. IS THE PROPORTION OF CAPACITY THAT TRANS MOUNTAIN**
 9 | **WILL HAVE AVAILABLE FOR UNCOMMITTED MONTHLY SERVICE**
 10 | **REASONABLE IN COMPARISON WITH OTHER PIPELINES?**

11 | A76. Yes. In the past, the Board has indicated that some capacity must be reserved for
 12 | uncommitted monthly uncommitted service. For example, in *IPL*, the open season resulted
 13 | in 100 percent of the pipeline's capacity being contracted. The Board rejected this service
 14 | structure, stating that it infringed upon the right of other shippers to access the pipeline, and
 15 | required the pipeline to submit revised tariff sheets in which 20 percent of nominal capacity
 16 | is reserved for uncommitted shippers. However, the Board has not specified a level of
 17 | uncommitted capacity that all pipelines must reserve. Instead, it has stated that:

18 | The Board is of the view that establishing the appropriate level of capacity
 19 | which will be available for spot shippers is a matter of judgment and involves
 20 | a balancing of interests.⁴⁷

21 | In *Keystone* and *Keystone XL*, the Board approved service structures in which six and twelve
 22 | percent of capacity were reserved for monthly nominations by uncommitted shippers,
 23 | respectively.⁴⁸ The twelve percent of capacity reserved for uncommitted shippers on the
 24 | Keystone system was deemed by the Board to be "set at the higher end of the range."⁴⁹
 25 | Thus, the uncommitted capacity proposed by the Company in this proceeding generally is

⁴⁷ NEB, Reasons for Decision, OH-1-2003, p. 14.

⁴⁸ NEB, Reasons for Decision, OH-1-2007; NEB, Reasons for Decision, OH-1-2009.

⁴⁹ NEB, Reasons for Decision, OH-1-2009, p. 45.

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1 greater in percentage terms than the uncommitted capacity proposed by other recently
2 approved pipelines.⁵⁰

3 | **Q77.Q78. IS TRANS MOUNTAIN'S PROPOSED SPLIT BETWEEN**
4 **CONTRACTED SERVICE AND UN-CONTRACTED SERVICE REASONABLE?**

5 A77. Yes. In my opinion, it sufficiently protects the interests of shippers that do not wish to
6 provide the pipeline with term commitments, it allows the pipeline to be market-responsive,
7 and it is consistent with Board-approved industry practices. It also provides uncommitted
8 shippers with a level of available service that is at least as favorable as that which would be
9 expected in a fully competitive market. Additionally, the uncommitted service increases the
10 risk to the pipeline because, as a stand-by service, the revenues associated with capacity
11 dedicated to that service are uncertain.

12 **VI. CONCLUSIONS**

13 | **Q78.Q79. WOULD YOU PLEASE SUMMARIZE THE CONCLUSIONS OF YOUR**
14 **EVIDENCE?**

15 A78. My analysis reaches three main conclusions. First, the proposed toll methodology is
16 reasonable because it meets the needs of the market by balancing risks, service features and
17 expected toll levels in a way that is attractive to sophisticated shippers with competitive
18 alternatives. The negotiated toll methodology reflects shippers' own economic judgments
19 and contains an integrated package of features that produce greater economic efficiency than
20 a prescriptive cost-of-service regulatory approach would be likely to provide. The toll
21 methodology also provides proper pricing signals that promote efficient sizing, usage and
22 allocation of capacity. This conclusion applies to the tolls for both committed firm service
23 and uncommitted service. Moreover, the caps on construction costs and the fixed schedule
24 of tolls insulate the committed shippers from large future toll increases. These provisions
25 limit shippers' risks and provide greater certainty throughout the 20-year terms of their
26 contracts. The fact that the same offer was made to all shippers ensures that all shippers
27 benefit from the negotiating leverage of the shipper with the best competitive alternatives.

⁵⁰ NEB, Reasons for Decision, OH-1-2007; NEB, Reasons for Decision, OH-1-2009.

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1 Finally, the features of the tolling methodology are consistent with industry practice and
2 Board precedent.

3 Second, the open season process can be relied upon to produce just and reasonable tolls
4 because it was conducted in a transparent, fair and equitable manner. All interested shippers
5 were provided with sufficient information, and given sufficient time, to make reasoned,
6 informed decisions as to whether they would like to contract for firm service on an
7 expanded system. Prior to, and during, the Open Season^s, Trans Mountain held many
8 meetings with potential shippers, made significant negotiated concessions requested by
9 shippers, and made the same negotiated terms available to all shippers. These discussions
10 and negotiations extended for ~~a year~~ more than a year and a half. Although the Open
11 Season, which began October 10, 2011, was originally scheduled to end January 19, 2012, it
12 was extended twice to ensure that potential shippers had adequate time for negotiations and
13 evaluation of their preferences and finally, a Round 3 Open Season was added to include
14 shippers that did not originally commit to the pipeline because of Section 2.2 to the FSA.
15 Ultimately, ~~the Rounds 1 and 2 of the~~ Open Season continued for five months, until April
16 10, 2012, and resulted in nine shippers making a large aggregate commitment of 508,000 bpd
17 to underwrite and use capacity on an expanded system. From the conclusion of Round 2
18 through the Round 3 Open Season another 200,000 bpd were committed to for a total firm
19 shipper commitment of 708,000 bpd. Complaints that insufficient information or
20 insufficient time was available to make informed decisions are without merit. The process
21 was consistent with accepted principles for a fair and reliable open season and it also was
22 consistent with industry and Board precedents.

23 Third, the proposal to reserve 20 percent of the capacity on the expanded system for
24 uncommitted service is reasonable and appropriate; between the secondary market and with
25 some of the existing uncommitted shippers committing to firm service,
26 ~~451,000~~ approximately 183,000 bpd is sufficient to ensure that much of the current
27 apportionment of uncommitted service should be alleviated by the expansion. In addition,
28 this level of uncommitted capacity properly balances the needs of the market to have some
29 uncommitted capacity available, while also meeting the need to have a large proportion of
30 capacity committed to firm, long-term contracts in order to underwrite the costs of an

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1 expansion. Again, the proportion of capacity reserved for uncommitted service is consistent
2 with industry and Board precedents.

3 | ~~Q79.~~Q80. **DOES THIS CONCLUDE YOUR PREPARED DIRECT EVIDENCE?**

4 A79. Yes.