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1999

ON TRAC Spring 1999

Spring 1999, Issue 16

<http://hdl.handle.net/1880/44316>

Newsletter

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NEWSLETTER

Spring 1999, Issue 16

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The Van Horne Institute has been established to address important **transportation** and related **regulatory** issues confronting industry and government, in North America and internationally, through research and education.

The Institute was incorporated federally in 1991 as a not-for-profit organization, and was granted affiliation with The Uni-

IMPORTANCE OF TRANSPORTATION STUDY

In a collaborative effort, the Institute is working with the Western Transportation Advisory Council (WESTAC) of Vancouver to produce a definitive handbook on the importance of transportation in Canada. This landmark project will raise the profile and awareness of transportation at a broad grassroots level. The target audience is the intelligent lay person who has only a passing knowledge of transportation and its contribution to his or her standard of living.

This document will be widely distributed: as a reference guide to the general public; to all levels of government and MPs (who are frequently asked to explain and/or support transportation projects); to schools, universities and other training institutions; and to WESTAC and Van Horne members who already understand the importance of transportation and who need a tool to help explain this to customers, government officials and others.

This high quality document will contain 30 to 40 pages, written in a plain, concise style. It is not intended to provide a detailed account of technical matters which are best left to specific studies; it will, however, be supported by recent and relevant statistical information. It will cover all modes, and the movement of both freight and passengers. It will describe how the transportation system works, its performance, recent developments and trends, and the critical role that transportation plays in supporting industry and trade, and in giving Canadians a high standard of living. A strategic profile of major issues, and a special section on careers in transportation will be included.

EVENTS AT THE CENTRES

The Institute is pleased to have the opportunity to collaborate with WESTAC on this very important project. The handbook will be published in mid-1999. If you would like to receive a copy, please call our office.

Both the Centre for Regulatory Affairs and the Centre for Transportation have offered or planned a number of events. On May 10th, a workshop was held on **Competition for Natural Gas Liquids: the Law and Economics of Introducing Competition through Access to a Common Gas Stream**. An overview was given of the natural gas liquids industry and prospects for its future development. The workshop gave an in-depth examination of the key economic and legal issues associated with increasing competition in gas processing by opening access to common gas streams. For a copy of the workshop proceedings, please contact us.

Starting May 18th, a course on **Process-Based Modelling** was offered featuring a Systems Dynamics (SD) modelling approach to transportation issues. Using a flexible approach to problem solving, management, operational, financial and risk variables can be integrated.

Watch for additional offerings in the Summer and Fall on: Regulatory Economics, Electricity Deregulation, Supply Chain Management, and First Nations Geographic

NEW WORLD IN GAS TRANSMISSION CONFERENCE

Information Systems and Industry Liasons.

The Centre for Information and Communication will be involved with the Smart 2000 Conference featuring *Smart People, Smart Places and Smart Policies* to be held in Calgary in October 2000. This world class event will showcase and benchmark electronic products, and promote innovation in Alberta, Canada and the world. A mini-conference, which will precede the Smart 2000 conference, is being planned for the Fall of 1999 at the University of Calgary. Stay tuned for details.

On April 28th, a very timely conference on *The New World in Gas Transmission: Regulatory Reform and Excess Capacity* was held in Calgary, organized by the Institute's Centre for Regulatory Affairs. The speeches given by the speakers have been summarized as follows:

Peter Fournier, of the Industrial Gas Users Association, gave an overview of natural gas pipeline regulation in Canada, and current developments including competition in gas transmission. He views the \$3.7 billion Alliance pipeline project as the most important Canadian pipeline development in the last 20 years. Although this will produce some competition in the marketplace, he does not see that pipeline tolls and tariffs will be deregulated in the near future. He also predicts many issues arising from the TCPL-NGTL system merger that will impact the entire industry, such as regulatory jurisdiction and toll design.

Jerry Ellig, of the Mercatus Center at George Mason University, spoke about gas pipeline regulations and developments in the U.S. He described the Federal Energy Review Commission's (FERC) recent initiatives in this area: a policy on incentive rates (1992), a policy on market-based rates (1996), rulemaking on short-term (less than one year) transportation, and an inquiry on long-term transportation.

Dan Alger, of Economists, Incorporated, in Washington, D.C., gave an overview of governance possibilities for the natural gas pipeline industry. He outlined three alternatives to market power: free markets, cost-of-service regulation (directly regulating behaviour) and regulating incentives to compete (a hybrid of the two). By regulating incentives to compete, he explained that this will create secondary markets, and will also allow outsiders to expand capacity if they pay an appropriate cost.

Eric Shelton, of TransCanada PipeLines, talked about some of the issues in the "New World of Pipeline Transportation" such as: pipe-on-pipe competition, excess capacity, short term contracts, customer choice and local distribution company (LDC) unbundling. His vision for the future would include a market where flexible service can be provided and prices reflect market value. In this market, there is cost efficiency and system

NEW MEMBERS

utilization efficiency, which can optimize the value of the pipeline.

Nick Schultz, of the Canadian Association of Petroleum Producers, discussed competing visions for the future, and gave a viewpoint of industry. Pipeline customers typically expect

GLOBAL CROSSROADS UPDATE

provided by regulation. Pipelines in both Canada and the U.S. express a desire for greater flexibility in regulations, but he cautioned that the industry must consider if something significantly different would be significantly better overall.

The luncheon speech was given by **Roland Priddle**, former Chairman of the National Energy Board, entitled *Competition and Regulation in Canadian Gas Transmission or Might Competition be Hazardous to Your Health?* Gas transmission services are likely to become commoditized if pipe-on-pipe competition occurs under conditions of surplus capacity. The pipes' high-fixed, low-variable costs structure will then permit and encourage pricing behaviours which have long characterized the upstream petroleum industry. Such behaviours will doubtfully be containable by contracts or other customer-segmentation mechanisms that will lack appeal in surplus capacity situations. The consequences for the pipes are likely to be far-reaching in terms of risk, earnings volatility and traditional methods of financing.

Ken VanderSchee, of Energy ERA, spoke about understanding the implications of competition, specifically, toll structures and service offerings. Pipelines are regulated because they are natural monopolies. They also require long-term contracts to underpin financing. Under this scenario, he outlined an optimal pricing structure. He then talked about why excess capacity exists in the market, and that regulators should allow pipelines to set prices/policies that remove capacity from the market. He also suggested to define strictly what primary service is, and then allow the secondary market to offer auxiliary services.

Roland George, of Purvin & Gertz, talked about secondary markets for gas transportation. Under a regulated market, there is a lack of flexibility to respond to change and little consumer choice. A deregulated market has many more players, and natural gas markets have become "gas bazaars." In his view, active, unfettered secondary markets are necessary. Markets will work, but establishing the rules of the game will be necessary. He advised that market changes should not be fought, but that companies should take advantage of the many new opportunities that are available.

Dr. Jeffrey Church, of the University of Calgary, discussed implications for capacity and entry in natural gas transmission. He reviewed how regulators should deal with applications for new facilities that will result in competition for gas supply (pipe-on-pipe competition). From an economist's viewpoint, the public interest is best served by ensuring that resources are efficiently allocated, and this occurs when the value of

WESTERN CANADIAN CORRIDORS AND PORTS INITIATIVE

production is maximized. The problem with the NEB's test for economic feasibility is that it is not efficiency based and hence is unlikely to adequately discriminate between efficient and inefficient applications for competitive facilities. In general, diversion of volumes from existing facilities will create a wedge between the private and social incentives for entry. The socially excessive incentives for competitive entry due to this business stealing effect are exacerbated by the regulatory policies in place for existing capacity.

If you would like a copy of the proceedings, please call our office.

We are pleased to announce the following new members to The Van Horne Institute:

- **Bell Nexxia**
- **Bombardier Aerospace**
- **SMED International**

ITS CANADA

NEW BOARD MEMBER

VHI MEMBERS

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