

**DRAFT**

***Energy Trade and Transportation: Conscious Parallelism***

**Speech by Carmen Dybwad,  
Board Member, National Energy Board  
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***Introduction***

Good morning. Given the topic for this panel, *Energy Trade and Transportation: Forward or Reverse?*, I would like to title my talk *North American Trade and Transportation: Conscious Parallelism* because I see us moving forward into very interesting times as an energy industry with greater cooperation on a number of fronts. The focus of my discussion will be on the gas industry since the NEB does not regulate electricity within Canada except as it pertains to the export of power and the development of export transmission lines. The Board regulates the construction and operation of pipelines from the perspective of environmental impact, safety and economics, as well as the tolls and tariffs of those systems and it regulates international trade in crude oil, natural gas, electricity, natural gas liquids and refined products. The Board also has an advisory role which includes monitoring the energy sector and issuing reports dealing with energy issues. In other words, the Board has regulatory responsibilities that are similar to the FERC and the CRE but it also has responsibilities similar to those of the Energy Information Administration in the U.S.

I use the term ‘interesting times’ because the environment before us, as seen through the economist’s crystal ball, looks quite different than the past. After two decades of moderate gas prices as a result of surplus capacity, we are moving into a more supply constrained period and, most believe, an era of higher prices. As a result, we are looking at different sources of supply than we have relied upon previously – LNG and frontier supplies as well as more non-conventional and offshore production. Greater reliance on LNG alone means increasing continentalism and globalization. LNG projects are being considered which would land liquefied natural gas in Canada for subsequent sale in the U.S. or into the U.S. with Canada being one of the target markets. Likewise, a number of proposed terminals in Mexico would serve the U.S. market. Northern supplies would also cross national boundaries. Even if total natural gas trade does not grow substantially as it did in the past, the opportunities to work together will increase as energy markets become more continental.

As panel members, it was suggested that we touch on three aspects of Trade and Transportation:

- First, Regulatory Harmonization and Transparency
- Second, Competitive Economics versus long-standing policies and
- Third, Corporate versus Political Realities

These three headings capture significant aspects of the regulation of North American energy trade and I will make some comments on each topic.

### ***Regulatory Harmonization and Transparency***

Regulatory harmonization goes to the essence of regulators moving forward together and we have been making important strides both within Canada and in a North American context. The capital required for investment in oil and gas is highly fluid and moves easily to the areas of the world with the best returns. Those investment decisions are based, not only on geology, royalty regimes and infrastructure availability but also on the regulatory processes that must be undertaken and the time required for those processes. There is competition between jurisdictions in terms of regulation and policy. Siting of LNG terminals is a current example of such “competition”. Project proponents looking at sites in Mexico, the U.S. and eastern Canada are taking into consideration local regulatory regimes and environmental and safety concerns in addition to economic issues. This competition imposes discipline on regulation. We need to be efficient, transparent and consistent. The effect of these forces is greater convergence or “harmonization” of regulatory processes.

An important international effort to work more closely together was initiated this year. Although staff from the FERC and the NEB have met together regularly for a long time, and we have met with CRE for many years, this year it became a trilateral initiative. Staff from all three organizations meet together three times annually to exchange information, discuss a range of issues and strengthen working relationships. At the second trilateral meeting, an Informal Agreement on Cooperation was signed. This agreement, while recognizing and respecting each organization’s mutual independence, legislative mandate and national responsibilities, reflects the desire of the three organizations to share information, provide compatible regulatory approaches, encourage cross-border initiatives and learn from one another. The NEB was pleased to offer advice and counsel to Mexico when the CRE was being established in the mid-1990’s. Now we are learning from their experiences!

While we as regulators have not overtly made any changes to harmonize our approaches, we are aware of each others methods and understand the implications of our respective approaches and differences. We often think of this as “conscious parallelism”. This has had an effect and over time we have seen this convergence between the three countries in terms of more similar tariff regimes, open access provisions, requirements to connect to other pipelines and our approval processes.

Safety and environmental legislation are often unique to each country, but particularly in the case of economic regulation, there is potential for coordinated and innovative approaches. I’ll give you an example. One idea raised has been a single tariff for cross-border pipelines. There are many suggestions as to what this might look like but we as regulators are signaling that we are open to considering new approaches that parties might bring forward. For example, in August FERC approved an international joint rate

for an oil line, the Express Pipeline, finding that the rate for the Canadian portion which was on file with the NEB satisfied FERC's requirements.

Harmonization goes beyond the function of regulators. The work of the North American Energy Standards Board (NAESB), an industry driven organization responsible for standardizing protocols and practices in the natural gas and electricity industry, is extremely important for the on-going development of continental gas and electric markets and the NEB is increasing its level of involvement in that forum.

With respect to the topic of transparency, as an independent, quasi-judicial tribunal, the Board's processes are by necessity very open and transparent. Under Canadian laws all stakeholders have a right to participate, to be heard, and to know the case that must be met. Therefore, prior to commencing decision-making, all persons whose interests may be affected by a decision must be alerted so that they can take steps to protect those interests. Further, any information taken into account by the tribunal must be disclosed to all parties prior to the decision being made. Occasionally, applicants express frustration at the level of transparency required, perhaps not fully understanding the requirements for all stakeholders to have the opportunity to be heard.

Within Canada, we are also working to increase harmonization. One example involves the regulatory framework for a northern pipeline coming down the Mackenzie Valley. There are 13 agencies with an interest in a pipeline through the Mackenzie Valley including various Land and Water Boards, environmental agencies and the NEB. Eight of them have public hearing processes. I might note that from a regulatory perspective, the frontiers are unique in Canada. To expedite the regulatory process in Canada for a line through the Mackenzie Valley, the various regulatory authorities worked together for more than two years to create a Cooperation Plan. This was finalized and published in June of last year. This plan provides for coordinated public hearings, a single environmental assessment panel and report and a Northern Gas Project Secretariat. It sets out a coordinated process for review of a major pipeline application in a way that reduces duplication, provides certainty and timeliness and enhances public participation. We are now working together to implement the Cooperation Plan by developing specific bilateral agreements, a project secretariat, shared technical support, a joint public registry, and a plan for public involvement.

With the submission of a Preliminary Information Package by the Mackenzie Valley Pipeline proponents last June, that process has now been triggered. The Preliminary Information Package doesn't constitute a formal regulatory filing but it does allow the environmental assessment process to commence. The actual regulatory application is expected in 2004 and the regulatory process is expected to be complete approximately two years after than application is made. Under the anticipated timeline for the project, gas from the Mackenzie Delta would then flow as early as 2009.

### ***Competitive Economics versus Long-Standing Policies***

The second topic is competitive economics versus long-standing policies. In Canada it has been almost two decades since policy makers recognized that certain segments of the natural gas industry, the production and sale of gas, were naturally competitive and these aspects were deregulated. As it relates to gas transmission, long-standing policies have largely reflected traditional cost of service regulation. Looking back over time at the natural gas industry in Canada, traditional pipeline regulation has been relatively successful in accommodating a rapidly growing infrastructure and stable tolls. Even so, it is recognized that the introduction of competitive forces can lead to improved services and lower costs.

Some pipeline corridors have a fair degree of competition and regulation has encouraged the innovation and market-responsiveness that this competition generates. Other corridors are close to monopolistic. But most fall somewhere in between. It is this 'in-between' case that poses the greatest challenge for regulators who want markets to benefit from competition without losing the significant benefits of the monopoly model.

Even where competition doesn't exist, we have introduced the options of incentive regulation and negotiated settlements. Incentive mechanisms encourage innovation, efficiency and customer responsiveness and the negotiation alternatives gives both sides the opportunity to devise a package which meets their needs and can save the cost of going through a traditional hearing process.

The Board is of the view that there is no one right regulatory framework for gas transmission. The current environment is flexible. The Board's philosophy is that markets should be allowed to work, wherever possible, while the regulator insures that the interests of all stakeholders are heard. The regulator must certainly not constrain competition. However, there is nothing wrong with "natural" monopolies. Where it prevails, we use the other tools at our disposal to address the concerns associated with traditional regulation.

There is always room for improvement and innovation in the regulatory process. Greater emphasis is being placed on encouraging the market to find solutions as opposed to relying solely on the regulatory process. At the NEB, we have been moving away from the prescriptive regulation of the past towards goal-oriented regulation wherein the pipeline is given discretion to achieve specific goals, whether they relate to safety, environment or economic efficiency for example, in what they perceive to be the most effective manner.

We are also working to increase consistency and clarity so that parties are not left trying to guess what the regulator is looking for. And we are streamlining regulations to the extent possible to more effectively use the resources of the company and the regulator and to facilitate the efficient development of the market.

The NEB strives to be a leader in economic regulation. As such, we are very open to new ideas and approaches. It is surprising how often companies express the view that they can't bring a new idea to the Board because it has always been done in a certain way, or

because the Board rejected the approach in one particular circumstance at some point in the past. I can tell you that the Board is open to innovation. The Board will examine fresh approaches brought to it while taking into account the interests of all stakeholders. Maybe it will be found to be suitable in the circumstances. Maybe it won't. However, if parties don't bring ideas forward, they will never see the light of day. New approaches by industry allow us all to move forward together.

### ***Corporate versus Political Realities***

The third topic is Corporate versus Political Realities. The Board hears many stakeholders including pipelines, their customers and shareholders, new market entrants, energy producers, end-users, land owners and users of the land as well as the general public who have environmental and safety interests. The NEB Act is not limited to just economic and corporate interests. The Board is free to consider any factor it believes to be relevant to a determination of Public Convenience and Necessity. The Board has latitude to consider all the interests of stakeholders.

One of the NEB's responsibilities *is* to ensure that the pipelines have adequate financial strength to enable them to attract capital on terms which allow them to build required infrastructure and maintain their systems. Markets can only operate efficiently if needed infrastructure is being built. The responsibility towards the pipelines must be balanced by our responsibility to ensure that pipelines are working with customers to offer the right services at fair prices and working appropriately with the other stakeholders. We take very seriously our obligation to balance all of these interests in a way in which parties feel that they have been listened to and treated fairly. In this regard, Canadian pipelines have fared quite well recently despite the serious financial challenges facing pipeline companies in North America.

While the Board is independent of the political process as I discussed, it is not isolated from changing public concerns over time. The increasing regard for the importance of environmental issues is an example of this and this is reflected in the time and effort given to it in the regulatory process. Increased natural gas supply concerns are already being reflected in the issues brought before the Board. Another reality for all of us is that consumer protection becomes of paramount concern when prices spike.

### ***Conclusion***

In conclusion, challenging environments and interesting times make the need for all of us to work together and to be creative in our approaches even more essential. Conscious parallelism has and will continue to serve us well as we meet these challenges. The information sharing and learning from one another tend to lead to greater harmonization of regulatory practices as we adopt the best from one another. Fresh approaches from industry feed this process and allow the entire industry to move forward together. Thank you.