

**CAMPUT 2003
CONFERENCE**

**CANADIAN ENERGY PIPELINE ASSOCIATION
PRESENTATION:**

**Continuous Improvement –
Combining Regulatory Efficiency
with Regulatory Quality**

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CONTINUOUS IMPROVEMENT – COMBINING REGULATORY EFFICIENCY WITH REGULATORY QUALITY

Introduction

Good morning ladies and gentlemen. My topic today is “Continuous Improvement - Combining Regulatory Efficiency with Regulatory Quality”.

When Terry Rochefort of the National Energy Board’s staff approached me to speak on this topic he said “Barry, we know you have strong feelings on this subject”. I asked whether he was referring to me or Duke Energy. He replied “both”.

So here I am today speaking on behalf of the Canadian Energy Pipeline Association in my role as Chairman of its Regulatory Affairs and Public Policy Committee.

The Canadian Energy Pipeline Association is dedicated to ensuring a strong and viable transmission pipeline industry in Canada in a manner that emphasizes public safety and pipeline integrity, social and environmental stewardship, and cost competitiveness.

Seventy per cent of CEPA's membership consists of pipeline companies that are regulated by the National Energy Board. Therefore, my comments and thoughts will focus on that Board.

The priorities of CEPA are:

- Pipeline safety and integrity
- Environmental stewardship/climate change
- Economic regulation and competitiveness
- Regulatory efficiency
- Aboriginal relations
- Landowner relations

CEPA's priorities and those of the National Energy Board, as expressed in the Board's five Corporate Goals, are very much aligned as one would hope to be the case.

Background

There is no question that regulation creates benefits as well as costs. Some degree of regulation can help markets function; however, it is important to consider the cost of regulation. Increases in time and money devoted to regulatory compliance decrease the resources available for improvement or construction of plants and pipelines. The costs of regulation must not outweigh the benefits.

The bulk of the cost of regulation is incurred by individuals and businesses in the private sector to implement, monitor and demonstrate regulatory compliance. But all stakeholders involved in regulatory processes should bear in mind that the cost of regulatory compliance – though often imposed on

businesses – is borne largely by consumers (i.e. you and me), since businesses pass on much of the cost of regulatory compliance as higher prices for goods and services.

What do CEPA members require of its regulators?

CEPA members require a timely and certain regulatory process. Uncertainty and delays in regulatory processes and decisions cause strained relations with customers which in turn lead to a competitive disadvantage for federally regulated pipelines. Board Chairman Ken Vollman recognized this when he explained at the April 2000 CEPA/INGA conference in Calgary that “Regulatory uncertainty causes risk for market participants, and risk translates into increased business costs”.

Improving Regulatory Efficiency

The Board receives applications from the pipeline companies it regulates under two major headings:

- (i) economic regulation – which relates to toll and tariff type issues; and
- (ii) facilities regulation – which relates to pipeline facilities expansions or modifications under Section 52 and 58 of the National Energy Board Act.

(i) **Economic Regulation**

I believe the Board has been a leader amongst Canadian regulators in its approach to economic regulation.

During the 1980s and early 1990s, annual rate cases for all the pipelines were the norm. Year after year the Board enjoyed listening to dueling cost of capital witnesses debating the intricacies of capital markets. This was not an efficient process.

The Board took two major innovative steps to address this inefficiency. The first step was to conduct the Multi-Pipeline Cost of Capital hearing in 1994. The Board decided it would be better to establish return on equity (“ROE”) pursuant to a pre-determined formula. This led to certainty with respect to a very contentious rate case issue. There is currently some debate amongst stakeholders as to the continued appropriateness of the Board’s ROE formula but that is a topic for another day.

The second step the Board took to encourage efficiency in the toll setting process was the introduction in 1994 of the Board’s “Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs”. These Guidelines were important because they established a broad framework for negotiations and the Board clearly indicated that it was prepared to accept or reject negotiated settlements as a package. This philosophy of not “cherry picking”

negotiated arrangements was extremely important to the parties at the negotiating table because it provided more certainty to the regulatory process. The Board fine-tuned these Guidelines in 2002 to address the issue of contested settlements and this should further the efficiency of the toll setting process.

The results speak for themselves. Most of the large federally regulated pipelines have had at least one long-term toll settlement and many of the pipelines continue to have their tolls established via negotiated toll settlements.

CEPA praises the Board for these improvements in the regulatory process that provided regulatory efficiency and increased regulatory certainty. This was a significant contribution to reducing Regulatory costs and

achieving the Board's third corporate goal that "Canadians derive the benefits of economic efficiency".

(ii) Facilities Regulation

As I mentioned earlier CEPA members require a timely and certain regulatory process. This is especially so with respect to the Board's timelines or "cycle times" for considering Section 52 and 58 facilities applications.

Let me outline the Board's process for dealing with facilities applications. As I see it, there are three major phases:

Phase 1

In Phase 1, industry participants are permitted to meet with Board staff to discuss upcoming applications. Applicants take this opportunity to provide staff with an overview of the application. Staff are available to

discuss issues related to general Board policy or processes but cannot give advice on substantive matters. If Board staff could have the flexibility to indicate to proponents where applications have historically had gaps, the efficiency of the regulatory process would be improved.

Phase 2

Once an application has been filed with the Board, all communication between the Board members and staff and the applicants and interested parties involved in the proceeding are handled by the Board's Legal Services Department or the Office of the Secretary. The Board has no further meetings with parties once the application has been filed. A "communications blackout" is effectively imposed on the process.

The Board is now in its quasi-judicial role and the stakeholders are now involved in a formal, costly and time consuming process. A formal public hearing is required for certain applications while a complex written process is required for other applications. Following the public hearing or written process the Board ultimately releases its Decision on the application.

The length of time for Phase 2 to run its course is getting longer and the associated uncertainty is of grave concern to all stakeholders, be they producers, pipeline companies or consumers of gas and oil. In the case of Section 52 applications, earlier release of the Board's Direction on Procedure would likely reduce the Phase 2 timelines. In addition, something must be done about the "communications blackout" which contributes to the uncertainty and increased business costs.

Phase 3

Once the Board renders its decision the “communications blackout” is no longer in effect and it is possible for the applicant to communicate with Board staff on such matters as:

- (a) satisfying any pre-construction conditions imposed by the Board;
- (b) working with Board staff inspectors to ensure that the construction satisfies all safety and environmental commitments; and
- (c) meeting the Leave to Open requirements.

Board staff involved in the post decision process, work well with the applicants to ensure timely resolution of issues and often go out of their way to help with expediting such matters as the Leave to Open.

From the perspective of CEPA members, I can say that Phase 3 is a reasonably efficient process.

Phase 2 of the Facilities Application Process

Now let me go back to Phase 2, that is, the communications blackout period between the filing of the application and the release of the Board's decision. CEPA believes this is the area of the Board's activities that needs to be examined for efficiency improvements. The Board took innovative steps to improve the efficiency of its economic regulatory processes in the mid-1990s and innovation is now required to improve the regulatory processes for facilities applications, reduce application cycle times and inject a greater measure of certainty into the regulatory process.

In its consideration of facilities applications the Board, amongst other things, must fulfill its responsibilities under the Canadian Environmental Assessment Act ("CEAA").

The Board considers facilities applications pursuant to its quasi-judicial role but CEAA contemplates an informal or “administrative” process. This quasi-judicial/administrative mismatch makes the application process more complex than necessary.

There are no timelines for process milestones and, as a result, the timelines for securing a Board decision on facilities applications are getting longer and longer. In addition, when comments are required from other federal departments there is a perceived lack of coordination and cooperation. The Board’s own statistics indicate that cycle times to render decisions on facilities applications are increasing, although there has been some improvement in cycle times in recent months.

Just as in the 1980s and early 1990s when the Board was faced with listening to dueling cost of capital experts, the

Board now faces listening to dueling environmental experts. The debates by the environmental experts lead to multiple information requests and create a bottleneck. The process has become lengthy, overly complicated, inefficient, adversarial and costly.

CEPA members cannot help but compare the Board's cycle times to those of some of its provincial counterparts.

For example, TransCanada Pipelines planned to construct its Westpath Expansion and, in order to do so; it had to apply to both the National Energy Board and the Alberta Energy Utilities Board ("AEUB"). TransCanada used the same environmental, engineering, Early Public Notification and construction policies and procedures for both applications. It took TransCanada about six months from the filing of the application to secure the NEB order and another five months to satisfy the pre-construction and Leave to Open

requirements for a total of 11 months. The Alberta process was completed in five months.

Another example involves an application by Duke Energy to extend a pipeline in Northeast British Columbia. It took Duke 18 months just to get into the hearing room. A producer customer, who had contracted for services on this pipeline, became so concerned with the timelines for this project that it applied to the BC Oil and Gas Commission for approval to construct an alternative pipeline to serve its needs. Approval from the Oil and Gas Commission was received in approximately four weeks.

Duke ultimately received the necessary Board approvals to construct the pipeline but it took almost two years – two years in a quasi-judicial communications blackout. The producers estimate that they lost gas sales revenues amounting to \$150 to \$200 million based on last summer's gas prices. This also

represents lost provincial royalties upwards of \$50 million. The Province of British Columbia needs such royalties to pay for health care and education. Therefore, I suggest that this revenue is a very important component of the public interest. Such considerations are as important an element in balancing the public interest as are environmental considerations.

**Suggestions to Improve Phase 2 of
the Facilities Application Process**

I believe there are a few basic assumptions that need to be stated, on which I think there should be general agreement.

With respect to the construction of pipeline facilities, the Pipeline Industry and the National Energy Board share the same objective of ensuring responsible resource management on behalf of all Canadians. In addition, the Pipeline Industry and the Board share the challenges of

balancing cost efficient resource development with effective environmental and social stewardship.

The quasi-judicial process frustrates regulatory efficiency. Innovation is needed to address the challenges shared by the Pipeline Industry and the Board. Let's think out of the box as the Board did for economic regulation in the mid-1990s.

(a) Some of the problems with the current facilities application process

Let me first list a few of the problems we have identified with the current facilities application process and then I will offer some potential solutions.

(i) The restriction on face-to-face communications:

I believe that environmental, engineering and safety issues, where the Board and the Pipeline Industry share the challenges of achieving an optimum

solution, should not be subject to the “communications blackout”. This restriction results in a missed opportunity to benefit from group knowledge, as well as a missed opportunity to evolve a shared understanding of and agreement upon the key assessment and management issues. Time and resources are wasted on minor issues, with a tendency to foster reactive planning late in the process, rather than focusing on innovative solutions early in the process. A lot of paper is exchanged between the regulator and pipeline companies with little or no value added for environmental protection.

- (ii) Lack of first hand knowledge of the project areas:** Board staff often do not have first hand knowledge of the project areas on which they are being asked to provide expert advice and recommendations to the Board. This results in an

inefficient use of resources and, I would suggest, sub-optimal advice to the Board.

(iii) Perceived micro-management of applications: It

appears to the Pipeline Industry that as cycle times increase, there is a perception of micro-management of facilities applications. Attention is often focused on very minor issues that have minimal impact given the nature of the subject facilities and there is no perceived benefit in focusing on such issues.

(iv) Uneven intensity of review at different phases of

the project: When minor variances to a project are submitted to the Board, they are often subjected to disproportionately intense scrutiny. This can result in time consuming and costly delays with little or no value added to the process.

(v) The “comprehensive checklist” approach to regulatory review: This is the assumption that the project can and must fit the process. Such an approach leads to a disincentive to invest resources in more in-depth analysis, innovative design and planning on the key issues for each project that would benefit all parties. Time and resources are spent on readily solvable or non issues. I would suggest this is regulatory process over regulatory substance.

(vi) The “federal/provincial solitudes”: The Pipeline Industry has experienced circumstances where the requirements imposed by the Board are at odds with provincial realities faced by provincially regulated pipelines or other industries. For example, the Board imposes a requirement that the Pipelines avoid right-of-way clearing during the migratory bird breeding

windows even if the right-of-way is in the middle of provincially designated timber harvest areas. While the pipelines are forbidden to clear the right-of-way in such periods, the forest industry is merrily cutting vast tracks of trees nearby.

As a result, federally regulated proponents must often implement costly measures that are not required of their provincially regulated counterparts, competitors or other industries that may have a greater impact on the environment than does pipeline construction. Thus, the greater investment required for a federally regulated project does not necessarily result in a greater overall benefit for the environment.

(b) Some possible solutions

- (i) Improve the efficiency of communications:** I would suggest the best evidence does not come through the Information Request process or from the witness box. Workshops or technical conferences where all stakeholders, including Board staff, are free to participate could shift the focus to identifying the key environmental, engineering and safety issues, agree on priorities and approaches to adhering to and addressing these issues and hopefully agreement could be reached on the preferred outcome. If necessary such workshops or technical conferences might be documented for public transparency and accountability but this could frustrate the free flow of communication amongst the participating stakeholders.

- (ii) **Site visits:** I believe it is important for the Board staff who are reviewing facilities applications to visit the site and view the project area where the pipeline facilities will be constructed. They need to "get out onto the land" and obtain first hand knowledge of the project on which they are providing advice to the Board.

Such visits would be more useful if the project areas were reviewed by Board staff and the proponents together. Perhaps this could be done before the application is submitted to the Board.

I'm sure you can imagine the benefits of a visit to the project site by Board Staff, both in the identification of key environmental, engineering and public safety issues, and in the potential for reduction of information

requests. The expression “a picture is worth a thousand words” comes to mind here.

(iii) Industry Best Management Practices: If

established practices for dealing with environmental, engineering and safety matters can be endorsed by federal and provincial regulators, then the project proponents need not re-plow the same ground over and over for each application that is filed. When a pipeline indicates that it will adhere to the CSA Z662 guidelines then it should not be necessary to detail each and every point that will be followed pursuant to the Z662 guidelines. The Pipelines have management systems in place, including comprehensive manuals to address environmental, engineering and safety issues, and they need not be micro-managed for each project. The Pipeline Industry is very conscious of its environmental and

safety responsibilities and is equally conscious of the consequences of not meeting those responsibilities.

(iv) Adaptive management policy on a regional scale:

Collectively, the stakeholders involved in a particular pipeline project may not have all of the information required on some subjects to accurately predict or mitigate some environmental effects on a regional or global scale. As a matter of policy, let's admit that, right up front. We need to foster collaborative regional scale initiatives (not just a single proponent's initiatives) and then we need to monitor the effectiveness of those initiatives. This will help to build a body of knowledge that will contribute to developing innovative solutions. For example, there is minimal benefit to the environment if the Pipelines are obliged to incorporate access management restrictions to their rights-of-way in multi-use

resource areas if other parties using the same area, be they oil and gas producers, forest companies, recreational users or whomever, are not obliged to adopt similar access management measures.

Closing Remarks

Some of you may point out that I neglected to mention that it is up to the proponent of a pipeline project to file a complete application. I agree completely that that is the proponent's responsibility. I would also like to note that in some cases the pipelines have experienced "movement of the goal posts" with respect to the Board's expectations as to what constitutes a complete application. With more effective communications between the proponents and the Board, I would expect that the Pipelines would be better able to react to the evolving expectations of the Board.

To help in this regard, the Board and stakeholders are currently engaged in a comprehensive review of the Board's Guidelines for Filing Requirements. CEPA members are participating in this review and we applaud the Board for this initiative. The Board has adopted an ambitious time table to complete this review of the Filing Guidelines. CEPA members are committed to working with the Board to realize its schedule.

From the perspective of the Pipeline Industry, it is imperative to address some of the challenges associated with the "communications blackout" that is now imposed on the regulatory process. I have offered two proposals that I believe would improve communication:

- technical conferences or workshops to identify and address the key engineering, environmental and safety issues associated with a particular project; and

- site visits that would provide Board staff with first hand knowledge of the project areas.

Effective communication will lead to better regulatory solutions which will make a contribution to achieving the Board's first corporate goal that "NEB-Regulated Facilities are safe and perceived to be safe" and the Board's second corporate goal that "NEB-Regulated Facilities are built and operated in a manner that protects the environment and respects individual rights".

I offer these suggestions for improving the regulatory review process for facilities applications for consideration by all stakeholders. The producers, pipeline companies and consumers of energy are concerned about the increase in cycle times for approving pipeline projects and the resulting direct and indirect costs. We all need to address this subject with new ideas. Reducing the risks,

the costs and the uncertainty associated with pipeline facilities applications will also contribute to achieving the Board's third corporate goal that "Canadians derive the benefits of economic efficiency".

It is time for innovative solutions to be considered. The Pipelines welcome a dialogue with the Board and other parties to find solutions that will lead to continued improvements in regulatory efficiency, a balanced regulatory process and timely regulatory decisions that will benefit all stakeholders.