2022-09

Some Benefits, Drawbacks and Perils of Negotiated Settlement as a Price Regulatory Method of Pipeline Services

Jimenez-Montiel, Guillermo

UNIVERSITY OF CALGARY

Some Benefits, Drawbacks and Perils of Negotiated Settlement as a Price Regulatory Method of Pipeline Services

by

Guillermo Jimenez Montiel

A THESIS

SUBMITTED TO THE FACULTY OF GRADUATE STUDIES

IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE

DEGREE OF MASTER OF LAWS

GRADUATE PROGRAM IN LAW

CALGARY, ALBERTA

SEPTEMBER, 2022

Abstract

Carriers and shippers have long preferred negotiation over litigation to solve issues of prices for natural gas pipeline services. However, parties frequently end up in litigation. This paper explains why this problem happens under Canadian law.

When parties negotiate, they create benefits by solving short-term issues of financial viability of pipeline systems. Parties sometimes unanimously agree upon their own rules and incentives on price and conditions of service under minimal regulatory intervention. In addition, parties find a balance of interests and certainty by agreeing on the carrier's total revenue requirement and the method to set the prices shippers will pay. Moreover, parties prevent abuse of monopoly and market power which used to be the main reasons for regulatory intervention based on adjudication. Parties have achieved these benefits without discussions based on regulatory principles.

However, parties' negotiation has some drawbacks and perils even in the presence of pipeline competition. Sometimes parties alone have not prevented cross-subsidization which can affect rivalry between shippers and rivalry between carriers. Even more, the growing degree of pipeline competition and other business risks can leave some transmission assets stranded. Therefore, shareholders cannot recover the profits permitted and the capital invested, and the long-term viability of a pipeline system is threatened. Here the drawback is that shippers alone cannot prevent a carrier from attempting to transfer that long-term risk to shippers. Finally, a carrier can take actions contrary to a settlement after the Regulator approves it, leading parties to new conflicts.

The Regulator has adapted the regulatory processes to manage the drawbacks and perils by adjudicating on the issues posed by parties who dissent from the settlement agreed or when negotiation do not work. Despite parties' preference for negotiation, the Regulator needs to adjudicate based on cost of service and the regulatory principles. Thus, adjudication remains the default process as the Regulator has solved the disputes based on the carrier's burden of proof to minimize the asymmetry of information between the carrier and shippers and between the carrier and the Regulator regarding the allocation of costs and business risks. That asymmetry explains the drawbacks and perils.

Acknowledgements

For an international student like me, completing an LL.M. project on Canada Energy Law was a challenge. The challenge was compounded by the stressful family circumstances I was undergoing and the unprecedent situation we all have faced over the last few years.

Fortunately, the University of Calgary was always willing to help me. The support of the Faculty of Graduate Studies and the Faculty of Law was crucial for completing the LL.M. program successfully. I am particularly grateful for the Honourable N.D. McDermid Graduate Scholarship in Law and the Queen Elizabeth II Graduate (Master's) Scholarship. I equally appreciate the University for understanding the family challenges I faced.

There are other reasons for being grateful. Dr. Gregory Hagen and Dr. Lyndsay Campbell together with my supervisor Professor Fenner Stewart supported my effort. They trusted me all the time without hesitation. I would like to express my deepest gratitude for their invaluable support.

The guidance of Professor Stewart helped me to make the project more manageable and to achieve my academic goals. The methodological foundations learnt from Professor Jonnette Watson-Hamilton were at the core of my academic endeavor. I am also indebted to Professor Nigel Bankes for his advice in the first stages of the project as co-supervisor.

I am equally thankful to Eunice Wong who was always ready to provide me assistance.

Finally, my family has been the central pillar of my work. Thanks to them for sacrificing their well being for supporting me all the time.

Table of Contents

Acknowledgments

Table of Contents

CHAPTER 1
INTRODUCTION

1.1 Objective

Under *Canadian Energy Regulator Act (CERA)* the Canadian Energy Regulator CER (the Regulator) which replaced the former National Energy Board NEB) has the legal mandate to ensure that prices for pipeline services are just, reasonable, and non-discriminatory.[1] The Regulator has met that mandate based on the regulatory principles developed under the former *National Energy Board Act (NEBA)*.[2]

In this thesis, I will study the use of negotiation between natural gas pipeline companies and their shippers. Together they are called the parties for the present purpose. Parties prefer to negotiate a solution for issues on prices and conditions of service.[3] When parties achieve a compromised solution to diverse issues affecting multiple parties, the agreement is called a negotiated settlement.[4] The parties' primary aim is to reach a balance by accepting mutual concessions to realize their interests.[5]

---

[1] *Canadian Energy Regulator Act (S.C. 2019, c. 28, s. 10)* [*CERA*], ss 230, 231 and 235. Section 10(1) of CERA created the Canadian Energy Regulator [hereafter the CER or the Regulator]. A similar mandate was established by the *National Energy Board Act,* RSC 1985, c N-7 [*NEBA*], ss 62-64, 67. NEBA created the federal energy Regulator, called the National Energy Board [hereafter, the NEB or the Regulator]. Yet, section 10(1) of CERA created the Canadian Energy Regulator, a federal corporation that replaced the former NEB. Pursuant to ss 31, 32 and 33 of CERA, the regulatory functions are fulfilled by the commission of that corporation. In this thesis, I rely on some NEB decisions and some CER decisions. For that reason, this thesis will use the expression "federal energy regulator" or merely "the regulator" to refer to either of them unless indicated otherwise. The word "federal" is used to differentiate the CER from provincial energy regulators created by and subject to provincial legislation.

[2] NEB, *Reasons for Decision: TransCanada Pipelines Limited*, *RH-1-2007* (Gros Cacouna Receipt Point Application, July 2007) [*NEB Decision RH-1-2007*] at 21. Online (pdf): *Canadian Energy Regulator* <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/443945/472730/471076/A16008-1_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Gros_Cacouna_Receipt_Point_%E2%80%93_RH-1-2007.pdf?nodeid=470970&vernum=-2>.

[3] NEB, *Canada's Pipeline Transportation System* (Report, 2016) [*NEB Pipeline Report*] at 21–22. Online (pdf): *Canadian Energy Regulator* < https://www.cer-rec.gc.ca/en/data-analysis/facilities-we-regulate/2016/canadas-pipeline-transportation-system-2016.pdf>

[4] CER, *Reasons for Decision, Nova Gas Transmission Ltd, RH-001-2019* (Application dated 14 March 2019 for NGTL Rate Design and Services, March 2020) [*CER Decision RH-001-2019*] at 11. Online (pdf): *Canadian Energy Regulator* <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/554137/3752363/3752364/3760156/3913151/C05448-1_CER_%E2%80%93_Reasons_for_Decision_RH-001-2019_%E2%80%93_NOVA_Gas_%E2%80%93_NGTL_System_Rate_Design_%20and_Services_-_A7E4S8.pdf?nodeid=3912507&vernum=-2>

[5] *Ibid*.

Therefore, parties do not focus on the substantive regulatory principles applicable to the issues involved.[6] Yet, the settlement is subject to the Regulators' review under the *Negotiated Settlement Guidelines*.[7] That is the way in which the Regulator ensures that the settlement is compatible with the legal mandate.[8]

Carriers and shippers rely on a negotiated settlement as an alternative to cost of service.[9] Under cost of service, parties discuss their differences before the Regulator with a view to solving specific issues based on the evidence on costs related to each issue.[10] Then, the Regulator applies the regulatory principles to solve each issue separately.

It must be noted that the regulatory principles are the legal reasons on which the Regulator relies to achieve the balance of interests between a pipeline company and its customers. The Regulator uses the principles to evaluate the costs which explains the prices proposed to charge to shippers in a period. I will explain these principles in detail in chapter 3 on the legal framework. At this stage suffice is to note that they include the prudent principle which leads the Regulator to allow the carrier to recover merely costs deemed reasonable to provide pipeline services. In addition, pursuant to the principle of used and useful assets, the Regulator permits the carrier to recover costs only associated with pipeline assets used to provide transportation services. Moreover, the Regulator applies the cost-based/user pay principle to make sure that each shipper or group of

---

[6] *Ibid*. In this case, the carrier submitted for approval the price method negotiated with shippers. The carrier proceeded in that way, given that shippers participated in the negotiation process and their interests were accommodated. In addition, the settlement met other conditions established by the Regulator's *Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs*, NEB File 4600-A0003-3 (12 June 2002), [*NEB Negotiated Settlement Guidelines*]. Online (pdf): *Canadian Energy Regulator* <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/155829/3773831/3890507/3901808/3930821/4099598/C13339-2_NEB_Revised_Guidelines_for_Negotiated_Settlements_of_Traffic_Tolls_and_Tariffs_%28A02885-1%29_-_A7U0F3.pdf?nodeid=4098581&vernum=-2>

[7] *NEB Negotiated Settlement Guidelines, supra* note 6.

[8] *Ibid* at para (iv).

[9] CER, *Regulation of Pipeline Traffic, Tolls and Tariffs"* (12 February 2021), [*CER Regulation of Traffic, Tolls and Tariffs*] at section "Toll Regulation." Online: *Canadian Energy Regulator* <https://www.cer-rec.gc.ca/en/about/who-we-are-what-we-do/responsibility/regulation-pipeline-traffic-tolls-tariffs.html>

[10] NEB, *Reasons for Decision, TransCanada Pipelines Ltd, RH-3-2004* (Application for approval to establish a new receipt and delivery point, the North Bay Junction, and for the corresponding tolls for services to and from that point, December 2004) [*NEB Decision RH-3-2004*] at 7-9. Online (pdf): *Canadian Energy Regulator* <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586892/293604/346558/342912/A08726-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_North_Bay_Junction_%E2%80%93_RH-3-2004.pdf?nodeid=342913&vernum=-2>

shippers pay the cost created for the services obtained. That principle serves the Regulator to prevent a carrier from making some shippers pay the costs created by rival shippers or to cause one generation of shippers pay the costs created by another which is called the principle of intergenerational equity.[11]

When pipeline services in a region were mainly provided by a single carrier under monopolistic conditions, cost of service used to be the conventional method to regulate prices for these services.[12] In fact, the Regulator developed the regulatory principles to meet the mandate based on cost of service.[13] Nevertheless, in a context of growing pipeline competition, parties have mainly preferred to negotiate as an alternative process to cost of service.[14] Despite that, parties frequently end up in litigation based on cost of service.[15] Therefore, it is necessary to explain why parties behave in that way and hence why the regulator needs to intervene in case of litigation.

1.2 Research question and sub-questions

To achieve that, I am studying negotiated settlement because I want to explain this question: what are some of the benefits, drawbacks and perils derived from the use of negotiation as the parties' preferred regulatory process to solve issues on prices and conditions for natural gas pipeline transportation services? This is the central question in the present thesis. To answer that question a key condition is to explain a second

[11] *Infra to pp 74-80*. In these pages I describe these principles.
[12] *Ibid* at 6.
[13] *Ibid* at 7–9.
[14] This perspective is supported in several decisions: see NEB*, Reasons for Decision, TransCanada Pipeline Ltd, Nova Gas Transmission Limited, Foothills Pipelines Ltd, RH-003-2011* (Business and Services Restructuring Proposal and Mainline Final Tolls for 2013 and 2013, March 2013) [*NEB Decision RH-003-2011*] at 1, 244, 246 Online (pdf): *Canadian Energy Regulator* < https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/665035/711778/941262/939799/A51040-1_NEB_-_Reasons_for_Decision_-_TransCanada%2C_NOVA_Gas_and_Foothills_-_2012_and_2013_Final_Tolls_-_RH-003-2011.pdf?nodeid=939800&vernum=-2>; NEB, *Examination Decision* (Examination to Determine Whether to Undertake an Inquiry of the Tolling Methodologies, Tariff Provisions and Competition in Northeast British Columbia, March 2018) [*NEB Examination Decision 2018*] at 1. Online (pdf): *Canadian Energy Regulator* < https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/3225050/3338199/3488659/A90483-1_NEB_-_Letter_Decision_-_Parties_-_Inquiry_of_the_Tolling_Methodologies%2C_Tariff_Provisions_and_Competition_-_NE_BC_-_A6A9Y3.pdf?nodeid=3490855&vernum=-2> and *CER Decision RH-001-2019*, *supra* note 4 at 1, 11, 33, 47.
[15] *NEB Decision RH-003-2011*, *supra* note 14 at 244, 246.

question: why does the Regulator intervene in the formation of prices even in the context of pipeline competition?

This second question emerges from the fact that the Regulator has held that the regulation of prices for pipeline transportation seeks to counter the ability of a monopolistic carrier to determine unilaterally the price and the conditions of services.[16] However, more recently there was a discussion not only between shippers but also between members of the regulatory body regarding the scope of regulatory intervention in the context of pipeline competition.[17] A dissenting view was that regulation must achieve prices for transportation services comparable to those prevailing under pipeline competition.[18] In that respect, the Regulator has recognized that pipeline competition is growing in most regions in Canada.[19] Despite that, the Regulator intervenes when parties' negotiation alone cannot prevent some conduct.[20] Therefore, it is relevant to investigate why negotiation fail and hence regulatory intervention in the formation of pipeline prices is necessary not only under monopoly but also under pipeline competition.

---

[16] This view was adopted in a case dealing with an application made by TransCanada regarding the Mainline system. That system connects the western Canada, natural gas producing area to the central and eastern areas, consuming areas in Canada and parts of the United States. See *NEB Decision RH-003-2011, supra* note 14 at 5–6. The NEB reiterated the same view in NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-2-2004, Phase II* (2004 Mainline Tolls and Tariffs Application, April 2005) [*NEB Decision RH-2-2004, Phase II*] at 16. Online (pdf): *Canadian Energy Regulator* <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/365090/A09636-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Cost_of_Capital_%E2%80%93_RH-2-2004%2C_Phase_II.pdf?nodeid=365091&vernum=-2> Yet, by 2004, pipeline competition was already a reality in other areas served by TransCanada's Mainline system. See *NEB Decision RH-3-2004, supra* note 10 at 6.

[17] NEB, *Nova Gas Transmission Ltd, GH-003-2015* (Report on application dated 2 September 2015 for the Towerbirch Expansion Project, Facilities and Tolling Methodology, October 2016) [*NEB GH-003-2015 Report*] at 72–78. Online (pdf): *Canadian Energy Regulator* <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/2671288/2819218/3065005/3065109/A79841-1_NEB__-_Report_-_NOVA_Gas_-_Towerbirch_Facilities%2C_Tolling_Methodology_-_GH-003-2015.pdf?nodeid=3065196&vernum=-2>

[18] *Ibid* at 77.

[19] The Regulator recognized the existence of pipeline competition in western Canada in several decisions, including *NEB Examination Decision 2018, supra* note 14 at 1. In some areas served by the TransCanada Mainline system the existence of pipeline competition has been recognized in *NEB Decision RH-3-2004, supra* note 10 at 6 and in *NEB Decision RH-003-2011, supra* note 14 at 1, 157. Yet, in the *NEB Decision RH-3-2004* at 21 the Regulator indicated that in some geographic markets served by TransCanada Mainline System a monopolistic supply of pipeline services still exists.

[20] *NEB Examination Decision 2018*, *supra* note 14 at 1, 5.

The answer to the second question will allow me to explain the economic problems that the Regulator seeks to confront. Hence, that answer will also help me to answer the central question. Complementary, I will explain how the Regulator manages in practice the associated drawbacks and perils. In the end, the answer to these questions can serve to make some modest contributions for a better understanding of the negotiated settlement as an alternative regulatory method and process. Based on that, I will be able to recommend a further measure to minimize the main drawback so that the legal mandate can be achieved more optimally.

1.3 The research problem

The supply of natural gas pipeline transportation services is a capital-intensive activity and operates in a risky business context.[21] The capital invested can only be recovered in the long term.[22] In that sense, likely changes in the production and demand for natural gas, the emergence or increase of pipeline rivalry and the occurrence of other business risks affect natural gas traffic as well as the income which can be obtained from carrying that product.[23] Therefore, business risks can affect the profitability of a pipeline company and ultimately the recovery of the capital invested.[24] As a result of these factors, parties become involved in repeated disputes over the useful life of transmission assets.[25]

These conflicts involve multiple parties and issues as follows. First, some types of conflicts are related to the total level of income that the carrier can generate. That income is obtained through prices in order to recover the capital invested in transmission assets and the operating costs necessary to keep a pipeline system running.[26] Hence,

---

[21] *NEB Decision RH-2-2004, Phase II, supra* note 16 at 13. The Regulator indicates that profits permitted represent the main cost of a pipeline company. NEB, *Reasons for Decision, RH-2-2004,* Phase I, at 5, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/334963/A08344-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Tolls_and_Tariff_%E2%80%93_RH-2-2004_Phase_I.pdf?nodeid=334859&vernum=-2>.

[22] *NEB Decision RH-003-2011, supra* note 14. That is the view of the parties as indicated at 35–36, 55, 148. That is also the view of the regulator as indicated at 44, 161.

[23] *Ibid* at 43, 148, 161.

[24] This view results from interpreting *NEB Decision, RH-2-2004, Phase II, supra* note 16, particularly at 13, 16, 30, 46–47.

[25] *Ibid* at p. 34.

[26] *NEB Decision, RH-2-2004, Phase I, supra* note 21 at 4, 5.

sometimes conflicts in this regard are related to the recovery of the capital invested.[27] At other times conflicts emerge from the level of profits that should be permitted over that investment.[28] The profits are called the rate of return.[29] Altogether these conflicts have to do with whether the requested revenue makes a carrier able to pay all its obligations and generate profits, and ultimately to recover the capital invested.[30] This carrier's ability is called the financial integrity or financial viability of a pipeline system.[31] Second, other conflicts are connected with how costs are divided between shippers in light of the services obtained to ensure that all shippers pay the costs each one causes.[32] Third, still other conflicts are related to whether the cost of assets no longer used as a result of the occurrence of business risks must be borne by shareholders or divided between carrier and shippers.[33] Parties and the Regulator also call them stranded assets.[34]

In that context, parties prefer to solve these issues by themselves and hence try to avoid litigation.[35] To achieve that purpose, parties do not rely on regulatory principles but on the negotiation process to reach a compromise on multiple issues.[36]

However, parties' negotiation sometimes do not work.[37] In fact, sometimes the negotiation process serve parties to resolve some issues but they are unable to solve

---

[27] *NEB Decision RH-003-2011, supra* note 14 at 27, 29, 31, 41. Both parties and the Regulator have made the distinction between the recovery of the investment made in transmission assets and the recovery of the profits allowed over these assets. They see that distinction as a summary of the Regulator's mandate.
[28] *Ibid*.
[29] *NEB Decision RH-2-2004, Phase II*, *supra* note 16 at 12–13.
[30] *NEB Pipeline Report, supra* note 3 at 21, 26; *NEB Decision RH-2-2004, Phase II, supra* note 16 at 77. Parties discussed about the financial integrity of a pipeline company. That concept means that the Regulator must facilitate that a carrier can recover all reasonable costs (*ibid* at 13). These costs encompass debts already contracted and obligations that the carrier can contract during the future period under analysis (*ibid)*. See also *Ontario (Energy Board) v. Ontario Power Generation Inc,* 2015 SCC 44, [2015] 3 R.S.C 147 at paras 82–83 in which the Supreme Court characterized the ability of a carrier to pay all its obligations as financial viability *Ibid* at paras 11, 20, 107.
[31] *Ibid*.
[32] *NEB Decision RH-2-2004, Phase II, supra* note 16 at 13. See also RH-1-2007, p. 21-22.
[33] *NEB Decision RH-003-2011, supra* note 14 at 41, 43.
[34] *Ibid* at 28–30, 65.
[35] For instance, in *CER Decision RH-001-2019, supra* note 4 at 11, the Regulator approved a negotiated settlement after recognizing the existence of pipeline competition in Northeast British Colombia in the *NEB Examination Decision 2018* (*supra* note 14). Similarly, in the *NEB Decision RH-003-2011* (*supra* note 14) at 246, the Regulator recognized that in prior occasions parties had resorted to negotiated settlement to solve issues.
[36] *NEB Decision RH-003-2011, supra* note 14 at 246–247; *CER Decision RH-001-2019, supra* note 4 at 11.
[37] *NEB Decision RH-003-2011, supra* note 14 at 244, 246.

others.[38] In other occasions parties' negotiation alone are unsuitable to deal with some issues derived from some carrier's conduct.[39] That leads parties to become involved in litigation.[40] Therefore, the Regulator has to intervene to solve the issues by adjudication based on the regulatory principles.[41] That is contrary to the parties' purpose of avoiding litigation.

1.4 Thesis

Parties prefer negotiation to solve pipeline price issues. That is because carrier and shippers obtain the following benefits. First, a carrier can be certain about the financial viability of its pipeline system during the term of the negotiated settlement while shippers can be certain about prices and conditions of service.[42] Thus, parties achieve the degree of certainty and predictability that they are willing to accept.[43] Second, when the supply of pipeline transportation services involves different costs in separate areas served by the same pipeline system, parties can agree on prices adapted to that situation.[44] Therefore, parties' negotiation serve to deal with short-term issues related to the division of costs to prevent cross-subsidization.[45] Third, parties go beyond the division of costs and can create incentives to minimize costs.[46]

---

[38] *Ibid* at 244.
[39] *NEB Examination Decision* 2018, *supra* note 14 at 2, 4-5.
[40] *NEB Decision RH-003-2011, supra* note 14 at 246–247.
[41] *Ibid*.
[42] CER*, Decision on the TransCanada Pipeline Limited,* (Letter in response to an Application for the Approval of the Mainline 2021–2026 Settlement, 17 April 2020) [*CER Decision, April 2020*] at 1–3, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3773158/3891141/3914560/C05780-1_CER_%E2%80%93_Letter_Decision_%E2%80%93_TransCanada_%E2%80%93_Mainline_2021-2026_Settlement_-_A7E9E9.pdf?nodeid=3914561&vernum=-2>.
[43] *Ibid* at 2–3.
[44] This situation is called segmentation. See *ibid* at 1 where the Regulator refers to the concept of segmentation. In addition, the explanations of the segmentation concept in the *NEB Decision RH-003-2011, supra* note 14 at 81–85, lead me to conclude that such a situation could involve cross-subsidization.
[45] *CER Decision, April 2020, supra* note 42 at 1-2. Sometimes parties assume that short-term could be equated with the term of a settlement. See *NEB Decision RH-2-2004, Phase II, supra* note 16 at 61.
[46] *CER Letter Decision, April 2020, supra* note 43 at 3. In an adversarial context, a carrier called TransCanada argued that regulation can serve to achieve those incentives when it considers two factors, namely the business risks which the carrier bears and the compensation that the carrier obtains in exchange. See *NEB Decision RH-003-2011, supra* note 14 at 159, 231, 241. This is one reason why parties prefer negotiation to achieve the balance between these factors.

These benefits can be explained in terms of the shippers' collective ability to minimize the carrier's power in the market for transportation services to dictate prices and conditions of service.[47]

However, sometimes parties become involved in litigation because the negotiation process alone is unsuitable to prevent several carriers' conduct that are contrary to the regulatory principles. Hence, the Regulator needs to intervene to prevent the following conduct. First, a carrier can attempt to transfer to shippers the risk of transmission assets no longer used.[48] That carrier's conduct is contrary to the principle of used and useful assets which serves to ensure that shippers merely pay for costs of assets used.[49] That conduct can also be contrary to the principle of efficiency which requires the carrier to invest only if transmission assets are needed to provide services and to promote the better use feasible under the prevailing market circumstances.[50] That conduct can affect shippers' long-term interests which go beyond the term of the settlement.[51] Second, parties' negotiation cannot prevent the carrier from trying to make some shippers pay the costs created by other shippers. Thus, this carrier's conduct can affect third parties' interests notably the interests of rival carriers. In fact, a carrier can make some shippers in one regional market pay the costs created by other shippers in another regional market to compete unfairly with rival carries.[52] This carrier's conduct involves cross-subsidization.[53] That conduct is contrary to the principle that shippers must pay the costs for the services obtained which is also called cost causation.[54] Third, the carrier can make one generation of shippers pay the costs created by another generation.[55]

---

[47] This ability of shippers emerges from the *NEB Negotiated Settlement Guidelines, supra* note 6 at para (i). According to the Guidelines, one of the conditions that the regulator demands, to approve a settlement, is that the carrier should facilitate the participation of all interested parties in the negotiation process.

[48] *NEB Decision RH-003-2011, supra* note 14 at 42–44. The Regulator indicated that despite the approval of a settlement, the carrier continues to be responsible for ensuring that its pipeline system is economically viable in the long-term - that is, beyond the term of the settlement.

[49] *NEB Decision RH-003-2011, supra* note 14 at 39–40.

[50] *Ibid*.

[51] *CER Decision RH-001-2019, supra* note 4 at 45–46.

[52] NEB, *Report on Nova Gas Transmission Ltd*, GH-001-2012 at 24–25, 29–31.

[53] *Ibid*.

[54] *Ibid* at 26.

[55] NEB*, Reasons for Decision, TransCanada Pipeline Ltd, RH-001-2018* (Application for the Approval of 2018 to 2020 Mainline Tolls 13 December 2018) [*NEB Decision RH-003-2011*], at 16–18.

These drawbacks and perils of parties' negotiation can be explained in terms of the asymmetry of information between the carrier and the Regulator.[56] In particular, the drawbacks and perils result from the lack of access by the Regulator and shippers to disaggregated information on several matters controlled by the carrier.[57] First, the carrier controls how to divide costs between shippers.[58] Second, the carrier controls information on the actual level of use as well as the expected useful life of assets.[59] Third, the carrier controls how to spread the recovery of capital over the useful life of assets through the depreciation cost.[60] Fourth, the carrier can decide how to divide the risks of assets no longer used between the carrier and shippers.[61]

The Regulator manages the drawbacks and perils of negotiated settlement mainly based on the adjudication process as a default process.[62] Hence, to meet the legal mandate the Regulator relies on the carrier's burden of proof and a public hearing to obtain and scrutinize the evidence necessary to solve the issues.[63]

1.5 Research methodology

To answer the research question and sub-questions, I will rely on the doctrinal legal analysis methodology. Thus, I will look at decisions adopted by the Regulator to fulfill the legal mandate under the former *NEBA* and under CERA. Complementary, I will look at decisions adopted by the Federal Court of Appeal regarding the scope of the legal mandate to determine the rate of return. Moreover, I will look at some Supreme Court's decisions on the discretionary power of regulators to determine whether the prices for utility services proposed by a utility company are just, reasonable, and non-discriminatory.

---

[56] Those decisions include, for instance, *NEB Examination Decision 2018, supra* note 14 at 5–8.
[57] *Ibid*.
[58] *Ibid*.
[59] *NEB Decision RH-003-2011, supra* note 14 at 45.
[60] *Ibid* at 44.
[61] *Ibid* at 44-45.
[62] This view results from two regulatory decisions. First, *NEB Decision RH-001-2019, supra* note 4 at 1–4, which approved a contested settlement. The interpretation of that decision reveals that it is not possible to apply the regulatory principles to solve discrete issues regarding natural gas pipeline transportation without regard to the evidence on the costs of the services involved. Second, *NEB Decision RH-2-2004, Phase II*, *supra* note 16 at 16. This decision indicates that the carrier can only recover the costs which the Regulator considers reasonable.
[63] *CER Decision RH-001-2019, supra* note 4 at 3, 24.

I will analyze several types of regulatory decisions. First, I will look at decisions by which the Regulator approves a negotiated settlement endorsed unanimously by shippers. Second, I will examine regulatory decisions made as result of an opposition to a settlement. Third, I will consider decisions in which the Regulator intervenes given that negotiation failed altogether. Fourth, I will study decisions by which the Regulator responds to a request for a recommendation on whether a certificate of public convenience and necessity must be granted to build new transmission assets.[64] Fifth, I will look at what is called the *Examination Decision 2018* concerning why negotiation must be based on some disaggregated information to make it possible to deal with issues of unfair pipeline competition.[65]

I will look at these types of decisions to ascertain whether they reveal benefits, drawbacks, and perils of parties' negotiation. To achieve that, I will look at the pipeline company arguments which support the course of action proposed regarding prices of pipeline services. I will also look at the arguments presented by shippers and other intervenors regarding the carrier's proposal.[66] In addition, I will look at the Regulator's reasoning.

I will also examine the following sources. First, I will look at the *Tolls Information Regulations 1979*.[67] I will examine when these rules apply when prices for pipeline services result from a negotiated settlement. Hence, I will look at the role of financial surveillance reports that some pipeline companies are obliged to submit. Second, I will consider the *Regulator's Filing Manual Guide P* to examine the information requirements applicable when the carrier applies for an approval of the proposed design, to determine prices and the revenue requirement under cost of service.[68] I seek to contrast these

[64] According CERA, ss 183 to 186, the Regulator is responsible for submitting this recommendation for the approval of the Executive Branch of Government. One aspect the Regulator must evaluate is the question of prices for pipeline services, which would be charged for the use of the new transmission assets. This is a factor in why these types of decisions are relevant for to this thesis.

[65] *NEB Examination Decision 2018, supra* note 14.

[66] Section 2 of the NEB Rules of Practices and Procedures 1995 SOR/95-208 identifies an intervenor is a person who has proven an interest, justifying their participation in a hearing before the Regulator. https://laws-lois.justice.gc.ca/PDF/SOR-95-208.pdf

[67] *Toll Information Regulations* (SOR/79-319). https://laws-lois.justice.gc.ca/PDF/SOR-79-319.pdf

[68] *Filing Manual - Guide P* – Tolls and Tariffs (ss. 225 -240 of CER Act) (Calgary: Canadian Energy Regulator), online (pdf) CER: <https://www.cer-rec.gc.ca/en/applications-hearings/submit-applications-documents/filing-

requirements with the information demanded by the 2002 Regulator's *Negotiated Settlement Guidelines* when the carrier's price proposal is based on a negotiated settlement.[69] Third, I will analyze the *Draft Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs* published in January 2002.[70] I will examine the reasons for replacing cost of service with negotiated settlement, the perils created by negotiation and the relevance of the Regulator's assessment of a settlement as a compromised solution to disputes between the negotiating parties. Fourth, I will consider *Canada's Pipeline Transportation System 2016 Report* to look at the context in which the natural gas pipeline industry operates.[71] Finally, I will consider the *CER's Regulation of Pipeline Traffic, Tolls and Tariffs* by which the Regulator describes briefly some aspects involved in regulatory practice.[72]

1.6 Structure of thesis

I will divide the thesis into two parts. The first part runs from the second to the fourth chapter. In this part I seek to provide the foundations to understand why the Regulator intervenes in the formation of prices of pipeline services. Thus, in the second chapter I will build the literature review. Based on authors' views, I will examine the

---

manuals/filing-manual/filing-manual.pdf>. This Guide establishes the information requirements that a pipeline company designated as part of Group One must submit when it applies for an approval of tolls to recover its revenue requirement. The CER has divided the regulated companies in two groups, based on the level of business. Group One comprises six oil pipelines and seven natural gas pipeline companies. The seven natural gas carriers are Alliance Pipeline Ltd, Foothills Pipeline Ltd, Gazoduct Tans Quebec &Maritimes Inc, Maritimes and Northeast Pipeline Management, Nova Gas Transmission Ltd, TransCanada Pipelines Ltd, and Westcoast Energy Inc. Group Two comprises approximately a hundred companies that are subject to regulation only when they cannot solve a dispute with their shippers and thereby give rise to a complaint. "CER Regulation of pipeline traffic, tolls and tariffs" (12 February 2021), [*CER Regulation of pipeline traffic, tolls and tariffs*] section Complaint-based regulation, online: *Canada Energy Regulator* <https://www.cer-rec.gc.ca/en/about/who-we-are-what-we-do/responsibility/regulation-pipeline-traffic-tolls-tariffs.html#:~:text=The%20CER%20regulates%20pipeline%20tolls,in%20tolls%2C%20service%20or%20facilities>.

[69] The Regulator's 2002 Negotiated Settlement Guidelines (*NEB Negotiated Settlement Guidelines, supra* note 5) establish the information requirements applicable when a pipeline company applies for an approval of a negotiated settlement.

[70] NEB, *Draft Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs,* 4600-A-0003-3 (30 January 2002) [NEB Draft Negotiated Settlement Guidelines, 2002], online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/157025/142122/Letter_%28A0C7Y1%29.pdf?nodeid=142123&vernum=-2>.

[71] *NEB Pipeline Report supra* note 3.

[72] *CER Regulation of Traffic, Tolls and Tariff, supra* note 9.

connection between some of the main concepts on which the Regulator relies to intervene in the formation of prices. In addition, I will analyze the authors' explanations of the nature of negotiation as a regulatory process to address the problems which give rise to regulatory intervention. In the third chapter I will describe and analyze the legal framework which encompass the methods, the processes and the regulatory principles used to intervene in the formation of prices. Hence, I will analyze the relationship between parties' negotiation and the traditional process of adjudication based on cost of service. In the fourth chapter I will describe and explain why the Regulator's intervention in practice seeks to achieve above all the financial viability of pipeline systems.

Based on the foregoing, in the second part of the thesis I will examine the evidence on the benefits, drawbacks and perils of the negotiation process and the resulting negotiated settlement. Hence, in the fifth chapter, I will describe and analyze these characteristics. After that, in the sixth chapter, I will describe and explain how the Regulator manages the drawbacks and peril. Finally, in the seventh chapter I present the conclusions on the use of negotiated settlement and recommend an additional measure to minimize further the main drawback of the negotiation process to better achieve the legal mandate.

FIRST PART
FOUNDATIONS FOR NEGOTIATION AS A REGULATORY PROCESS

CHAPTER 2
LITERATURE REVIEW AND THE EXPLANATIONS OF REGULATORY INTERVENTION

2.1 Purpose and scope

In the present chapter I seek two related purposes. First, I seek to analyze the economic and legal views relevant to answer the question of why the Regulator intervenes in the formation of prices for natural gas pipeline transportation services not only when there is a monopolistic pipeline carrier but also in the presence of pipeline competition. Second, I seek to identify the terms on which it is possible to explain the benefits, drawbacks, and perils of parties' negotiation as the alternative method to cost of service to intervene in the formation of prices.

These purposes are interrelated because to comprehend the benefits, drawbacks, and perils of parties' negotiation, it is necessary to comprehend first the reasons for and the complexity of regulatory intervention under cost of service.

The scope of the literature review is delimited by some specific concerns. The specific concerns are derived from the fact that the Regulator intervenes in the formation of prices on a case-by-case basis to solve specific disputes.[1] Each dispute, in turn, emerges from a proposal made within the business environment faced by a carrier.[2] The

[1] NEB, *Reasons for Decision*, *Maritimes & Northeast Pipeline Management Ltd*, RH-1-2000 (Tolls Application, August 2000) [*NEB Decision RH-1-2000*] at 39, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/155829/3773831/3890507/3901808/3930821/4098801/C13338-6_%28e%29_NEB_Reasons_for_Decision_RH-1-2000_Maritimes_and_Northeast_Tolls_%282000-08-01%29_-_Chapter_11_-_A7U0E4.pdf?nodeid=4098576&vernum=-2>.This decision indicates that the Regulator does not necessarily apply past decisions to solve a new case.

[2] *Ibid*; NEB, *Reasons for Decision, TransCanada Pipelines Ltd, RH-3-2004* (Application for approval to establish a new receipt and delivery point, the North Bay Junction, and for the corresponding tolls for services to and from that point, December 2004) [*NEB Decision RH-3-2004*] at 71, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586892/293604/346558/342912/A08726-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_North_Bay_Junction_%E2%80%93_RH-3-2004.pdf?nodeid=342913&vernum=-2>.

Regulator solves the disputes on prices for pipeline transportation services based on broad principles developed to meet the legal mandate.[3]

Given that way of regulating, it is not possible to have an overview of why the Regulator intervenes by looking merely at one decision. Yet, the Regulator not always relies on the same concepts in separate decisions.

For these reasons, the purpose of looking at the literature is to answer the following specific concerns. The first one is to understand the implications of some concepts which CERA and the Regulator use. The second concern is to determine the connection between these concepts to explain why the Regulator intervenes in the formation of prices under CERA. Once that connection is made clear, I will look at commentators' views on the factors which help or prevent the Regulator from achieving its policy aims through the negotiation process between the parties.

The relevant concepts

CERA seeks to achieve a purpose based on several concepts which that Act does not define.[4] From the substantive perspective, the legal mandate requires the Regulator to ensure efficiency in the construction and operation of pipelines.[5] Moreover, CERA requires the Regulator to achieve just, reasonable and non-discriminatory prices for pipeline services.[6] Meanwhile, from the perspective of the process to make decisions CERA seeks to ensure that regulatory decisions are adopted timely and create certainty and predictability for investors.[7] In addition, pursuant to CERA the Regulator must ensure that regulatory hearings and decision-making processes are fair, inclusive, transparent and efficient.[8]

---

[3] NEB, *Reasons for Decision, TransCanada Pipeline* Limited, RH-1-2007 (Gros Cacouna Receipt Point Application, July 2007) [*NEB Decision RH-1-2007*] at 21–23, online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/443945/472730/471076/A16008-1_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Gros_Cacouna_Receipt_Point_%E2%80%93_RH-1-2007.pdf?nodeid=470970&vernum=-2>.

[4] *Canadian Energy Regulator Act* (S.C. 2019, c. 28, s. 10) [*CERA*]. CERA*'s* purpose is established in s 6. However, the Regulator has a specific mandate on prices under ss 11, 230, 231, and 235.

[5] CERA, *supra* note 4 at s 6(a)

[6] *Ibid* at s 11, 230, 231, 235

[7] *CERA*, *supra* note 4 at Preamble.

[8] *CERA, supra* note 4 at s 6(d)

The Regulator, in turn, relies on several concepts.[9] CERA does not employ these concepts. In particular, the Regulator has relied on the concepts of monopolistic abuse, abuse of market power, transfer of risk of stranded assets and cross-subsidization.[10] The Regulator and parties also use the concept of free riding.[11] The Regulator uses these concepts to describe some carriers' conduct.[12] The understanding of these concepts is necessary because the Regulator suggests that the carrier's conduct reveal the economic problems explaining the regulatory intervention in the formation of prices.[13]

Parties and the Regulator also use the concept of incentives.[14] Therefore, it is necessary to understand the implications of this concept and the relationship between it and monopoly, market power, stranded assets, cross-subsidization, and free riding.

---

[9] In each decision the Regulator indicates the regulatory principles that will serve to solve the issues in dispute. See for instance, *NEB Decision RH-3-2004*, *supra* note 2 at 7–9. Similarly, CER, *Reasons for Decision, Nova Gas Transmission Ltd, RH-001-2019* (Application dated 14 March 2019 for NGTL Rate Design and Services, March 2020) [*CER Decision RH-001-2019*] at 2–3, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/554137/3752363/3752364/3760156/3913151/C05448-1_CER_%E2%80%93_Reasons_for_Decision_RH-001-2019_%E2%80%93_NOVA_Gas_%E2%80%93_NGTL_System_Rate_Design_%20and_Services_-_A7E4S8.pdf?nodeid=3912507&vernum=-2>.

[10] The concept of monopolistic exploitation was used in NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-2-2004, Phase II* (2004 Mainline Tolls and Tariffs Application, April 2005) [*NEB Decision RH-2-2004, Phase II*] at 16, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/365090/A09636-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Cost_of_Capital_%E2%80%93_RH-2-2004%2C_Phase_II.pdf?nodeid=365091&vernum=-2>. The concept of abuse of market power was used in *NEB Decision RH-3-2004, supra* note 2 at 8. The concept of stranded assets was used by shippers in NEB*, Reasons for Decision, TransCanada Pipeline Ltd, NOVA Gas Transmission Ltd, and Foothills Pipe Lines Ltd, RH-003-2011* (Business and Services Restructuring Proposal and Mainline Final Tolls for 2013 and 2013, March 2013) [*NEB Decision RH-003-2011*] at 57, 160, 167, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/665035/711778/941262/939799/A51040-1_NEB_-_Reasons_for_Decision_-_TransCanada%2C_NOVA_Gas_and_Foothills_-_2012_and_2013_Final_Tolls_-_RH-003-2011.pdf?nodeid=939800&vernum=-2>. It also appeared in *CER Decision RH-001-2019, supra* note 9 at 43-44.

[11] *NEB Decision RH-003-2011, supra* note 10 at 81, 83, 84, 85, 200.

[12] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 16 refers to monopolistic exploitation, while *NEB Decision RH-3-2004*, *supra* note 2 at 8 refers to abuse of market power. Moreover, *NEB Decision RH-003-2011, supra* note 10 at 65 refers to the concept of stranded assets; at 43–45, it refers to the transfer of risks of under-utilized assets. Regarding such assets, *CER Decision RH-001-2019*, *supra* note 9 at 43 equates stranded costs with transmission assets no longer used; finally, this same decision refers to cross-subsidization at 15, 24, 32.

[13] For example, the Regulator affirms that the legal mandate requires to prevent a monopolistic carrier from taking unjustified advantage of shippers; see *NEB Decision RH-2-2004, Phase II, supra* note 10 at 16.

[14] For some examples, see *NEB Decision RH-003-2011, supra* note 10 at 124, 128, in which parties used the concept of incentive, while the regulator used the concept at 1–2. Indeed, parties and the regulator use this concept numerous times throughout this decision, with respect to multiple issues, which included parties discussing the TransCanada's proposal to restructure the rules that had governed the pipeline system for a long time (see 1–3,

Furthermore, in some cases the carrier and shippers use the concept of sunk costs to describe the long-term nature of the investment made in transmission assets and to demand regulatory intervention.[15] Yet, they do not explain that concept.[16]

Shippers and the Regulator also use the concept of economies of scale.[17] The Regulator and shippers alike use that concept to explain the relationship between the level of shippers using a pipeline system and the method to divide the costs between all shippers through prices.[18] The Regulator recognizes that the method to allocate the costs derived from a pipeline system must be unified between shippers, whether they deliver natural gas to the system in producing regions or receive that product in consuming regions.[19] The Regulator appears to suggest that the adoption of a unified price method applicable to all shippers using the same pipeline system is explained by the fact that the greater the total number of shippers relying on the system, the lower the prices for all because the total costs are divided between a greater number of shippers.[20] However, it is unclear the connection between economies of scale and the other concepts of concern indicated earlier.

14–15). This system is known as TransCanada's Mainline, which connects western Canada with central and eastern Canada (see 5–6). In addition, in a case related to a western pipeline system called Nova, the incentive concept is used by shippers and the carrier to ask for regulatory intervention that will incentivize a carrier to create new services and price designs, to compete with other carrier; see *CER Decision RH-001-2019*, *supra* note 9 at 32, 45. Therefore, the use of the incentive concept is central to understanding why the regulator intervenes in the formation of prices.

[15] *NEB Decision RH-003-2011, supra* note 10 at 148; *NEB Decision RH-3-2004, supra* note 2 at 24, 33.

[16] *Ibid*. *NEB Decision RH-003-2011, supra* note 10 at 148.

[17] *NEB Decision RH-003-2011, supra* note 10 at 101, 103.

[18] *Ibid*.

[19] *Ibid*. The reliance of all shippers on the transmission assets that form a system is what the Regulator calls the "integration" of a natural gas pipeline system. This reliability explains why the Regulator adopts a unified price method for all shippers. Yet, in some events, the economic context faced by the carrier differs across separate geographic segments of the same system. Accordingly, when this happens, the division of costs between shippers differs by segment even if the system physically operates as an integrated one; see *ibid* at 51–52, 65, as well as CER, *Letter Decision on the TransCanada Pipelines Limited* (Application for the Approval of the Mainline 2021–2026 Settlement, 17 April 2020) [*CER Letter Decision April 2020*] at 7, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3773158/3891141/3914560/C05780-1_CER_%E2%80%93_Letter_Decision_%E2%80%93_TransCanada_%E2%80%93_Mainline_2021-2026_Settlement_-_A7E9E9.pdf?nodeid=3914561&vernum=-2>. Therefore, the physical operation of a pipeline under the control of the same carrier does not necessarily align with how the costs in that system are divided. This disconnect may be due, for example, to the carrier building some facilities at the request of a shipper or group of shippers; see *NEB Decision RH-1-2007, supra* note 3 at 22-23.

[20] *NEB Decision RH-003-2011, supra* note 10 at 101, 103.

The Regulator starts from the premise that the regulatory principles are the means to meet the mandate.[21] Thus, the Regulator decides conflicts between the carrier and shippers based on the regulatory principles.[22] On that point, sometimes the Regulator connects the principle of used and useful assets with efficiency to determine what cost the carrier can recover.[23] At other times the Regulator indicates that the principle according to which all shippers must pay for the costs caused and the efficiency principle are complementary to determine whether the prices proposed by the carrier meet the legal mandate.[24] In addition, the Regulator considers that efficiency on its own is one of the regulatory principles.[25] Thus, generally the Regulator views efficiency at the core of its mandate.[26] Even so, the Regulator also applies the principles of fairness and equity.[27] Likewise, the Regulator applies what is called the "fair return standard" to determine the main cost of pipeline companies which is the rate of return.[28] Therefore, it is necessary to understand whether there is any connection between these concepts.

Finally, there is another concept which the Regulator uses to intervene in the formation of prices under CERA. That concept is the existence of business risks affecting the provision of pipeline services.[29] In principle it is unclear the connection between this concept and the concepts of efficiency and just and reasonable prices.[30] In practice, the

[21] *NEB Decision RH-3-2004, supra* note 2 at 7–9.
[22] *Ibid* at 7–9.
[23] *NEB Decision RH-003-2011, supra* note 10 at 40.
[24] *CER Decision RH-001-2019*, *supra* note 9 at 36–37.
[25] *Ibid* at 2–3. According to the Regulator, the principle of efficiency links the decisions of a carrier and its shippers. This principle means that prices must ensure the carrier only invests in transmission assets that shippers need, while shippers make the better use feasible.
[26] *Ibid.*
[27] NEB, *Reasons for Decision, TransCanada Pipeline Ltd, RH-001-2016* (Storage Transportation Service Modernization and Standardization Application—Part IV, Tolls and Tariffs, November 2016) [*NEB Decision RH-001-2016*] at 32–33, Online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/2927182/2926727/3311222/3083894/A80788-1_NEB_-_Reasons_for_Decision_-_TransCanada_-_Storage_Transportation_Service_-_RH-001-2016.pdf?nodeid=3084214&vernum=-2>.
[28] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 13, 17.
[29] *Ibid* at 43, 46; *NEB Decision RH-003-2011, supra* note 10 at 43–45.
[30] *NEB Decision RH-003-2011, supra* note 10 at 39–40.

Regulator sometimes affirms that the carrier must bear some business risks.[31] At other times, the Regulator indicates that shippers must bear some type of business risks.[32]

In what follows I will examine each of these concepts and their connection and how the authors' views can explain the Regulator's intervention in the formation of prices.

2.2 Market failures

Cooter and Ulen argue that the regulation of prices emerges from the fact that sometimes markets do not function as they should.[33] Thus, most of the literature reviewed shows that regulation is necessary to deal with what authors call a "market failure".[34] They use that concept to refer to a situation in which the supply of goods or services does not lead the customers who purchase them to obtain conditions for parties and the rest of society as it could be achieved if a market operated properly, particularly due to the existence of a natural monopoly and market power.[35]

Based on the above, in principle it can be interpreted that under CERA the regulatory intervention in the formation of prices is explained due to the presence of two related market failures: natural monopoly and market power.

However, there are other market failures explaining the regulatory intervention in the formation of prices. Although natural monopoly and market power are the traditional concerns in the literature, in recent practice the Regulator's concern under CERA tends to focus on other market failures. Yet, to understand the benefits, drawbacks, and perils of parties' negotiation it is critical to understand in the first place the concepts of natural monopoly and market power.

---

[31] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 46; *NEB Decision RH-003-2011, supra* note 10 at 43–45.
[32] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 46.
[33] Robert Cooter & Thomas Ulen, *Law and Economics*, 5th ed (Boston: Pearson 2008) at 5, 43-46.
[34] *Ibid*; Anthony I Ogus, *Regulation: Legal Form and Economic Theory* (Oxford: Hart, 1994) at 29–30 and 35–38; Ernest Gellhorn, William E Kovacic & Stephen Kalkins, *Antitrust Law and Economics in a Nutshell*, 5th ed (St Paul MN: Thomson West, 2004) at 67–69. Furthermore, the fact that the carrier and its users create potential harm to others and the environment through transport activity, without bearing those consequences, is also regarded as a market failure; see Jose A Gomez Ibanez, *Regulating Infrastructure. Monopoly, Contracts and Discretion* (Cambridge, MA: Harvard University Press, 2003) at 6. These consequences—which they described as "negative externalities"—are not used by authors to explain economic regulation, but instead other type of intervention called environmental regulation; see Ogus, *supra* note 34 at 35–38.
[35] Cooter & Ulen, *supra* note 33 at 35,43.

2.2.1 Natural monopoly

Ogus contends that a natural monopoly is a situation in which one producer meets all customers' needs for a given good or service in a region given the economic nature of the costs of the activity developed.[36] This is why the monopoly is qualified as natural.[37] As a result of that situation, in the absence of regulation the producer acquires total control over supply and enjoys a power asymmetry over consumers in the negotiation of price.[38] In that regard, Kahn explains that an increase in production in capital-intensive activities can lead to a decrease in costs.[39] This cost characteristic is called economies of scale.[40] According to Ogus, if an electricity transmission company expands production, then its costs become lower over the long run.[41] Therefore, Ogus contends that a natural monopoly emerges from the existence of economies of scale rather than from anticompetitive practices.[42]

Ogus emphasizes that the existence of a natural monopoly depends on the producer's effort to materialize the economies of scale.[43] Yet, he recognizes that if a regulatory decision allows a company to be the single supplier of a service in a market, then that decision can facilitate the materialization of these economies when regulation limits the number of producers.[44]

In the presence of a natural monopoly, a regulator is employed to prevent the monopolist from taking advantage of buyers of the product or service.[45] Kahn argues that to combat a monopoly, a regulator will dictate the terms of exchange.[46] To achieve that,

[36] Ogus, *supra* note 34 at 30–32.
[37] *Ibid* at 30.
[38] *Ibid*.
[39] Alfred E Kahn, *The Economics of Regulation: Principles and Institutions*, 1st ed (Cambridge, MA: MIT Press, 1995) Vol 1 at 11-12.
[40] Ogus, *supra* note 34 at 30–31.
[41] *Ibid*.
[42] *Ibid*.
[43] *Ibid* at 31.
[44] *Ibid* at 318–320.
[45] Kahn, *supra* note 39, Vol I at 21. Kahn calls this conduct monopolistic exploitation.
[46] *Ibid* Vol I at 3,5.

in some jurisdictions, the law grants power to a regulator to determine prices, subject to the mandate, to ensure they are just and reasonable.[47]

Nonetheless, there are other views about the explanation of a natural monopoly.[48] For instance, Joskow contents that a natural monopoly emerges from the fact that some economic activities have two sets of characteristics.[49] First, Joskow as well as Kahn argue that the greater the quantity of the good or service produced by the same supplier, the lower the level of cost.[50] Therefore, Joskow recognizes that economies of scale are part of the explanation of a natural monopoly.[51] Second, for Joskow there is a complementary set of characteristics which equally determine the existence of a natural monopoly.[52] That is, in order to provide the service in question, the supplier invests capital in assets which are built for that specific activity under the expectation that the assets will be useful and profitable for a long term.[53] Consequently, if assets still productive need to be reassigned to a different activity, part of its worth is lost.[54] Joskow calls this kind of cost, a sunk cost.[55] In addition, the likelihood of new competitors entering the market is minimal because once the investment is made, other competitors are dissuaded to undertake the same business activity in the same region.[56]

---

[47] *Ibid* Vol I at 21, 40.

[48] Paul L Joskow, "*Regulation of Natural Monopoly*" in A Mitchell Polinsky & Steven Shavell, eds, *Handbook of Law and Economics*, Vol 2, 2007 (Amsterdam: North Holland, 2007) 1227 at 1233, 1241, 1245, 1252. The relevance of such views emerges from the fact that Joskow seeks to explain regulation in gas pipelines, in other economic activities (mostly utility services), and even in other contexts, such as railroads (*ibid* at 1241). Although Joskow examines theoretical aspects of economic regulation based on the views of multiple sources, he also looks at regulatory methods, processes, and policy aspects.

[49] *Ibid*.

[50] *Ibid*. See also Kahn, *supra* note 39, Vol I at 11, 123–124.

[51] Joskow, *supra* note 48 1227 at 1233, 1241, 1245, 1252.

[52] Joskow, *supra* note 48 1227 at 1240–1241.

[53] *Ibid* 1227 at 1240–1241, 1245.

[54] *Ibid*. The concept of sunk costs has additional implications according to the Competition Bureau Canada, "Abuse of Dominance: Enforcement Guidelines" (7 March 2019) at para 39, online (pdf): Competition Bureau <https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/CB-ADEG-Eng.pdf/$file/CB-ADEG-Eng.pdf> [Competition Bureau, "ADEG"]. The Competition Bureau is the federal competition authority in Canada. Sunk costs may be unrecoverable if the supplier stops providing the service in question. This is relevant because these views emerge not from theory but from the fact that the Competition Bureau relies on the concepts of concern discussed here to examine business conduct across markets to enforce the Canadian *Competition Act* rules (*Competition Act* [R.S.C., 1985, c. C-34] at i, 1–3).

[55] Joskow, *supra* note 48 1227 at 1244-1245.

[56] Competition Bureau, "ADEG," *supra* note 54 at 14.

Joskow's explanation of a natural monopoly connects the question of costs with the concept of incentives.[57] He indicates that the existence of sunk costs incents the supplier to charge prices above the level at which costs can be recovered and to prevent the emergence of rivals.[58] Therefore, regulatory intervention in the formation of prices is necessary to prevent these conduct and to ensure that the supplier recovers the costs necessary to provide the services but nothing else.[59]

The recovery of costs is the primary aim of regulation.[60] According to Joskow, if that aim is not achieved, then private investors are not willing to invest capital to supply the good or service in question.[61] When that aim is achieved the monopolist attains what Joskow categorizes as a viable company.[62] He argues that regulation seeks above all to encourage investors to use capital to supply the service.[63] If a company can neither recover the profits permitted over the capital nor the capital itself, then the services expected will not be available.[64] In that regard, Kahn indicates that the main component of the costs is the rate of return over the capital.[65] Therefore, that rate of return constitutes the main incentive for the investors.[66] That view suggests that regulatory intervention in the formation of prices above all seeks to incent the monopolistic supplier to build the assets to provide the services which customers need by allowing the recovery of the costs including the rate of return.[67]

Before explaining why these views on natural monopoly are relevant to understand the regulatory intervention in the formation of prices under CERA, it is necessary to explain two related concepts. They are market power and just and reasonable prices. That is because the Regulator views monopoly and market power as descriptions of a

[57] Joskow, *supra* note 48 1227 at 1245.
[58] *Ibid*.
[59] *Ibid* 1227 at 1245, 1262, 1289–1290.
[60] *Ibid* 1227 at 1254–1255.
[61] *Ibid*.
[62] *Ibid*. Joskow categorizes the achievement of this aim as the "breakeven point".
[63] *Ibid*.
[64] *Ibid*.
[65] Kahn, *supra* note 39, Vol I at 32, 35–36.
[66] *Ibid* Vol I, at 44–45,53.
[67] Joskow, *supra* note 48 1227 at 1254–1255.

varying degree of a carrier's power to dictate the prices in a market.[68] It is also necessary to explain why it is necessary to intervene even in the presence of pipeline competition.

2.2.2 Market power

Hunt and Shuttleworth explain that when a supplier of a good or service even in the presence of competition has the power to dictate the price and to prevent new suppliers from entering that market, that supplier has market power.[69] I call this supplier the stronger supplier for the present purposes. Tirole indicates that the possession of that power puts the stronger supplier in a position to charge a price which does not reflect the costs required to supply the good or service.[70] The stronger supplier can also provide a good or service whose quality is not commensurate with the price.[71]

Even if there are multiple rivals in a market, the remaining rivals acting independently are unable to moderate the behaviour of the stronger supplier to charge that level of prices or engaging in the conduct described above.[72]

There are some critical factors which explain the existence of a stronger supplier.[73] One factor is the number of customers which the stronger supplier regularly serves compared to the total customers in that market which is called the market share.[74] Yet, there are two decisive factors to explain the existence of the power of the stronger supplier.[75] These factors are derived from the existence of some facts, called barriers, preventing rivals from participating in that activity or from increasing the volume of their

[68] The Regulator does not use the concept of natural monopoly but the concept of monopoly. *NEB Decision RH-3-2004, supra* note 2 at 6, 21. Some authors do differentiate between natural monopoly and monopoly; see Cooter & Ulen, *supra* note 33 at 43. Even more, some authors still rely on the concept of natural monopoly to describe gas pipeline transportation. For example, Joskow, *supra* note 48 1227 at 1241.
[69] Sally Hunt & Graham Shuttleworth, *Competition and Choice in Electricity* (Chichester, England: John Willey Sons, 1999) at 27; equally, see Ibanez, *supra* note 34 at 6–8.
[70] Jean Tirole, *Economics for the Common Good* (Princeton: Princeton University Press, 2017) at 159.
[71] *Ibid*.
[72] Competition Bureau, "ADEG," *supra* note 54 at 10–11. The question of rivals acting individually is relevant because if these parties agree to act collectively in a market, then they would be creating collective market power. Therefore, their conduct could be questioned under competition law (*ibid* at 16–17).
[73] *Ibid* at 11–14.
[74] *Ibid* at 11–12.
[75] *Ibid*.

business.[76] One of these barriers is the existence of sunk costs.[77] Another barrier is the existence of economies of scale.[78]

For that reason, Joskow affirms that the existence of economies of scale and sunk costs, which in his view are the two main factors explaining a natural monopoly, also explain the existence of market power.[79] Hence, these two factors connect the concept of natural monopoly and the possession of market power with the need of regulatory intervention in the formation of prices.[80]

Regulatory intervention in the presence of actual competition

Joskow affirms that sometimes there are several suppliers in a region competing to provide a service usually regarded as a natural monopoly.[81] Klein, in turns, illustrates that point with the case of competition in natural gas pipeline services.[82]

Klein also contends that if law relies merely on competition to confront a natural monopoly problem, then the pipeline rivals can build more pipeline assets than necessary to meet customers transportation demand.[83] This is why discussions have occurred about the need for regulatory intervention in the formation of prices when there is competition

[76] *Ibid at* 10, 13–14.
[77] *Ibid at* 14. This concept was explained earlier in this chapter, under the heading of "Relevant Concepts."
[78] *Ibid* at 11, 14. This concept was explained earlier in this chapter, under the heading of "Relevant Concepts." Pursuant to the Canadian Competition Act, *supra* note 54, such a situation is called dominant position, which can prevent or reduce competition in a market. Yet, the Competition Bureau makes it clear that the existence of dominance, or even a monopoly, is legal. What is illegal is the utility company's conduct when it involves abuse of the position pursuant to the *Competition Act* (*Competition Act, supra* note 54 at 1)
[79] Joskow, *supra* note 48 1227 at 1241, 1248–1249, 1252.
[80] *Ibid*; Competition Bureau, "ADEG," *supra* note 54 at 1, 14. The Competition Bureau refers to monopoly rather than natural monopoly. Yet, this clarification is relevant because, as I will show later in this chapter, some commentators question the usefulness of the concept of natural monopoly to explain the existence of a single supplier in a market and thereby prefer to use merely the concept of monopoly or even the concept of market power.
[81] Joskow, *supra* note 48 1227 at 1248–1249. For that reason, the existence of natural monopolies has been questioned. In that regard, some authors argue that the notion of natural monopoly was used to describe so many unconnected market practices that ultimately the concept did not explain any of them. Horace M. Gray, "*The Passing of the Public Utility Concept"*, in American Economic Association, *Readings in the Social Control of Industry*, (Philadelphia: The Blakiston Company, 1942), at 283-284, cited by Kahn, *supra* note 39, Vol II at 2-3.
[82] Michael Klein, "*Network Industries*" in Dieter Helm & Tim Jenkinson, eds, *Competition in Regulated Industries* (Oxford: Oxford University Press, 1998), 40 at 43.
[83] *Ibid* at 69–70.

in an activity characterized by sunk costs and economies of scale.[84] Some of these discussions emerge from the excess of assets in that activity resulting from competition.[85] Thus, for Klein competition in these activities serves to moderate a monopolistic conduct and hence makes regulation unnecessary.[86] Yet, the presence of rivals can result in excessive assets which make necessary regulatory intervention.[87] In practice, these discussions are solved after examining the advantages and disadvantages of regulatory intervention to address what the free and independent interaction of market participants is unable to achieve.[88]

In the presence of a natural monopoly or market power Joskow and other economists argue that the role of regulation is to achieve efficiency aims.[89] However, there are diverse views on the scope of the efficiency aims. Ogus for instance contends that regulation seeks to prevent the supplier from making buyers pay more than what they would pay in the presence of multiple suppliers operating under conditions of rivalry.[90] This is called allocative inefficiency.[91] Kahn affirms that regulation also seeks to prevent

---

[84] Joskow, *supra* note 48 1227 at 1240. About this, some authors argue that competition law and intervention under other Acts are alternative instruments to control market power; see Tirole, *supra* note 70 at 159. The Competition Bureau has a different view. It considers that a monopoly situation represents the highest degree of market power within a sequence of situations involving actual or potential competition, all of which can be confronted under competition law when there is an abuse of that power. Yet, the Competition Bureau does not refer to a "natural monopoly" but to a "monopoly"; Competition Bureau, "ADEG," *supra* note 54 at para I, iii, 1–6, 23. The role of the Competition Bureau is to enforce rules that only prohibit some kinds of conduct and to authorize the imposition of fines. Hence, the Bureau applies the *Competition Act* after a prohibited conduct has been realized; Competition Bureau, "ADEG," *supra* note 54 at para viii. The Competition Bureau suggests that the *Competition Act* is not the instrument to prevent the abuse of market power. That seems to be one reason why Parliament established regulatory intervention in the formation of prices under CERA*,* rather than leaving pipeline companies under the purview of the Competition Bureau. Yet, the Competition Bureau' views are relevant in this thesis because they explain the conduct of economic agents based on the concepts subject matter of this chapter.

[85] Joskow, *supra* note 48 1227 at 1253.

[86] Klein, *supra* note 82 40 at 43, 48, 55.

[87] *Ibid.*

[88] *Ibid*; Joskow, *supra* note 48 1227 at 1249.

[89] Joskow, *supra* note 48 1227 at 1248–1255. Some authors justify regulation not only in the presence of a natural monopoly, notably in electricity transmission, but also in the presence of market power in other activities. Yet, they consider that in any event regulation should seek efficiency aims; see Hunt & Shuttleworth, *supra* note 69 at 1, 27–28, 230.

[90] Ogus, *supra* note 34 at 30.

[91] When prices exceed the level resulting from competitive conditions, some authors consider that the difference represents what they call deadweight loss. That means a price that exceeds what the customers would pay in exchange for that sum when market rivalry can moderate the conduct of competitors. Louis Kaplow & Carl Shapiro, "*Antitrust*" in A. Mitchell Polinsky & Steven Shavell, eds, *Handbook of Law and Economics,* Vol 2, 2007 (Amsterdam: North Holland, 2007) 1073 at 1099.

the waste of capital and other resources associated, for example, with the duplication or excessive assets.[92] That waste is what Joskow calls productive inefficiency.[93] In addition, Kahn considers that in the absence of competition, innovation is affected because the supplier neither creates new services nor improves the existing ones.[94] Hence, regulatory intervention prevents what is called dynamic inefficiency.[95]

These views connect some of the concepts of concern in this chapter. In fact, these views connect the presence of two market failures, particularly a natural monopoly and market power, to the need of preventing inefficient conduct by regulatory intervention in the formation of prices.[96]

Regulatory intervention seeks efficiency but also other aims.[97] Joskow defends the view that regulation as a response to problems of natural monopoly seeks to achieve efficiency.[98] Despite that, he recognizes that the legislative history, for instance in the United States of America, shows that intervention in practice has been governed in many cases by a legal mandate that requires a regulator to ensure just, reasonable, and non-discriminatory prices.[99] Based on this, Joskow argues that regulatory intervention in practice does not merely seek efficiency.[100]

Regulatory intervention under CERA, natural monopoly and market power

The connection between these concepts help to explain some of the cases in which the Regulator intervenes in the formation of prices under CERA. In that respect it

[92] Kahn, *supra* note 39, Vol I at 66–67, Vol II at I; Joskow, *supra* note 48 at 1236, 1252–1253. He argues that if an activity can be developed under conditions of a natural monopoly, then the presence of several suppliers building parallel assets in a region is a waste of resources, which does not take advantage of the fact that the greater the quantity of the good or service provided by a single supplier, the lower its costs. Despite that, he recognizes that an unregulated natural monopoly supplier can also incur excessive costs to supply the service in question.
[93] Joskow, *supra* note 48 1227 at 1252–1253.
[94] Kahn, *supra* note 39, Vol II at i–ii.
[95] *Ibid.*
[96] Joskow, *supra* note 48 1227 at 1240–1241, 1245, 1248, 1252.
[97] *Ibid* at 1249, 1255.
[98] *Ibid.*
[99] *Ibid* at 1258–1259. About this, Joskow cites James C Bonbright, *"*Principles of Public Utilities Rates*"* Columbia University Press, New York (1961) at 22, at 1256-1257, Joskow further contends that under this type of mandate, regulators have sought to facilitate for final users—who are unable to pay the full costs—access to some utility services by making the remaining users pay part of the costs created by low-income users. Therefore, he affirms that under this type of mandate regulators in the United States of America have facilitated cross-subsidization.
[100] *Ibid*.

must be indicated that neither CERA nor the Regulator's decisions refer to market failures. Despite that, in *Decision RH-3-2004* the Regulator indicated that its mandate involves preventing the abuse of market power to achieve efficiency.[101] According to the Regulator, when there is market power, intervention is necessary for two reasons.[102] First, the Regulator seeks to prevent the carrier's from creating barriers affecting the operation of the market or giving favorable treatment to companies in which the shareholders of the carrier have business interests.[103] Second, the Regulator seeks to incent carriers to compete fairly with other carriers and to innovate in services to meet changing shippers' business needs.[104]

Given the excess of transmission assets in northern Ontario, TransCanada (a carrier connecting the natural gas producing area in western Canada with consuming areas in eastern Canada) sought to create a new receipt and delivery point of natural gas over the line in that area, to promote the use of those assets.[105] That proposal was questioned by shippers as an abuse of market power and thereby requested regulatory intervention.[106] In particular, shippers contended that TransCanada relied on the sunk costs derived from investments made in existing assets to dissuade rivals from building new assets.[107] Yet, some parties recognized that the construction of assets in other close regions had been necessary to meet growing shippers' transportation demand.[108] Hence, the Regulator concluded that the proposal was legal because the creation of a receipt and delivery point to facilitate negotiation of transportation contracts represented an innovation in services and hence was efficient.[109] Although the Regulator did not find an abuse of market power in that case, the Regulator indicated that the prevention of that kind of abuse is one of the regulatory principles applicable to meet its mandate.[110]

---

[101] *NEB Decision RH-3-2004, supra* note 2 at 8.
[102] *Ibid*.
[103] *Ibid*.
[104] *Ibid*.
[105] *Ibid*.
[106] *Ibid* at 6, 19, 33.
[107] *Ibid*.
[108] *Ibid*.
[109] *Ibid* at 37, 42-43.
[110] *Ibid* at 7–8, 37.

Just and reasonable prices and the regulatory process

Kahn contends that regulatory intervention in the formation of prices seeks to prevent a monopolistic company from taking an unjustified advantage from consumers by charging prices which do not reflect the quality of services commensurate with that price.[111] He calls that conduct monopolistic abuse of consumers.[112]

Kahn explains the scope of the concept of just and reasonable prices based on the *Federal Power Commission v. Hope Natural Gas Co,* 320 US. 591 (1944), a decision of the Supreme Court of United States of America.[113] According to Kahn, a price for utility services is just and reasonable when the price puts the utility company in a position to raise the capital required to supply the services as demanded by customers.[114] A regulator fulfills that function when the price set meets three conditions.[115] One condition is related to whether the utility company in question can pay all its debts.[116] The remaining conditions reflect investors' interests.[117] Thus, regulation makes sure that investors are actually incented to provide the capital which the company needs.[118] In addition, a regulator looks at whether prices allow investors to be covered against the risks taken by investing in that company.[119] For these reasons Kahn affirms that the assessment of a price in light of these conditions is based on the practices which happen in markets for capital.[120] Specifically, that regulatory assessment is based on factors that investors take into account to decide whether to invest in a given company.[121]

For Kahn, regulation is viewed by economists as an instrument to achieve economic aims, specifically efficiency, but in practice regulation involves more than that

[111] Khan, supra note 39 at 21 Vol I.
[112] *Ibid* at 21, 31 Vol I.
[113] *Ibid* at 40–44 Vol I.
[114] *Ibid.*
[115] *Ibid*.
[116] *Ibid*.
[117] *Ibid*.
[118] *Ibid*.
[119] *Ibid*.
[120] *Ibid*.
[121] *Ibid*.

aim.[122] He indicates that one of the cost components in that evaluation is the rate of return.[123] He considers that in practice the regulatory evaluation of that component goes beyond economic aims.[124] Thus, a regulator weighs the interests of all the parties involved.[125] In Kahn's opinion the regulatory decision is a political one because the regulator has the last word on how to articulate conflicting interests.[126] In addition, the regulatory decision also reflects what market participants consider fair.[127] Therefore, the role of a regulator in determining the level of that cost is not confined to look at investors and lenders' market practices.[128]

It is from that broad view that Kahn considers that the traditional regulatory adjudication process can be seen from two perspectives.[129] From the economic perspective, the process allows the regulator to look at the level of profits required to raise new capital.[130] Hence, the role of the regulator is to articulate the interests of the parties based merely on economic factors.[131] The problem with this perspective, he argues, is that there are multiple acceptable ways of determining that cost.[132] That is why the alternative perspective on the regulatory process is closer to what happens in practice.[133] Thus, the regulated company and its customers negotiate the level of profits which they consider acceptable to encourage the regulated company to supply the services customers want.[134] Accordingly, under this perspective the regulator does not dictate the

[122] Kahn, *supra* note 39, Vol I, at 42–50. Kahn considers that regulation of utility services is a task involving lessons from regulatory experience and the regulator's assessment of facts. Yet, in his view, that assessment must also be based on the lessons of economic theory. Even more, he considers that regulation in practice needs to articulate economic aims with non-economic aims, as in due process (*ibid* Vol II, at i-ii).
[123] *Ibid* Vol 1 at 42.
[124] *Ibid*.
[125] *Ibid*.
[126] *Ibid*.
[127] *Ibid*.
[128] *Ibid* Vol 1 at 44–54.
[129] *Ibid* Vol 1 at 41–44.
[130] *Ibid* Vol 1 at 41–42.
[131] *Ibid*.
[132] *Ibid*.
[133] *Ibid* Vol 1 at 43–44.
[134] *Ibid*.

rate of return permitted but instead helps parties to reach an agreement on this rate, based on negotiation between the parties.[135]

The regulatory intervention under CERA to achieve just and reasonable prices

These views are relevant to explain the regulatory intervention in the formation of prices under CERA. According to the decision in *Northwestern Utilities Limited v City of Edmonton,* [1929] S.C.R 186 the concept of just and reasonable prices has been a guide to set utilities prices under Canadian law since 1929.[136] In the Supreme Court's views that kind of legal mandate means that the regulator's mandate is to articulate the interests of the utility company and its customers based on the approval of a fair rate of return.[137] The Court describes that mandate as the achievement of a balance.[138] The Court reaffirmed that view in *Ontario (Energy Board) v. Ontario Power Generation Inc*, 2015 SCC 44, which was adopted in a context in which the relevant statutory rules required the regulator to achieve efficiency and just and reasonable prices.[139] That is also the case of the mandate under CERA as indicated earlier.[140] Therefore, intervention in the formation of prices under CERA can be explained as the Regulator's mandate to achieve a balance of parties' interests based on efficiency and other principles.[141]

In addition, Kahn's view of the regulatory process as a negotiation process is relevant to explain the negotiated settlement process under CERA. In that respect, parties' negotiation serves to achieve a balance of interests with minimal regulatory intervention.[142] Although the Regulator intervenes in the formation of prices agreed, the Regulator only does that when the balance is contrary to the regulatory principles.[143]

---

[135] *Ibid*.
[136] *Northwestern Utilities Limited v City of Edmonton,* [1929] S.C.R 186 [*NW Utilities*], reaffirmed in *Ontario (Energy Board) v. Ontario Power Generation Inc*, 2015 SCC 44, [2015] 3 S.C.R, 147 [*Ontario Energy*] at para 15.
[137] *Ontario Energy* at paras 15–16, 76.
[138] *Ibid*.
[139] *Ibid* at paras 12, 20, 91, 76, 120.
[140] *CERA, supra* note 4 at ss 6, 230, 231, and 235
[141] *CER Decision RH-001-2019*, *supra* note 9 at 11. The Regulator explains that the principles developed under the *National Energy Board Act,* RSC 1985, c N-7 [*NEBA*] to meet the mandate involved the principle of efficiency and other principles. *Ibid* p. 2–3.
[142] *CER Decision RH-001-2019*, *supra* note 9 at 11.
[143] *Ibid*.

Hence, the Regulator reviews that balance to solve the issues in dispute.[144] Yet, the Regulator does that by trying to preserve the private balance reached as far as possible.[145]

Regulators seek to emulate what would happen in the presence of pipeline competition

These views on just and reasonable prices requires looking at the scope of the regulatory intervention in the formation of prices. In that regard, Kahn contends that the regulator's role is to determine prices comparable to the level which would prevail if competition existed.[146] He indicates that prices derived from competition are efficient.[147] Similarly, Ogus argues that if a regulator does not prevent the monopoly company from charging a price above the competitive level, then customers would pay an unjustified sum which he calls an economic deadweight loss.[148]

Joskow shares the view that a price reflecting conditions prevailing in competitive markets leads to efficiency.[149] Despite that, Joskow makes the point that a company operating a natural monopoly cannot survive by charging that level of price because it would not allow the company to recover all its costs.[150] In that regard, Ogus explains that unlike competitive economic activities, in capital-intensive activities which operate as natural monopolies, for instance the transmission of electricity, the existence of economies of scale implies that the cost of increasing production to meet additional needs of customers becomes lower in the long run.[151] Ogus further explains that capital is a fixed cost which implies that the regulated company incurs it since the construction of the assets required to provide services and must pay the cost associated with the capital regardless of the changing level of demand of its goods and services.[152] Therefore,

[144] *Ibid*.
[145] *Ibid*.
[146] Kahn, *supra* note 39, Vol I at 17.
[147] *Ibid* at 31.
[148] Ogus, *supra* note 34 at 23.
[149] Joskow, *supra* note 48 1227 at 1254–1255, 1274.
[150] *Ibid*.
[151] Ogus, *supra* note 34 at 30–31.
[152] *Ibid*.

Vickers contends that if a regulator determined the price by reference to a declining cost, the price would not cover all the fixed costs of the regulated company.[153]

Joskow provides an alternative explanation of why a price reflecting the conditions prevailing in a competitive market is not enough to ensure the survival of a regulated company.[154] He affirms that some costs can only be recovered over the economic life of the assets which are built to provide a specific good or service.[155] If the company reassigned the assets to other activities, then its investors would face capital losses.[156] As indicated earlier, these costs are called sunk costs.[157]

Based on the above, Joskow contends that the role of a regulator regarding a natural monopoly company is twofold.[158] First, if a regulator seeks to promote that a private company provides utility services for customers, then it is necessary to make sure that the regulated company can recover over the long run all reasonable costs incurred to meet customers needs, including the profits permitted and the capital invested.[159] In his view, regulation should make it possible the recovery of these costs to make the regulated monopoly viable.[160] Therefore, the role of intervention is to incent the regulated company to ensure the supply of the service in question.[161] Second, regulation must prevent the regulated company from charging customers any amount that exceeds that level of costs to ensure that the monopoly is managed efficiently and does not abuse the power in the market to dictate prices.[162]

---

[153] John Vickers, "*Regulation, Competition and the Structure of Prices in Competition in Regulated Industries*" in Dieter Helm & Tim Jenkinson, eds, *Competition in Regulated Industries* (Oxford: Oxford University Press, 1998) 23 at 24–25.
[154] Joskow, *supra* note 48 1227 at 1240–1241, 1245, 1254–1255.
[155] *Ibid*.
[156] *Ibid*.
[157] *Ibid* at 1254–1255.
[158] *Ibid* at 1254–1255, 1262, 1288–1289.
[159] *Ibid* at 1254–1255, 1262.
[160] *Ibid*.
[161] *Ibid*.
[162] *Ibid* pp. 1254, 1262, 1289.

Regulatory intervention under CERA to determine the rate of return

These views serve to understand one of the reasons for the intervention of the Regulator under CERA. According to the *Decision RH-2-2004*, *Phase I*, TransCanada applied in January 2004 to request the approval of prices and the level of revenue required to cover its costs for the period 1 January to 31 December 2004.[163] The most significant cost components included in the proposed revenue were the rate of return and the depreciation of assets.[164] In TransCanada's view, the revenue would cover all the costs for that period and would be obtained through the prices approved for the supply of transportation services.[165] In September 2004 the Regulator approved the revenue required for 1 January to 31 December 2004 as petitioned.[166] Yet, the Regulator clarified that the rate of return would be added to the revenue required.[167]

That clarification resulted from the fact that on 23 March 2004 the Regulator indicated that the rate of return would be considered in a decision separate from the one dealing with the rest of the requests made in the application of January 2004.[168] The reason was that there was a TransCanada appeal pending before the Federal Court of Appeal which was related to the *RH-R-1-2002 Decision* on the rate of return of that company for the 2001-2002 period.[169]

Below I will proceed as follows. First, I will summarize the *Decision RH-2-2004*, *Phase II*, adopted in April 2005. In that decision the Regulator responded to a request

---

[163] NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-2-2004, Phase I* (2004 Mainline Tolls and Tariffs Application, September 2004) [*NEB Decision RH-2-2004, Phase I*] at 2, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/334963/A08344-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Tolls_and_Tariff_%E2%80%93_RH-2-2004_Phase_I.pdf?nodeid=334859&vernum=-2> As stated at 4 in this decision, TransCanada provides pipeline transportation services to connect the western, natural gas producing area with the eastern, consuming areas in Canada. This pipeline system is called the TransCanada Mainline. Previously, in December 2003, the Regulator approved TransCanada's proposed interim prices, which were applicable while the Regulator decided on the final prices for that period; see *NEB Decision RH-2-2004, Phase II, supra* note 10 at 101. TransCanada's application included other matters that are not relevant for the present purposes.

[164] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 5, 30. The Regulator considers the depreciation cost as the instrument used to recover the capital invested. Ibid at 30.

[165] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 2, 6, 41.

[166] *NEB Decision RH-2-2004, Phase I, supra* note 163 at 6.

[167] *Ibid* at 6.

[168] *Ibid*.

[169] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 4.

from TransCanada on the rate of return for the year 2004 and the base on which that rate should be determined. Second, I will synthetize the Federal Court of Appeal decision adopted on 16 April 2004. Finally, I will explain the relationship between the Regulator's holding regarding the rate of return for 2004 and the decision of the court.

In the *Decision RH-2-2004, Phase II*, the Regulator approved TransCanada's request regarding the proportion of shareholders' equity within the total financing of the company (the sum of equity and debt that a pipeline company uses to finance its business is called the capital structure).[170] TransCanada had requested the Regulator to change the proportion of equity from 33 percent to 40 percent.[171] In support of the application, TransCanada argued that given the variations in supply and demand of natural gas, pipeline competition and other business risks, the Regulator should consider these facts to determine the ratio of shareholders' equity included in the capital structure.[172] Thus, the Regulator assessed the changes in business risks that company had faced.[173] Based on this assessment, the Regulator approved an increase in the ratio of equity from 33 to 36 percent.[174] With regard to the debt component of the capital structure, the Regulator approved a ratio of 64 percent.[175]

To understand better that decision, it is necessary to explain how the Regulator determined the rate of return under the methodology adopted in the *Multi-Pipeline Cost of Capital Decision RH-2-94*.[176] In this 1994 decision the Regulator established that the

---

[170] *Ibid* at 17–20, 79–80.
[171] *Ibid* at 79.
[172] *Ibid* at 18, 41–47.
[173] *Ibid* at 41–47.
[174] *Ibid* at 79–80.
[175] *Ibid* at 80.
[176] *Ibid* at 1. I cite the NEB *Decision RH-2-2004, Phase II* and the *TransCanada Pipelines Limited v. National Energy Board* [2004] FCA 149 to describe the NEB *Decision RH-2-94* because the first two decisions summarize the points of the latter which were relevant for the purposes of the of the former. The *RH-2-94* was a decision adopted in the NEB, *Reasons for Decision, TransCanada Pipeline Limited, Westcoast Energy Inc, Foothills Pipe Lines Ltd, Alberta Gas Natural Gas Company, Trans Quebec and Maritimes Pipeline Inc, Interprovincial Pipeline Inc, Trans Mountain Pipeline Company Limited, Trans-Northern Pipeline Inc, RH-2-94*, (Cost of Capital, March 1995) [*NEB Decision RH-2-94*].
It is worth indicating that in 2009, the Regulator decided in NEB, *Reasons for Decision, Multi-Client Review of RH-2-94* (Cost of Capital, RH-R-2-94, 8 October Decision, October 2009) [*NEB Review Decision RH-2-94*] that the NEB *Decision RH-2-94* would no longer be applicable. Given the NEB *Review Decision RH-2-94,* in the decision of NEB, *Reasons for Decision, Trans Québec & Maritimes Pipeline Inc, RH-1-2008* (Cost of Capital for 2007 and 2008, March 2009) [*NEB Decision RH-1-2008*] at 81, the Regulator indicated that each pipeline would henceforth be able to

rate of return for six pipeline companies including TransCanada, would be 12.25% for 1995.[177] The Regulator calculated this rate of return by taking as a point of reference a capital structure of 30% of capital equity and 70% of debt for all six companies.[178] The Regulator assumed that such ratios reflected the average capital structure of that group of pipeline companies at the time.[179] The Regulator held that from January 1996 onwards the rate of return on equity would be adjusted annually using a formula.[180] The Regulator also recognized that any individual pipeline company could ask for a revision of the capital structure in a subsequent year, in the event that there were substantial variations in business risks.[181]

In the application of January 2004, TransCanada proposed a rate of return on equity calculated with a methodology alternative to the one the Regulator used in the *Decision RH-2-94*.[182] In response to that proposal, the Regulator reaffirmed the methodology adopted in the *Decision RH-2-94* and did not change the resulting rate of return on equity.[183] That rate was 9.56 percent for 2004.[184] Nevertheless, the Regulator considered it necessary to make sure that this rate of return was the same as the one which could be derived from applying the criteria indicated by the Federal Court of Appeal in *TransCanada Pipelines Limited v. National Energy Board*, [2004] FCA 149 of April 16 2004 to estimate that cost.[185] Even more, the Regulator adopted the fair return standard which reflects the criteria indicated by the Federal Court of Appeal in this decision.[186]

---

choose the proportion of debt and equity to finance its operations without regulatory intervention, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92841/490113/551491/551283/A21378-1_%E2%80%93_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_TQM-_Cost_of_Capital_for_2007_and_2008_%E2%80%93_RH-1-2008.pdf?nodeid=551438&vernum=-2>.

[177] *TransCanada Pipelines Limited v. National Energy Board*, [2004] FCA 149 [*FCA TransCanada Ltd*] at paras 14–17.

[178] *Ibid* at para 15.

[179] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 1–2.

[180] *FCA TransCanada Ltd, supra* note 177 at para 16.

[181] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 17–19.

[182] *Ibid* at 48.

[183] *Ibid at* 20, 102.

[184] *Ibid* at 1.

[185] *Ibid* at 19–20.

[186] *Ibid* at 16–17.

Meanwhile, in the appeal TransCanada had questioned the way in which the Regulator determined the rate of return for 2001-2002.[187] That company had argued that the Regulator's methodology under *Decision RH-2-94* did not guarantee a fair rate of return for that period.[188] Yet, the Regulator did not accept TransCanada's request to change that decision.[189] Hence, TransCanada appealed to the Federal Court of Appeal.[190] The court denied TransCanada's argument and upheld the rate of return determined by the Regulator for that period.[191]

The Regulator's mandate is to guarantee just and reasonable prices but the germane legislation, at that time *NEBA* but now CERA, grants the Regulator the discretion to decide how to achieve its mandate.[192] In that respect, the Federal Court of Appeal held that the germane legislation requires that the rate of return should be fair.[193] The court recognized that when cost of service is the method used to intervene in the formation of prices the Regulator should allow the company to recover all the costs approved to supply services in a future period, including the rate of return.[194] If the Regulator does that, then a balance of parties' interests is reached and hence the prices are just and reasonable.[195]

The court affirmed that despite the difficulties associated with the determination of the rate of return, the Regulator's methodology used must allow the pipeline company to recover that cost.[196] When the Regulator fails to do so there are several consequences.[197] First, the company would be unable to obtain additional capital to expand its services to meet new customers needs and could even cease to operate.[198] Second, in that event customers would not have transportation services.[199]

---

[187] *FCA TransCanada Ltd, supra* note 177 at para 2.
[188] *Ibid* at paras 18, 19, 21–22, 24.
[189] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 3.
[190] *Ibid* at 4.
[191] *FCA TransCanada Ltd, supra* note 177 at para 43.
[192] *B.C Hydro and Power Authority v. Westcoast Transmission Company Ltd*, [1981], 2 F.C. 646 (C.A) at 655–656. That was the view of the court under the former *NEBA*.
[193] *FCA TransCanada Ltd, supra* note 177 at paras 11–12, 33, 36.
[194] *Ibid* at para 33.
[195] *Ibid*.
[196] *Ibid* at para 12.
[197] *Ibid* at paras 12,13.
[198] *Ibid* at para 13.
[199] *Ibid*.

Moreover, the court held that the effect of the rate of return on the level of prices payable by shippers is not determinative of whether the rate of return is fair.[200] According to the court, fairness of a rate of return does not depend on whether shippers regard unaffordable the prices authorized by the Regulator.[201] Rather, fairness of the rate of return depends on whether the Regulator takes into account the level of profits which investors would obtain if they used their capital in comparable alternative investments facing similar risks.[202]

The court held that under the method of cost of service, the Regulator fulfills the legal mandate on just and reasonable prices if two conditions are met.[203] First, the Regulator makes customers pay prices reflecting the real costs incurred to provide the services demanded.[204] Second, the Regulator allows the carrier to obtain a fair rate of return.[205]

Based on the decision of the Federal Court of Appeal, the Regulator affirmed that the intervention based on cost of service must facilitate that the pipeline company generates in a future period the revenue to cover all prudent costs including the fair rate of return.[206] The court did not define the concept of prudency. Although the Regulator did not define the prudent concept either, the Regulator indicated that the mandate makes it necessary to allow the carrier to obtain the level of income required to cover the costs permitted to meet shippers' needs.[207]

In order to assess the rate of return proposed by a carrier, in the *Decision RH-2-2004 Phase II* the Regulator adopted three requirements which together are called the fair return standard.[208] First, the Regulator must examine whether the carrier's proposal on rate of return is commensurate with investing the capital in companies facing similar

[200] *FCA TransCanada Ltd, supra* note 177 at paras 35–36
[201] *Ibid*.
[202] *Ibid at* para 33.
[203] *Ibid at* para 34.
[204] *Ibid*.
[205] *Ibid*.
[206] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 13.
[207] *Ibid* at 13-16.
[208] *Ibid* at 17.

risks.[209] Second, the Regulator must examine whether the rate proposed puts the pipeline company in question in a position to compete in capital markets with other companies which seek funding.[210] Third, the Regulator must evaluate whether the rate proposed allows the pipeline company to meet all its obligations.[211] In the Regulator's view, if a rate of return fulfills all these requirements, then that rate is fair.[212]

The Regulator affirmed that the legal mandate seeks to prevent that a monopolistic carrier can take unjustified advantage of shippers.[213] The implication of this view is that if the Regulator recognizes prudent costs including a fair rate of return, then the prices approved for a given period meet the legal mandate.[214] That is the way in which the Regulator prevents the carrier from taking unjustified advantage of shippers because the carrier cannot charge prices over and above the costs approved by the Regulator based on the prudency of cost and the fairness of the rate of return.[215] That view also means that the Regulator's intervention in the formation of prices seeks to ensure above all that the pipeline company can be a viable business in the long run.[216] The above reveals that the Regulator's intervention in the formation of prices is not necessarily based on the level of prices which would prevail if pipeline transportation markets were competitive.

Regarding the rate of return, the Regulator looks at capital markets to assess whether a given rate of return proposed is fair.[217] Nonetheless, as the Regulator held in another decision on rate of return, *RH-1-2008*, the concept of fairness used to intervene in the formation of prices does not imply that the Regulator can oblige the shareholders to grant a benefit to shippers at the expense of interests of the shareholders.[218] Instead, the concept of fairness in the context of the rate of return means that the Regulator seeks

[209] *Ibid*.
[210] *Ibid*.
[211] *FCA TransCanada Ltd, supra* note 177 at para 5 and *NEB Decision RH-2-2004, Phase II, supra* note 10 at 13, 19. According to the CER, the carrier's ability to cover all its expenses is called financial integrity.
[212] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 17–18.
[213] *Ibid* at 16.
[214] *Ibid* at 16.
[215] *Ibid*.
[216] *FCA TransCanada Ltd, supra* note 177 at para 13.
[217] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 17, 54–56.
[218] *NEB Decision RH-1-2008, supra* note 176 at 54–56.

to ensure that such a rate reflects the fair return standard.[219] The application of that standard requires to analyze evidence taken from capital markets to assess for instance the profitability of investments of comparable risks.[220] In addition, the application of the standard requires the Regulator's expertise and the assistance of expert witnesses.[221] In any case, the Regulator said, the application of the fair return standard is not based merely on theoretical factors.[222]

2.2.3 Stranded assets

In *Decision RH-003-2011* the Regulator intervened to solve an issue of underused transmission assets derived from an increase in pipeline competition and other risks.[223] The Regulator held that the carrier could not transfer to shippers the risk of assets no longer used due to pipeline rivalry and other business risks.[224]

The Regulator adopted that position based on the following factors.[225] First, when the executive branch of government concludes that the application for allowing the construction of new pipeline transmission assets is convenient and necessary, the applicant company is merely entitled to build transportation assets if the company wants to take that risk.[226] Second, regulation starts from the premise that pipeline rivalry is one of the business risks of that activity.[227] Third, the Regulator seeks to facilitate the recovery of costs including the rate of return.[228] Yet, the Regulator does not ensure that the carrier will obtain a given rate of return.[229] Fourth, the Regulator merely seeks to incent the carrier

---

[219] *Ibid*.
[220] *Ibid* at 18–19.
[221] *Ibid* at 18, 62, 78–82, 86.
[222] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 12, 54–56. To support this view, the Regulator relied on *NW Utilities, supra note* 136, as well as on two United States of America Supreme Court decisions, namely *Bluefield Waterworks & Improvement Co Vs Public of West Virginia*, 262. US *679 (1923)* [*Bluefield, US, 1923*] and *Federal Power Commission and Hope Natural Gas 320 US 591 (1944)* [*Hope, US 1944*]. Although the details of these judgments differ, all indicate that to set just and reasonable prices for public utilities a regulator must ensure a fair return on the capital invested. That can only be achieved if the regulated company can first pay its obligations to creditors; see *NEB Decision RH-2-2004, Phase II, supra* note 10 at 14–16, 19–20, 54.
[223] *NEB Decision RH-003-2011, supra* note 10 at 42–44.
[224] *Ibid.*
[225] *Ibid* at 42–45.
[226] *Ibid* at 38.
[227] *Ibid* at 42–43.
[228] *Ibid* at 3.
[229] *Ibid* at 44.

to build the level of transmission assets that shippers actually demand which is the way to ensure an efficient pipeline transportation system.[230] Fifth, if shippers do not use some transmission assets, the Regulator can order that the costs associated with these assets should not be considered to determine the price.[231] In the Regulators' view, the exercise of that power does not involve confiscation.[232] Thus, that decision raises the question as whether there is any connection of the multiple factors supporting that decision. On this matter, authors provide opposing explanations.

From the perspective of the law in the United States of America, Tomain and Cudahy argue that one of the reasons for regulatory intervention in energy services is the risk of capital losses derived from the regulatory decision to replace monopoly by competition.[233] That view relies on several interrelated factors.[234] When a regulator permits the supply of a service under monopolistic conditions, the regulator seeks to ensure the supply of that service by compelling the supplier to meet the demand for that service.[235] In order to prevent monopolistic abuse, the regulator subjects the monopolist to price control.[236] On this matter, they affirm that if private investors employ capital to build energy infrastructure for a designated time, they undertake this long-term and capital-intensive project based on the certainty that the legal rules will allow them to recover the capital invested and a return on that investment.[237] Hence, when the regulator changes the rules in order to promote competition, that decision makes productive assets obsolete (that is, makes them stranded assets).[238] Given that regulatory decisions can make costs unrecoverable, regulation must address this problem.[239]

These views only partly explain the Regulator's position under CERA. In fact, only one of the reasons presented by Tomain and Cudahy reflects one the factors supporting

[230] *Ibid* at 39–40.
[231] *Ibid* at 41, 45.
[232] *Ibid* at 41.
[233] Joseph P Tomain & Richard D Cudahy, *Energy Law in a Nutshell*, 3rd ed, (St Paul, MN: West Academic Publishing, 2017) at 201–203.
[234] *Ibid*.
[235] *Ibid* at 202.
[236] *Ibid*.
[237] *Ibid*.
[238] *Ibid* at 201–203.
[239] *Ibid*.

the Regulator's position.[240] This factor is that the investors use their capital under the expectation of a long-term prospect of obtaining income and profits.[241] In fact, that is the reason why the Regulator considers that regulation must facilitate that the carrier can recover the costs realized to provide services in the long run.[242] That is also the reason why Joskow considers that the concept of sunk costs is useful to explain regulatory intervention in the formation of prices in the presence of stranded assets.[243]

Nevertheless, the other factors that support Tomain and Cudahy's view directly contradict regulatory intervention under CERA.[244] In fact, according to *Decision RH-003-2011* the Regulator does not ensure a given level of profits or the recovery of capital.[245] Equally, the monopolist is aware of the fact that pipeline competition is part of the business risks faced under Canadian law.[246] Hence, it is incumbent on the carrier to evaluate whether to run the risk of building transmission assets once the certificate of public convenience and necessity has been granted.[247]

Other authors seem to provide a deeper explanation. Maloney and Sauer explain regulatory intervention in the presence of stranded assets based on the idea that regulation must permit prices comparable to those that would result from the free interaction between customers and rival utility companies if these market conditions existed.[248] They argue that prices obtained under these conditions reflect efficient prices.[249] Based on that understanding, they argue that the price established by the regulator does not seek to ensure investors the recovery of its investment or a given rate of profits because that is not what happens in any risky unregulated activity subject merely

[240] As indicated above, the Regulator seeks to facilitate the recovery of costs; see *NEB Decision RH-003-2011, supra* note 10 at 3.
[241] Tomain & Cudahy, *supra* note 233 at 201–202.
[242] *NEB Decision RH-003-2011, supra* note 10 at 3.
[243] Joskow, *supra* note 48 1227 at 1241.
[244] Despite this contradiction, the carrier presented arguments that resemble those supporting the view of Tomain and Cudahy, *supra* note 233. Also see *NEB Decision RH-003-2011, supra* note 10 at 34–35; nevertheless, the Regulator did not accept those arguments (see *ibid* at 37–44.)
[245] *NEB Decision RH-003-2011, supra* note 10 at 41,45.
[246] *Ibid* at 42–43.
[247] *Ibid* at 38.
[248] Michael T Maloney & Raymond D Sauer, "*A Principled Approach to the Stranded Cost Issue*" (1988) 11:3 The Electric Journal, 58 at 58–59.
[249] *Ibid*.

to competition.[250] The regulator merely indicates what is the level of prices and profits which can be achieved if several suppliers were competing for customers.[251] In that context, the decision to invest in a utility company is an investor's decision and the level of assets built is made by the utility company.[252] Therefore, if the utility company owns the assets, then that company bears the risk of competition.[253]

These views explain better the Regulator's position under CERA. In fact, the Regulator views competition as one of the business risks which the carrier faces.[254] Accordingly, the Regulator adjusts the rate of return in view of the changes in that risk as well as in the other business risks.[255] Hence, a carrier which invests in transmission assets in a monopolistic context knows that the investment made runs the risk that the assets can be underused if rival carriers enter in the market in question.[256]

Even more, natural gas pipeline competition, and thereby the emergence of stranded assets in natural gas pipeline transportation in Canada, have both been the result not only of regulatory decisions but also the result of decisions adopted by foreign investors.[257] In fact, TransCanada's Mainline, which connects the natural gas producing area in Western Canada to Central and Eastern Canada, has faced competition from Canadian carriers as well as rivalry from the United States carriers.[258] In addition, the Regulator has indicated that the emergence of foreign regional sources of natural gas production in the North East of the United States of America closer to Ontario and Quebec has led to the underutilization of TransCanada's Mainline.[259] Therefore, the issue of stranded assets in regulatory practice under CERA results not only from the regulatory decision to promote pipeline competition.

---

[250] *Ibid* at 59–61.
[251] *Ibid* at 59, 60
[252] *Ibid* at 59.
[253] *Ibid* at 59–61.
[254] *NEB Decision RH-003-2011, supra* note 10 at 42–45.
[255] *Ibid* at 157.
[256] *Ibid* at 42–44.
[257] *Ibid* at 1–3, 8, 149–150.
[258] *Ibid*.
[259] *Ibid* at 8, 162.

In any event, Cearley and Cole conclude that the decision to introduce competition alters the balance of parties' interests.[260] For Hunt and Shuttleworth, in turn, the affected party is the utility company.[261] In contrast, Cearley and Cole conclude that the decision of promoting competition affects the supplier and shareholders but the effect on consumers is higher.[262] Therefore, Tomain and Cudahy believe that regulation is required to establish which party must assume the costs of stranded assets.[263]

That view explains why the Supreme Court affirmed that a utility regulator should consider any facts which can occur after it evaluates a utility company's decision to invest in assets.[264] According to the Court, in that way a utility regulator can prevent the utility company from being discouraged from investing in the expansion of assets to meet the growing demand of customers.[265]

2.2.4 Cross-subsidization and free riding

In the *Decision RH-1-2007* the Regulator affirmed that all shippers must pay for the costs created to obtain the services supplied.[266] If the carrier makes some shippers pay the costs created by other shippers, then there can be cross-subsidization.[267] Nevertheless, in the Regulator's view, cross-subsidization is sometimes justified to ensure fairness.[268] The question, then, is why and when is that conduct problematic.

There are complementary views to answer that question. Tirole considers that if a good is used by many parties, then that fact encourages some of the users to make less effort than others to preserve that good.[269] Joskow, in turn, approaches that problem

---

[260] Reed W Cearley & Daniel H Cole, "*Stranded Benefits Versus Stranded Costs in Utility Deregulation*" in Daniel H Cole & Peter Grossman, eds, *The End of a Natural Monopoly: Deregulation and Competition in the Electric Power Industry* (ProQuest Ebook Central, 2003) 158 at 161, 170–171.
[261] Hunt & Shuttleworth, *supra* note 69 at 73.
[262] Cearley & Cole, *supra* note 260 at 158, 160–161.
[263] Tomain & Cudahy, supra note 233 at 202-203. They argue that unless these costs are paid by taxpayers, it creates a risk for the shareholders of the supplier company, its users, or even new rivals.
[264] *Ontario Energy*, *supra* note 136 at para 104.
[265] *Ibid* at paras 91, 108.
[266] *NEB Decision RH-1-2007*, *supra* note 3 at 21–22.
[267] *Ibid*.
[268] *NEB Decision RH-001-2016*, *supra* note 27 at 33–34.
[269] Tirole, *supra* note 70 at 188–189, 200. He categorizes this problem as free riding and uses this concept mainly in connection with environmental damage.

specifically in the context of the natural monopoly problem.[270] He comments that cross-subsidization is usually understood as a situation in which some customers pay the costs created by others.[271] Yet, in his opinion that definition of the cross-subsidization problem assumes that it is possible to determine exactly what the cost is that each customer must pay to avoid paying part of the costs caused by others.[272] Although the total costs of providing a service can be ascertained, there is no consensus on the methodology applicable to determine how to apportion the costs between different types of consumers mainly when the same company provides separate services.[273] Furthermore, he contends, not all customers demand regularly the same level of the service specially when the price changes.[274] Consequently, it is not always clear whether some customers are benefiting at the expense of others.[275] Finally, Kaplow and Shapiro see free riding as a problem affecting competition between sellers.[276] In their view, the problem emerges when a seller limits the ability of buyers to choose an alternative seller to prevent rivalry in the market for a given good or service.[277]

These views help to explain the Regulator's intervention in the formation of prices under CERA. In fact, the Regulator relies on that concept for two purposes.[278] First, the Regulator seeks to prevent some shippers paying costs caused by rival shippers.[279] Hence, the regulator seeks to preserve competition between shippers. Second, the Regulator seeks to avoid a pipeline company preventing rivalry from other carriers by making some shippers in the area served by one carrier pay the costs derived from

[270] Joskow, *supra* note 48 1227 at 1257.
[271] *Ibid*.
[272] *Ibid*.
[273] *Ibid*.
[274] *Ibid*.
[275] *Ibid*.
[276] Kaplow & Shapiro, *supra* note 91 1073 at 1204–1209.
[277] *Ibid*.
[278] The Regulator refers to cross-subsidization between shippers in *NEB Decision RH-1-2007, supra* note 3 at 21–22. The Regulator refers to cross-subsidization affecting pipeline competition in NEB, *Letter Decision* (Examination to Determine Whether to Undertake an Inquiry of the Tolling Methodologies, Tariff Provisions and Competition in Northeast British Columbia, 8 March 2018) [*NEB Examination Decision 2018*] at 3–5, online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/3225050/3338199/3488659/A90483-1_NEB_-_Letter_Decision_-_Parties_-_Inquiry_of_the_Tolling_Methodologies%2C_Tariff_Provisions_and_Competition_-_NE_BC_-_A6A9Y3.pdf?nodeid=3490855&vernum=-2>.
[279] *NEB Decision RH-1-2007, supra* note 3 at 21–22.

expanding its system to a neighbouring market.[280] That conduct could allow one carrier to charge a lower price in the neighbouring market to exclude a rival carrier from that market.[281] Thus, the Regulator seeks to preserve competition between pipeline companies. In the fifth chapter I will describe and explain in more detail how the concept of cross-subsidization explains the regulatory intervention to achieve these purposes.

Incentives and the conduct of the regulated company and its customers

The Regulator and parties under CERA seeks to create some incentives.[282] Carriers and shippers use that concept to demand regulatory intervention.[283] Equally, carriers sometimes consider that a negotiated settlement serves to create incentives.[284] At other times, the Regulator considers that certain carrier's proposals regarding prices for pipeline services can create incentives for conduct which the Regulator disapproves.[285] For instance, in the Regulator's view a carrier can use an auction as a competitive process to allocate the use of transmission assets between rival shippers.[286] Nonetheless, the Regulator has warned about the risk that shippers can use that process to make a profit rather than as an instrument to better allocate the pipeline capacity available to transport natural gas.[287] That regulatory warning suggests that sometimes an auction process can create an undesirable incentive for shippers. Consequently, it is necessary to examine the connection between market failures and incentives.

Tirole argues that when companies and individuals interact their conduct can be explained by facts which encourage the behavior in or outside the markets.[288] He calls these facts incentives.[289] In that respect, Tirole differentiates between incentives created by markets and those created by statutory law and regulation.[290]

---

[280] *NEB Examination Decision 2018, supra* note 278 at 3–5.
[281] *Ibid*.
[282] *NEB Decision RH-003-2011, supra* note 10 at 241.
[283] In *CER Decision RH-001-2019*, *supra* note 9 at 32, shippers use that concept to request regulatory intervention.
[284] *NEB Decision RH-003-2011, supra* note 10 at 239.
[285] *Ibid* at 132.
[286] *Ibid* at 131–132.
[287] *Ibid*.
[288] Tirole, *supra* note 70 at 39.
[289] *Ibid.*
[290] *Ibid* at 33, Tirole explains the incentives created by the market and, at 147, the incentives created by regulation.

In addition, McNollgast explains that regulation seeks several aims all of which reflect efficiency.[291] First, the regulator seeks to avoid the supplier charging prices above the costs prevailing in competitive markets.[292] Second, the regulator seeks to minimize the supplier's incentives to adopt conduct contrary to public policy aims.[293]

These opinions synthetize some of the views already examined and are useful to explain the regulatory intervention under CERA. As I have explained above, the Regulator seeks to create incentives.[294] For instance, parties expect and the Regulator incents the carrier through the rate of return to invest in building pipelines.[295] Moreover, in the presence of pipeline rivalry the Regulator has created incentives for cost reduction to enable the carrier to compete.[296] In addition, the Regulator seeks to prevent other incentives given that they lead the carrier to engage in conduct contrary to the regulatory principles.[297] For instance, the Regulator seeks to disincentivize the abuse of market power.[298] In any event, carriers recognize that negotiation represent the main instrument to create incentives.[299]

2.3 Conclusion on the reasons for regulatory intervention in practice

The literature review shows that there is a central connection between monopoly, market power, stranded assets, and cross-subsidization. The connection is that these concepts describe situations in which the markets for pipeline transportation services fail to work as market participants and the Regulator expect. Based on that connection, it can be argued that the Regulator's intervention in the formation of prices under CERA seeks to address conduct reflecting several market failures.

---

[291] McNollgast, *"The Political Economy of Law"* A Mitchell Polinsky & Steven Shavell, eds, *Handbook of Law and Economics*, Vol 2, 2007 (Amsterdam: North Holland, 2007) 1651 at 1661.
[292] *Ibid*.
[293] *Ibid*. McNollgast also indicates that the law seeks to minimize the cost of doing business. Yet, the evidence examined in this thesis suggests that regulatory intervention under CERA seeks mainly to explain the other two aims posed by this author indicate above.
[294] *NEB Decision RH-003-2011, supra* note 10 at 241–243.
[295] *Ibid* at 34–35.
[296] *Ibid* at 241–243.
[297] *NEB Decision RH-3-2004, supra* note 2 at 8.
[298] *Ibid*.
[299] *NEB Decision RH-003-2011, supra* note 10 at 241.

The literature review also shows that sunk costs represent a more specific connection of natural monopoly, market power, and stranded assets.[300] Therefore, this concept provides a more specific explanation of the regulatory intervention in the presence of these three market failures.

That specific connection does not imply that all regulatory actions under CERA are the same regardless of the nature of conduct derived from these three market failures. Rather, the Regulator deals with each issue posed by the carrier's conduct based on the business context in which the carrier operates and the applicable principles.[301] For instance, the Regulator incents investors through the rate of return to build transmission assets up to the level required to meet shippers' needs.[302] In contrast, the Regulator seeks to disincentivize other carrier's conduct like unfair competition and cross-subsidization.[303]

The literature review also reveals the connection between market failures and efficiency.[304] Thus, in principle the Regulator seeks to set prices comparable to the price level that would result from the free exchange by shippers and rival carriers.[305] In principle, then, that connection makes it possible to explain the regulatory intervention under CERA in terms of efficiency.[306]

Nevertheless, CERA also requires the Regulator to ensure just, reasonable and non-discriminatory prices.[307] In that respect, the Supreme Court affirms that the mandate

---

[300] The connection of natural monopoly and market power is explained by both Joskow, *supra* note 48 1227 at 1241, 1248–1249, 1252 and the Competition Bureau, "ADEG," *supra* note 54 at 1, 14. Moreover, the connection between stranded assets and sunk costs is suggested by Joskow, *supra* note 48 1227 at 1241, 1295.

[301] For example, the Regulator deals with stranded assets based on the principles of efficiency and used and useful assets; see *NEB Decision RH-003-2011, supra* note 10 at 40, 43. Meanwhile, the Regulator deals with market power issues under the principle of abuse of market power; see *NEB Decision RH-3-2004*, *supra* note 2 at 8. Finally, the Regulator deals with monopolistic abuse by allowing a carrier to recover prudent costs and ensuring that the rate of return is fair; see *NEB Decision RH-2-2004, Phase II, supra* note 10 at 13, 16–17. In any case, the Regulator decides on the issues based on the business context in which the carrier operates; see *NEB Decision RH-3-2004, supra* note 2 at 6–7, 71–72.

[302] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 16-17.

[303] *NEB Examination Decision 2018, supra* note 278 at 2, 5.

[304] Cooter & Ulen, *supra* note 33 at 43.

[305] Kahn, *supra* note 39, Vol I at 17, 56, 65–67.

[306] *CERA, supra* note 4 at s 6(a), provides that one purpose of the Act is to ensure pipelines are constructed and operated efficiently.

[307] *CERA, supra* note 4 at ss 230, 231, 235.

of a utility regulator is to achieve a balance of interests between parties.[308] Congruent with that view, the regulatory decisions cited earlier show that the Regulator has sought to address market failures by articulating efficiency and other regulatory principles.[309] To achieve that, the Regulator has intervened based on the experience gained over the years first in the context of monopoly and then under pipeline competition.[310] Accordingly, the Regulator intervenes because experience has shown that to achieve just and reasonable prices in monopolistic and competitive business contexts it is necessary to apply not only the efficiency principle but also other regulatory principles including fairness.[311]

It is necessary to note the importance of the concept of business risks in the explanation of the regulatory intervention in the formation of prices under CERA. The *Decision RH-003-2011* on TransCanada's application for restructuring the rules on price and conditions of service on the Mainline pipeline system illustrates that point.[312] One of the issues solved in that case had to do with which party should bear the business risks affecting the carrier's income and thereby the recovery of the capital and the rate of return.[313] Parties and the Regulator categorized one of the specific issues as stranded assets.[314] That issue is explained in terms of changes in several business risks, not only in terms of the emergence of pipeline competition as some authors suggest.[315]

In addition, in the same *Decision RH-003-2011* the Regulator addressed as a separate issue the discussion of a fair rate of return.[316] To solve that issue, the Regulator evaluated whether there had been changes in all the business risks affecting the Mainline

[308] *NW Utilities, supra* note 136, reaffirmed in *Ontario Energy, supra note 136* at para 15–16, 76.
[309] For example, *NEB Decision RH-1-2007, supra* note 3 at 21–22.
[310] *NEB Decision RH-3-2004, supra* note 2 at 6–7.
[311] *Ibid*. Also, *NEB Decision RH-1-2007, supra* note 3 at 21–23.
[312] The Mainline system connects the western natural gas producing areas with the consuming areas in central and eastern Canada; see *NEB Decision RH-003-2011, supra* note 10 at 5–6. That decision explains the scope of the restructuring proposal (*ibid* at 14–35).
[313] *Ibid* at 42–45.
[314] *Ibid* at 28–30, 65.
[315] *Ibid* at 35, 43–45. Tomain & Cudahy, *supra* note 233 at 201–203, are two authors who support this view.
[316] *NEB Decision RH-003-2011, supra* note 10 at 147-148.

pipeline system and how the overall impact of the changes had affected TransCanada profits.[317]

The business risks faced by a natural gas carrier seem to show the relevance of the concept of sunk costs to explain the intervention of the Regulator in most cases.[318] With the exception of cross-subsidization, the concept of sunk costs is useful to explain in concrete terms why the Regulator intervenes under CERA to allow the carrier to recover its costs.[319] In fact, the overall changes in business risks leads the Regulator to adjust the rate of return permitted.[320] Even more, in extreme circumstances the magnitude of these changes can shorten the useful life of the assets and hence impede the recovery of the capital invested which can only be achieved in the long term.[321] In any case, the Regulator seeks to facilitate the recovery of costs incurred to supply natural gas pipeline transportation services within the context of business risks.[322] That is why in the fourth chapter I will describe and explain why the Regulator's intervention in practice seeks above all to achieve the viability of pipeline systems.

In addition, the business risks can incent the carrier to engage in conduct contrary to the regulatory principles. For instance, business risks can incent the carrier to transfer to shippers the risk of underutilized assets.[323]

2.4 Questions raised when the Regulator relies on parties' negotiation

It is now necessary to analyze the commentators' views on the benefits, drawbacks, and perils of the parties' negotiation process to address the market failures.

As indicated earlier, CERA*'s* purpose is to achieve efficiency in the construction and operation of pipelines.[324] Equally, CERA establishes that the Regulator's mandate is

[317] *Ibid*.
[318] *Ibid* at 148.
[319] *Ibid*.
[320] *Ibid* at 147–148.
[321] *Ibid* at 34–35, 148.
[322] *Ibid* at 39–40, 44. This conclusion derives from several Regulator's statements. First, the Regulator interprets the mandate to mean that the recovery of costs must be facilitated. Second, the Regulator affirms that pipeline transportation is a risky activity.
[323] *Ibid* at 43–45.
[324] *CERA, supra* note 4 at s 6.

to ensure just, reasonable, and non-discriminatory prices for pipeline services.[325] In that respect, CERA seeks a regulatory system which provides certainty and predictability to investors.[326]

Given the above, I will look at commentator's views on two related questions. First, I will look at what negotiation entails as a process to address market failures. Second, to evaluate what characteristics of the negotiation process can be considered as benefits, drawbacks, and perils, I will look at the literature to determine the specific factors of the negotiation process which either help or prevent the Regulator from achieving CERA*'s* purpose and hence fulfill the mandate.

Negotiation as an alternative method to cost of service

Littlechild and Doucet examine the use of parties' negotiation to achieve aims unattainable under the litigation process.[327] They contend that parties have preferred the use of negotiation because that process allows parties to achieve aims that regulation cannot achieve through its own means alone.[328] They do not deny that parties have achieved efficiency and other traditional aims.[329] Rather, their point is that the explanation of negotiation is that parties are able to accommodate their interests in ways which regulation cannot achieve because a regulator can never act with as much knowledge as the parties in question.[330]

Although they show the advantage of negotiation, they recognize that it is a private solution to deal with conflicts in the context of public utility regulation which raises questions regarding the defense of the public interest.[331]

---

[325] *CERA, supra* note 4 at ss 230, 231, and 235.
[326] *CERA, supra* note 4 at the Preamble of that Act.
[327] Joseph Doucet & Stephen Littlechild, *"Negotiated Settlements: The Development of Legal and Economic Thinking"* (2006) 14 Utilities Policy [Doucet & Littlechild, 2006] 266 at 266, 274. Their conclusions are based on the use of negotiated settlement in the United States of America and Canada.
[328] *Ibid*.
[329] *Ibid*.
[330] *Ibid*.
[331] They consider that preserving efficiency in public utilities involves the defense of the interests of final consumers; see Joseph Doucet & Stephen Littlechild, *"Negotiated Settlements and the National Energy Board in Canada"* (2009) 37 Energy Policy [Doucet & Littlechild, 2009] 4633 at 4643.

These views help to explain what negotiation entail as a regulatory process under CERA. In fact, as indicated earlier, the Supreme Court considers that regulation of utility services seeks the articulation of parties' conflicting interests.[332] That is what the Supreme Court deems is required to achieve a balance of parties' interests.[333] The Regulator, in turn, believes that parties' negotiation make it possible to achieve this end.[334]

In that regard, parties' negotiation serves to achieve some of the aims pursued under adjudication. In fact, when parties resort to adjudication the Regulator applies the principles of efficiency and fairness.[335] In this regard, the Regulator has recognized that parties' negotiation serve to achieve efficiency and fairness.[336] Thus, in the 2002 Draft Revised Guidelines for Negotiated Settlement the Regulator indicated that negotiation between a carrier and its shippers and other interested parties serve to achieve two goals.[337] First, parties' negotiation serve to ensure that a carrier invests in building the level of transmission assets only up the point where the assets serve to meet the shippers' transportation needs.[338] The Regulator categorizes that point as efficient.[339] Second, parties' negotiation make it possible that the carrier can obtain a fair return on the investment made.[340]

However, as I will explain in the fifth chapter, parties' negotiation also makes it possible to go beyond discussions of cost recovery and division of costs.[341] In fact, the Regulator has recognized that negotiated settlement creates incentives for cost

---

[332] *NW Utilities, supra* note 136, reaffirmed in *Ontario Energy, supra* note 136 at para 15–16, 76. The Court refers to regulation under the method of cost of service.
[333] *Ibid*.
[334] *CER Decision RH-001-2019*, *supra* note 9 at 11.
[335] The solution of disputes in the *NEB Decision RH-3-2004, supra* note 2 at 7, is based on efficiency. The solution of disputes in the *NEB Decision RH-001-2016, supra* note 27 at 34, is based on fairness.
[336] 2002 NEB Discussion and Draft Negotiated Settlement Guidelines at 1 [*Draft Negotiated Settlement Guidelines 2002*] < https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/157025/142122/Letter_%28A0C7Y1%29.pdf?nodeid=142123&vernum=-2>
[337] *Ibid*. The Regulator also indicated that parties' negotiation serves to protect the public interest. It is necessary to indicate that CERA uses the concept of public interest in several sections. However, CERA does not use that concept in ss 6, 11, 230, 231, and 235, which contain the mandate regarding prices for pipeline services. For instance, *CERA* at s 183 (2) the uses the concept of public interest regarding the assessment of an application for the construction of transmission assets.
[338] *Ibid*.
[339] *Ibid*.
[340] *Ibid*.
[341] *CER Letter Decision April 2020, supra note 19* at 3.

reduction.[342] More generally, the *Negotiated Settlement Guidelines* seeks expressly to preserve the public interest.[343] In the fifth and sixth chapters I will explain the implications of these aspects.

The nature of parties' negotiation

Littlechild and Doucet argue that litigation leads a regulator to make decisions based on the regulator's interpretation of what law seeks.[344] In contrast, if parties negotiate, then they take control over the regulatory process and achieve by themselves solutions to the issues in dispute.[345]

That view helps to explain the nature of the balance of interests derived from negotiation under CERA. Although the balance reached by parties reflects parties' control over the process, that control is limited. In fact, according to the *Negotiated Settlement Guidelines*, the negotiation process is subject to the Regulator's review.[346] In particular, if the settlement is unanimous, then the Regulator's review is focused mainly on verifying the conditions required by the Guidelines.[347] In contrast, if the balance reached by some parties is questioned by other interested parties, then the Regulator intervenes to solve the issues posed by the opposing parties.[348] Therefore, negotiating parties can achieve their own solution to the issues in dispute, subject to the scrutiny of the Regulator.[349] The Regulator's scrutiny seeks to ensure that the settlement reflects the interests of parties which were not represented in the negotiation process.[350]

---

[342] *Ibid*.
[343] *NEB Revised Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs*, 12 June 2002 [*Negotiated Settlement Guidelines 2002*] at para (ii) & (iii) provide that the Regulator's review will deny a settlement incompatible with CERA or the public interest. online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/157025/208496/A02885-1_NEB_Decision_%E2%80%93_Guidelines_for_Negotiated_Settlements_of_Traffic%2C_Tolls_and_Tariffs_%28A0E4C1%29.pdf?nodeid=208497&vernum=-2>
[344] *Ibid* Doucet & Littlechild, 2006, *supra* note 327 at 275.
[345] *Ibid*.
[346] *Negotiated Settlement Guidelines 2002 supra* note 343 at 1–2.
[347] *Ibid* at para (iii).
[348] *Ibid* at para (iv).
[349] *Ibid*.
[350] *Ibid* at para (ii).

Parties' negotiation as a regulatory process to address market failures

Doucet and Littlechild recognize that negotiation could serve to address situations in which markets fail to work as expected.[351] In their view the feasibility of using that process depends on the regulator's opinion regarding whether private or public views should prevail in the regulatory process.[352] They argue that parties' negotiation can be feasible to address market failures if the regulator recognizes that regulated utility companies and its customers can contribute to find solutions useful to address these problems even if the regulator plays some role.[353]

Other authors adopt a similar position. Thus, Baldwin, Cave and Lodge argue that the negotiation process has been used to facilitate a regulated company and its customers to make decisions previously adopted by the utility regulator.[354] That implies that public intervention in prices and conditions of utility services is minimized.[355] Regulation seeks to address the problem that a monopolistic supplier can take advantage of users by preventing the monopolist from dictating the rules governing utility services.[356] To achieve that, the regulator's intervention in practice scrutinizes both the negotiation process and the content of the agreement reached.[357] Therefore, in practice the question is how the regulator reviews the negotiation process.

These opinions are useful to explain the use of negotiation under CERA. In fact, the Regulator has stated that intervention in the formation of prices is necessary when the supplier operates in a monopolistic context.[358] Thus, in the Regulator's view if parties negotiate in that context, then a monopolistic supplier could take advantage of users and could even affect third parties.[359] Even more, in a context in which the negotiation process has not worked, the Regulator has considered that regulation is even necessary in the

[351] Doucet & Littlechild, 2006, *supra* note 327 at 275.
[352] *Ibid*.
[353] *Ibid*.
[354] Robert Baldwin, Martin Cave & Martin Lodge, *Understanding Regulation, Theory, Strategy and Practice*, 2nd ed (New York: Oxford University Press, 2012) at 490–491.
[355] *Ibid*.
[356] *Ibid*.
[357] *Ibid*.
[358] *NEB Draft Negotiated Settlement Guidelines, 2002*, *supra* note 343 at 1.
[359] *Ibid*.

presence of pipeline competition to ensure carriers do not distort rivalry.[360] In that case, the Regulator intervenes to protect shippers, the operation of the market and pipeline systems.[361]

Procedural differences between adjudication and negotiated settlement

The authors indicated above focus on the substantive aspects on negotiation. Nevertheless, Wang examines the procedural differences of litigation and negotiation in regulatory practice.[362] In that respect, he argues that a critical difference between a negotiated settlement and litigation is the way of approaching the issues in dispute.[363] Under litigation a regulator addresses one issue at a time to solve them based on the applicable rules and the aim sought.[364] In contrast, in the negotiation process parties link multiple issues to find an integrated solution.[365] That view leads to examine what happens when the agreement reached is questioned. On this point, Doucet and Littlechild affirm that in practice litigation comes into play when negotiation do not work.[366]

That view is relevant to understand why the Regulator under CERA tries to preserve the balance which parties reached provided that the balance meets the legal mandate.[367] In fact, in the *Decision RH-001-2019* the Regulator held that it must preserve the private balance in order to recognize the mutual concessions parties make which reflect what the Regulator categorizes as a package of solutions of multiple disputes.[368] However, the Regulator intervenes to review the congruence of that balance with the *Negotiated Settlement Guidelines*.[369] In the event of a contested settlement, the

[360] *NEB Decision RH-3-2004*, *supra* note 2 at 6–8. In such cases, negotiation fail to work (*ibid* at 70).
[361] *Ibid*.
[362] Zhongmin Wang, "Settling Utility Rate Cases: An Alternative Ratemaking Procedure" (2004) 26:2 Journal of Regulatory Economics 141 at 142. His views are based on the experience of the Federal Energy Regulatory Commission, FERC, in the United States of America.
[363] *Ibid*
[364] *Ibid*
[365] *Ibid*
[366] Doucet & Littlechild, 2009, *supra* note 331 at 4633.
[367] *CER Decision RH-001-2019*, *supra* note 9 at 11.
[368] *Ibid*.
[369] *Negotiated Settlement Guidelines 2002, supra* note 343 at 1.

Regulator also reviews that balance based on the regulatory principles.[370] I will examine these points in detail in the fifth and sixth chapters.

2.5 Conclusions on what is entailed in parties' negotiation

Based on the literature review, it can be argued that in principle parties' negotiation entail a private balance of interests achieved by the regulated company and its customers. That process can be understood in terms of parties' control over the process.[371] Unlike adjudication, in the negotiation process parties achieve that balance through an integrated solution of multiple interests and issues.[372] However, given that parties reached a balance in the context of market failures, the negotiation process and the balance is subject to regulatory scrutiny under the *Negotiated Settlement Guidelines*.[373]

Having said that, in the fifth chapter I will argue that negotiation is unsuitable to address two market failures. Specifically, I will show that in some cases the negotiation process has been unsuitable to prevent cross-subsidization.[374] In addition, that process has been unsuitable to prevent the carrier from attempting to transfer to shippers the risks of stranded assets.[375] That problem is a more recent one in natural gas pipeline transportation than the other market failures.[376] The question, then, is why the negotiation process is sometimes unsuitable to confront these market failures.

2.6 Factors which help or prevent that parties' negotiation can address market failures

The Regulator has recognized the drawbacks of parties' negotiation.[377] In that respect, in 2002, the Regulator made a draft proposal on Negotiated Settlement Guidelines to reform the Negotiated Settlement Guidelines adopted in 1994.[378] In

[370] *CER Decision RH-001-2019*, *supra* note 9 at 1.
[371] Doucet & Littlechild, 2006, *supra* note 327 at 275.
[372] *CER Decision RH-001-2019*, *supra* note 9 at 11.
[373] *Negotiated Settlement Guidelines 2002, supra* note 343 at 1–3.
[374] *NEB Examination Decision 2018, supra* note 278 at 4–8.
[375] *CER Decision RH-001-2019*, *supra* note 9 at 45–46.
[376] Carriers and shippers have held discussions about stranded assets, mainly since the *NEB Decision RH-003-2011, supra* note 10.
[377] *Draft Negotiated Settlement Guidelines, 2002*, *supra* note 336 and covering letter at 4.
[378] *Ibid*.

particular, the Regulator pointed to the difficulties of a carrier's application based on a contested settlement.[379] On this point, the Regulator posed two main related concerns.[380] The Regulator sought to prevent that a settlement which is useful for the negotiating parties could be detrimental for third parties.[381] Furthermore, the Regulator wanted to make sure that all interested parties could participate in the negotiation process.[382] Even more, the Regulator sought to facilitate the opposing parties having access to a public hearing to present their reasons for their opposition.[383]

As explained above, free interaction of parties to reach agreements is problematic for them and third parties. That is why regulatory intervention is necessary to review a negotiated settlement to prevent some carrier's conduct which reveal market failures. Therefore, it is necessary to investigate what factors either help or prevent parties from succeeding in dealing with market failures through negotiation.

2.6.1 Countervailing power

Doucet and Littlechild affirm that the presence of pipeline competition facilitates the use of the parties' negotiation process.[384] As indicated before, these authors start from the premise that the negotiation process is suitable to deal with market failures.[385]

In that respect, in NEB *Decision RH-3-2004* the Regulator affirmed that in the context of pipeline competition regulatory intervention can be necessary to prevent the carrier from abusing its market power and to ensure fair pipeline competition.[386] In that case some shippers questioned the suitability of parties' negotiation.[387] Specifically, some shippers questioned negotiation as a process to solve disputes when a pipeline system

[379] *Ibid* covering letter accompanying the *Draft Negotiated Settlement Guidelines, 2002, supra* note 336.
[380] *Ibid*.
[381] *Draft Negotiated Settlement Guidelines, 2002*, *supra* note 336 at 3.
[382] *Ibid*.
[383] *Ibid*.
[384] Doucet & Littlechild, 2009, *supra* note 331 at 4641.
[385] Doucet & Littlechild, 2006, *supra* note 327 at 275.
[386] *NEB Decision RH-3-2004, supra* note 2 at 6, 8.
[387] *Ibid* at 65–66.

is undergoing significant changes.[388] Part of the changes were the increasing degree of pipeline competition.[389]

It is relevant to indicate that under the *Negotiated Settlement Guidelines* the regulatory intervention takes place after the negotiation process is concluded.[390] Thus, in practice, the Regulator does not intervene during the negotiation process.[391] Instead, what happens is that the carrier applies for the approval of a settlement already negotiated with interested parties.[392] Therefore, it is necessary to investigate what factors help or prevent the feasibility of the negotiation process itself.

In that respect, Galbraith argues that one way in which customers limit the ability of a monopolist to abuse its economic power is when customers negotiate collectively with the monopolist.[393] He considers that when customers join forces to negotiate with a monopolistic supplier, they can moderate the behavior of the monopolist in the market in question.[394] He calls that action countervailing power.[395]

That view reveals one of the critical factors which makes the negotiation process feasible in regulatory matters. Thus, in the fifth and sixth chapters I will analyze the implications of the conditions established by the *Negotiated Settlement Guidelines*. These conditions seek to ensure that all interested parties have a chance to intervene in the negotiation process.[396] Moreover, the carrier must prove that the parties have had the chance to have their interests reflected in the balance reached.[397] Thus, I will show that these conditions can be explained in terms of the shippers' countervailing power.

---

[388] *Ibid* at 65.
[389] *Ibid* at 6.
[390] *Negotiated Settlement Guidelines 2002, supra* note 343 at 1–2.
[391] Covering Letter attached to the *Negotiated Settlement Guidelines 2002, supra* note 343 at 2.
[392] *Negotiated Settlement Guidelines 2002, supra* note 343 at 1–2.
[393] John Kenneth Galbraith, *American Capitalism, the Concept of Countervailing Power* (New York: M E Sharpe, 1952, reprinted 1980) at 110–114.
[394] *Ibid*.
[395] *Ibid*.
[396] *Negotiated Settlement Guidelines 2002, supra* note 343 at para (i).
[397] *Ibid*.

2.6.2 Asymmetry of information

The NEB *Decision RH-3-2004* shows that shippers need to have access to carrier's information to be able to solve their issues by negotiation.[398] In that case the Regulator had to adjudicate disputes because parties' negotiation failed and some shippers contended that the negotiation process relies on the parties' willingness to cooperate to achieve a joint solution to their problems.[399] Hence, under that view parties' negotiation can only succeed when shippers have access to the relevant information of the carrier.[400] Yet, sometimes the carrier denies shippers access to that information. In fact, one of the intervenors in that process raised the point that parties had to resort to a public hearing merely to obtain information.[401] According to that intervenor, shippers' access to carrier's information is critical whether parties rely on litigation or negotiation.[402]

In principle, the difficulty of shippers to having access to the carrier's information can be seen through the Regulators' rules on that matter.[403] The Regulator requests information about whether the carrier's application is based on litigation or negotiation.[404] However, the scope of the Regulator's request in each of these cases differs.[405] In that respect, the information requested regarding negotiation is focused on the settlement agreed as a result of that process.[406] In contrast, in the case of cost of service and the associated litigated dispute resolution process, the Regulator demands disaggregated information from the carrier.[407] Therefore, it is relevant to look at the literature to find an explanation for that differential treatment.

---

[398] *NEB Decision RH-3-2004, supra* note 2 at 66, 70.
[399] *Ibid* at 66, 70.
[400] *Ibid* at 66.
[401] *Ibid*. The intervenor was the Canadian Association of Petroleum Producers.
[402] *Ibid*.
[403] Canada, Canadian Energy Regulator, *Filing Manual - Guide P – Tolls and Tariffs (ss. 225-240 of CER Act)* (Calgary: Canadian Energy Regulator) [*CER Filing Manual Guide P*] online (pdf): <https://www.cer-rec.gc.ca/en/applications-hearings/submit-applications-documents/filing-manuals/filing-manual/filing-manual.pdf> at 184-194. It establishes a detail level of information requirements when the carrier's application is based on cost of service. In contrast, if the carrier's application is based on a negotiated settlement, the information requirements are lower and focus on the balance reached. *Negotiated Settlement Guidelines 2002, supra* note 343 at para (iii).
[404] *Ibid*.
[405] *Ibid*.
[406] *Negotiated Settlement Guidelines 2002, supra* note 343 at para (iii).
[407] *CER Filing Manual Guide P supra* note 404 at 184–194.

Authors' views vary. Joskow argues that the regulator's access to regulated company's information regarding costs and customers needs has been the main difficulty in the regulatory process to achieve the relevant policy aims.[408] He categorizes that difficulty as asymmetry of information.[409] In his view, that difficulty has been the critical one when a regulator relies on cost of service because the regulated company controls that information.[410] As a matter of fact, that information is associated with the way in which the regulated company manages its business.[411] The implication of this fact is that the regulated company can decide what information it discloses to the regulator and thereby is able to take advantage of that fact.[412] Doucet and Littlechild appear to have a different view.[413] They indicate, based on Canadian regulatory experience, that major customers are well informed about the regulated activity in question and the services they need.[414]

In practice, as it is shown by the *Examination Decision 2018*, the Regulator requests information from carriers when they negotiate with shippers even in the context of pipeline competition.[415] In that respect, the Regulator requests information to be able to determine whether prices avoid cross-subsidization and whether pipeline carriers compete fairly for shippers.[416]

In the third chapter, I will show that the asymmetry of information is mainly connected with the discretion of the carrier to forecast costs and assess business risks.[417] In line with that, I will argue that the asymmetry of information poses a central difficulty in parties' negotiation not only between the carrier and shippers but also between the carrier

[408] Joskow, *supra* note 48 1227 at 1285–1286.
[409] *Ibid*.
[410] *Ibid*.
[411] *Ibid*.
[412] *Ibid*.
[413] Doucet & Littlechild, 2009, *supra* note 331 at 4634. They describe the variety and profile of interested parties in the regulatory process. They also affirm that most of these parties have experience and information relevant to the negotiation process (*ibid* at 4641).
[414] *Ibid*.
[415] *NEB Examination Decision 2018, supra* note 278 at 5.
[416] *Ibid* at 1, 4. This decision was adopted regarding carriers that compete in Northeast British Columbia. Hence, the inherent message here is that the carrier not only must submit that information to the Regulator but also disclose that information to shippers.
[417] *NEB Decision RH-003-2011, supra* note 10 at 24–25.

and the Regulator. Hence, I will explain the drawbacks and perils of parties' negotiation in the sixth chapter based on asymmetry of information.

2.6.3 Certainty and predictability

The Regulator under CERA considers that intervention must provide certainty and predictability by minimizing changes in the regulatory methods.[418] In the Regulator's view, these changes can affect the carrier's level of income which can be recovered through prices and thereby the recovery of investment.[419] Congruent with that view, the Regulator affirms that one business risk that a carrier faces is the stability of the regulatory rules on the recovery of cost of pipeline transportation which is called the regulatory risk.[420]

The Regulator's intervention in the formation of prices sometimes has given rise to uncertainty.[421] For instance, in *Decision RH-003-2011* the Regulator affirmed that preventing the carrier from recovering cost of assets no longer used does not constitute an expropriation of the carrier's assets.[422] That regulatory view was adopted in a context of a case in which parties' negotiation were unfeasible to solve disputes regarding the allocation of risk of stranded assets and hence the Regulator directly solved these issues.[423] Some years later the Regulator recognized that *Decision RH-003-2011* had created uncertainty for shippers which led parties to engage in litigation.[424]

The Regulator affirms that not only litigation but also negotiation create certainty.[425] Therefore, it is necessary to understand the relationship between parties' negotiation and certainty.

---

[418] *NEB Decision RH-1-2007, supra* note 3 at 3, 38, 43. *NEB Decision RH-1-2008, supra* note 176 at 51.
[419] *Ibid*.
[420] *Ibid*.
[421] *NEB Decision RH-001-2016, supra* note 27 at 5.
[422] *NEB Decision RH-003-2011, supra* note 10 at 40–41.
[423] *Ibid* at 244.
[424] *NEB Decision RH-001-2016, supra* note 27 at 5.
[425] The Regulator adopted this view regarding litigation in *NEB Decision RH-1-2007, supra* note 3 at 43, and regarding negotiation in *CER Letter Decision, April 2020, supra* note 19 at 1, 3.

Cooter and Rubinfeld recognize that the uncertainty derived from litigation can lead parties to negotiate.[426] Joskow goes further.[427] He explains that one of the weaknesses of the method of cost of service and the associated litigation process is that once investors use their capital in building assets with the prospect of recovering that investment in the long term, the regulator can prevent that recovery.[428] That can occur if the regulator does not allow the regulated company to recover all its costs.[429] Thus, he associates uncertainty with expropriation.[430]

These views are useful to explain that parties' negotiation help to deal with market failures by creating certainty. For that reason, in the fourth chapter I will explain why regulatory intervention seeks above all to facilitate the carrier recovering all reasonable costs including the cost of capital.[431] Complementary, in the fifth chapter, I will describe and explain that when parties resort to negotiation they achieve by themselves a balance of their interests and hence the degree of certainty they are willing to accept. Based on that, in the sixth chapter, I will argue that one of the benefits of the negotiation process is to facilitate the recovery of all reasonable costs and hence to remove discussions regarding regulatory risk and expropriation.

2.7 Parties' negotiation and the literature on alternative dispute resolution processes

According to *CERA*, part of the Regulator's legal mandate is to facilitate alternative dispute resolution processes.[432] The Regulator must do that when all the parties to the relevant dispute accept the use of one of these processes to deal with a matter under that Act.[433] *CERA* equally provides that the result of the alternative dispute resolution process is not binding but the Regulator can take it into account when making an order.[434] In

[426] Robert D Cooter & Daniel L Rubinfeld, "Economic Analysis of Legal Disputes and their Resolution" (1989) 27 Journal of Economic Literature 1067 (Cited by Doucet & Littlechild, 2006, *supra* note 327 at 272).
[427] Joskow, *supra* note 48 1227 at 1255, 1273
[428] *Ibid* at 1254–1255.
[429] *Ibid* at 1255.
[430] *Ibid* at 1255, 1273.
[431] *NEB Decision RH-2-2004, Phase II, supra* note 10 at 16.
[432] CERA *supra* note at s 11(f).
[433] *Ibid*, at s 73(1)
[434] *Ibid*, at s 73(3).

addition, *CERA* requires the Regulator to ensure that the decision-making processes are fair, inclusive, transparent and efficient.[435] Given these legal rules, it is relevant to look at the literature to understand why statutory law requires the Regulator to facilitate alternative processes including negotiation to solve disputes in a matter like pipeline transportation prices which Parliament subjected to public regulatory intervention in the formation of prices.

Cooter and Ulen affirm that when parties negotiate to solve a private law dispute, the resulting settlement is reached considering the expected decision a court would make if the case in question were solved by adjudication.[436] They call this conduct "*negotiating in the shadow of the law*".[437] However, Collins questions whether the agreement resulting from negotiation really reflects the decision which a court would adopt in that specific case.[438] This can not happen due to the practical difficulties for one party to find evidence to support a contractual claim which could make the judicial decision unpredictable.[439] In other cases the negotiating power of one party may explain why the other can obtain less than it could be obtained if the dispute were adjudicated.[440] In any event, Collins believes that regardless of whether a settlement may deviate from the potential legal solution under expected adjudication, a settlement allows parties to align their economic interests and adapt their agreements to the changing business context.[441]

The critical point, he argues, is that negotiating parties are focused directly on their economic interests.[442] In that respect he comments that some legal reforms proposed in Britain by judges themselves have indicated the benefit of a settlement to facilitate the private solution of disputes by allowing parties to make their own arrangements based on incenting the availability of information.[443] In addition, there are other benefits derived from a settlement, notably the parties' ability to preserve long-term business relationships

[435] *Ibid*, at s 6.
[436] Cooter and Ulen, *supra* note 33 at 442-443.
[437] *Ibid.*
[438] Hugh Collins, *Regulating Contracts,* First Edition (Oxford: Oxford University Press, 2002) at 330, 335.
[439] *Ibid*, at 333.
[440] Ibid, at 335.
[441] *Ibid*, at 332, 335-336.
[442] *Ibid*, at 335.
[443] *Ibid, at* 335-336.

and reduce the judicial costs of solving disputes.[444] Given the foregoing, he concludes that law must support settlement to achieve efficient solution of commercial contractual disputes because parties obtain what they set out to achieve within a negotiating context.[445]

Meanwhile, in the context of public law disputes, Levin and Lubbers argue that parties' negotiation has other benefits.[446] Specifically, when parties settle a dispute, they reduce the uncertainty associated with litigation and minimize the effects on the commercial credibility of the companies involved.[447] However, these authors maintain that the use of settlement to solve public law issues is problematic because the negotiating parties can prejudice third parties' interests, particularly the interest of competitors and consumers who did not participate in the negotiation process.[448] Moreover, during that process parties cannot question the facts and policy implications derived from the settlement.[449] Consequently, judicial review of a settlement is unfeasible.[450]

These are some of the reasons why, according to Levin and Lubbers, the negotiation process in public law matters is subject to other legal restraints.[451] In particular, the administrative body in charge of solving disputes by adjudication must enact procedural rules which negotiating parties must follow.[452] Moreover, the regulator must make sure that interested parties can raise their concerns on the settlement reached.[453] Consequently, all these factors make settlement an efficient way of solving public law disputes.[454]

These views help to explain why *CERA* facilitates the use of alternative dispute resolution process such as the negotiated settlement. As a matter of fact, according to

---

[444] *Ibid*, at 329, 331.
[445] *Ibid*, at 335-336.
[446] Ronald M. Levin and Jeffrey S. Lubbers, *Administrative Law in a Nutshell* (St Paul, MN: West Academic Publishing, 2017) at 172.
[447] *Ibid*.
[448] *Ibid.*
[449] *Ibid*.
[450] *Ibid*, at 174.
[451] *Ibid*, at 170, 172-173.
[452] *Ibid*, at 172-174.
[453] *Ibid*, at 174.
[454] *Ibid*, at 169, 176

the *Negotiated Settlement Guidelines* the settlement lacks any legal force unless the Regulator approves it when it is unanimously endorsed by shippers and other interested parties.[455] Furthermore, the Regulator approves a contested settlement only after the opposing parties have had the opportunity to explain the reasons for the opposition and the carrier has presented evidence and arguments explaining why the Regulator must approve it despite the opposition.[456] Hence, the Regulator intervenes to ensure three aims. First, the negotiating parties must fulfil the conditions and procedural conditions established by the *Negotiated Settlement Guidelines* particularly fair participation and the recognition of accommodation of interests of all relevant parties.[457] Second, the settlement must lead the carrier to charge just and reasonable prices.[458] Third, the parties' settlement must be congruent with public interest considerations.[459] For all these reason, the use of a negotiated settlement can be seen as an illustration of the literature on interest-based negotiations indicated above.

[455] *Negotiated Settlement Guidelines 2002 supra* note 343 at 1.
[456] *Ibid*, at para (iv).
[457] *Ibid*, at para (i).
[458] *Ibid*, at para (iii).
[459] *Ibid*, at para (ii).

CHAPTER 3
THE LEGAL FRAMEWORK

3.1 Introduction

Under CERA the Regulator has the mandate to ensure that prices for the use of pipeline transportation services are just, reasonable, and non-discriminatory.[1] In *Northwestern Utilities Limited v. City of Edmonton*, [1929] S.C.R. 186 the Supreme Court held that the mandate implies that a utility regulator must achieve a balance of interests between the utility company and its customers.[2]

The substantive elements of the mandate

That mandate must be achieved within the context of the legal framework established by CERA. In that respect, the legal framework relies on some concepts. Consequently, it is necessary to describe them to be able to explain the substantive aspects of the legal framework, how it works and to what end.

The mandate under CERA requires the Regulator to intervene in the formation of prices for pipeline services but goes beyond that.[3] In that regard, according to CERA, the Regulator's mandate includes several matters.[4] First, the Regulator can make orders regarding pipelines, power lines and renewable energy projects.[5] Second, the Regulator must oversee the life cycle of pipelines, namely from construction and operation to the abandonment of that infrastructure.[6] Third, the Regulator can make orders regarding

[1] *Canadian Energy Regulator Act* (S.C. 2019, c. 28, s. 10) [*CERA*]. The Regulator's mandate regarding pipeline transportation prices and conditions of service is established by several sections of CERA. CERA provisions that are directly related to prices are established from ss 225 to 241; however, the provisions related to just, reasonable, and non-discriminatory prices are at ss 230, 231, and 235. The mandate must be interpreted considering the broader "purpose" of CERA. According to s 6, the purpose CERA is to regulate energy matters that fall under the jurisdiction of Parliament, which include the following: First, the Regulator can regulate pipelines, power lines, and facilitates associated with offshore renewable energy projects. Second, the Regulator can regulate exploration and exploitation of oil and natural gas. Third, the Regulator can regulate trade in energy products. Fourth, the Regulator must ensure that regulatory hearings and decision-making processes related to these matters are fair, inclusive, transparent, and efficient.

[2] *Northwestern Utilities Limited v. City of Edmonton*, [1929], S.C.R 186 [NW Utilities] at 192–93. See also *Ontario (Energy Board) v. Ontario Power Generation Inc*, 2015 SCC 44, [2015] 3 R.S.C 147 [*Ontario Energy*] at paras 20, 76.

[3] *CERA, supra* note 1 at ss 11 (a), (b), (c), 230, 231 and 235.

[4] *Ibid* at s 11.

[5] *Ibid.*

[6] *Ibid.*

some related matters, namely traffic, tolls and tariffs and oversee them.[7] I will explain these concepts further down. Furthermore, the Regulator can even intervene in energy trade matters.[8]

In this thesis I focus on the operation of pipelines to transport natural gas rather than on oil pipelines. Although I examine the Regulator's legal mandate regarding tariffs, tolls and traffic, my primary concern is on price issues.

According to CERA, tolls are the prices charged for pipeline services.[9] In principle, the regulation of prices involves the compensation approved by the Regulator to a carrier for the costs associated with providing transportation services in a future period.[10] Given that the level of costs varies over time, the carrier applies from time to time for the approval of the costs for a new period.[11] The prices charged by the carrier and associated costs are one of the components of the tariff.[12]

Pursuant to CERA, the concept of tariffs encompasses the way to determine prices charged and other parties' rights and obligations associated with pipeline services.[13] Some of the main elements of a tariff include the following ones. First, the carrier indicates the technical specifications of gas to be transported.[14] Second, the carrier indicates the type of pipeline transportation services offered.[15] Third, the carrier makes known the list of prices for the services offered.[16] Fourth, the carrier publishes the terms and procedures for shippers to have access to services.[17] Fifth, the carrier establishes whether it is

---

[7] *Ibid.*
[8] *CERA, supra* note 1 at s 6 (c).
[9] *Ibid* at s 2.
[10] "CER Regulation of pipeline traffic, tolls and tariffs" (12 February 2021), [*CER Regulation of pipeline traffic, tolls and tariffs*] sections Tariffs, Tolls Regulation, online: *Canada Energy Regulator* <https://www.cer-rec.gc.ca/en/about/who-we-are-what-we-do/responsibility/regulation-pipeline-traffic-tolls-tariffs.html#:~:text=The%20CER%20regulates%20pipeline%20tolls,in%20tolls%2C%20service%20or%20facilities>.
[11] *Ibid*.
[12] *CERA, supra* note 1 at s 225.
[13] *Ibid*.
[14] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at section Tariffs.
[15] *Ibid*.
[16] "Mainline Tariff" section "List of Approved Tolls (2022 to 2026) and Abandonment Surcharges (2022)", online: *TC Energy* <http://www.tccustomerexpress.com/891.html>
[17] *Ibid*. See also NEB, *Reasons for Decision, Imperial Oil Resources Venture Limited and its Partners,* GH-1-2004, Volume 2 (Mackenzie Gas Project, 16 December 2010) [*NEB Decision GH-1-2004, Vol 2*] at 181, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/338535/338661/659850/658356/A27695-

possible to renew transportation contracts.[18] Sixth, the carrier indicates the pledges which a potential shipper must give to ensure the payment for transportation services and the duration of contracts.[19] Seventh, the carrier makes known the list of points where that company receipts and delivers natural gas in the geographic areas served, the standard terms of contracts used and the conditions applicable to create new receipt and delivery points.[20]

According to CERA, a pipeline is a line operated by a company for carrying oil, gas and other energy products.[21] A line encompasses not only the branches but also other facilities including tanks and compressors.[22] The concept of pipeline even includes the associated real property used.[23]

The legal mandate has to do with a pipeline connecting two or more Canadian provinces.[24] That is because they are the only ones under the jurisdiction of Parliament.[25] Thus, the Regulator's mandate is limited to interprovincial pipelines.

The pipeline company's services are multiple.[26] They include not only the receipt, movement, handling, and delivery of natural gas but also storage and the connection of a pipeline with other facilities used for natural gas transportation.[27]

The Regulator's approval of the tariff plays several related purposes. First, the Regulator seeks to oblige the carrier to ensure that actual and potential shippers know about the terms and conditions under which they will obtain pipeline services to move their energy products from producing to consuming areas.[28] Second, the Regulator's

---

3_NEB_-_Reasons_for_Decision_-_Mackenzie_Gas_Project_-_GH-1-2004%2C_Volume_2.pdf?nodeid=658255&vernum=-2>.

[18] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at section Tariffs.

[19] *Ibid*.

[20] "Mainline Tariff" sections "Receipt and Delivery Points", "General Terms and Conditions" and "Procedure for Adding Points", online: *TC Energy* <http://www.tccustomerexpress.com/891.html>

[21] *CERA, supra* note 1 at s 2, s 239.

[22] *Ibid*.

[23] *Ibid*.

[24] *CERA, supra* note 1 at s 2.

[25] *CERA, supra* note 1 at Preamble and s 2, s 6.

[26] *CERA, supra* note 1 at s 239.

[27] *Ibid*.

[28] NEB, *Reasons for Decision, TransCanada Pipelines Ltd, RH-3-2004* (Application for approval to establish a new receipt and delivery point, the North Bay Junction, and for the corresponding tolls for services to and from that

approval of the tariff serves to ensure that a pipeline company gives the same treatment to all customers.[29]

In practice, natural gas pipeline companies require each new customer to make a contract as a condition to undertake pipeline services.[30] Thus, although a pipeline company can negotiate with each customer some of the terms and conditions of the services offered, these individual contracts must adhere to the general conditions of the tariff approved by the Regulator.[31] Given that some of the shippers can be co-owners of the pipeline used while others are merely shippers, the tariff seeks to ensure equal access to all shippers.[32]

A pipeline company must charge the same price to all shippers when traffic has similar conditions and circumstances and is carried over the same route.[33] Although CERA does not define the concept of traffic, the Regulator considers that such concept has several meanings.[34] First, traffic refers to the gas transported.[35] In that respect, a carrier receives gas from multiple shippers in different localities also call points throughout the geographic area covered by its pipeline system.[36] Hence, a pipeline company carries a mixed of different gas flows.[37] That fact implies that it is not always feasible to differentiate between routes particularly when the gas is moved towards the same zone

point, December 2004) [*NEB Decision RH-3-2004*] at 9, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586892/293604/346558/342912/A08726-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_North_Bay_Junction_%E2%80%93_RH-3-2004.pdf?nodeid=342913&vernum=-2>.

[29] *Ibid*. I do not examine this kind of issue in detail since is not the focus of this thesis.

[30] *Ibid*. See also *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Tariffs, Traffic.

[31] *Ibid*.

[32] *NEB Report GH-1-2004, Vol 2, supra* note 17 at 172, 182.

[33] *CERA, supra* note 1 at s 230.

[34] NEB, *Decision, TransCanada PipeLines Limited*, *GH-2-87* (Applications for Facilities and Approval of Toll Methodology and Related Tariffs Matters, July 1988) [*NEB Decision GH-2-87*] at 73–74, Online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/955803/963233/963565/965818/1038930/C17-7-1_-_Decision_GH-2-87_-_A3L1U5_.pdf?nodeid=1038931&vernum=-2>.

[35] *Ibid*.

[36] *Ibid*.

[37] *Ibid*.

encompassing multiple localities.[38] Second, traffic refers to the types of transportation services a pipeline company offers.[39]

A related aspect of the concept of traffic is the total volume of natural gas transported by a carrier.[40] One of the main implications of this concept is that a substantial decrease in the volume derived from the materialization of business risks can threaten the survival of the pipeline system in question.[41] On this point, the Regulator relies on the concept of business risks to describe the likely occurrence of some facts, for instance a decrease in the supply or demand of natural gas and an increase in the degree of pipeline competition.[42] If the occurrence of business risks leads a carrier to move lower and falling volumes of gas, then his income and profitability is reduced and thereby his shareholders cannot recover part of the capital invested.[43] When that happens the Regulator may consider that the pipeline system is not economically viable.[44]

CERA prohibits pipeline companies to discriminate against customers or localities regarding prices, services or facilities.[45] That prohibition does not prevent the carrier from offering diverse transportation services to give preference in the delivery of natural gas to some shippers.[46] Thus, a carrier can make contracts to divide between shippers the capacity of its pipeline transportation system.[47] To achieve that, sometimes the carrier accepts to deliver daily to a shipper a maximum volume of gas.[48] When parties agree to

---

[38] *Ibid*.

[39] *Ibid*. Further, the Regulator suggests that the circumstances and routes are characteristics that can be identified more clearly with respect to oil than in the case of natural gas transportation (*ibid* at 72–73).

[40] NEB*, Reasons for Decision, TransCanada Pipeline Ltd, Nova Gas Transmission Limited, Foothills Pipelines Ltd, RH-003-2011* (Business and Services Restructuring Proposal and Mainline Final Tolls for 2013 and 2013, March 2013) [*NEB Decision RH-003-2011*] at 1–3, online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/665035/711778/941262/939799/A51040-1_NEB_-_Reasons_for_Decision_-_TransCanada%2C_NOVA_Gas_and_Foothills_-_2012_and_2013_Final_Tolls_-_RH-003-2011.pdf?nodeid=939800&vernum=-2>.

[41] *Ibid* at 36, 42–43, 47.

[42] *Ibid*.

[43] *NEB Decision RH-003-2011, supra* note 40 at 43, 148, 161.

[44] *Ibid.*

[45] *CERA, supra* note 1 at s 235.

[46] *NEB Decision RH-003-2011, supra* note 40 at 120, 127.

[47] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Tariff, Traffic.

[48] The Commission of the corporation Canadian Energy Regulation executes the regulatory functions. The Commission is formed by experts and adopts decisions addressed to carriers and shippers, actors that are also experts in the energy business and have been involved in regulatory issues for years. The Regulator has published the "Energy Information Program – Glossary" (1 April 2021), [*Energy Information Program Glossary*] online:

that, the price comprises one component for the gas actually carried and a separate component for the pipeline capacity reserved even if that capacity is not used.[49] The service in that case is firm also called non-interruptible service.[50] Alternatively, a carrier can agree to deliver gas to a shipper only if there is pipeline capacity available at the date agreed in which case the shipper in question only pays for the volume of gas delivered.[51] This transportation service is called interruptible service.[52] In any event, these individual contracts are subject to the tariff.[53]

To meet the mandate, the Regulator generally intervenes whenever a pipeline company applies for the approval of a proposal to adopt or amend the tariff.[54] In that respect, the pipeline company can either structure unilaterally its own application or rely on a collective agreement negotiated with a group of shippers.[55] That collective agreement is called a negotiated settlement.[56] This type of agreement differs from the individual contracts which a pipeline company can make with customers for the allocation of pipeline capacity as explained above.

Canadian Energy Regulator https://www.cer-rec.gc.ca/en/data-analysis/glossary/. Although this glossary is not exhaustive and cannot be used as an authoritative interpretation of CERA, it has been designed to facilitate the comprehension of some of the concepts used in the Regulator's decisions. See explanations about Firm Transportation (FT) Service and Interruptible Transportation Service (IT).

[49] *Ibid;* See also *NEB Decision RH-003-2011, supra* note 40 at 12.

[50] *Ibid*.

[51] *Ibid*.

[52] *Ibid*.

[53] According to *CERA, supra* note 1 at s 225, the concept of tariffs includes any practices, conditions, or rules applicable to the supply of services.

[54] This practice is established by *CERA*, *supra* note 1 at s 227 and s 229. Yet, *CERA* at s 33 empowers the Regulator to initiate an inquiry into any matter under its jurisdiction. Although the Regulator can do that, the Regulator generally meets the mandate on prices at the request of the carrier, either to respond to an application based on cost of service or for the approval of a negotiated settlement; see NEB, *Letter Decision* (Examination to Determine Whether to Undertake an Inquiry of the Tolling Methodologies, Tariff Provisions and Competition in Northeast British Columbia, 8 March 2018) [*NEB Examination Decision 2018*] at 3–4.

[55] Canada, Canadian Energy Regulator, *Filing Manual - Guide P* – Tolls and Tariffs (ss. 225 -240 of CER Act) (Calgary: Canadian Energy Regulator) [*CER Filing Manual - Guide P*] online (pdf): <https://www.cer-rec.gc.ca/en/applications-hearings/submit-applications-documents/filing-manuals/filing-manual/filing-manual.pdf> at p. 184. See also *NEB Revised Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs*, 12 June 2002 [*Negotiated Settlement Guidelines 2002*] at 1–3. online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/157025/208496/A02885-1_NEB_Decision_%E2%80%93_Guidelines_for_Negotiated_Settlements_of_Traffic%2C_Tolls_and_Tariffs_%28A0E4C1%29.pdf?nodeid=208497&vernum=-2>

[56] *Negotiated Settlement Guidelines 2002, supra* note 55 at 1.

The Regulator's discretion to complete the gaps in the legal framework

CERA does not establish how the Regulator can determine whether the prices proposed by a carrier are just and reasonable. To achieve the mandate, according to courts, the Regulator has legal discretion on two matters.[57] First, the Regulator can choose the methods for estimating the costs which are the factors determining prices.[58] In the Supreme Court's view, the methods serve the utility regulator to balance the interests of the utility company and its customers.[59] Second, the Regulator has discretion to establish the legal reasons for justifying whether the prices proposed by the carrier are just and reasonable.[60] The Regulator refers to these reasons as regulatory principles.[61] I will describe these principles later.

The Regulator has adopted two methods to regulate prices and conditions of pipeline transportation services. The methods are negotiated settlement and cost of service.[62] I will describe these methods later in this chapter.

---

[57] *British Columbia and Hydro Authority v. West Coast Transmission Company Ltd,* [1981] 2 F.C 646 [*BC & Hydro*] at 655–656 (C.A). Similar views were adopted in *Trans Mountain PipeLine Company v. National Energy Board*, [1979] 2 F.C 118 [*Trans Mountain PipeLine*] at para 9. The Regulator itself affirms that these court decisions recognize that discretion; see NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-2-2004, Phase II* (2004 Mainline Tolls and Tariffs Application, April 2005) [NEB Decision RH-2-2004, Phase II] at 11–12, Online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/365090/A09636-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Cost_of_Capital_%E2%80%93_RH-2-2004%2C_Phase_II.pdf?nodeid=365091&vernum=-2>.

[58] *NEB Decision RH-2-2004, Phase II supra* note 57 at 11-12.

[59] *Ontario Energy, supra* note 2 at paras 20, 76, 77.

[60] *BC & Hydro, supra* note 57 at 655–656 (CA). Similar views were adopted in *Trans Mountain PipeLine, supra* note 57 at para 9.

[61] NEB, *Reasons for Decision, TransCanada Pipeline* Limited, *RH-1-2007* (Gros Cacouna Receipt Point Application, July 2007) [*NEB Decision RH-1-2007*] at 21–22, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/443945/472730/471076/A16008-1_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Gros_Cacouna_Receipt_Point_%E2%80%93_RH-1-2007.pdf?nodeid=470970&vernum=-2>.

[62] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Overview, Cost of Service, Regulatory Process, Cost of Service Regulation, Negotiated Settlement. See also *CER Filing Manual - Guide P supra* note 55 at 184.

The regulatory premises

CERA contains some provisions germane to the Regulator's mandate.[63] In that respect, sometimes the Regulator interprets said provisions to establish the scope of the legal mandate.[64] I call these interpretations of law regulatory premises (or premises).

I must indicate that the Regulator has not adopted an exhaustive list of premises. In addition, some of the premises rely on concepts that the Regulator does not define.[65] For example, sometimes the Regulator indicates that a carrier has the duty to ensure the viability of a pipeline system while at other times indicates that the carrier's duty is to ensure the economic viability.[66] For that reason, it is necessary to examine multiple discussions between the parties on that issue to try to understand this concept.[67] Thus, it is unclear whether viability and economic viability have the same meaning. Therefore, it is unclear what action is required from the carrier. I will examine this issue in more detail in the fifth chapter. That premise is critical because if a carrier's proposal does not ensure the viability of its pipeline system, then the Regulator can deny the approval which can lead the carrier to recognize capital losses or to redeploy the assets to transport alternative energy products.[68]

In other cases, the Regulator indicates the most appropriate course of action a carrier can follow in some circumstances.[69] Therefore, the premise in question can be viewed as a regulatory directive informing action but not in the sense of an order which involves a legal consequence in case of non-compliance. For instance, the Regulator indicates that a carrier and shippers can share information and discuss with a view to agreeing to solutions but if that is unfeasible then parties must submit the remaining issues to adjudication.[70] Yet, the Regulator accepts that it cannot oblige parties to

[63] *CERA, supra* note 1 at ss 225 to 240.
[64] These premises are reflected in several decisions, as I will discuss in this chapter.
[65] *NEB Decision RH-003-2011, supra* note 40 at 3, 77. That may be explained because both the Regulator and the parties are experts in energy business.
[66] *Energy Information Program Glossary supra* note 48 does not provide an explanation of economic viability.
[67] *NEB Decision RH-003-2011, supra* note 40 at 3, 4, 8, 47, 50, 55, 57, 60 68, 69, 72, 77, 86, 91, 102, 110, 122, 135, 155, 160, 211, 213, 217, 241. Parties and the Regulator use this concept multiple times in this decision, regarding several issues. Nevertheless, the Regulator does not define the concept.
[68] *Ibid* at 42–44.
[69] *NEB Decision RH-3-2004, supra* note 28 at 70–72.
[70] *Ibid*.

negotiate.[71] Therefore, the Regulator expects that the carrier and shippers proceed in that way to facilitate the fulfilment of its mandate.[72]

The premises which involve carrier's actions

First, the carrier can decide whether to negotiate or litigate with its shippers.[73] On this matter, a carrier's proposal usually becomes contentious or involves parties' negotiation, but in either case the proposal is subject to the Regulator's review.[74]

Second, the carrier must present evidence to persuade the Regulator that the request made for the approval is congruent with the legal mandate.[75] That carrier's duty is what the Regulator calls the burden of proof.[76]

Third, the carrier has the duty to design the actions on prices necessary to generate enough income to recover all the costs involved in supplying services, including the capital and the cost of capital which represents the profits permitted.[77] As a part of that duty the carrier must manage the business risks involved in supplying pipeline

---

[71] *Ibid* at 71.

[72] *Ibid.* Thus the Regulator incents parties to use what is called a "tolls task force" formed by multiple shippers and the carrier to generate effective solutions which the carrier can submit for regulatory approval. This strategy seeks not only to alleviate the Regulator's workload but also to promote cooperation between parties.

[73] *NEB Decision RH-003-2011, supra* note 40 at 246–247.

[74] This is the reason why the Regulator asks carriers to discuss proposals with shippers—to present specific solutions to disputes and indicate which ones must be adjudicated; see *NEB Decision RH-3-2004, supra* note 28 at 70–72. In any event, I have not found any decision in which the Regulator approves a carrier's proposal considering that the application is unquestionable and hence does not require that parties engage in negotiation or litigation. As indicated in the first chapter, the Regulator has divided the regulated companies into two groups based on the level of business. Group One comprises six oil pipelines and seven natural gas pipeline companies. The other comprises approximately a hundred companies, is categorized as Group Two and is subject to regulation only when a company cannot solve a dispute with its shippers and thereby instigates a complaint. "CER Regulation of pipeline traffic, tolls and tariffs" (12 February 2021), [*CER Regulation of pipeline traffic, tolls and tariffs*] section Complaint-based regulation, online: *Canada Energy Regulator* <https://www.cer-rec.gc.ca/en/about/who-we-are-what-we-do/responsibility/regulation-pipeline-traffic-tolls-tariffs.html#:~:text=The%20CER%20regulates%20pipeline%20tolls,in%20tolls%2C%20service%20or%20facilities>.

[75] NEB, *Reasons for Decision, Maritimes & Northeast Pipeline Management Ltd, RH-1-2000* (Tolls Application, August 2002) [*NEB Decision RH-1-2000*] at 37–38, online(pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/155829/3773831/3890507/3901808/3930821/4098801/C13338-6_%28e%29_NEB_Reasons_for_Decision_RH-1-2000_Maritimes_and_Northeast_Tolls_%282000-08-01%29_-_Chapter_11_-_A7U0E4.pdf?nodeid=4098576&vernum=-2>.

[76] *Ibid*.

[77] *NEB Decision RH-003-2011, supra* note 40 at 3, 77. In this decision the Regulator affirms that it is incumbent on the carrier to take care of the economic viability of the pipeline system owned.

services.[78] With that aim, the carrier has several main duties.[79] First, the carrier must periodically revise the cost of depreciation to be able to recover the long-term capital invested given that the useful life of assets may be affected by business risks.[80] Second, the carrier must examine the level of traffic of natural gas and hence the actual and forecast use of the transmission capacity of the pipeline system based on the types of contracts made with shippers.[81] That seems to be what the Regulator calls the carrier's duty to achieve the long-term economic viability of a pipeline system.[82] Complementary, the carrier must identify any modification to the tariff regarding conditions of service to adapt them to the market prevailing context.[83]

The premises which involve actions on the part of the Regulator

CERA seeks to ensure that regulatory decisions are predictable and timely and to create certainty to investors and other stakeholders.[84] These policy aims were not established under the former *NEBA*.[85] Yet, under *NEBA* the Regulator started from the premise that it should provide certainty and predictability to investors.[86] That is congruent with the fact that the Regulator has long recognized that regulatory risk is one the business risks the carrier faces.[87] The Regulator seeks to minimize the regulatory risk

[78] CER, *Reasons for Decision, Nova Gas Transmission Ltd, RH-001-2019* (Application dated 14 March 2019 for NGTL Rate Design and Services, March 2020) [*CER Decision RH-001-2019*] at 21, 45–46.
[79] *Ibid*.
[80] *Ibid*. See also *NEB Decision RH-003-2011, supra* note 40 at 43–44.
[81] *NEB Decision RH-003-2011, supra* note 40 at 43-44.
[82] *NEB Decision RH-003-2011, supra* note 40 at 1–3, 8, 77, 160, 211.
[83] *NEB Decision RH-3-2004, supra* note 28 at 70. See also *NEB Decision RH-003-2011, supra* note 40 at 1–3.
[84] These policy aims are indicated in CERA Preamble. Apart from that, CERA does not establish aims that the Regulator must achieve to meet the mandate. The Preamble provides that CERA seeks to increase the competitiveness of the Canadian economy based on predictable regulatory decisions, which will promote certainty for investors and other interested parties. Although *CERA*, ss 225 to 240 does not refer to certainty and predictability, given that these principles are contained in the Preamble of the Act, they inform all the Regulator's functions and thereby apply to the regulation of prices for pipeline services.
[85] It is worth noting that ss 225 to 240 of CERA are the ones specifically related to traffic, prices, and conditions of service. None of these rules refer to any aims. Some ss, notably 230, 231, and 235, solely refer to the concepts of just, reasonable, and non-discriminatory tolls and conditions of service. The Regulator, under the former *NEBA,* called these concepts "standards" by which it could set prices. See *NEB Decision RH-1-2007, supra* note 61 at 21.
[86] *NEB Decision RH-01-2007, supra* note 61 at 3.
[87] *Ibid* at 3, 38, 43; NEB, *Reasons for Decision, Trans Québec & Maritimes Pipeline Inc, RH-1-2008* (Cost of Capital for 2007 and 2008, March 2009) [*NEB Decision RH-1-2008*] at 51, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92841/490113/551491/551283/A21378-1_%E2%80%93_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_TQM-_Cost_of_Capital_for_2007_and_2008_%E2%80%93_RH-1-2008.pdf?nodeid=551438&vernum=-2>.

which is the one derived from changes in the regulatory methods that affect the carrier's level of income.[88]

Moreover, the Regulator must apply the regulatory principles to determine whether the proposal structured by the carrier meets the legal mandate.[89] In addition, the Regulator can dictate procedural principles and conditions to which the negotiation process and the settlement must adhere.[90] These conditions and the procedural principles have been established by *the Negotiated Settlement Guidelines*.[91] I categorize these principles as procedural ones to differentiate them from the substantive principles which are describe below.

The substantive regulatory principles

The Regulator intervenes in the formation of prices and conditions of service on a case-by-case basis.[92] It applies the principles adopted in earlier decisions but decides each case based on the facts which give rise to the dispute in question.[93] To decide a given case the Regulator is not obliged to follow its previous decisions.[94] The Regulator believes that adherence to past decisions may prevent that body from adapting regulation to a changing business context.[95]

[88] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 33–34. See also *NEB Decision RH-1-2008, supra* note 87 at 42, 51.
[89] *CER Decision RH-001-2019, supra* note 78 at 40. See also *NEB Decision RH-1-2007, supra* note 61 at 21.
[90] *Negotiated Settlement Guidelines 2002, supra* note 55 at 1–3.
[91] *Ibid* at 1.
[92] *NEB Decision RH-1-2000, supra* note 75 at 39. It must be indicated that the cost of capital was regulated taking into account the information of multiple pipeline companies; see NEB Decision *Reasons for Decision, TransCanada Pipeline Limited, Westcoast Energy Inc, Foothills Pipe Lines Ltd, Alberta Gas Natural Gas Company, Trans Quebec and Maritimes Pipeline Inc, Interprovincial Pipeline Inc, Trans Mountain Pipeline Company Limited, Trans-Northern Pipeline Inc, RH-2-94* (Cost of Capital, March 1995) [*NEB Decision RH-2-94*] at 32. However, after 15 years of using that approach the Regulator decided that the cost of capital must be regulated based on the circumstances of each pipeline company; see NEB, *Reasons for Decision, Multi-Client Review of RH-2-94* (Cost of Capital, RH-R-2-94, 8 October Decision, October 2009) [*NEB Review Decision RH-2-94*] at 2. Equally, see *NEB Decision RH-1-2008, supra* note 87 at 81.
[93] *NEB Decision RH-1-2000, supra note 75* at 39.
[94] *Ibid*.
[95] *Ibid*.

The Regulator has not defined some of the principles.[96] This makes it necessary to resort to judicial decisions to understand the scope of some of the principles. Thus, for example, under the principle of prudence, the Regulator must examine whether the costs which the carrier estimates for a given period amount to the level necessary to provide the pipeline services offered.[97] In any event, there is no single definition of that principle.[98]

The Supreme Court in *Ontario (Energy Board) v. Ontario Power Generation Inc*, 2015 takes the view that unless Parliament or the provincial legislature orders to compensate the utility supplier for specific costs, it is incumbent on the utility regulator to determine what costs can be recovered to meet the mandate.[99] Accordingly, when the legal mandate is to determine just and reasonable prices, the utility regulator must compensate the company for the costs realized to the extent proved to be prudent to supply the services in the long term.[100] With that purpose the Supreme Court equates prudent costs with reasonable ones.[101]

---

[96] This point is illustrated by the principles of prudency and used and useful assets; see *NEB Decision RH-003-2011, supra* note 40 at 38-40. In this decision, the Regulator affirms that not even courts have made clear the relationship between these principles.

[97] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 13. The legal mandate requires the Regulator to recognize the carrier's prudent costs. This decision later indicated that the principle of prudency compels the carrier to provide pipeline services by employing the minimum resources necessary *(ibid* at 24).

[98] *Ontario Energy, supra* note 2 at para 102. The Supreme Court indicated the connection between the prudent and the used and useful principle. According to the Court, in the US, regulators have examined costs based on that principle along with the principle of used of used and useful expense (*ibid* at paras 90–92. About this, the Supreme Court warned that the understanding of these principles in that country is not necessarily applicable in Canada (*ibid* at para 88). Nonetheless, the Supreme Court believed that the experience in the United States of America shows the relationship of these principles. First, the prudence principle has been used under the condition that it is compatible with the specific statutory provisions being applied (*ibid* at para 94). Second, the prudence principle prevents the Regulator from refusing to recognize some realized costs based on considerations that the utility company did not know at the time the decision about those expenses was made. Specifically, the prudent principle avoids the creation of disincentives emerging from the application of the used and useful principle. In particular, this principle can affect the future provision of utility services when the recovery of a cost initially deemed reasonable is refused afterwards (*ibid* at para 91).

[99] *Ontario Energy, supra* note 2 at paras 103, 105.

[100] *Ibid* at paras 20, 76, 102–105, 107.

[101] *Ibid* at paras 20, 80, 102–105. When no presumption of prudence exists, it is incumbent on the utility company to persuade the Regulator that the costs are prudent (*ibid* at paras 74, 79, 104, 107). Under CERA, no presumption exists that the carrier's decisions on costs are prudent; indeed, quite the opposite is the case. Under the *NEBA,* the Regulator started from the premise that the carrier has the burden of proof. See *NEB Decision RH-1-2000, supra note 75* at 37–38. Therefore, the carrier has the burden to prove that costs for which it seeks regulatory compensation were prudently incurred.

The Supreme Court in *ATCO Gas and Pipelines Limited v Alberta (Utilities Commission*), 2015 indicated that the principle of prudence encompasses two complementary obligations.[102] First, the utility regulator must allow the company to recover the capital and operating costs reasonable to supply the services.[103] Second, the utility regulator must prevent the company from charging customers more than the costs realized to provide services.[104] With that aim, the regulator should prevent the utility company from obtaining a rate of profits over and above a fair return on the capital invested as I explained in the second chapter.[105] In this way, the utility regulator prevents the abuse of monopoly or market power as I explained in the second chapter. If the utility regulator fulfills these two related obligations, then the utility company achieves what the Supreme Court calls the financial viability of a pipeline system.[106] In the Supreme Court's opinion, a mandate to ensure just and reasonable prices involves the achievement of that viability and when it is attained there exists a balance of parties' interests between a utility company and its customers.[107]

Utility regulators usually apply the principle of prudence to examine the utility company's reasonableness of past expenses based on the prevailing conditions at the time they were made.[108] However, a utility regulator does and can look at the facts which occurred after the utility company incurred costs.[109] Hence, according to the Supreme Court even if the utility regulator approves some costs, the regulator can disallow them afterwards.[110] That could mean that the Regulator can order the carrier to exclude some assets from the base on which the rate of profits permitted is calculated.[111] The Regulator

---

[102] *ATCO Gas and Pipelines Limited v Alberta (Utilities Commission),* 2015 SCC 45 [*ATCO Gas*] at para 7.
[103] *Ibid*.
[104] *Ibid* at para 7.
[105] *Ontario Energy, supra* note 2 at para 16. The Supreme Court indicates that a return is fair when it meets two conditions: First, the return is determined considering the level of profits that could be obtained if the capital were used in a business of similar risk, and second, the return makes it possible to raise new capital. The Federal Court of Appeal views the fair return standard explained in the second chapter as a regulatory principle; see *TransCanada PipeLines Ltd. v. National Energy Board [2004]* F.C.A 149 [*FCA TransCanada Ltd*] at para 33.
[106] *Ontario Energy, supra* note 2 at para 11.
[107] *Ibid* at paras 20, 76, 102–105.
[108] *Ibid* at para 104.
[109] *Ibid.*
[110] *Ibid.*
[111] *NEB Decision RH-003-2011, supra* note 40 at 38. *CER Decision RH-001-2019, supra* note 78 at 43–44.

calls that base the rate base.[112] That order also seeks to ensure that the capital invested can be recovered through depreciation provided that the assets are used to supply services.[113] That order does not imply confiscation because the Regulator believes that the carrier must bear the risk of lack of use of the pipeline assets derived from a lasting reduction of traffic.[114] These assets constitute the problem of stranded assets as I explained in the second chapter. The principle of used and useful assets is employed to deal with that problem.[115] I will examine this principle in more detail in the fourth chapter.

According to the principle of cost causation also called cost-based/user pay, shippers must pay for the costs created by the transportation services obtained.[116] Conversely, the Regulator must prevent some shippers paying the costs caused by rival shippers.[117] That is the way in which the Regulator prevents the conduct called cross-subsidization.[118] Hence, the Regulator considers the cost-based/user pay principle to be the foundation to prevent cross-subsidization.[119]

Under the principle of efficiency, the Regulator seeks to ensure that prices lead parties to make the best use feasible of an existing pipeline system.[120] Based on that principle the Regulator sometimes authorizes the carrier to charge a price for a service which reflects the prevailing conditions of supply and demand for transportation services.[121] When that is the case, the Regulator accepts that the carrier charges prices

---

[112] *NEB Decision RH-003-2011, supra* note 40 at 26.
[113] *Ibid* at 38. *CER Decision RH-001-2019, supra* note 78 at 43–44.
[114] *NEB Decision RH-003-2011, supra* note 40 at 40–41.
[115] *Ibid* at 42–45.
[116] *NEB Decision RH-1-2007, supra* note 61 at 21.
[117] NEB, *Report on Nova Gas Transmission Ltd, GH-003-2015* (Application dated 2 September 2015 for the Towerbirch Expansion Project, October 2016) [*NEB Report GH-003-2015*] at 70, 73, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/2671288/2819218/3065005/3065109/A79841-1_NEB__-_Report_-_NOVA_Gas_-_Towerbirch_Facilities%2C_Tolling_Methodology_-_GH-003-2015.pdf?nodeid=3065196&vernum=-2>.
[118] NEB, *Reasons for Decision, TransCanada Pipeline Ltd, RH-001-2016* (Storage Transportation Service Modernization and Standardization Application—Part IV, Tolls and Tariffs, November 2016) [*NEB Decision RH-001-2016*] at 33, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/2927182/2926727/3311222/3083894/A80788-1_NEB_-_Reasons_for_Decision_-_TransCanada_-_Storage_Transportation_Service_-_RH-001-2016.pdf?nodeid=3084214&vernum=-2>.
[119] *NEB Decision RH-1-2007, supra* note 61 at 22.
[120] *Ibid*.
[121] *Ibid*.

which reflect the shippers' willingness to pay for a pipeline service rather than the actual costs involved.[122] That is the case for example when the Regulator approves an auction process to allocate the transmission capacity available.[123] In addition, the Regulator considers that the principle of efficiency has other implications.[124] One of them is that the Regulator can refuse the approval of a carrier's proposal to build pipeline assets when they are unnecessary to meet shippers' needs.[125]

In the Regulator's views, pursuant to the principle of non-acquired rights, the fact that shippers have paid a price for pipeline services does not create rights for them over pipeline assets.[126] The foundation of that principle is that the carrier rather than shippers is the owner of the transmission assets.[127] Accordingly, the carrier can request the Regulator to update the costs incurred by the carrier to supply services because the payment of a price for a given service does not create a right for shippers to continue paying indefinitely the same amount.[128]

The Regulator applies the principle of prevention of abuse of market power to avoid several actions.[129] First, the Regulator must prevent the carrier from charging diverse prices to different customers for the same service.[130] Second, the Regulator must prevent the carrier from taking actions which hinder the operation of market forces.[131] Third, the Regulator must ensure the carrier does not provide preferential treatment to subsidiaries and affiliated companies.[132] Fourth, the Regulator must prevent a carrier from engaging in unfair pipeline competition.[133] The scope of this principle shows that the Regulator

---

[122] *Ibid*.
[123] *NEB Decision RH-003-2011, supra* note 40 at 120.
[124] *Ibid* at 39–40.
[125] *Ibid*.
[126] *Ibid*.
[127] *Ibid*.
[128] *Ibid*.
[129] *NEB Decision RH-3-2004, supra* note 28 at 8.
[130] *Ibid*.
[131] *Ibid*.
[132] *Ibid*.
[133] *Ibid*. It is worth noting that the Regulator uses the concept of unfair pipeline competition rather than price collusion. This is because the Regulator does not seek to prevent an agreement between rival pipeline companies, contrary to the *Competition Act*—a behavior under the purview of the Competition Bureau. Rather, regarding competition between pipeline companies, the Regulator seeks instead to prevent one carrier from making some shippers in one market pay the costs created by shippers in another market. This conduct is not only contrary to

sometimes seeks to prevent the abuse of market power through the application of other principles, notably the unjust discrimination and cost causation ones.

The Regulator relies on but does not define the scope of the principle of fairness and equity.[134] Thus, in some cases, the Regulator has applied this principle to prohibit a carrier from changing the conditions of a service.[135] For instance, the Regulator has applied that principle when the changing business context in which a carrier operates is expected to cause the restructuring of the conditions of that service for other customers and to modify the conditions for the supply of other services.[136] When that is the case, the Regulator believes that it is unfair to change the conditions of supply for a specific group of shippers.[137]

As I explained earlier in this chapter, pursuant to the principle of open access and transparency, the Regulator must ensure that all shippers obtain equal treatment from the carrier regarding access to transportation facilities.[138] Finally, the Regulator applies the principle of non-discrimination which I explained earlier in the present chapter.

The efficiency principle under CERA

It is necessary to note that the regulatory principles were developed under *NEBA*.[139] That Act did not adopt any guiding principle.[140] However, unlike *NEBA*, one of the explicit purposes of CERA is that the construction and operation of pipelines must be efficient.[141] On this point, in a recent case the Regulator maintained that the principles

---

the principle of cost causation via cross-subsidization but also distorts pipeline competition. Thus, the Regulator understands that its purview encompasses the prevention of the behavior by which one carrier tries to overcome pipeline rivals by using cross-subsidization. See *NEB Examination Decision 2018, supra* note 54 at 5.

[134] *NEB Decision RH-001-2016, supra* note 118 at 34–35.

[135] *Ibid*.

[136] *Ibid*.

[137] *Ibid*.

[138] *Ibid* at 9.

[139] *NEB Decision RH-1-2007, supra* note 61 at 20–21.

[140] However, the *NEBA,* at ss 63 and 67, prohibited unjust discrimination. Yet, the Act did not indicate that the Regulator had to give preeminence to avoiding discrimination. In fact, NEBA did not refer to any other principle with respect to prices and other tariff conditions. Rather, the Act gave the Regulator discretion to develop the principles, as I will describe later.

[141] *CERA*, s 6, provides that one purpose of the Act is to ensure that pipelines are constructed, operated, and abandoned in a safe, secure, and efficient way, one that protects people, property, and the environment. Under the *NEBA*, the Regulator adopted the principle of efficiency as one of several principles to meet this mandate. See *NEB Decision RH-1-2007, supra* note 61 at 21–22.

developed under the former *NEBA* are applicable under CERA.[142] This Act equally establishes that part of the purpose is to ensure that the regulatory hearings and processes must be not only fair, inclusive, and transparent but also efficient.[143]

The foregoing has several implications. First, CERA seeks to ensure not only efficiency regarding the pipeline transportation activity but also regarding the legal processes used to achieve the mandate.[144] Second, the Regulator in practice seems to suggest that the principles developed to achieve the mandate are congruent with efficiency.[145] However, the Regulator has indicated that there are some conflicts between the principles.[146] That is one of the reasons why parties prefer negotiation.

The regulatory principles, the balance of parties' interests and the public interest

In the Supreme Court's opinion, the regulatory principles are the means to achieve the balance of parties' interests between a utility company and its customers.[147] In that respect, the Regulator affirms that if the carrier's proposals meet the regulatory principles, then the legal mandate is fulfilled.[148] Therefore, the Regulator applies the regulatory

---

[142] CER*, Reasons for Decision, Enbridge PipeLines Inc, RH-001-2020* (Application dated 19 December 2019 for Canadian Mining Contracting, November 2021) [*CER Decision RH-001-2020*] at 74–75, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/155829/3773831/3890507/4038614/4167013/C16317-1_Commission_-_Canada_Energy_Regulator_Reasons_for_Decision_RH-001-2020_%E2%80%93_Enbridge_Pipelines_Inc._%E2%80%93_Canadian_Mainline_Contracting_-_A7Y9R1.pdf?nodeid=4166515&vernum=-2>.
This decision concerns an oil pipeline company.

[143] *CERA, supra* note 1 at s 6 (d).

[144] That conclusion is derived from comparing *CERA, supra* note 1, ss (a) and 6 (d).

[145] *CER Decision RH-001-2019 supra* note 78 at 41.

[146] *NEB Decision RH-003-2011, supra* note 40 at 38, 103–104. The Regulator considers that sometimes the principle of prudency can be incongruent with the principle of used and useful assets. Similarly, in the Regulator's opinion, in some situations the principle of cost causation that serves to prevent cross-subsidization may give way to the principle of fairness and equity.

[147] *Ontario Energy, supra* note 2 at paras 20, 76, 102–105. In this decision the Supreme Court examined mainly the relationship between the principles of prudence and use and useful assets in utility regulation. Yet, the Supreme Court indicates that the legal mandate to ensure just and reasonable prices means that the regulator must achieve a balance of parties' interests. Therefore, the remaining principles equally serve to achieve that balance.

[148] *CER Decision RH-001-2019, supra* note 78 at 2, 37; *NEB Decision RH-1-2007, supra* note 61 at 21–23. The Regulator indicated that the regulatory principles are the instruments to interpret and apply the legal mandate; thus, also see *NEB Decision RH-1-2007, supra* note 61 at 21, as well as *NEB Decision RH-3-2004, supra* note 28 at 7, and *CER Decision RH-001-2019, supra* note 78 at 2.

principles to ensure that the carrier's behavior makes it possible to achieve that balance.[149]

That said, it is relevant to note that sometimes the Regulator assesses a carrier's proposal on prices, other tariff conditions and traffic to ensure that the prices and conditions are aligned with the public interest.[150] The Regulator does not define what public interest means.[151]

In that regard, in the *RH-003-2011* case parties argued that a carrier must examine how to recover the costs and deal with the business risks involved in pipeline transportation.[152] For that reason, they contended that shippers using one pipeline system did not have to bear the costs and business risks of a separate pipeline system controlled by the same carrier, but which they do not use, because doing so would be contrary to the public interest.[153] Yet, the Regulator solved that dispute based on the principle of cost causation.[154] Therefore, sometimes it is difficult to understand whether the public interest is merely the reflection of the regulatory principles or something else.

In other cases, the Regulator suggests that the exercise of regulatory powers and principles reflects the public interest.[155] More specifically, the Regulator indicates that such a concept goes beyond the individual private interests reflected in an agreement between a carrier and shippers involved in a dispute.[156] Consequently, the Regulator can intervene to review an agreement.[157] This is one of the situations in which the application of the public interest is clearest. This view is central to the *Negotiated Settlement Guidelines*.[158] In the Regulator's view, the fact that a carrier reaches a settlement

---

[149] *CER Decision RH-001-2019, supra* note 78 at 2, 37. *NEB Decision RH-1-2007, supra* note 61 at 21-23.
[150] *NEB Decision RH-3-2004*, *supra* note 28 at 49. Strictly speaking *CERA,* ss 225 to 240—related to prices and other tariff conditions—uses the concept of public interest only to indicate that the Regulator can require an oil or gas pipeline company to provide facilities or to extend them in a region to make it possible the supply of pipeline services. Yet, in the Regulator's view, public interest factors are relevant in other matters related to prices, other tariff conditions, and traffic. See *CER Decision RH-001-2020*, *supra* note 142 at 12–13.
[151] *CER Decision RH-001-2020*, *supra* note 142 at 13.
[152] *NEB Decision RH-003-2011, supra* note 40 at 73–74.
[153] *Ibid*.
[154] *Ibid* at 77.
[155] *CER Decision RH-001-2020*, *supra* note 142 at 12–13.
[156] *Ibid*.
[157] *Ibid* at 13, footnote 28 of that decision.
[158] *Negotiated Settlement Guidelines 2002, supra* note 55 at para (ii).

supported by a wide variety of shippers and other interested parties indicates the congruence of the settlement with the public interest.[159] Despite that, the Regulator can intervene to examine whether the settlement also reflects other interests not represented in the negotiation process.[160]

The Regulator relies on the premises to fill the gaps in the legal framework and to operationalize CERA into a working mechanism

According to the Supreme Court, the mandate to ensure just and reasonable prices implies that a utility regulator must find a balance of economic interests between the parties.[161] To achieve that balance, a utility regulator relies on the methods to weigh the parties' interests by looking at the costs which the carrier seeks to recover through prices.[162] In addition, the regulator relies on the principles to assess the reasonableness of the costs which the carrier seeks to recover through prices.[163]

Under CERA, the Regulator intervenes in the formation of prices in specific cases by responding to a carrier's application.[164] To achieve the balance of parties interests, the Regulator has developed two processes, each one associated with a method.[165] Specifically, the Regulator adjudicates based on the method of cost of service.[166] Thus, if the carrier chooses that method, then the Regulator adjudicates based on a public hearing process.[167] Alternatively, if carrier and shippers rely on the negotiation process to reach a settlement, the regulatory method is negotiated settlement.[168]

The carrier has autonomy to choose either cost of service or negotiated settlement to attain certainty and predictability.[169] Under cost of service the Regulator provides

[159] *Ibid*.
[160] *Ibid*.
[161] *Ontario Energy, supra* note 2 at paras 20, 76.
[162] *Ibid* at paras 7, 80, 81, 87.
[163] *Ibid* at paras 81, 90.
[164] *CERA, supra* note 1 at s 227.
[165] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Overview, Cost of Service Regulation, Negotiated Settlements.
[166] *Ibid*.
[167] *Ibid* at sections Overview and Regulatory Processes.
[168] *Ibid* at sections Overview and Negotiated Settlements. See also the *Negotiated Settlement Guidelines 2002, supra* note 55 at 1.
[169] *NEB Decision RH-3-2004, supra* note 28 at 70.

certainty to the carrier on the revenue requirement and to shippers on the prices.[170] The Regulator does that based on the application of the regulatory principles.[171] In contrast, parties prefer to negotiate to achieve their own degree of certainty on these matters.[172] In my opinion that suggests that parties prefer negotiation over adjudication to minimize regulatory risk, that is when parties negotiate they minimize the effect of changes in regulatory rules on the carrier's ability to generate income to cover the costs incurred.[173]

The Regulator achieves the balance of parties' interests through a two-part working mechanism: the revenue requirement and the price design.[174] The revenue requirement represents the total income the carrier must generate to recover all of the reasonable costs to provide pipeline services.[175] The price design, in turn, is the way in which the carrier divides the total of costs between shippers considering the volume of gas agreed to be transported or the actual volume carried during a given period for a shipper, the distance between receipt and delivery points and other characteristics of the services supplied to a shipper or group of shippers.[176] According to the Regulator, whatever the method and the associated process used, in practice the Regulator approves first the revenue requirement and then the price design adopted to obtain that revenue.[177]

Regardless of the method, the Regulator relies on the carrier's burden of proof to obtain the information regarding costs given that the carrier has the relevant

[170] *Ibid* at 244, 246. The Regulator decided that case, based on cost of service. The Regulator addressed the question of certainty at 1–3.
[171] *NEB Decision RH-3-2004, supra* note 28 at 6–9.
[172] *CER Letter Decision, April 2020, supra* note 19 at 2–3.
[173] The concept of regulatory risks is defined in *NEB Decision RH-2-2004, Phase II, supra* note 57 at 33, 43.
[174] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Overview, Cost of Service, Regulatory Process, Cost of Service Regulation, Negotiated Settlement, Toll Design. See also *NEB Decision RH-2-2004, Phase II, supra* note 57 at vii.
[175] *NEB Decision RH-2-2004, Phase II, supra* note 57 at vii.
[176] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at section Toll Design. See also *NEB Report GH-1-2004, Vol 2, supra* note 17 at 171.
[177] *Negotiated Settlement Guidelines 2002, supra* note 55 at 1; The letter accompanying the Guidelines dated 12 June 2002 at 2; *NEB Decision RH-003-2011, supra* note 40 at 246. See also *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at section toll design.

information.[178] Hence, when the application is based on cost of service it is incumbent on the carrier to prove to the satisfaction of the Regulator that each proposal meets the legal mandate.[179] Nevertheless, when the proposal is based on a negotiated settlement the carrier discharges the burden of proof demonstrating that the settlement as a package meets the legal mandate.[180]

The use of cost of service means that the carrier calculates the disaggregated costs for supplying pipeline services in a future period called the test year.[181] Hence, the use of that method implies that the carrier has the burden to proof that each proposal is based on the regulatory principles.[182] Then, the Regulator decides after considering the arguments of shippers and other interested parties on whether each cost issue derived from the proposal is congruent with the substantive regulatory principles.[183] That is the way in which the Regulator adjudicates on the revenue requirement and the apportion of costs.[184]

In contrast, the negotiation of a settlement means that the parties agree on an integrated solution, categorized as a package, on three price aspects: the costs recoverable, how to allocate them and the business risks.[185] In that respect, parties can agree that prices strictly reflect cost of services.[186] Yet, parties can also agree that prices reflect the shippers' willingness to pay for a service (for instance, when the carrier uses an auction process to allocate transmission capacity).[187] In other cases, the prices agreed to in principle can reflect the costs caused, but parties will sometimes agree to give discounts; accordingly the price payable does not always adhere strictly to the cost

[178] Regarding cost of service see *NEB Decision RH-1-2000, supra note 75* at 37–38. See also *NEB Decision RH-3-2004, supra* note 28 at 53, 55. Regarding a negotiated settlement, see *CER Decision RH-001-2019, supra* note 78 at 3.
[179] That conclusion emerges from the *CER Filing Manual Guide P* supra note 55 at 184, 192; and from *NEB Decision RH-1-2000* at 38.
[180] *Negotiated Settlement Guidelines 2002*, *supra* note 55 at para (iii).
[181] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at section Cost of Service Regulation.
[182] *NEB Decision RH-3-2004, supra* note 28 at 7, 55. See also *NEB Decision RH-1-2000, supra note 75* at 37–38.
[183] *NEB Decision RH-3-2004, supra* note 28 at 6–9. See *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Cost of Service Regulation and Toll Design.
[184] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Overview, Cost of Service Regulation and Tolls Design. See also *NEB Decision RH-2-2004, Phase II, supra* note 57 at 13, 16.
[185] *CER Decision RH-001-2019, supra* note 78 at 11. See also *CER Decision RH-001-2020*, *supra* note 142 at 79–80.
[186] *CER Decision RH-001-2020*, *supra* note 142 at 79–80.
[187] *NEB Decision RH-003-2011, supra* note 40 at 120.

caused.[188] In any event, parties determine the revenue requirement and price design which will govern the parties' relationships for several years.[189]

The role of the working mechanism

In brief, the Regulator achieves the balance of the parties' interests through the approval of the carrier's proposal on revenue requirement and the price design.[190] That balance is based on regulatory principles. Under adjudication and cost of service, the Regulator determines first the total level of costs required to supply pipeline services, evaluates the reasonableness of both the costs and allocates the business risks for the test year.[191] Hence, the Regulator's approval of the revenue requirement is the way to facilitate that the pipeline system in question is financially viable.[192] Second, based on the revenue requirement the Regulator authorizes the apportion of costs between the shippers by approving the price design.[193] In contrast, in negotiation parties have control over the mechanism.[194] The balance of parties' interests and hence the financial viability of a pipeline system results from the settlement which parties agree and the Regulator approves as a package.[195] In the end, the carrier can choose the method to make sure its pipeline system is financially viable.[196]

3.2 Elements of the legal framework

In what follows I will describe how the premises emerge from the Regulator's interpretation of its powers granted by CERA and serve to achieve the balance of parties' interests.

---

[188] *CER Decision RH-001-2020, supra* note 42 at 77.
[189] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at section Negotiated Settlements.
[190] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Tolls Regulation and Tolls design.
[191] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 16, 77.
[192] *Ibid*.
[193] *Ibid* at 16, 41–47.
[194] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Tolls Regulation, Negotiated Settlement and Tolls design.
[195] *Ibid;* See also *CER Decision RH-001-2019, supra* note 78 at 11.
[196] *NEB Decision RH-003-2011, supra* note 40 at 3, 246–247. Since the adoption of the negotiated settlement as an alternative method in the mid-1980s, the carrier has been able to choose which method better serves its interests to structure the price proposal; see *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Overview and Negotiated Settlement.

CERA establishes a set of powers germane to the Regulator's mandate.[197] The Regulator has power to approve price and other conditions of the tariff.[198] In that respect, CERA establishes that whenever the carrier seeks to adopt or change the price and other conditions of the tariff, the carrier has the obligation to submit a proposal for the Regulator's approval.[199] The Regulator also has power to suspend or disallow prices and other conditions of the tariff.[200] In addition, the Regulator has the power to issue orders on tariffs, prices and traffic.[201]

However, CERA does not establish how the Regulator can meet the mandate.[202] In particular, CERA does not establish the methods and the regulatory principles. Moreover, CERA does not establish all the processes applicable.[203] In fact, CERA gives the Regulator power to develop alternative methods of dispute resolution.[204]

The Regulator fills the gaps in CERA by using several instruments. First, the Regulator uses the legal powers already described.[205] Second, the Regulator relies on the premises which are based on the discretion granted by the mandate as I will describe below.

Regulatory discretion

CERA establishes a broad mandate for the Regulator to intervene in the formation of prices.[206] According to the courts, Parliament granted the Regulator discretionary power to develop the methods to meet that mandate.[207] In the courts' views that discretion

[197] *CERA, supra* note 1 at ss 226 to 235.
[198] *Ibid* at ss 227 to 232.
[199] *Ibid* at ss 227 and 229.
[200] *Ibid* at ss 229 and 233.
[201] *Ibid* at s 226.
[202] *Ibid* at s 226. This section merely gives power to the Regulator to make orders to fulfill the mandate established under *CERA* ss 11(a) and (c), and ss 230 and 231.
[203] *Ibid* at ss 6(d) and 45-53.
[204] *Ibid* at ss 11 (f) and 73.
[205] *CER Decision RH-001-2019, supra* note 78 at 2–3. See also *NEB RH-3-2004, supra note* 28 at 7–9.
[206] That mandate is provided for in *CERA, supra* note 1 at ss 11, 226, 230, and 231.
[207] *BC & Hydro, supra* note 57 at 655–656 (CA). The equal view was adopted in *TransCanada Pipelines Limited v. National Energy Board,* 2004, FCA 149 [*FAC TransCanada Ltd 2004*] at para 30.

also allows the Regulator to develop the substantive regulatory principles, which it uses to provide the foundation for its decision-making.[208]

The Regulator's discretion emerges from the nature of its mandate granted to it by Parliament through CERA.[209] Germane statutory law, in Canada but also elsewhere, frequently uses the terms just and reasonable prices to entrust utility regulators with the mandate to intervene in the formation of prices.[210] In that regard, the Supreme Court also held that the discretion to establish the methods relies on the utility regulator's expertise recognized by statutory law.[211]

---

[208] *BC & Hydro, supra* note 57 at 655–56 (CA). This decision relies on NEBAand does not use the concept of regulatory principles but indicates that the Regulator's power allows it to determine how to achieve the mandate. In addition, other courts' decisions that endorse the regulatory discretion refer to "the considerations" that the Regulator can used; see *Trans Mountain PipeLine, supra* note 57 at para 9. It must be indicated that Parliament and provincial legislatures usually grant powers to utility regulators to establish regulatory methods. That conclusion emerges from several statements made by the Supreme Court in *Ontario Energy, supra* note 2 at paras 20, 77, 78, 80 and 81. This decision is not based on CERA (*ibid* at para 77). However, this decision has to do with utility services, particularly electricity generation (*ibid* at para 11). Part of the discussions in the case addressed the question of the regulator's methodological discretion (*ibid* at para 77, 80). Thus, it is relevant to indicate that the Federal Court of Appeal considers pipeline transportation as a utility service; see *FCA TransCanada Ltd, supra* note 105 at paras 5–6, 11–12. That is also the Regulator's view; see *NEB Decision RH-2-2004, Phase II, supra* note 57 at 13, 16. Therefore, the Supreme Court's views on the regulatory discretion to develop methods are applicable to the regulation of pipeline services under CERA.

[209] About this, the Supreme Court indicates that in the event of a judicial review of a regulatory decision, the reviewing court looks at the reasonableness of the methodology applied. Thus, then, the Court differentiates two aspects of reasonableness in utility regulation. The first one is related to the utility regulator's mandate to intervene in the formation of prices, to ensure a balance of parties' interests. This is the most relevant aspect for the purposes of this thesis. The second aspect refers to the nature of the assessment that a court makes when an interested party asks for the judicial review of a regulatory decision; see *Ontario Energy, supra* note 2 at paras 73–74. In the Courts' view, the judicial review tends to be made under the reasonable standard. In other words, courts consider that when Parliament delegates power to an administrative tribunal it recognizes that some of the problems under the purview of the tribunal (which can perform regulatory functions) can have several acceptable solutions. Hence, a reviewing court gives the utility regulator the benefit of the doubt provided that two conditions are met. On the one hand, the regulators' reasons are comprehensible and justify the decision made. On the other hand, the course of action taken represents one of the several options that can reasonably be adopted under the enabling Act considering the relevant facts. Hence, Parliament relies on the expertise of the utility regulator to make the mandate a reality. See *Dunsmuir vs New Brunswick, 2008 S.C.C 9,* [2008] 1 S.C.R 190, para 47. According to the Court, the reasonableness standard contrasts with the correctness one, which looks at whether the utility regulator made the right choice (*ibid* at para 50). The later standard of review involves a more demanding judicial assessment of a regulatory decision (*ibid*). That second aspect of the reasonableness is not the focus of this thesis. However, that aspect enables understanding of the rationale behind the regulatory discretion and the expertise recognized by courts, as well as the limits of that discretion—which is revealed in how courts review regulatory decisions. Ultimately, the scope of judicial review implies that utility law is mainly developed by utility regulators, which are experts in the matters delegated by statutory law.

[210] *Ontario Energy, supra* note 2 at paras 20, 74, 76, 104, 105.

[211] *Ibid* at paras 80, 81.

Moreover, although courts do not mention regulatory discretion to develop processes, the Regulator does have discretion on this matter.[212] In fact, CERA establishes that one of its purposes is to ensure fairness, transparency, inclusiveness and efficiency in regulatory hearings and decision-making processes.[213] CERA does not define these concepts but gives power to the Regulator to adopt rules on procedures and practices.[214] The Regulator adopted these rules since 1995 under the former *NEBA* to conduct the litigation processes.[215] In addition, CERA gives the Regulator power to facilitate alternative dispute resolution processes.[216] The Regulator used that discretion to adopt the *Negotiated Settlement Guidelines*.[217]

Based on these powers, the Regulator relies on litigation to meet the mandate using a public hearing and adjudication process.[218] In addition, the Regulator has developed parties' negotiation as an alternative process to litigation.[219] In that respect, CERA provides that an agreement on matters under CERA resulting from alternative methods of dispute resolution do not create obligations.[220] Nevertheless, the Regulator can take the agreement into account to make the pertinent decisions pursuant to CERA.[221] Congruent with that rule, the *Negotiated Settlement Guidelines* conditions the negotiation process to the Regulator's review and approval.[222] Therefore, even in the case of negotiation the Regulator must intervene to deny or approve the settlement to ensure the fulfillment of the mandate.[223]

---

[212] *CERA, supra* note 1 at *s* 11 (f).
[213] *CERA, supra* note 1 at s 6.
[214] *CERA, supra* note 1 at s 35(d).
[215] The NEB adopted the Rules of Practice and Procedure 1995 (SOR/95-208) [*NEB Prac & Proc*], which are still in force. https://laws-lois.justice.gc.ca/PDF/SOR-95-208.pdf
These rules establish how to conduct the litigation process. The Regulator adopted these rules based on the power granted by *NEBA*, s 8, to make rules regarding applications and complaints. CERA*, supra* note 1 at ss 11(f), 35(d), 52(3), and 73, grants similar powers.
[216] *CERA, supra* note 1 at s 11(f).
[217] The current *Negotiated Settlement Guidelines 2002* were adopted in June 2002 to amend the Guidelines enacted in 1994. Covering letter of the *Negotiated Settlement Guidelines 2002, supra* note 55.
[218] *CERA, supra* note 1 at s 52(3); *NEB Decision RH-003-2011, supra* note 40 at 246–247.
[219] *Ibid*.
[220] *CERA, supra* note 1 at s 73.
[221] *Ibid*.
[222] *Negotiated Settlement Guidelines 2002, supra* note 55 at (ii), (iii), and (iv).
[223] *Ibid* at para (iv).

The regulatory methods and principles to achieve a balance of parties' interests

The Regulator uses the methods, the processes, and the principles to achieve the balance of parties' interests. I elaborate that point below.

According to the Supreme Court, when a utility regulator relies on cost of service, the mandate to ensure just, reasonable, and non-discriminatory prices for utility services means the balance of interests is achieved when consumers pay merely the costs required to provide the services needed.[224] As explained earlier, one of these costs is the cost of capital which is the profits permitted over the capital invested.[225]

The judicial view is that the methods represent the way to determine the components of the total costs involved in providing a utility service.[226] That view emerges from the fact that courts see regulation mainly in terms of the traditional cost of service method.[227]

On that point, the Federal Court of Appeal has maintained that in the absence of Parliament's guidelines on how to determine the justness and reasonableness of prices, the Regulator can use any relevant method within its regulatory toolbox.[228] In the court's view, cost of service is merely one of these assessment tools.[229] Yet, to achieve the mandate, the Regulator can use additional methods including, for instance, prices charged by other carriers or mechanisms to incent greater efficiency of the carrier.[230] As indicated earlier, since the mid 1980s, the Regulator (and its predecessor) has also relied on negotiated settlement.[231]

---

[224] *Ontario Energy, supra* note 2 at paras 20, 76.
[225] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 13, 16.
[226] *Ibid*.
[227] *Ibid* at paras 78, 80, 81.
[228] *FCA TransCanada Ltd, supra* note 105 at para 30-31. This interpretation was adopted under the *NEBA,* but this mandate is established under CERA at ss 230 and 231, as well as at s 22, through its power to enact orders about all matters regarding traffic, prices, and tariffs.
[229] *FCA TransCanada Ltd, supra* note 105 at para 30-31.
[230] *Ibid*.
[231] NEB Draft Guidelines for Negotiated Settlements on Traffic, Tolls and Tariffs, File 4600-A0003-3, January 30 January 2002 at 2. [*Draft Negotiated Settlement Guidelines 2002*] online <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/157025/142122/Letter_%28A0C7Y1%29.pdf?nodeid=142123&vernum=-2>

However, on very few occasions courts have examined the use of negotiated settlement as a utility regulatory method. That seems to be explained by the fact that the settlement is the result of parties' negotiation reflecting the balance of interests which they agree.[232]

Given the long term and the changing context within which the business relationship between the carrier and shippers operates, the balance of interests is regularly adjusted throughout the life cycle of transmission assets.[233] The carrier attains that aim by using cost of service or negotiated settlement sequentially as the carrier can consider appropriate to recover its costs.[234] In that regard, the Regulator has indicated that it cannot oblige the carrier to negotiate.[235]

The above implies that every time that the carrier applies it does not begin anew the relationship with shippers but seeks to adapt prices and conditions of service to the changing business context.[236] Hence, the carrier regularly asks the Regulator to adjust the balance of interests considering the changes in the business context.[237] Hence, the submission of an application does not always imply a complete change of the price design.[238] As a matter of fact, sometimes the carrier applies merely to adjust some of the elements of the price design.[239]

The carrier's burden of proof and the prudence of the carrier's decisions

CERA expressly refers to the burden of proof on matters of pipeline prices only under the section that prohibits unjust discrimination.[240] Thus, if it is proved that a carrier

That document indicates that for several years the parties start using settlements that adopted conditions, to overcome the need to ask for annual approval of price and other tariff conditions. Yet, the NEB adopted the Guidelines in Negotiated Settlements in 1985 and parties used that method since then.

[232] *CER Decision RH-001-2019, supra* note 78 at 11.
[233] *NEB Decision RH-003-2011, supra* note 40 at 1–3, 39, 44, 246–247.
[234] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 1–4.
[235] *NEB Decision RH-3-2004, supra* note 28 at 71.
[236] *NEB Decision RH-003-2011, supra* note 40 at 3, 39, 45, 141.
[237] *Ibid* at 42–45.
[238] *Negotiated Settlement Guidelines 2002, supra* note 55 at para 3.
[239] *Ibid*.
[240] *CERA, supra* note 1 at ss 235 and 236.

discriminates in prices, services or facilities, the carrier has the burden to prove that the discrimination is justified.[241]

However, the Regulator starts from the premise that the carrier's burden of proof applies not only to prove that discrimination is justified but also to other issues.[242] Hence, the Regulator considers that the carrier must prove in any case that the proposal to recover costs leads to just, reasonable, and non-discriminatory prices.[243] Consequently, a carrier can obtain regulatory approval of an application only if it discharges the burden of proof.[244]

Given the above, it is relevant to investigate the legal foundations which serve the Regulator to adopt that premise.[245] On this point, the Supreme Court indicates that sometimes Parliament or a provincial legislature adopts a presumption of prudence as the approach to evaluate the utility company's decisions on costs rather than the burden for the company to prove that the costs incurred are prudent.[246] The Court does not explain why legislatures and Parliament prefer one or the other approach.[247] Yet, in the absence of a statutory provision containing the presumption of prudence, a utility company has the duty to prove that a price proposal meets the mandate.[248] In that event, the way in which a utility regulator allocates the burden of proof is part of the legal discretion granted.[249]

---

[241] *Ibid* at s 236.

[242] The Regulator under NEBAconcluded that the burden of proof was on the applicant to obtain the relief it sought in the application. The Regulator adopted this view without indicating the specific section of NEBAthat supported this perspective. This position was adopted in *NEB Decision GH-2-87, supra* note 34, and reiterated in *NEB Decision RH-1-2000, supra note 75* at 37–38. The Regulator also contended that the applicant must provide evidence and arguments. *CERA*, ss 230, 231 and 235, establishes that prices must be just, reasonable, and non-discriminatory (adopting the same language as in NEBA, ss 62, 67 and 68); thus, the Regulator's views on the carrier's burden of proof seem to be a consequence derived from these provisions.

[243] *CER Filing Manual - Guide P supra* note 55 at 192.

[244] *Ibid*. See also *NEB Decision RH-1-2000, supra note 75* at 37–38.

[245] I affirmed above that the Regulator's discretion granted by Parliament covers methods, processes, and principles.

[246] *Ontario Energy, supra* note 2 at paras 79, 80, 104, 107.

[247] *Ibid*.

[248] *Ibid*.

[249] *Ibid* at paras 80, 81.

According to the Supreme Court, the burden of proof is the regulatory instrument to determine whether the utility company's decisions on costs are prudent.[250] That instrument serves the regulator to determine whether the utility company can fully recover the prudent costs realized including the profits permitted.[251] Based on that burden, the regulator can assess the reasonableness of costs from the perspective of both the utility company and the customers based on the burden of proof.[252] Therefore, that burden is an instrument to find the balance of parties' interests.[253]

Meanwhile, CERA does not contain a carrier's presumption of prudence. Instead, the *Regulators' Filing Manual Guide P* and the *Negotiated Settlement Guidelines* require the carrier to provide the information necessary to put the Regulator and shippers in a position to evaluate the reasonableness of the carrier's costs.[254] Therefore, under CERA it is the Regulator who assigns the burden of proof to the carrier and thereby assumes that the carrier has the information relevant for regulatory purposes.[255] In any event, the level of information which a carrier must supply depends on the degree of the carrier's market power.[256]

The Regulator can obtain the evidence from the carrier mainly through the carrier's application, information requests and the public hearing process.[257] In that respect, the

[250] *Ibid* at paras 75-80, 104.
[251] *Ibid*.
[252] *Ibid*.
[253] *Ibid*.
[254] *CER Filing Manual - Guide P supra* note 55 at 186, 192. *Negotiated Settlement Guidelines 2002, supra* note 55 at (iii).
[255] *NEB Decision RH-1-2000, supra note 75* at 37–38. See also *CER Filing Manual - Guide P supra* note 55 at 185–191 and the *Negotiated Settlement Guidelines 2002, supra* note 55 at para (iii).
[256] *CER Filing Manual - Guide P supra* note 55 at 184.
[257] *NEB Prac & Proc, supra* note 215 at ss 15–18, 32, 36(8), 37. Specifically, ss 32, 36(8) and 37(5) of these rules establish the means that can be used within the litigation process to obtain information. This includes the information provided in the application as well as the evidence obtained through the public hearing process. According to these rules, the evidence that forms the record of the applicant in a regulatory process includes the information obtained through either an oral or written public hearing. See also *NEB Decision RH-1-2000, supra note 75* at 37–38. When a carrier applies based on cost of service, the burden of proof must be discharged mainly in the application as indicated in *CER Filing Manual - Guide P supra* note 55 at 184-187. The information required is based on NEB Rules of Practice and Procedure. When the carrier submits a negotiated settlement for approval, the carrier must submit the information established in the *Negotiated Settlement Guidelines 2002, supra* note 55 at para (iii).

Regulator uses the public hearing not only as an instrument to obtain more evidence but also to scrutinize the evidence presented in the application.[258]

However, in the Regulator's view the carrier's burden of proof goes beyond evidence on costs and business risks.[259] In fact, the *Regulator's Filing Manual Guide P* requires the carrier to provide descriptions, explanations and justifications necessary to understand some of the evidence.[260] For instance, the carrier must supply explanations on increases or decreases in costs.[261] Moreover, the carrier needs to explain the method used to apportion costs between regulated and non-regulated activities.[262] Equally, the carrier has the duty to describe the techniques and assumptions used to calculate the rate of return and to justify the estimates made on that matter.[263]

The asymmetry of information between the carrier and the Regulator

Since the 1970s, the practice under cost of service regulation has been that a carrier makes a proposal based on forecast costs which will be recoverable in the test year.[264] That carrier's forecast usually covers one year.[265] Although the Regulator can contrast and compare that information with the carrier's data from previous years, the carrier's estimations of costs for the test year are the key aspect to approve prices under the method of cost of service.[266]

In contrast, in the case of a negotiated settlement, parties agree on the level of costs which the carrier can incur for several years.[267] In that respect, in the view of one carrier the longer the term of a settlement, the less reliable are the carrier's estimations of costs and the assessment of business risks given their changing nature.[268] Therefore, in a negotiated settlement parties do not merely rely on the unilateral carrier's

[258] *Ibid*.
[259] *CER Filing Manual - Guide P supra* note 55 at 184-194. *Negotiated Settlement Guidelines 2002, supra* note 55 at (iii). Both documents show that the main source of evidence in the regulatory processes is the carrier itself.
[260] *CER Filing Manual - Guide P supra* note 55 at 185–191.
[261] *Ibid*.
[262] *Ibid* at 185–186.
[263] *Ibid* at 189–191.
[264] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 1, 13.
[265] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at heading Toll Regulation.
[266] *CER Filing Manual - Guide P supra* note 55 at 185, 187.
[267] *Ibid* section Negotiated Settlements.
[268] *CER Decision RH-001-2020*, *supra* note 142 at 82.

assumptions and estimations.[269] Rather, in negotiation parties are based on their expertise acquired by years of participating in the energy industry.[270] That implies that in negotiation parties are more willing to share business risks.[271]

Congruent with the practice of the test year, the *Toll Information Regulations* expressly recognize that there can be differences between the carrier's forecast data on which the Regulator approved prices for a given test year and the subsequent actual data on costs, traffic, capital, revenue requirement and rate of return for the test year.[272] For that reason, after the approval of a proposal every carrier must explain every three months the reasons for these differences.[273] Therefore, it is necessary to investigate why these differences can happen.

A utility company faces two types of costs.[274] First, some costs which reflect obligations that a utility company has acquired but will be totally or partly payable in the test year.[275] They are known as committed costs.[276] Second, other costs that the utility company can opt to incur (or not) in the test year.[277] These costs are known as forecast costs.[278] The Supreme Court considers that some obligations can reflect both types of costs.[279]

Complementary, a carrier's proposal relies on estimations of the level of natural gas traffic for the test year.[280] To make these estimations a carrier needs to assess the likelihood of business risks affecting traffic.[281] As explained earlier, these risks include changes in the level of supply, demand of natural gas and pipeline competition and other

---

[269] *Ibid*.
[270] *Ibid*.
[271] *Ibid* at 82–83.
[272] *Toll Information Regulations SOR/79-319* [*Toll Information Regulations*] at ss 3,5 online: (pdf) <https://laws-lois.justice.gc.ca/PDF/SOR-79-319.pdf>. These regulations were enacted in 1979 before negotiated settlement was adopted in practice.
[273] *Ibid* at section 4.
[274] *Ontario Energy, supra* note 2 at paras 31, 82–83, 117.
[275] *Ibid* at paras 82–83.
[276] *Ibid*.
[277] *Ibid*.
[278] *Ibid*.
[279] *Ibid* at para 117.
[280] *NEB Decision RH-003-2011, supra* note 40 at 24–25, 43–45, 148, 161.
[281] *Ibid* at 24–25.

factors.[282] Thus, a carrier also has to consider the magnitude of these risks as it can be lower or higher than forecast.[283] Accordingly, the Regulator recognizes that the data used to make these assessments is contingent upon multiple economic factors some of which are unknown at the time of making the estimations.[284] In addition, the Regulator indicates that the estimations involve the carrier's discretion to choose what aspects are relevant to consider.[285] In this respect, the Regulator admits that the evolution of these factors does not always depend on the carrier's actions.[286] Even so, the Regulator expects that the carrier will take reasonable actions to minimize the business risks to the extent feasible.[287]

One of the implications of the assessment of actual and forecast traffic is that a carrier can estimate the useful economic life of transmission assets.[288] Based on that, a carrier can depreciate these assets.[289] In that regard, the Regulator has recognized that the carrier has discretion to decide how to deal with business risks by choosing the depreciation method applicable to the assets.[290] The depreciation cost is the value of a asset minus the wear on that asset over time; yet, the Regulator also considers that depreciation is the cost the carrier charges to recover the capital invested over the estimated useful life of the assets.[291] Therefore, the forecast of traffic is a forecast of useful life of assets and is thus central to a calculation of the recovery of capital.[292]

In that regard, the Regulator asks carriers to revisit with frequency their depreciation calculations and to submit them to regulatory scrutiny to prevent the carrier from transferring to shippers the risks of assets, which – in the Regulator's view – should

[282] *NEB Decision RH-003-2011, supra* note 40 at 42–45.
[283] *Ibid* at 24–25.
[284] *Ibid* at 25, 43–45.
[285] *Ibid* at para 25, 148.
[286] *Ibid*.
[287] *Ibid* at 25. See also *NEB Decision RH-2-2004, Phase II, supra* note 57 at 46.
[288] *NEB Decision RH-003-2011, supra* note 40 at 43–45, 226.
[289] *Ibid*. See also *NEB Examination Decision 2018, supra* note 54 at 5–8. In that decision the Regulator asked competing carriers to supply detail information on depreciation policies and practices, capital spending, and price design—beyond what is usually requested under the *CER Filing Manual - Guide P supra* note 55 at 184-194.
[290] *CER Decision RH-001-2019, supra* note 78 at 45–46.
[291] *NEB Decision RH-2-2004, Phase II, supra* note 57 at ix, 30–31, 46.
[292] *Ibid.*

be borne by its shareholders.[293] To achieve this aim, the Regulator expects that carriers report with diligence the evolution of business risks and the actual use of assets over time.[294] Thus, the Regulator demands the carrier to maintain transparency as projections mature into realities.[295]

The above shows that the differences between forecast and actual data recognized by the *Toll Information Regulations* can be explained not only by the unpredictable nature of some the factors involved in the carrier's estimations but also by the carrier's discretion to decide how to estimate costs and evaluate business risks.[296]

That discretion reveals what the Alberta Utility Commission (AUC) calls the asymmetry of information between the utility company and the Regulator.[297] As expressly recognized by the AUC, the utility company controls the information regarding the costs recoverable.[298] Hence, according to the AUC, the asymmetry of information creates the risk that the utility company can choose what information is relevant for the Regulator to scrutinize the company's conduct.[299] As I indicated in the literature review in the second

---

[293] *NEB Decision RH-003-2011, supra* note 40 at 42–45. See also *CER Decision RH-001-2019, supra* note 78 at 45–46.

[294] *NEB Decision RH-003-2011, supra* note 40 at 44.

[295] *Ibid* at 42–45.

[296] *Ibid* at 24–25. See also *CER Decision RH-001-2019, supra* note 78 at 45–46.

[297] The Regulator recognizes that the mandate involves the division of costs and business risks between carrier and shippers. The Regulator starts from the premise that the information on these matters is controlled by the carrier. In fact, the Regulator 's *CER Filing Manual - Guide P supra* note 55 at 184-194 details the information that the carrier must submit with the application. The same rationale exists under the Negotiated Settlement Guidelines, which require the carrier to provide all the necessary information to understand the settlement reached. *Negotiated Settlement Guidelines 2002, supra* note 55. Despite these requirements, shippers repeatedly ask for additional information to understand and question the carrier's proposal. See *CER Decision RH-001-2019, supra* note 78 at 11, 42, 47.

[298] Unlike the NEB and the CER, the Alberta Utility Commission (the AUC) has explicitly recognized that regulatory difficulty under the *Alberta Electric Utilities Act,* S.A 1995, c. E-5.5. See AUC, *Decision 2014-283: ATCO Electric Ltd. 2012 Transmission Deferral Account and Annual Filing for Adjustment Balances, Application 1609720, Proceeding 2683, October 2, 2014* at paras 64–67; this Decision is no longer available online. According to the AUC, this difficulty emerges from the fact that the regulated company, which owns and manages the transmission assets, is the party controlling the information required to regulate the prices of that activity. In the AUC's views, this fact creates a disadvantage for those who pay the prices. Nevertheless, the AUC argues that it has several mechanisms to minimize that asymmetry. These mechanisms include the burden of proof, requests of information, and cross-examination. In addition, the AUC can adopt measures outside the regulatory process, notably monitoring the utility company's performance and adopting independent auditing processes. AUC Decision 2014-283 (October 2, 2014) at paras 28, 64–66.

[299] *Ibid*.

chapter, some authors consider that, given that asymmetry, a utility company can even distort the information.[300]

Meanwhile, it is relevant to indicate that under CERA the Regulator sometimes uses the expression asymmetry of information to refer to the fact that a carrier does not submit to shippers and other interested parties all the information necessary for them to negotiate on an equal footing.[301] At other times the Regulator does not use that expression but recognizes the asymmetry by requiring not only data but also explanations and justifications of the carrier's evaluation of business risks and estimation of costs.[302]

Based on the above, it can be said that the problem of asymmetry of information between the carrier and the Regulator is not whether the carrier supplies to the Regulator the evidence required. In fact, the *Filing Manual Guide P* starts from the premise that the burden of proof compels the carrier to supply the information on costs and the evaluation of long-term business risks to obtain regulatory approval of the proposal.[303] Instead, the problem of asymmetry of information is that the carrier can choose, at its discretion, what information is relevant to estimate future costs.[304] That discretion involves the carrier's preferences on the techniques used to assess data and make assumptions to forecast costs and evaluate business risks.[305] In that respect, the Regulator considers that the longer the period the carrier uses to evaluate the business risks, the more unpredictable their evolution.[306]

The Regulator seeks to minimize the asymmetry of information to ensure the prudency of carrier's decisions on costs using several instruments.[307] First, before the approval of a carrier's application, the Regulator needs to examine in a public forum not

---

[300] Paul L Joskow, "Regulation of Natural Monopoly" in A Mitchell Polinsky & Steven Shavell, eds, *Handbook of Law and Economics*, Vol 2, 2007 (Amsterdam: North Holland, 2007) at 1231, 1301–1302.
[301] *CER Decision RH-001-2020*, *supra* note 142 at 81.
[302] *NEB Decision RH-003-2011, supra* note 40 at 24–25. See also *CER Filing Manual - Guide P supra* note 55 at 185–190.
[303] *CER Filing Manual - Guide P supra* note 55 at 184–192.
[304] *NEB Decision RH-003-2011, supra* note 40 at 24–25. This regulatory view is associated with the degree of the carrier's market power. In fact, the Regulator indicates that the greater the degree of market power, the greater the degree of information the carrier must provide; see *CER Filing Manual - Guide P supra* note 55 at 184.
[305] *Ibid*; *CER Filing Manual - Guide P supra* note 55 at 184–192.
[306] *NEB Decision RH-003-2011, supra* note 40 at 24–25, 191, 235.
[307] *Ibid*.

only the data but also the carrier's assumptions, assessments and justifications involved in its given proposal.[308] To achieve that, the Regulator does not rely merely on its own expertise but allows the carrier, shippers and other interested parties in the regulatory process to submit expert evidence.[309] Second, after the approval of an application the Regulator must examine every three months the carrier's explanations on the differences between forecast and actual data.[310] Third, if the explanations do not satisfy the Regulator, then it must require more information.[311] Therefore, the Regulator needs to examine the prices actually charged after the approval of an application.[312] That implies that the *Toll Information Regulations* lead the Regulator to go beyond the mere approval of the carrier's estimations of costs at a given point in time to fulfill a subsequent supervisory role to counter the asymmetry of information.

3.3 How parties litigate and negotiate

In what follows I will describe how the Regulator determines the revenue requirement and the price design to achieve the balance of parties' interests in response to a carrier's application. I will describe how parties litigate based on cost of service and hence how the Regulator adjudicates to solve disputes. Then, I will describe how parties negotiate and then how the Regulator reviews the negotiation process and the resulting settlement.

The balance of parties' interests under cost of service and adjudication

Under cost of service, the Regulator achieves the balance of interests between the carrier and its shippers by examining the carrier's proposal.[313] To do so, the Regulator follows two steps.[314] In the first step the Regulator approves the revenue requirement which involves approving the total level of costs for the test year.[315] In the second step

[308] *Ibid*.
[309] *NEB Decision RH-003-2011, supra* note 40 at 56, 60, 148, 154.
[310] *Toll Information Regulations supra* note 272 at ss 3, 5
[311] *Ibid* at s 4.
[312] *Ibid* at ss 4, 5.
[313] *FCA TransCanada Ltd, supra* note 207 at para 5. This court decision endorsed the way in which the Regulator calculated the rate of return using cost of service, under the *NEBA*.
[314] *Ibid.*
[315] *Ibid.*

the Regulator approves the price design which the carrier will use to divide the total level of costs between shippers.[316]

The carrier's revenue requirement

To approve the revenue requirement the Regulator examines the carrier's total capital and operating costs as explained below.[317] It is incumbent on the carrier to prove that all the claimed costs are prudent.[318] To that effect, the Regulator establishes the content and scope of the disaggregated information on costs which the carrier must submit in the application.[319]

I will describe in more detail below the main issues which give rise to litigation and the Regulator's adjudication.

According to the Regulator, the concept of capital involves two aspects.[320] On the one hand, the recovery of the capital itself, namely the amount invested to build transmission assets.[321] With that aim, the Regulator approves the carrier's application on the cost of depreciation of assets.[322] That cost is recovered throughout the useful economic life in which the carrier expects to use the assets to provide pipeline services.[323] On the other hand, the recovery of the cost of capital.[324] This cost basically involves two components.[325] First, the carrier's payment of interest derived from the loans contracted.[326] Second, the carrier's profits on the capital invested which are calculated as

[316] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Cost-of-service Regulation and Toll design.
[317] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 15, 17–18.
[318] *Ibid* at 13, 43. See also *NEB Decision RH-1-2000, supra note 75* at 37–38.
[319] *CER Filing Manual - Guide P supra* note 55 at 184.
[320] *NEB Decision RH-003-2011, supra* note 40 at 41.
[321] *NEB Decision RH-2-2004, Phase II, supra* note 57 at p 30. As well, *NEB Decision RH-003-2011, supra note 40* at 26, indicates that the total amount of investment to build pipeline facilities amounts to the rate base. This amount is used to calculate the level of profits (also called "return") that the Regulator considers can be earned on that investment.
[322] *NEB Decision RH-2-2004, Phase II, supra* note 57 at p ix.
[323] *Ibid* at 46. The cost of depreciation is deducted from the generated earnings of the company but does not involve a disbursement of funds (*ibid* at ix).
[324] *Ibid* at 13. According to the Federal Court of Appeal, the most significant part of the carrier's full costs is the cost of capital. See FCA *TransCanada Ltd, supra* note 105 at para 5.
[325] FCA *TransCanada Ltd, supra* note 105 at paras 6–8.
[326] *Ibid*.

a percentage of the total amount of assets actually used to supply services.[327] That percentage of profits is called the rate of return.[328]

The carrier's operating costs, in turn, include labour, pipeline maintenance and administrative expenses, amortization of debts, and taxes.[329]

Depreciation and the allocation of business risks

Central to the calculation of revenue required is how the allocation of business risks is made through the depreciation cost.[330] I develop this point below.

According to the Regulator, it is the carrier's duty to evaluate the useful life of assets by looking at the business risks.[331] If the business risks become a reality, then the carrier may not recover the capital invested.[332] Hence, if the carrier considers that the depreciation rate being used at a given point in time is incongruent with the estimates of useful life of assets, then it is incumbent on the carrier to review the depreciation methodology and to apply for the Regulator's approval.[333]

In addition, the Regulator examines parties' issues on whether some transmission assets are no longer used.[334] To solve these issues the Regulator applies the principle of used and useful assets to prevent the carrier from transferring to shippers their costs.[335] To achieve that, the Regulator can order to exclude unused assets from the rate base.[336]

---

[327] *Ibid*. See also *NEB Decision RH-003-2011, supra note 40* at 26.
[328] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 13, citing *FCA TransCanada Ltd, supra* note 105 at para 6.
[329] NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-2-2004, Phase I* (2004 Mainline Tolls and Tariffs Application, September 2004) [*NEB Decision RH-2-2004, Phase I*] at 5, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/334963/A08344-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Tolls_and_Tariff_%E2%80%93_RH-2-2004_Phase_I.pdf?nodeid=334859&vernum=-2>. See also *NEB Decision RH-2-2004, Phase II, supra* note 57 at xi, 15. Those decisions do not define what the operating costs are. Yet, the latter decision does not include cost of capital and depreciation within the operating costs.
[330] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 46.
[331] *Ibid*.
[332] *Ibid*. See also *NEB Decision RH-003-2011, supra note 40* at 42–45.
[333] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 46.
[334] *NEB Decision RH-003-2011, supra* note at 42–45.
[335] *Ibid.*
[336] *Ibid at* 43

The Regulator has also indicated that to achieve the mandate, it is necessary to ensure that costs reflect the level that would prevail under pipeline competition.[337] To achieve that, the Regulator applies the principle of efficiency to prevent a pipeline company from building assets over and above the level necessary to meet shippers' needs.[338]

The rate of return and the allocation of business risks

When a carrier applies for approval of the cost of capital it has the burden to prove that the proposed rate meets the fair return standard.[339] As I explained in the second chapter, to apply that standard the Regulator evaluates three aspects of the rate of return proposed.[340] First, the Regulator evaluates whether that rate provides shareholders with dividends comparable to the level which they could obtain by investing in other companies exposed to a similar level of risk.[341] Second, the Regulator examines whether the rate proposed facilitates the pipeline company to effectively raise all the money via capital and loans to pay all obligations.[342] Third, the Regulator assesses whether the rate proposed makes it possible for the carrier to compete for funding with similar companies.[343]

The application of the fair return standard requires the carrier to examine the business risks for several reasons.[344] First, the business risks determine whether the carrier is able to generate the revenue required to pay debts to creditors and dividends to investors, and ultimately to recover the capital.[345] Thus, the carrier needs to examine

[337] *NEB Report GH-003-2015, supra* note 117 at 71. The majority and the dissenting opinions shared the view that the decision to invest in the construction of new transmission assets must be analyzed while considering various principles, including prudency and efficiency. *Ibid* at 77.
[338] *Ibid*.
[339] *NEB Decision RH-1-2008, supra* note 87 at 5–7.
[340] *FCA TransCanada Ltd, supra* note 105 at paras 33–34. See also *NEB Decision RH-2-2004, Phase II, supra* note 57 at 17.
[341] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 17. According to the Supreme Court, to meet the mandate the utility regulator must look at capital markets and take as a point of reference investments that investors regard to be comparable in terms of certainty, attractiveness, and stability. About this, the Federal Court of Appeal cited the Supreme Court decision *NW Utilities, supra* note 2 at 192-93.
[342] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 77.
[343] *NEB Decision RH-1-2008, supra* note 87 at 30, 67.
[344] *Ibid* at 18–19.
[345] I concluded this based on *NEB Decision RH-003-2011, supra note 40* at 1–3, 13, 26, 148, 161. In fact, the Regulator adopted that decision in response to an application designed to restructure the regulatory framework of

whether business risks have varied after the Regulator evaluated them the last time.[346] That is because the Regulator seeks to compensate the shareholders for investing in a context in which capital can be lost if business risks become a reality.[347] Second, the carrier must examine the business risks faced by a group of companies exposed to risks comparable to the level faced by the carrier.[348] The carrier needs to do that to prove that the rate of return derived from the market data available for that sample of companies is a valid point of reference to determine the rate of return sought.[349]

In brief, when the Regulator approves the revenue requirement that decision includes the assessment of the prudency of the costs required to provide pipeline services.[350] Some of these costs are the rate of return and the depreciation cost which leads the Regulator to assess and approve how business risks are allocated between a carrier and shippers.[351]

The carrier's price design

The Regulator approves the division of the total costs between shippers based on the principle that prices must reflect the costs caused for the supply of the specific type

---

TransCanada. That regulatory intervention was necessary to deal with the consequences resulting from the growing level of business risks faced by TransCanada.

[346] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 41–47. It is also relevant that the Regulator applied the rate of return standard to determine the rate of return on capital equity. After that, the Regulator examined the evidence on two separate matters. First, the Regulator examined the business risks to ascertain whether any net change between them had occurred since the last Regulators' review. Second, the Regulator examined other type of risk associated with how the carrier seeks to finance its operations. This risk emerges from the relationship between the debt to creditors and the shareholders' capital used. The Regulator categorizes the relationship between these sources of funding as capital structure. In the Regulator's view, the higher the level of debt to creditors, the less likely it is that shareholders can obtain dividends. For that reason, how the costs of a carrier's activities are covered is seen as a financial risk. Finally, the Regulator adapted the rate of return to reflect the financial risk and any net increase or decrease in business risks (*ibid* at X, 13, 17–18). However, in *NEB Decision RH-1-2008, supra* note 87, the Regulator adopted a different approach to apply the rate of return standard, which is the one already described. According to this decision, it is incumbent on the carrier to determine the capital structure and to evaluate both the business and financial risks as the determining factors in the rate of return (*ibid* at 18–19, 81).

[347] *NEB Decision RH-003-2011, supra note 40* at 44. See also *NEB Decision RH-2-2004, Phase II, supra* note 57 at 46.

[348] *NEB Decision RH-1-2008, supra* note 87 at 18–19.

[349] *Ibid.*

[350] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 16.

[351] *Ibid* at 13, 16, 26, 41–47.

of services.[352] To achieve that, the Regulator evaluates and approves the carrier's proposed methodology to calculate the prices that the carrier seeks to charge to recover the costs caused by each type of service or group of shippers.[353]

On that point, the Regulator seeks to prevent cross-subsidization between shippers but recognizes that this practice is inevitable to some degree.[354] Accordingly, in the Regulator's view, what is contrary to the legal framework is unreasonable cross-subsidization.[355] Specifically, the Regulator considers that the aim of preventing cross-subsidization has limits.[356] In particular, the Regulator argues that such an aim must be balanced with other regulatory principles.[357] Thus, the Regulator abstains from ordering the elimination of cross-subsidization if that is necessary to preserve the principles of fairness and equity.[358]

In regulating conditions of service under the method of cost of service, the Regulator applies the principle of open access and transparency.[359] The Regulator does that to ensure that all shippers can obtain equal treatment from the carrier regarding access to transportation facilities.[360]

When parties litigate on revenue requirement and cost issues associated with the price design, the Regulator adjudicates disputes based on several premises. First, the carrier's burden of proof which implies that the carrier must prove that the prices derived from the price design meet the legal mandate.[361] That burden has to be met in the application, and in any other event in which the Regulator requires the carrier to provide additional information.[362] Moreover, the Regulator resorts to a public hearing to obtain further evidence and to subject the carrier's evidence to public scrutiny by interested

---

[352] *FCA TransCanada Ltd, supra* note 105 at para 5, 32, 34. See also *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at section Toll design.
[353] *CER Filing Manual - Guide P supra* note 55 at 191-192.
[354] *NEB Decision RH-001-2016, supra* note 118 at 33.
[355] *CER Decision RH-001-2019, supra* note 78 at 2–3.
[356] *NEB Decision RH-001-2016, supra* note 118 at 33.
[357] *Ibid* at 33.
[358] *Ibid*.
[359] *NEB Decision RH-3-2004 Supra* note 28 at 9.
[360] *Ibid.*
[361] *CER Filing Manual - Guide P supra* note 55 at 184. See also *NEB Decision RH-1-2000, supra note 75* at 37–38.
[362] *Ibid*.

parties which again requires the carrier to prove that its proposal satisfies the legal mandate.[363] In addition, the Regulator decides disputes by applying the substantive regulatory principles to the revenue requirement and the price design for each disputed issue.[364] That is the way in which the Regulator ensures certainty and predictability within the regulated space.[365]

3.4 Balance of parties' interests under negotiated settlement

Some disadvantages of litigation and adjudication

Parties tend to rely on negotiation to achieve their balance of interests because litigation and adjudication have some disadvantages as I illustrate below.

When the Regulator applies multiple legal principles to adjudicate based on cost of service it does not necessarily ensure the degree of certainty and predictability which parties expect.[366] In fact, in the *Decision RH-003-2011* the Regulator adopted decisions based on several regulatory principles to allow TransCanada to deal with the increasing level of business risks.[367] One of the decisions was to establish fixed prices for four and half years aimed at creating certainty for shippers.[368] However, in the *Decision RH-001-2016* the Regulator expressly indicated that the *Decision RH-003-2011* had created uncertainty for TransCanada regarding the recovery of costs and for shippers on the use of transportation services.[369] The Regulator also recognized that the *Decision RH-003-2011* led TransCanada and its shippers to become involved in conflicts. For instance, parties discussed whether the prices approved in that decision effectively stimulated TransCanada to build new facilities required to meet the shippers' transportation needs. Hence, parties ended up in contractual disputes before the courts and the Regulator.[370]

---

[363] *NEB Decision RH-003-2011, supra note 40* at 251; *NEB Prac & Proc, supra* note 215 *at ss* 21–23, 32, 36.
[364] This conclusion emerges from reading together the *NEB Decision RH-3-2004, supra* note 28 at 6–9 and the *CER Filing Manual - Guide P supra* note 55 at 185, 192.
[365] *NEB Decision RH-3-2004, supra* note 28 at 6–8, 42, 55.
[366] *NEB Decision RH-001-2016, supra* note 118 at 5.
[367] *NEB Decision RH-003-2011, supra note 40* at 1–3.
[368] *Ibid* at 2.
[369] *NEB Decision RH-001-2016, supra* note 118 at 5.
[370] NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-001-2014* (2015–2030 Tolls and Tariffs Application—Part IV, December 2014) at 6, online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/955803/2397890/2585806/2585804/A65154-1_NEB_-

In addition, some of the regulatory principles point in different directions.[371] For example, the Regulator has affirmed that the prudent principle is not necessarily congruent with the principle of used and useful assets.[372] In fact, the prudent principle can lead the Regulator to recognize all the costs necessary to provide pipeline services while the used and useful principle can lead the Regulator to disallow some costs incurred.[373] The Regulator also indicates that the efficiency principle prevents the recognition of inefficient costs.[374] In addition, the Regulator seeks to prevent cross-subsidization but has also held that this conduct can be justified for reasons of equity and fairness.[375]

Given the above, parties prefer to rely on negotiation to solve their disputes.[376] Thus, the settlement provides parties with the degree of certainty and predictability they themselves are willing to accept.[377] In fact, parties merely link multiple issues and reach a private agreement which reflects mutual concessions between the interests of numerous parties.[378]

How parties negotiate

In a negotiated settlement parties follow the two-step process applicable under cost of service to determine first the revenue requirement and then the price design.[379] However, the Regulator generally looks at the overall balance of interests instead of examining each cost component.[380] In the Regulator's opinion, the reason for doing that

_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_2015-2030_Tolls_and_Tariff_%E2%80%93_RH-001-2014.pdf?nodeid=2585408&vernum=-2>

[371] *NEB Decision RH-001-2016, supra* note 118 at 33–34.

[372] *NEB Decision RH-003-2011, supra note 40* at 38–40.

[373] *Ibid*.

[374] *Ibid* at 39–40.

[375] *NEB Decision RH-001-2016 supra* note 118 at 33.

[376] *CER Decision RH-001-2019, supra* note 78 at 11.

[377] *Ibid* at 14, 24, 25. In this case, the carrier and shippers defended the agreement reached, on the grounds of certainty for both. The Regulator, in turn, approved the settlement considering that the balance reached led to just and reasonable prices and met the changing needs of the parties (*ibid* at 50).

[378] *Ibid*.

[379] *Negotiated Settlement Guidelines 2002, supra* note 55 at para (iii).

[380] *Ibid* covering letter *Negotiated Settlement Guidelines 2002, supra* note 55 at 1.

is that parties link multiple interests of diverse parties to reach a solution acceptable for all negotiating parties which is why the settlement is called a package deal.[381]

In that regard, the *Negotiated Settlement Guidelines* do not require the applicant to provide disaggregated cost information.[382] What the Regulator requires is that the carrier explains how parties determined the revenue requirement, how the prices were calculated and to indicate the reasons that supported the solution of each issue.[383]

In principle, negotiating parties achieve the balance of interests based on costs.[384] In fact, the Regulator recognizes that in negotiation parties use the methodology of cost of service to determine prices if they want.[385]

Even if parties adhere to costs, they sometimes agree to give discounts or incent the carrier to reduce costs over time.[386] Even more, parties sometimes negotiate prices in which shippers are willing to pay for a specific service taking into account the conditions of demand for that service.[387] In this event, shippers pay the market value that they attribute to a given service.[388] In that respect, the Regulator equates prices based on

---

[381] *CER Decision RH-001-2019, supra* note 78 at 11.

[382] Letter attached to the *Negotiated Settlement Guidelines 2002, supra* note 55 at 2.

[383] *Negotiated Settlement Guidelines 2002, supra* note 55 at para (iii).

[384] Under the Negotiated Settlement Guidelines, the settlement is approved only if the carrier persuades the Regulator that the resulting prices are compatible with the legal mandate. To assess that, the Regulator requires the carrier to provide information on the balance reached even if that evidence is not disaggregated. *Negotiated Settlement Guidelines 2002, supra* note 55 at (iii). Thus, the Regulator approved a contested settlement based on the evidence of costs of service provided by the carrier. See *CER Letter Decision April 2020, supra* note 19 at 2.

[385] *NEB Decision RH-2-2004, Phase I, supra* note 329 at 1 indicates that TransCanada Ltd sometimes operated under a settlement, while at other times the settlement was agreed on, based on the methodology of cost of service. See *NEB Decision RH-003-2011, supra note 40* at 13, 51, 194, 232, as well as *CER Letter Decision April 2020, supra* note 19 at 2. The Regulator approved a settlement in which parties agreed that prices would be determined based on the methodology of cost of service.

[386] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at section Negotiated Settlement.

[387] Prices at market value have been used under conditions of pipeline competition. See NEB*, Letter Decision, TransCanada Pipeline Limited, RH-003-2017* (Application for Approval of Dawn Long Term Fixed Price Service, 23 November 2017) [*NEB Letter Decision, RH-003-2017, November 2017*] at 26–29. There are other events in which the price for some pipeline services is not determined by considering the relevant costs. For instance, a carrier can use an auction process to allocate available short-term pipeline capacity. When this happens, prices merely reveal the market value that the highest bidder attributes to the transportation services. That value is derived from a competitive process designed to allocate capacity, to supply these services. See *NEB Decision RH-003-2011, supra* note 40 at 120, 126–128. If the Regulator does that it requires the carrier to consider the regulated price of another pipeline service offered by the same carrier so that shippers can choose which service best suits their needs (*ibid)*.

[388] *NEB Letter Decision, RH-003-2017, November 2017, supra* note 387 at 28. See also *NEB Decision RH-003-2011, supra* note 40 at 37, 120 and *NEB Decision RH-1-2007, supra* note 61 at 22.

willingness to pay with efficient prices.[389] Despite that, the Regulator affirms that unless the carrier proves that there are reasons for approving prices based on the willingness to pay, shippers generally must pay the costs caused by the supply of services they need.[390]

The Regulator's review of a negotiated settlement

CERA seeks to ensure not only efficiency regarding the pipeline transportation activity but also regarding the legal processes used to achieve the Regulator's mandate.[391] Thus, CERA establishes that part of the purpose is to ensure that regulatory hearings and processes must be not only fair, inclusive and transparent but also efficient.[392] The Regulator developed that purpose by the *Negotiated Settlement Guidelines* which provides that a settlement is acceptable when negotiation meet three types of conditions.[393]

The first type of conditions are ones applicable to the negotiation process.[394] In particular, the process must be open and all interested parties must be invited to participate.[395] In addition, parties should have a fair opportunity both to participate in the negotiation process and to have their interests accommodated in the agreement reached.[396] Moreover, parties must have understood and agreed on the way to conduct that process.[397] Consequently, these type of conditions reflects procedural principles.[398]

The second type of conditions applies to the content of the agreement reached.[399] Specifically, the settlement cannot have provisions contrary to CERA and cannot prevent the Regulator from using its discretion to preserve the public interest.[400]

---

[389] *NEB Decision RH-1-2007, supra* note 61 at 22.
[390] *Ibid*.
[391] *CERA, supra* note 1, ss 6(a) and 6 (d).
[392] *Ibid* at s 6 (d).
[393] *Negotiated Settlement Guidelines 2002, supra* note 55 at 1-4.
[394] *Ibid* at para (i).
[395] *Ibid*.
[396] *Ibid*.
[397] *Ibid*.
[398] Since the enactment of CERA, these procedural principles have developed s 6 (d), which prescribes that the processes must be fair, inclusive, transparent, and efficient.
[399] *Ibid* at para (ii).
[400] *Ibid*.

The third type of conditions require the carrier to provide information to the Regulators' satisfaction explaining how the settlement was achieved and the level of shippers' endorsement obtained.[401] In addition, the carrier must provide information to put the Regulator in a position to understand the basis of the agreement, evaluate its reasonableness and whether it leads to prices which meet the legal mandate.[402]

The Regulator concludes that parties have achieved a balance of their interests when the negotiation process and the settlement fulfill all the conditions established by the *Negotiated Settlement Guidelines*.[403] These conditions do not include substantive regulatory principles. That is why in my view parties are not obliged to negotiate subject to the regulatory principles.

The Regulator has indicated that even when prices do not adhere strictly to costs, the prices proposed meet the legal mandate when several requirements are met.[404] First, the interested parties representing multiple and wide-ranging interests effectively participated in bilateral and collective negotiation.[405] Second, shippers and other interested parties obtained from the carrier all the information required.[406] Third, shippers and other interested parties endorsed the settlement reached.[407] In the Regulator's view, if these conditions are met, then the negotiation process approximates what market participants usually achieve in a competitive market.[408] For that reason, the Regulator suggests that under these conditions the negotiation process leads to efficient prices.[409]

When there is opposition to a negotiated settlement the degree of regulatory intervention is greater than the one applied in the presence of an unopposed settlement.[410] In that case the Regulator seeks to preserve the private balance of interests

---

[401] *Ibid* at para (iii).
[402] *Ibid*.
[403] *CER Decision RH-001-2019, supra* note 78 at 1, 11. This regulatory decision approved a contested negotiated settlement. See also *CER Letter Decision April 2020, supra* note 19 at 2–3, in which the Regulator approved a unanimous settlement.
[404] *CER Decision RH-001-2020*, *supra* note 142 at 79–81.
[405] *Ibid*.
[406] *Ibid*.
[407] *Ibid*.
[408] *Ibid* at 79–80.
[409] *Ibid* at 74–75, 80.
[410] *Negotiated Settlement Guidelines 2002, supra* note 55 at para (iv).

negotiated by the parties but the Regulator examines the issues which led some interested parties to oppose the settlement.[411] Hence, the Regulator applies the relevant regulatory substantive principles to solve these issues.[412] The role of the Regulator is not usually to modify the conditions to which the parties agreed.[413] The judicial view on this point summarized below serves to explain that role.

The judicial view of the utility regulator's role in a negotiated settlement

In *ATCO Electric Ltd. v. Alberta* (Energy and Utilities Board), 2004 ABCA 215 the court examined the scope of regulatory intervention when parties negotiate a settlement.[414] Although that decision was made in the context of Alberta electricity law, that judicial view is relevant to understanding the role of the utility regulator in the presence of a negotiated settlement when the legal mandate is to ensure just and reasonable prices.[415]

That kind of legal mandate implies that a utility regulator must preserve the public interest.[416] According to the court, the public interest means that a utility regulator has to consider both the interests of the utility company to recover all the costs incurred to provide the services including the profits permitted and the interests of its customers who pay for them.[417] The regulatory mandate should be met even when the utility company operating an activity subject to regulation negotiates a settlement with its customers.[418] In addition, the regulator must intervene to ensure that the negotiation process is fair for

[411] *CER Decision RH-001-2019, supra* note 78 at 1, 11, 54.
[412] *Ibid*.
[413] *Ibid* at 11.
[414] *ATCO Electric Ltd. v. Alberta (Energy and Utilities Board),* 2004 Alberta Court of Appeal ABCA 215 [*ATCO Electric, ABCA*] at paras 123–164. This judicial decision was adopted based on the *Electric Utilities Amendment Act,* S.A. 1998, c. 13. In addition, the *Electric Utilities Act*, S.A 2003, c. E-5.1 ss 132-137 contains detailed rules on negotiated settlement. This is not the case with CERA, which merely gives the Regulator power to develop alternative methods of dispute resolution. This shows the degree of discretion that Parliament granted to the Regulator under CERA.
[415] The issues discussed in that case are related to a settlement on prices charged to utility companies for distribution and transmission services, which are regulated activities under Alberta legislation. *ATCO Electric, ABCA* at paras 32–46.
[416] *Ibid* at paras 137–141.
[417] *Ibid* at paras 132–133.
[418] *Ibid* at paras 137–139. This judicial decision has to do with electricity and gas distribution, which are subject to regulation under Alberta law, unlike generation.

all interested parties.[419] Regulatory intervention is even more necessary when some customers do not participate in the negotiation process.[420] In that case, the regulator must intervene to prevent the negotiating parties from ignoring the interest of third parties.[421]

The scope of the regulatory intervention varies depending on what the regulator seeks to achieve in a specific case.[422] If a utility company asks for the regulatory approval of a negotiated settlement, then the company itself recognizes that the settlement preserves its economic interests.[423] In that case, the regulator does not need to intervene to protect the utility company.[424] Thus, the regulator is not obliged to correct any disadvantageous outcome for the carrier derived from the negotiated settlement process.[425] On this point, the court held that the existence of regulation does not prevent the utility company from sharing risks with customers and hence the company can agree to assume some risks of losses.[426]

Congruent with that view, if the regulator does not seek to modify the conditions of a negotiated settlement but merely to examine whether parties reached a balance of multiple issues of all the parties involved, the mandate to ensure just and reasonable prices merely implies that the Regulator must defend customers' interests.[427] That suggests that the Regulator must examine whether the balance reached reflects the interests of all actual and potential customers and not merely the interests of some of them.[428]

Meanwhile, if the Regulator seeks to modify the conditions agreed in a negotiated settlement, then the Regulator must consider the interests of both the utility company and its customers.[429]

---

[419] *Ibid* at para 138.
[420] *Ibid*.
[421] *Ibid*.
[422] *Ibid* at paras 141–143.
[423] *Ibid* at paras 145–146.
[424] *Ibid* at para 157.
[425] *Ibid* at paras 145–150.
[426] *Ibid* at paras 150, 155–156. On this aspect, the court believes that the regulator must start from the premise that a utility company knows how to defend its own interests. *Ibid* at paras 145, 155–156.
[427] *Ibid* at paras 141–142, 161.
[428] *Ibid*.
[429] *Ibid* at para 143.

3.5 Cost of service as a default regulatory method

It is only when an interested party opposes the negotiated settlement that the Regulator reviews specific issues considering the substantive regulatory principles.[430] The Regulator's review seeks to determine whether the issues in dispute have been considered and are reflected in the settlement in question.[431]

The Regulator relies on cost of service as the default method to adjudicate disputes when parties do not elect to use the negotiated settlement process or parties fail to achieve a settlement.[432] Under the method of cost of service the carrier has the duty to meet the burden of proof regarding each issue in dispute.[433] In contrast, in a negotiated settlement the burden of proof has a different scope. Thus, the carrier's duty is to prove that the negotiation process adheres to procedural principles and the settlement fulfills the conditions established by the *Negotiated Settlement Guidelines*.[434] Moreover, the carrier must provide information to put the Regulator in a position to understand and assess the agreement reached.[435] This requires the carrier to prove two facts.[436] First, the carrier needs to prove that the overall balance accommodates the competing interests of all the negotiating parties.[437] Second, the carrier needs to prove that the balance reflected in the settlement leads to just, reasonable and non-discriminatory prices.[438]

When the settlement is unanimous, that way of discharging the burden of proof is the end of the matter.[439] However, that is not the case regarding a contested settlement. In this case, cost of service plays the role of the default regulatory method as the

[430] *CER Decision RH-001-2019, supra* note 78 at 1–3, 11, 37.
[431] *Negotiated Settlement Guidelines 2002, supra* note 55 p. 1 at para (i).
[432] *NEB Decision RH-003-2011, supra* note 40 at 246. Equally, see *Draft Negotiated Settlement Guidelines 2002, supra* note 231 at 4.
[433] *CER Filing Manual - Guide P supra* note 55 at 184-194.
[434] Negotiated Settlement Guidelines 2002 *supra* note 55 at 1.
[435] *Ibid* at para (iii).
[436] *Ibid* at paras (i) and (iii).
[437] *Ibid* at para (i).
[438] *Ibid* at para (iii). See also *CER Decision RH-001-2019, supra* note 78 at 11.
[439] *CER Letter Decision April 2020, supra* note 19 at 2–3.

Regulator intervenes to solve the issues regarding prices and conditions of service which parties could not resolve through negotiation.[440]

To achieve that, the Regulator relies on several premises. First, the Regulator relies on the carrier's burden of proof.[441] Second, the Regulator requests comments of interested parties on whether the negotiation process and the settlement meet procedural principles and the other conditions required by the *Negotiated Settlement Guidelines*.[442] Third, once the Regulator examines the evidence and arguments regarding the issues unresolved by the negotiation, the Regulator applies the principles to solve the issues posed by the parties opposing the settlement.[443]

The review of a contested settlement can lead the Regulator to adopt one of the following decisions.[444] First, if the Regulator finds that the objections are unfounded, then that body approves the settlement based on the evidence presented.[445] Second, the Regulator can deny the settlement and resort to a hearing.[446] Third, the Regulator can approve the settlement on an interim basis but require a public hearing.[447] Whatever the decision, the Regulator relies on the costs of the service in question to solve the issues that support the opposition to the settlement.[448]

---

[440] The Negotiated Settlement Guidelines at para (iv) indicate that the carrier can submit a settlement for regulatory approval even if some shippers have opposed the agreement that has been reached. *NEB Decision RH-003-2011, supra* note 40 at 246–247. See also *CER Decision RH-001-2019, supra* note 78 at 1–2, 65.

[441] *Negotiated Settlement Guidelines 2002, supra* note 55 at (iv).

[442] *Ibid* at para (iii). See also *CER Decision RH-001-2019, supra* note 78 at 4.

[443] *CER Decision RH-001-2019, supra* note 78 at 1–2, 17.

[444] Negotiated Settlement Guidelines para (iv).

[445] *Ibid*.

[446] *Ibid*.

[447] *Ibid*.

[448] It is necessary to indicate that the Regulator applies the legal mandate based on the regulatory principles. Except when prices are based on market value and hence on the efficiency principle, these principles rely on the cost of service in question; see *NEB Decision RH-1-2007, supra* note 61 at 22. Yet, according to the Regulator, the principle of cost causation takes precedence over the principle of efficiency; see *ibid*. The Regulator has also held that to promote efficiency, prices must lead shippers to pay the cost caused for the service obtained; see *CER Decision RH-001-2019, supra* note 78 at 41. Therefore, to solve the issues that support an opposition to a settlement, the Regulator must look at costs of the service in question, a practice that follows the Regulator reasoning in *CER Decision RH-001-2019, supra* note 78 at 1–3.

3.6 Conclusions

At a general level, the Regulator uses its discretionary powers to develop methods, processes, and principles to execute its mandate under CERA.[449] By doing so, the Regulator ensures that the prices and other conditions of the tariff are just, reasonable, and non-discriminatory.[450]

To achieve its mandate the Regulator examines the costs and the allocation of business risks between carrier and shippers given that these are the determining factors of prices for pipeline services.[451] With that aim, the Regulator has developed a two-part working mechanism to operationalize its mandate and find the balance of parties' interests: the carrier's revenue requirement for a future period and the price design employed to determine the prices charged to shippers.[452]

The Regulator intervenes in the formation of prices in response to a carrier application which seeks the approval of the revenue requirement or to modify the price design.[453] To do that, the Regulator examines the application.[454] It is incumbent on the carrier to make its application based upon a negotiated settlement process or on a unilateral proposal which will lead to adjudication.[455]

Whatever the process and hence the method used, the carrier has the burden to prove that the proposal on revenue requirement and the price design meet the legal mandate.[456] The Regulator intervenes by approving or denying the application.[457]

---

[449] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Overview, Regulatory processes, and Toll regulation, describes the methods and processes. Moreover, the regulatory principles are described in *NEB Decision RH-1-2007, supra* note 61 at 21–22.
[450] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at section overview.
[451] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 13, 16, 26, 41–47.
[452] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Toll Regulation, Cost of Service Regulation and Toll Design.
[453] *Ibid* at sections Overview, Cost of service Regulation and Negotiated Settlements.
[454] *Ibid*. The legal powers are mainly granted by *CERA, supra* note 1, ss 226 to 236.
[455] *CER Regulation of pipeline traffic, tolls and tariffs supra* note 10 at sections Overview.
[456] *NEB Decision RH-1-2000, supra note 75* at 37–38. See also *NEB Decision RH-3-2004, supra* note 28 at 53, 55 and *CER Decision RH-001-2019, supra* note 78 at 3.
[457] *CERA, supra* note 1, ss 226–236.

In the case of adjudication, the Regulator approves the revenue requirement and the price design based on substantive regulatory principles.[458] In contrast, when parties engage in negotiation of a settlement it is not based on substantive regulatory principles.[459] Rather, each party merely pursues its own economic interests.[460] In fact, parties seek compromise solutions between diverse positions on multiple issues.[461] In practice, parties prefer a negotiated solution rather than adjudication to achieve their own degree of certainty and predictability.[462]

The negotiated settlement only acquires legal force if the Regulator approves it.[463] In that respect, the Regulator fulfills the mandate by reviewing the negotiation process and the outcome, to ensure that they meet the procedural principles and other conditions established by the *Negotiated Settlement Guidelines*.[464]

However, when parties are unable to solve disputes by negotiation, the Regulator intervenes.[465] Hence, the Regulator solves the issues which create opposition to the settlement in question but even in that case the Regulator tries to preserve the balance of interests embodied in that agreement.[466] Thus, adjudication becomes the default regulatory process to intervene in the formation of prices for pipeline services.[467]

The Regulator seeks to achieve the balance of economic interests between a carrier and shippers.[468] With that aim, the Regulator facilitates a pipeline system being financially viable by allowing the carrier to recover reasonable costs including the capital invested and the profits permitted.[469] In addition, as I explained in the second chapter, the

---

[458] *NEB Decision RH-3-2004, supra* note 28 at 6–9. See also *NEB Decision RH-1-2007, supra* note 61 at 21–23.
[459] *CER Decision RH-001-2019, supra* note 78 at 11. The Regulator indicates that a negotiated settlement is the result of concessions between parties. Therefore, the negotiated settlement is not based on regulatory principles.
[460] *Ibid*.
[461] *Ibid*.
[462] Canada, National Energy Board, *Canada's Pipeline Transportation System 2016* (Calgary: National Energy Board, 2016) at 21–22. online (pdf): Government of Canada <https://www.cer-rec.gc.ca/en/data-analysis/facilities-we-regulate/2016/canadas-pipeline-transportation-system-2016.pdf>
[463] *Negotiated Settlement Guidelines 2002, supra* note 55 at 1,3.
[464] *Ibid* at paras (i) to (iv).
[465] *CER Decision RH-001-2019, supra* note 78 at 1–3.
[466] *Ibid* at 11.
[467] *Draft Negotiated Settlement Guidelines 2002, supra* note 231 at 4.
[468] *Ibid* at 11.
[469] *NEB Decision RH-2-2004, Phase II, supra* note 57 at 13, 16.

Regulator preserves the balance of parties' interests by preventing some carrier actions on prices and conditions of service which are contrary to the Regulator's mandate.[470]

Finally, whatever the regulatory process is used, the carrier has the duty to adapt costs, prices, and conditions of service to pipeline competition and other changing business risks involved in natural gas pipeline transportation.[471] For that reason, the Regulator considers the achievement of the long-term economic viability of a natural gas pipeline system to be the carrier's duty.[472] I will explain this matter in more detail in the next chapter.

[470] *NEB Decision RH-3-2004, supra* note 28 at 7–9.
[471] *NEB Decision RH-003-2011, supra* note 40 at 1–3.
[472] *Ibid*.

CHAPTER 4
THE VIABILITY OF PIPELINE SYSTEMS AND REGULATORY INTERVENTION

4.1 Purpose and main argument

In the third chapter I explained how the Regulator finds the balance of parties' interests by adopting two types of regulatory actions. First, the Regulator approves the revenue requirement usually for one year under cost of service and for several years under negotiated settlement.[1] The Regulator understands that the legal mandate implies allowing the carrier to charge prices to recover all costs realized to supply transportation services when the Regulator has qualified the relevant costs as prudent.[2] If the Regulator fulfills the mandate in that way, then a utility company can attain what the Supreme Court in *Ontario (Energy Board) v. Ontario Power Generation Inc*, 2015 SCC 44 calls the financial viability because the company can charge prices to recover the operating costs, the rate of return and ultimately the capital invested.[3] With that aim, the Regulator reviews the short-term allocation of business risks between the parties reflected in the rate of return by looking at their changes since the last regulatory review.[4] Second, the Regulator seeks to prevent some carrier's conduct which are contrary to the principles and hence affect the revenue requirement or the price design.[5]

---

[1] "CER Regulation of pipeline traffic, tolls and tariffs" (12 February 2021), [*CER Regulation of pipeline traffic, tolls and tariffs*] at sections Overview, Cost-of-service-regulation, Negotiated Settlements online: *Canada Energy Regulator* <https://www.cer-rec.gc.ca/en/about/who-we-are-what-we-do/responsibility/regulation-pipeline-traffic-tolls-tariffs.html#:~:text=The%20CER%20regulates%20pipeline%20tolls,in%20tolls%2C%20service%20or%20facilities>.

[2] NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-2-2004, Phase II* (2004 Mainline Tolls and Tariffs Application, April 2005) [*NEB Decision RH-2-2004, Phase II*] at 16, 17.

[3] *Ontario (Energy Board) v. Ontario Power Generation Inc*, 2015 SCC 44, [2015] 3 R.S.C 147, [Ontario Energy] at paras 11, 20, 76.

[4] *NEB Decision RH-2-2004, Phase II, supra* note 2 at 13, 16, 26, 41–47. See also NEB, *Reasons for Decision, TransCanada Pipeline Ltd, Nova Gas Transmission Limited, Foothills Pipelines Ltd, RH-003-2011* (Business and Services Restructuring Proposal and Mainline Final Tolls for 2013 and 2013, March 2013) [*NEB Decision RH-003-2011*] at 148, 161.

[5] NEB, *Reasons for Decision, TransCanada Pipelines Ltd, RH-3-2004* (Application for approval to establish a new receipt and delivery point, the North Bay Junction, and for the corresponding tolls for services to and from that point, December 2004) [*NEB Decision RH-3-2004*] at 7–8, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586892/293604/346558/342912/A08726-1_NEB_-

That said, the purpose of the present chapter is to describe and explain why the Regulator also intervenes when the magnitude of business risks can impede a carrier from recovering in the long term the rate of return and even part of the capital invested.[6]

The central argument in this chapter is that the Regulator operates under the presumption that the magnitude of business risks can make some carrier's transmission assets no longer useful to transport natural gas.[7] Hence, that magnitude can affect what the Regulator calls the economic viability of a pipeline system.[8] The Regulator does not define this concept but affirms that it is incumbent on the carrier to make the business decisions necessary to achieve that viability. Thus, this viability seems to constitute the long-term financial viability of a pipeline system.[9] In this respect, the Regulator considers that the legal mandate makes it necessary to scrutinize the long-term allocation of business risks to prevent the carrier from transferring these risks to shippers.[10]

In the second chapter, I explained that when pipeline assets become no longer used to provide services given the occurrence of business risks, the assets are called stranded. The point in this chapter is that the Regulator considers the carrier must deal with the business risks to preserve the long-term financial viability of the pipeline system. To monitor the carrier's business actions designed to achieve that aim the Regulator has developed the concept of fundamental risk, which will be explained in this chapter.

_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_North_Bay_Junction_%E2%80%93_RH-3-2004.pdf?nodeid=342913&vernum=-2>.

[6] *NEB Decision RH-003-2011, supra* note 4 at 40–41, 43–44, 148, 161.

[7] *Ibid* at 28, 42–45. CER, *Reasons for Decision, Nova Gas Transmission Ltd, RH-001-2019* (Application dated 14 March 2019 for NGTL Rate Design and Services, March 2020) [*CER Decision RH-001-2019*] at 43, 45–46, Online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/554137/3752363/3752364/3760156/3913151/C05448-1_CER_%E2%80%93_Reasons_for_Decision_RH-001-2019_%E2%80%93_NOVA_Gas_%E2%80%93_NGTL_System_Rate_Design_%20and_Services_-_A7E4S8.pdf?nodeid=3912507&vernum=-2>. As I explained in the second chapter, the Regulator calls these assets stranded.

[8] *NEB Decision RH-003-2011, supra* note 4 at 1–3.

[9] *Ibid* at 1–3, 50.

[10] *Ibid* at 42–45.

The nature of the business of pipeline energy transportation

The Regulator recognizes that oil and gas transportation is characterized by business risks.[11] Given the nature of that activity, in the Regulator's view intervention in the formation of prices for pipeline services must consider how the occurrence of these risks can affect the recovery of costs.[12]

On this point, Parliament explicitly recognized that to meet its mandate the Regulator must evaluate two aspects.[13] On the one hand, the difference in terms of business and business risks involved in oil and gas pipeline transportation and their changing nature.[14] On the other hand, the differences in the business context faced by each company carrying each of these products.[15]

One of the main characteristics of pipeline transportation is that the carrier invests in this activity with the long-term expectation that the level of natural gas traffic will likely lead the pipeline company to generate revenue that recovers the operating costs, the profits permitted, and the capital invested.[16] Yet, the level of traffic which can be moved through a pipeline system depends on the business risks described in the third chapter.[17] These risks are changes in the level of supply and demand for natural gas, pipeline competition, physical risks affecting the operation of a pipeline system and the way in which the Regulator governs transportation services called the regulatory risk.[18] Therefore, the carrier's generation of revenue will depend on the magnitude of the business risks affecting the traffic of natural gas over the pipeline's useful life.[19]

---

[11] *NEB Decision RH-003-2011, supra* note 4 at 39–40, 42–43
[12] *Ibid*.
[13] *NEB Decision RH-003-2011, supra* note 4 at 39–40, 42–45.
[14] *Ibid*.
[15] *Ibid*.
[16] I concluded this by reading several decisions, but particularly the following: *NEB Decision RH-2-2004, Phase II, supra* note 2 at 13–16, 41–46 and *NEB Decision RH-003-2011, supra* note 4 at 34–35, 43–45, 122, 125, 161. The carrier and its shareholders' long-term expectations explain why the carrier tends to build transmission assets only after making long-term contracts that ensure some customers are committed to using them.
[17] *NEB Decision RH-003-2011, supra* note 4 at 43–45, 161.
[18] *NEB Decision RH-2-2004, Phase II, supra* note 2 at 26.
[19] *Ibid* at 13–16, 41–46. See also *NEB Decision RH-003-2011, supra* note 4 at 43–45, 161.

4.2 The difference between financial and economic viability of a pipeline system

The Regulator has indicated that it is incumbent on the pipeline company to ensure that the transportation system it owns is economically viable.[20] Nonetheless, neither CERA nor the Regulator define that concept.[21] Therefore, it is necessary to investigate the scope and implications of economic viability based on the judicial interpretation and the Regulator's application of that concept.

In that respect, the Supreme Court in *Ontario (Energy Board) v. Ontario Power Generation Inc*, 2015 SCC 44 held that a utility regulator should facilitate a company recovering the prudent costs.[22] Thus, under the method of cost of service the Regulator has two complementary obligations.[23] First, the regulator must allow the utility company to recover the capital and operating costs.[24] To achieve that aim, the regulator must ensure that the rate of profits approved over the capital invested is fair.[25] Second, the regulator must prevent the utility company from charging more than the costs the utility company incurs to supply the services.[26] As a part of this obligation, the regulator should

---

[20] The Regulator made this declaration regarding cost of service in *NEB Decision RH-003-2011, supra* note 4 at 3, 50, 77. It also made a similar assertion about negotiated settlements in *CER Decision RH-001-2019, supra* note 7 *at* 45–46.

[21] Canadian Energy Regulator Act (S.C. 2019, c. 28, s. 10) [CERA] at s 183(2) (h), uses the concept of economic feasibility regarding the application for a "certificate of public convenience and necessity" required for the construction of a new pipeline. This rule does not define the concept, but it does differentiate economic viability from the financial resources that will be used to build the assets—notably equity or debt. Similar rules existed under the *National Energy Board Act*, RSC 1985, c N-7 [NEBA]. Notably, *NEBA* at s 52(2) led the Regulator to examine price issues. This is because the assessment of the proposed prices was critical for evaluating the economic viability of the pipeline project, but the assessment was also crucial for ascertaining whether the prices were just and reasonable. NEB, *Report on Nova Gas Transmission Ltd, GH-003-2015* (Application dated 2 September 2015 for the Towerbirch Expansion Project, October 2016) [*NEB Report GH-003-2015*] at 71, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/2671288/2819218/3065005/3065109/A79841-1_NEB__-_Report_-_NOVA_Gas_-_Towerbirch_Facilities%2C_Tolling_Methodology_-_GH-003-2015.pdf?nodeid=3065196&vernum=-2>.

[22] *Ontario Energy, supra* note 3 at paras 16, 20.

[23] *ATCO Gas and Pipelines Limited v Alberta (Utilities Commission), 2015 SCC 45* [*ATCO Gas*] at para 7. This Supreme Court decision explains the regulatory principles as a reflection of the method of cost of service. The same can be said regarding the decision adopted in *Ontario Energy, supra* note 3 at para 76.

[24] *Ibid*.

[25] *Northwestern Utilities Ltd v City of Edmonton* [1929], S.C.R. 186 [NW Utilities] at 192–193. Cited by *Ontario Energy, supra* note 3 at para 15.

[26] *ATCO Gas, supra* note 23 at para 7.

ensure that the utility company cannot obtain any profit over and above a fair return on the capital invested.[27]

According to the Court, under the principle of prudence the utility regulator must recognize the rate of return required to incent the utility company to invest in assets in the long-term to the extent necessary to meet customers' needs.[28] If that is done, then the regulator ensures just and reasonable prices because the Regulator facilitates a utility company to achieve financial viability of its pipeline system.[29]

Nevertheless, the Court maintains the regulator's mandate merely involves giving a utility company an opportunity to achieve the financial viability of the pipeline system.[30] Thus, the legal mandate of ensuring just a reasonable price does not oblige the regulator to ensure that a regulated company will generate a level of income to cover costs and obtain the rate of return, since business risks are inherent in utility services.[31] In that respect, the Supreme Court recognizes that some facts can prevent the company from achieving the recovery of all the costs permitted.[32] Specifically, the Court admits that utility companies face risks which can affect the recovery of the capital invested in the long term.[33]

The Regulator under CERA, in turn, has provided that the carrier has the duty to deal with pipeline competition as well as with any other business risk to ensure its economic viability.[34] The Regulator has also affirmed that although all business risks are relevant for regulatory purposes, when they occur their consequences vary depending on their magnitude.[35]

---

[27] *Ontario Energy, supra* note 3 at para 76.
[28] *Ibid* at paras 76, 107.
[29] *Ibid* at paras 16–17, 76, 91.
[30] *Ibid* at paras 11, 107, 112.
[31] *Ibid*. This explains why the Regulator refers to giving the pipeline company an opportunity to recover, rather than the assurance of recovery. See also *NEB Decision RH-2-2004, Phase II, supra* note 2 at 16 and *NEB Decision RH-003-2011, supra* note 4 at 2.
[32] *Ontario Energy, supra* note 3 at para 17.
[33] *Ibid* at para 107.
[34] *NEB Decision RH-003-2011, supra* note 4 at 24–25, 45–46, 148, 161, 164, 206.
[35] *Ibid* at 161.

In brief, given the above it can be said that the financial viability of a pipeline system means the ability of a utility company to recover operating costs, the rate of return and the capital invested based on prices which meet the legal mandate.[36] As the Court recognizes, the financial viability involves short and long-term aspects.[37]

The natural gas carrier faces business risks affecting the survival of its pipeline system and hence has the duty to manage them to have a profitable business.[38] If the carrier can manage the long-term aspects of business risks, then the carrier can achieve the long-term financial viability of the pipeline system owned.[39] This long-term aspect seems to be what the Regulator calls the economic viability of a pipeline system.[40] In fact, the Regulator sometimes uses the concept of long-term viability to refer to the recovery of costs.[41] Therefore, from the point of view of the Regulator's mandate on prices of pipeline services, it is possible to equate the concept of economic viability with the long-term financial viability of a pipeline system.[42] That means that a pipeline system is financially viable in the long-term when the carrier manages the long-term business risks and hence is able to recover all costs including the rate of return and the capital invested based on prices which meet the legal mandate.[43]

The distinction between short-term and long-term financial viability is relevant. In that respect, the Regulator must approve prices that ensure the short-term financial viability of a pipeline system.[44] This short term is reflected in the year or few years involved in a carrier's application.[45] The carrier does that by apportioning between shippers all the prudent cost recognized by using the price design approved by the

[36] *Ontario Energy, supra* note 3 at para 11, 20, 76, 107, 112, 156.
[37] *Ibid* at paras 16–17, 76, 91, 120.
[38] I concluded this based a set of Regulator's statements made in *NEB Decision RH-003-2011, supra* note 4 at 1–3, 25, 39–40, 42–45.
[39] *CER Decision RH-001-2019, supra* note 20 at 45–46.
[40] *Ibid* at 1–3.
[41] *Ibid* at 49.
[42] *Ibid* at 45–46.
[43] *NEB Decision RH-003-2011, supra* note 4 at 3, 50. See also *CER Decision RH-001-2019, supra* note 20 at 45–46.
[44] *NEB Decision RH-2-2004, Phase II, supra* note 2 at 13.
[45] When the carrier applies, based on cost of service, the application typically relies on a single test year, while the application based on a negotiated settlement depends on seeking the approval of prices for several years. See *CER Regulation of pipeline traffic, tolls and tariffs supra* note 1 at sections Toll Regulation and Negotiated Settlement.

Regulator.[46] In contrast, it is the carrier which has the duty to manage the long-term aspect of business risks and cannot transfer these risks to shippers.[47] With that aim, the carrier's management of business risks is subject to the Regulator's scrutiny to examine whether their magnitude can affect the survival of a pipeline system and what party will bear these risks.[48] The Regulator has developed the concept of fundamental risk to analyze the long-term financial viability of a natural gas pipeline system.[49] That concept is explained below.

4.3 The fundamental risk

The Regulator has affirmed that the combined magnitude and duration of the occurrence of supply, demand and pipeline competition risks can lead a carrier to a situation in which some transmission assets can be permanently underutilized.[50] Hence, that situation implies that the carrier cannot recover part of the costs, particularly the rate of return and the capital invested.[51] The Regulator categorizes that situation as fundamental risk.[52] Some parties, in turn, consider that the occurrence of that risk creates stranded assets.[53]

According to the Regulator, fundamental risk is not a separate type of business risk.[54] Instead, the Regulator said, it is a long-term reflection of the business risks

[46] *NEB Decision RH-2-2004, Phase II, supra* note 2 at 13.
[47] *NEB Decision RH-003-2011, supra* note 4 at 1–3, 25, 42–45, 128, 161, 164.
[48] *Ibid* at 1–3, 42–45, 50.
[49] *Ibid* at 42–45.
[50] *Ibid* at 42–44.
[51] Ibid at 3, 42-44. When the fundamental risk becomes a reality, the Regulator can disallow the depreciation cost that the carrier is being charged to shippers. Thus, the carrier needs to ensure that the depreciation of transmission assets reflects the level of utilization throughout its economic life. Yet, it is incumbent upon the Regulator to decide whether to approve the depreciation methodology proposed by the carrier. The Regulator's view highlights the role of depreciation as an instrument to recover the capital invested in transmission assets and to reflect the materialization of business risks.
[52] *Ibid*. The Regulator recognizes that transmission assets are not always used fully throughout their economic useful life (*ibid* at 45). Yet, this situation does not lead to reducing the permitted level of rate of return; indeed, quite the opposite is the case. The rate of return is adopted to compensate the carrier for the risk involved in assuming that assets have a given economic life (*ibid* at 44). Yet, when the level of use is reduced to the point that it reveals the assets are no longer actually in use, the Regulator can consider that the depreciation rate of assets does not reflect this reality. If the Regulator reaches this conclusion, it intervenes to make sure the carrier reflects this in its depreciation method. In such cases, the Regulator can legally disallow the cost. *Ibid* at 44.
[53] *CER Decision RH-001-2019, supra* note 20 at 43.
[54] *NEB Decision RH-003-2011, supra* note 4 at 43–44, 161.

described in the third chapter, namely decline in the supply and demand of natural gas, increased pipeline competition, regulatory and operating risks.[55] The Regulator contends that one specific aspect which differentiates fundamental risk from the others is the likelihood and magnitude of the reduction of traffic associated with the occurrence of the supply, demand and competition risks.[56]

The carrier has the duty to evaluate whether the current and expected level of natural gas traffic is so low that transmission assets have become underused or not used at all and whether these assets at least serve to provide reliable services to shippers.[57] Hence, it is the carrier's evaluation of both past traffic and the forecast of business risks affecting traffic that allows the Regulator to examine whether fundamental risk exists and whether it threatens the economic viability of a natural gas pipeline transportation system.[58]

The Regulator affirms that it is incumbent on the carrier to make a proposal on how to recover costs and the measures to mitigate business risks.[59] To achieve that, the carrier needs to examine whether it is feasible to reassign the assets to transport other energy products.[60] Yet, if that is not feasible, then the carrier's recognition of the materialization of fundamental risk can even imply capital losses.[61]

When fundamental risk has occurred the pipeline company no longer recovers the costs associated with stranded assets.[62] For that reason, the Regulator must intervene to determine whether the carrier's proposal on the management of business risks is congruent with the legal mandate.[63] Specifically, the Regulator should prevent shareholders from obtaining profits over assets no longer used as they must be excluded from the rate base that serves to calculate the rate of return.[64] In the end, the Regulator

[55] *Ibid*.
[56] *Ibid* at 161.
[57] *Ibid* at 43–45.
[58] *Ibid* at 4 at 3, 42–45.
[59] *Ibid* at 44. See also *CER Decision RH-001-2019, supra* note 20 at 45–46.
[60] *NEB Decision RH-003-2011, supra* note 4 at 44, 235.
[61] *Ibid* at 39–40, 44.
[62] *CER Decision RH-001-2019, supra* note 20 at 43, 45–46.
[63] *NEB Decision RH-003-2011, supra* note 4 at 42-45.
[64] *NEB Decision RH-003-2011, supra* note 4 at 43–44.

has concluded that shareholders must bear the fundamental risk and hence cannot transfer it to shippers.[65]

The relationship between the principles of efficiency, prudent costs and used and useful assets

With regard to the long-term viability of a pipeline system, the Regulator has concluded that the carrier's decisions must adhere to several principles.[66] The reason being that the carrier has to adapt prices to the dynamic and high-risk business context in which transportation services are provided.[67] Thus, it is incumbent upon the carrier to evaluate in the first place whether the decision to build new transmission assets responds to shippers' transportation needs.[68] Consequently, the Regulator affirms that in the absence of an increasing demand for transportation services, if a carrier decides to invest in new assets, then that decision would be contrary to the principle of efficiency.[69] In addition, the carrier must examine depreciation rates from time to time to evaluate whether the method of calculating depreciation at a given point in time still reflects both the current level of use and the prospect of utilization.[70]

Given the above, it can be argued that when the Regulator applies the principle of prudency it seeks to ensure the financial viability of the pipeline company.[71] That principle is complemented by the Regulator's use of the efficiency principle which seeks to prevent a carrier from building assets beyond the level required to meet customers' transportation needs.[72] In contrast, the application of the principle of used and useful assets can lead the Regulator to recognize the existence of stranded assets and allocate the long-term fundamental risk.[73] If this risk occurs, then the economic viability of a carrier's pipeline

---

[65] *Ibid* at 43–44.
[66] *NEB Decision RH-003-2011, supra* note 4 at 39–40. In this decision, at 38, the Regulator recognized that the prudency, and used and useful principles are in conflict. The Regulator adopted this decision in March 2013 before the Supreme Court's decision in *Ontario Energy, supra* note 3, which provides guidelines on how to articulate these principles. I will explain this matter in the Chapter 5.
[67] *NEB Decision RH-003-2011, supra* note 4 at 39.
[68] *Ibid* at 40.
[69] *Ibid.*
[70] *Ibid*.
[71] *NEB Decision RH-2-2004, Phase II, supra* note 2 at 16–17.
[72] *NEB Decision RH-003-2011, supra* note 4 at 39–40.
[73] *Ibid* at 43.

system can be affected.[74] In the end, these three principles emphasize diverse aspects of the Regulator's intervention via adjudication to incent the private construction and operation of pipeline systems.

4.4 Conclusions

Its legal mandate requires the Regulator to intervene in the formation of prices to facilitate the financial viability of a pipeline system.[75] The Regulator seeks to achieve that aim mainly under the prudent principle and to assess the short-term changes in business risks as described in the third chapter.[76]

However, as the Regulator has recognized, natural gas pipeline transportation also involves the long-term aspects of business risks.[77] If these risks occur, then their consequences can impede the carrier from recovering costs and hence affect the long-term financial viability of a pipeline system.[78] This viability depends on the magnitude of the business risks affecting the level of traffic.[79] That is why these consequences are called fundamental risk or the risk of stranded assets.

The occurrence of fundamental risk can involve capital losses and hence affect the survival of a pipeline system.[80] The Regulator believes that shareholders must bear the fundamental risk.[81] Congruent with that view, the Regulator is neither legally obliged nor able to ensure the long-term financial viability of a pipeline system.[82] Rather, the Regulator seeks to prevent the carrier from transferring to shippers the fundamental risk.[83] To achieve that, the Regulator reviews the long-term allocation of business risks under the principle of used and useful assets.[84] To the extent that the fundamental risk can be

[74] *Ibid* at 1–3.
[75] *Ontario Energy, supra* note 3 at paras 11, 20,76. See also *NEB Decision RH-2-2004, Phase II, supra* note 2 at 15–16.
[76] *NEB Decision RH-2-2004, Phase II, supra* note 2 at 46.
[77] *NEB Decision RH-003-2011, supra* note 4 at 161.
[78] *Ibid* at 39, 42–43.
[79] *Ibid* at 42–45.
[80] *Ibid* at 1–3.
[81] *Ibid* at 43–44.
[82] *Ibid* at 3, 43–45.
[83] *Ibid* at 43.
[84] *Ibid* at 43, 161.

mitigated, it is the carrier's duty to do so.[85] The main carrier's instrument to achieve that aim is the depreciation cost.[86] Having said that, it is useful to summarize what I have done thus far in this thesis and the connection of it with the next chapter.

In the second chapter, I examined the conceptual bases derived from the literature review on the reasons for regulatory intervention in the formation of prices. Based on that, I explained why the Regulator intervenes in practice pursuant to the legal mandate.

In the third chapter on the legal framework, I described and explained how the Regulator intervenes in the formation of prices either by applying the regulatory principles or by administrative review of the negotiated settlement process. I explained why parties prefer the use of negotiation.

In the present chapter I have described and explained how the Regulator facilitates the long-term financial viability of pipeline systems. To achieve that, I explained how the Regulator tries to articulate the principles of efficiency, used and useful assets and prudency to deal with fundamental risk.

The long-term financial viability of a pipeline system described in the present chapter is critical to examine the benefits and drawbacks of the parties' negotiation process which I will explain in the fifth chapter. One of these drawbacks is the unsuitability of parties' negotiation to solve long-term issues like fundamental risk.

[85] *Ibid* at 42–45.
[86] *Ibid at* 1, 3, 25, 43–45, 128.

SECOND PART
EVIDENCE ON THE BENEFITS, DRAWBACKS AND PERILS OF PARTIES' NEGOTIATION

CHAPTER 5
THE BENEFITS, DRAWBACKS AND PERILS OF PARTIES' NEGOTIATION

5.1 Purpose and structure

Parties prefer to rely in practice on the negotiation process to solve their disputes.[1] The purpose of the present chapter is to describe and explain the benefits, drawbacks, and perils of parties' negotiation to regulate the price of natural gas pipeline transportation services. Unless indicated otherwise, for the purpose of the present chapter I will use the terms "a negotiated settlement" and the "parties' negotiation process" to refer to the same practice as this process can lead parties reaching a settlement.

I argue that a benefit means that the parties' negotiation process is suitable for dealing with an issue associated with price and conditions of pipeline services. A drawback, in turn, means that parties' negotiation could not resolve some issues or could not prevent carrier conduct contrary to the regulatory principles. Finally, when I affirm that negotiation pose a peril, I mean that a carrier's conduct can deviate from a negotiated settlement by taking an action after the Regulator approves the settlement and that carrier's action is contrary to the regulatory principles. Therefore, the Regulator needs to intervene to minimize the drawback or peril in question.

I will develop the chapter in the following order. First, I will examine the benefits and drawbacks of parties' negotiation to deal with issues of cross-subsidization in the northeast part of British Columbia. This is a natural gas producing region which is part of a broader area called the Western Canada Sedimentary Basin.[2] Second, I will examine

[1] Canada, National Energy Board, *Canada's Pipeline Transportation System 2016* (Calgary: National Energy Board, 2016) [*Canada's Pipeline Transportation System 2016*] at 21–22. online (pdf): Government of Canada <https://www.cer-rec.gc.ca/en/data-analysis/facilities-we-regulate/2016/canadas-pipeline-transportation-system-2016.pdf>

[2] CER, *Reasons for Decision, NOVA Gas Transmission Ltd, RH-001-2019* (Application dated 14 March 2019 for NGTL System Rate Design, March 2020) [*CER Decision RH-001-2019*] at 5, online (pdf): CER < https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/554137/3752363/3752364/3760156/3913151/C05448-1_CER_%E2%80%93_Reasons_for_Decision_RH-001-

the benefits and drawbacks of parties' negotiation to deal with issues in the area served by TransCanada's Mainline system. It connects the Western Canada Sedimentary Basin with consuming areas from Saskatchewan to Ontario, to parts of Quebec, and to other pipeline systems in both Canada and the United States.[3] Finally, I will examine the peril of parties' negotiation.

It should be noted that in northeast British Columbia there are three competing carriers which operate the following natural gas pipeline transportation systems: the Nova, the Westcoast, and the Alliance systems.[4]

Nova Gas Transmission Ltd (Nova) manages what used to be called the Alberta Pipeline System.[5] This system provided pipeline transportation services to producers of natural gas in Alberta and British Columbia. On November 27th, 2009, Nova requested the regulatory approval of the commercial integration of the Alberta System and the ATCO Pipeline System which led the Alberta System to be subject to the rules under *NEBA*.[6] Since the approval of that integration, these two pipeline systems operate as one under the name Nova System subject to the same price design and conditions of service.[7] In that respect, it must be noted that the Nova System encompasses 24,000 kilometers of

---

2019_%E2%80%93_NOVA_Gas_%E2%80%93_NGTL_System_Rate_Design_and_Services_-_A7E4S8.pdf?nodeid=3912507&vernum=-2>

[3] NEB, *Reasons for Decision, TransCanada Pipeline Ltd, NOVA Gas Transmission Ltd, and Foothills Pipe Lines Ltd, RH-003-2011* (Business and Services Restructuring Proposal and Mainline Final Tolls for 2012 and 2013, March 2013) [*NEB Decision RH-003-2011*] at 3, 5–7, 14, 80, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/665035/711778/941262/939799/A51040-1_NEB_-_Reasons_for_Decision_-_TransCanada%2C_NOVA_Gas_and_Foothills_-_2012_and_2013_Final_Tolls_-_RH-003-2011.pdf?nodeid=939800&vernum=-2>.

[4] NEB, *Letter Decision* (Examination to Determine Whether to Undertake an Inquiry of the Tolling Methodologies, Tariff Provisions and Competition in Northeast British Columbia, 8 March 2018) [*NEB Examination Decision 2018*] at 1.

[5] NEB, *Reasons for Decision, NOVA Gas Transmission Ltd, RHW-1-2010* (Rate Design Methodology and Integration Application, August 2020) [*NEB Decision RHW-1-2010*] at 2, online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/554137/578285/585636/629285/629048/A25890-3_NEB_-_Decision_-_Nova_Gas_%E2%80%93_Toll_Methodology_and_Integration_%E2%80%93_RHW-1-2010.pdf?nodeid=629083&vernum=-2>

[6] *Ibid* at 1–2.

[7] *Ibid*.

transmission facilities and other transportation assets.[8] It connects the natural gas producing area in Western Canada with customers across the United States of America.[9]

There are some reasons for examining separately the use of negotiation in northeast British Columbia and in the area served by TransCanada's Mainline System. Although parties in these areas face similar issues, the context in which carriers operate in each area differs.[10] In fact, in northeast British Columbia, the issues emerged in a context of pipeline competition between carriers who decided to build new assets to expand their pipeline systems to meet the growing demand for transportation services in a natural gas producing area in Western Canada called the Montney Formation.[11] Meanwhile, in the area served by the TransCanada's Mainline system, parties' disputes have emerged from pipeline competition and other business risks.[12] Yet, these disputes were not mainly connected with the expansion of the TransCanada's Mainline system as it faced problems of transmission assets no longer being used.[13] Although in both areas parties have relied on negotiation in the context of growing pipeline competition, they sometimes have solved the issues while at other times have failed to do so.[14]

I will look at several types of regulatory decisions. First, some decisions in which the Regulator approved an unopposed negotiated settlement as filed.[15] Second, I will look

[8] *CER Decision RH-001-2019, supra* note 2 at 5.
[9] *Ibid*.
[10] The Nova and the TransCanada's Mainline systems are the most important ones for the transportation of natural gas in Canada. They are under the control of TransCanada. In fact, TransCanada controls Nova Gas Transmission Ltd; see *NEB Decision RH-003-2011, supra* note 3 at 5–6. In any case, the Nova and TransCanada's Mainline system operate as separate carriers in different geographic markets where there is pipeline competition.
[11] *NEB Examination Decision 2018, supra* note 4 at 1–3. The Montney is a cross-border area between British Columbia and Alberta, rich in oil and natural gas. See NEB, *The Ultimate Potential for Unconventional Petroleum from the Montney Formation of British Columbia and Alberta* (Energy Briefing Note, BC Oil and Gas Commission, Alberta Energy Regulator, and BC Ministry of Natural Gas Development, November 2013) [*NEB Briefing Note, 2013*] at 1, online (pdf) CER: <https://www.cer-rec.gc.ca/en/data-analysis/energy-commodities/natural-gas/report/ultimate-potential-montney-formation/the-ultimate-potential-unconventional-petroleum-from-montney-formation-british-columbia-alberta-energy-briefing-note.pdf>.
[12] *NEB Decision RH-003-2011, supra* note 3 at 1–3.
[13] *Ibid* at 42–45.
[14] *Ibid* at 1–3. See also *NEB Examination Decision 2018, supra* note 4 at 3–5.
[15] For instance, CER, *Letter Decision, TransCanada Pipelines Limited* (Application for the Approval of the Mainline 2021–2026 Settlement, 17 April 2020) [*CER Letter Decision, April 2020*], online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3773158/3891141/3914560/C05780-1_CER_%E2%80%93_Letter_Decision_%E2%80%93_TransCanada_%E2%80%93_Mainline_2021-2026_Settlement_-_A7E9E9.pdf?nodeid=3914561&vernum=-2>.

at some decisions by which the Regulator intervened because parties' negotiation could not solve the relevant issues.[16] Third, I will look at some decisions that were not adopted in response to a carrier's application for the approval of the price design it negotiated with the shippers.[17] Rather, the decisions were made to respond to a pipeline company application for approval to build new transmission assets.[18] This type of application is called a facilities application.[19] I will examine some facilities applications as they reveal that parties' negotiation on their own could not prevent issues of cross-subsidization and unfair pipeline competition.[20]

5.2 Central argument

Parties prefer negotiation because that regulatory process serves them to achieve a balance of their interests in their own way.[21] Parties frequently do that within the context of pipeline competition.[22] However, the fact that natural gas pipeline carriers compete has not eliminated the need for regulatory oversight of a negotiated settlement.

The benefits of parties' negotiation are several. First, parties can agree on the revenue requirement which the carrier will obtain through prices payable by shippers for the term of the settlement.[23] Once the revenue is agreed the carrier can be certain about its income while shippers can be certain about the level of prices they must pay.[24] Hence, both parties can adapt their interests to a changing competitive context during the term

[16] For instance, the *NEB Decision RH-003-2011, supra* note 3, adopted in March 2013.
[17] The Regulator explained that a carrier's application for this purpose used to be made under the *National Energy Board Act*, RSC 1985, c N-7 [NEBA], Part III. See *NEB Examination Decision 2018, supra* note 4 at 4–5. Under the current *Canadian Energy Regulator Act* (S.C. 2019, c. 28, s. 10) [CERA] this application is made under ss 230, 231, and 235.
[18] Under the former *NEBA, supra* note 17, these rules were in Part III. Under CERA*, supra* note 17, that application is made under s 183 and related rules of Part 3.
[19] For example, NEB, *Report on Nova Gas Transmission Ltd, GH-001-2012* (Application dated 14 October 2011 for Northwest Mainline Komie North Extension, January 2013) [*NEB Report GH-001-2012*] at 17, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/666941/737909/914331/914110/A50255-1_NEB_-_Report_-_NOVA_Gas_-_Komie_North_Extension_-_GH-001-2012.pdf?nodeid=913955&vernum=-2>.
[20] *NEB Examination Decision 2018, supra* note 4 at 3–5.
[21] *Canada's Pipeline Transportation System 2016 supra* note 1 at 21–22.
[22] *NEB Decision RH-003-2011, supra* note 3 at 1–3, 244. See also *NEB Examination Decision 2018, supra* note 4 at 1, 5.
[23] *CER Letter Decision, April 2020, supra* note 15 at 2–3.
[24] *Ibid*.

of the settlement.[25] Second, parties go beyond the division of costs to incent the carrier to reduce them.[26] Third, in the event that a carrier charges different prices for the use of separate segments of its pipeline system, which is called segmentation, parties' negotiation can minimize cross-subsidization between shippers.[27]

Several facts explain the benefits of parties' negotiation. The shipper's countervailing power and the presence of pipeline competition help parties to achieve the benefits.[28] In addition, the experience gained over the years under regulatory oversight also helps parties achieve the benefits.[29] In any event, the critical factor which explains the benefits is that parties negotiate based on the information shared when the Regulator intervenes to make sure that the carrier provides germane information.[30]

However, parties' negotiation has some drawbacks. First, in some events parties' negotiation are not suitable for dealing with long-term issues which transcend the duration of a settlement.[31] In particular, parties' negotiation cannot prevent the carrier from transferring to shippers all the long-term business risks associated with stranded assets.[32] Second, parties' negotiation are not suitable for dealing with issues involving third parties' interests.[33] Specifically, parties' negotiation cannot prevent the carrier from relying on cross-subsidization to compete unfairly with rival carriers.[34]

---

[25] *CER Decision RH-001-2019, supra* note 2 at 45.
[26] *CER Letter Decision, April 2020, supra* note 15 at 3.
[27] *Ibid* at 1. The scope of the concept of segmentation is contained in the TransCanada Pipelines Ltd, *2021–2026 Mainline Settlement Application* (December 20, 2019) [*TCPL, Mainline Settlement Application*] at 7–8, online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3773158/3891141/3895154/C03833-1_TCPL_2021-2026_Mainline_Settlement_Application_-_A7C1U1.pdf?nodeid=3895155&vernum=-2> It must be indicated that the Regulator equates the concept of segmentation with cross-subsidization. See *NEB Decision RH-003-2011, supra* note 3 at 103–104.
[28] *CER Letter Decision, April 2020, supra* note 15 at 2-3. The unanimous support of parties interested in the settlement was critical to achieve the benefit of certainty. Meanwhile, the level of pipeline competition faced by TransCanada's Mainline had been so significant that it has threatened the survival of that system. See *NEB Decision RH-003-2011, supra* note 3 at 1–3.
[29] *TCPL, Mainline Settlement Application, supra* note 27 at 4. The background of these negotiation shows how the settlement the parties reached was facilitated by multiple decisions that involved regulatory intervention in various degrees.
[30] *CER Decision RH-001-2019, supra* note 2 at 1.
[31] *Ibid* at 45–46.
[32] *NEB Decision RH-003-2011, supra* note 3 at 42–45, 244.
[33] *NEB Examination Decision 2018, supra* note 4 at 5.
[34] *Ibid*.

Furthermore, parties' negotiation can lead the carrier to make present shippers pay for the costs which future shippers must bear.[35] This peril implies that the carrier can take actions contrary to the regulatory principles after the Regulator has approved the negotiated settlement in question.[36]

The drawbacks and peril can be explained in terms of the asymmetry of information between the carrier and the Regulator.[37] As a matter of fact, sometimes shippers negotiate without having full access to the carrier's disaggregated information on costs and the management of business risks.[38] Although the asymmetry of information between the carrier and its shippers is relevant, it is even more relevant for regulatory purpose the asymmetry of information between the carrier and the Regulator.[39]

5.3 The use of a negotiated settlement to solve conflicts in Northeast British Columbia

5.3.1 Parties' negotiation created certainty

According to the *Decision RHW-1-2010*, Nova applied for approval of a negotiated settlement regarding the 2010-2012 period.[40] Nova's application was based on an unopposed settlement.[41] In 2010 the Regulator approved that settlement.[42] In the Regulator's view all interested parties had had the opportunity to participate in the

[35] NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-001-2018* (Application for Approval of 2018–2020 Mainline Tolls 13 December 2018) [*NEB Decision RH-001-2018*] at 14–18, online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3119193/3413374/3466681/3723990/A96655-1_NEB_%E2%80%93_Letter_Decision_%E2%80%93_TransCanada_%E2%80%93_2018_to_2020_Mainline_Tolls_-_A6Q0L3.pdf?nodeid=3723583&vernum=-2>.

[36] *Ibid* at 18–19.

[37] *NEB Examination Decision 2018, supra* note 4 at 1, 5–8. The regulator's detailed requirements for disaggregated information ordered in this decision illustrate the point that pipeline competition alone does not replace the need for regulatory intervention to compel carriers to disclose information. These disclosures achieve two aims. First, shippers can make informed decisions during the negotiation or adjudication regulatory process. Second, the regulator can examine the allocation of business risks between the parties.

[38] *NEB Examination Decision 2018, supra* note 4 at 5–8. This decision shows that the regulator had to intervene to make it possible for both the Regulator and shippers to obtain information. The decision also enabled parties to pursue further negotiation.

[39] This is the reason why the Regulator has affirmed that a settlement cannot prevent the examination of the impact of a settlement on third parties; see *ibid* at 5.

[40] *NEB Decision RHW-1-2010, supra* note 5 at 1.

[41] *Ibid* at 1, 12. In this decision, the Regulator approved the price design methodology.

[42] *Ibid*.

negotiation process and their interests were accommodated.[43] Thus, the Regulator concluded that the settlement led Nova to determine pipeline prices in a way compatible with its legal mandate and thereby approved the settlement.[44] Therefore, the parties' negotiation process solved short-term issues leading parties to achieve the degree of certainty they considered acceptable.

5.3.2 Parties' negotiation were unsuitable to prevent cross-subsidization which created conflicts of unfair pipeline competition

According to the Regulator's *Examination Decision 2018*, between 2011 and 2015 Nova submitted several facilities applications to expand the existing pipeline system to meet new transportation needs from the Montney formation in northeast British Columbia area.[45] These applications sought to obtain the Regulator's recommendation on the issuance of a certificate of the public convenience and necessity to build new transmission assets.[46]

In that area, Nova competes with two other pipeline carriers: Westcoast Energy Inc (Westcoast) and Alliance Pipeline Limited Ltd (Alliance).[47] Some of the carrier's price designs had been the result of negotiation between each carrier and its shippers and the resulting settlements were approved by the Regulator.[48]

---

[43] *Ibid* at 11–12.
[44] *Ibid*.
[45] *NEB Examination Decision 2018, supra* note 4 at 4. The Regulator examined these applications in three separate reports: *NEB Report GH-001-2012, supra* note 19; NEB, *Report on Nova Gas Transmission Ltd, GH-001-2014* (Application dated 8 November 2013 for the North Montney Mainline Project) [*NEB Report GH-001-2014*] online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/915551/1060220/2452264/2413697/A3-3_Hearing_Order_GH-001-2014_-_A3T7V0.pdf?nodeid=2413610&vernum=-2> and NEB, *Report on Nova Gas Transmission Ltd, GH-003-2015* (Application dated 2 September 2015 for the Towerbirch Expansion Project, October 2016) [*NEB Report GH-003-2015*], online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/2671288/2819218/3065005/3065109/A79841-1_NEB__-_Report_-_NOVA_Gas_-_Towerbirch_Facilities%2C_Tolling_Methodology_-_GH-003-2015.pdf?nodeid=3065196&vernum=-2>
[46] *NEB Examination Decision 2018, supra* note 4 at 2, 4. According to the former *NEBA*, *supra* note 17 at s 51, the construction or expansion of a pipeline requires a prior certificate of public convenience and necessity, which is approved by the Executive Branch based on the regulators' recommendation. *CERA, supra* note 17 at s 183, establishes a similar provision.
[47] *NEB Examination Decision 2018, supra* note 4 at at 1–3.
[48] *NEB Report GH-001-2012, supra* note 19 at 29; *NEB Decision RHW-1-2010, supra* note 5 at 2, 11–12.

Nova, Westcoast, and their shippers had requested the Regulator's intervention outside the context of facilities applications.[49] Specifically, parties asked the Regulator to investigate whether these carriers were competing fairly based on their price design.[50]

In that respect some shippers and Westcoast had questioned Nova's investment in building new assets.[51] Nova's price design was the result of a negotiated settlement which the Regulator approved for the use of the Alberta pipeline system.[52] Accordingly, the parties questioned whether the use of that price design implied that Nova was competing unfairly with Westcoast and Alliance in the separate market of northeast British Columbia.[53] Furthermore, some parties had questioned Westcoast's competitive conduct.[54]

The Regulator appointed L. Mercier, one of the members of the regulatory body, to analyze whether an investigation on price design and conditions of service was justified and what the relevant matters could be.[55]

Based on the information and arguments obtained from multiple interested parties, the Regulator reached some preliminary conclusions about Nova and Westcoast's past conduct and identified some potential disputes between these carriers and between them and their shippers.[56]

The Regulator indicated that Nova invested in the construction of new transmission assets relying on contracts made with some shippers, but the length of the contracts was

---

[49] *NEB Examination Decision 2018, supra* note 4 at 2. According to the former *NEBA, supra* note 17 at Part III, the regulator had to evaluate the characteristics of the price design proposed by the company, which planned to build transmission assets; see *NEB Report GH-001-2012, supra* note 19 at 17, 28–30. Currently, *CERA, supra* note 17, governs that proceeding under similar rules, explicated at 179 to 183. These characteristics constitute some of the multiple legal factors the Regulator must consider when preparing a recommendation for the federal executive branch about issuing a certificate on the public convenience and necessity of a pipeline project. The Regulator considered that these characteristics are equally relevant to prevent unfair pipeline competition.

[50] *NEB Examination Decision 2018, supra* note 4 at 2.

[51] *Ibid supra* note 4 at 3–5.

[52] *NEB Decision RHW-1-2010, supra* note 5.

[53] *NEB Report GH-001-2012, supra* note 19 at 29–31.

[54] *NEB Examination Decision 2018, supra* note 4 at 5.

[55] *Ibid* at 2. Under the former *NEBA, supra* note 17, the regulatory power was entrusted to the NEB. The regulator ordered the preliminary investigation based on the *NEBA*, s 15(1), which granted power to assess any matter related to its functions. *CERA, supra* note 17 at s 33 grants the regulator similar power. Thus, the regulator can, on its own initiative, investigate and determine any matter under its legal purview.

[56] *NEB Examination Decision 2018, supra* note 4 at 2–5.

shorter than the expected useful life of the assets.[57] This mismatch created doubts about whether Nova would need to design prices to recover part of the costs from shippers which had not asked for that construction.[58] Moreover, the Regulator considered that if Nova's price design negotiated for the Alberta System was applied to recover the costs of the expansion in northeast British Columbia, that conduct could be contrary to the principle that each shipper must pay the costs caused.[59]

The Regulator affirmed that Westcoast calculated prices using one single set of costs which means that this company added the costs of new assets to the costs of existing ones.[60] As a result, all shippers would be paying the costs of the new assets despite that only some shippers would use them.[61] For that reason, that price design posed doubt about whether Westcoast would compete in northeast British Columbia based on cross-subsidization between shippers.[62] Furthermore, the Regulator noted that Westcoast lacked a written public statement on investment in new assets.[63] Thus, the Regulator and shippers were unable to understand how Westcoast would allocate the risks of recovering the capital invested in building new assets between that company and its shippers.[64]

The Regulator indicated that there were potential competition disputes between Nova and Westcoast derived from the use of cross-subsidization.[65] Consequently, the Regulator asked Nova to explain how this company planned to deal with building new assets when their expected useful life was longer than the contracts agreed in advance for their construction.[66] Specifically, the Regulator asked Nova to explain how that company would recover from shippers the costs of assets after the expiration of the transportation contracts.[67]

---

[57] *Ibid* at 5.
[58] *Ibid* at 6.
[59] *Ibid* at 4–5.
[60] *Ibid* at 5.
[61] *Ibid*.
[62] *Ibid*.
[63] *Ibid*.
[64] *Ibid*.
[65] *Ibid* at 4–5.
[66] *Ibid* at 5.
[67] *Ibid*.

In addition, the Regulator requested Nova and Westcoast detail evidence and explanations on the management of several interrelated matters: the investment in new assets, the approach to depreciation to recover costs in the long term, and the price design and conditions of service.[68] The Regulator sought to obtain not only detailed data on costs but also explanations to understand the carriers' reasons for expanding their systems and their practices on how they manage costs and business risks.[69]

The Regulator affirmed that it would not undertake a market investigation to deal with the potential disputes identified.[70] Instead, the Regulator indicated that the issues would be examined within the context of each of Nova and Westcoast's applications for the approval of a price proposal.[71] On that point, the Regulator made it clear that even if Nova and Westcoast had concluded a negotiated settlement with their shippers, the carriers had to provide the information requested.[72]

In the *NEB Examination Decision 2018* the Regulator indicated that the *Negotiated Settlement Guidelines* do not confine the Regulator merely to examine the balance of interests achieved by the negotiating parties.[73] Rather, the Regulator's mandate requires an examination of the settlement in question based on public interest considerations.[74] In that respect, the Regulator considered that to promote fair pipeline competition a greater disclosure of carrier's information it is necessary.[75]

The Regulator's view and requests for information reveal several points. First, the Regulator suggests that the information provided by a carrier under the *Negotiated Settlement Guidelines* does not include the disaggregated information required to achieve the purposes sought by the Regulator's information request under *Examination Decision*

---

[68] *Ibid* at 5–8.
[69] *Ibid* at 5–8.
[70] *Ibid* at 3–4.
[71] *Ibid*. The Regulator also affirmed that it would promote a review of the Filing Manual to establish the information requirements of an application and ensure fair pipeline competition. This includes informing third parties affected. *Filing Manual - Guide P – Tolls and Tariffs (ss. 225-240 of CER Act) [Filing Manual - Guide P]* online (pdf): CER <https://www.cer-rec.gc.ca/en/applications-hearings/submit-applications-documents/filing-manuals/filing-manual/filing-manual.pdf>. Moreover, this review will also demand an explanation on the use of one or a separate set of costs in the event of building new assets.
[72] *NEB Examination Decision 2018, supra* note 4 at 3-4
[73] *Ibid* at 5.
[74] *Ibid*.
[75] *Ibid.*

2018.[76] In particular, the protection of third parties, notably rival carriers, cannot be achieved under the information requirements of the *Negotiated Settlement Guidelines* because this information has to do with the settlement itself. Second, the drawback of the parties' negotiation process to prevent a carrier from using cross-subsidization to compete unfairly is explained by the fact that the carrier negotiates based on better information than the shippers have. Third, the asymmetry of information between the carrier and the Regulator is even more relevant than the asymmetry of information between the carrier and shippers. That is because the information is necessary not only to examine the prices shippers will pay to their carrier but also to analyze the effects of these prices on rival pipeline carriers.[77]

5.4 The use of negotiation to solve conflicts in the area served by the TransCanada's Mainline pipeline system

5.4.1 Parties' negotiation were unsuitable for preventing the carrier from attempting to transfer to shippers the cost of stranded assets

According to *Decision RH-003-2011*, the parties could not prevent TransCanada from trying to transfer to shippers the costs of stranded assets.[78] In fact, the negotiation process held between TransCanada and its shippers from 2009 to 2011 failed.[79]

The issue of stranded assets emerged from several facts which affected the long-term financial viability of the TransCanada's Mainline system.[80] First, TransCanada faced

---

[76] *NEB Revised Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs*, 12 June 2002 [*Negotiated Settlement Guidelines 2002*] at (iii)-(iv), online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/157025/208496/A02885-1_NEB_Decision_%E2%80%93_Guidelines_for_Negotiated_Settlements_of_Traffic%2C_Tolls_and_Tariffs_%28A0E4C1%29.pdf?nodeid=208497&vernum=-2>
The *Negotiated Settlement Guidelines 2002* requires the applicant to provide information that enables the Regulator to understand the settlement, and thus whether the prices resulting from the settlement meet the legal mandate. However, given that the Regulator evaluates the settlement as an integrated solution (that is, as a package) the information provided is aggregated. See Regulator's letter dated June 2002 attached to the Guidelines. When a party opposes the settlement, it should present evidence on how the balance of interests that the consenting parties reached affects their interests. The carrier and the consenting parties can then respond the opposition**.**

[77] *NEB Examination Decision 2018, supra* note 4 at 3–4. This explains why the Regulator announced the need to increase the information requirements under the *Filing Manual - Guide P supra* note 71.

[78] *NEB Decision RH-003-2011, supra* note 3 at 26, 34–46, 43–45.

[79] *Ibid* at 244.

[80] *Ibid* at 1–3.

lower natural gas supply in western Canada caused by declining prices of that energy product.[81] Second, TransCanada confronted a new source of natural gas developed in the northeastern part of the United States closer to the consuming areas in Ontario and Quebec.[82] Third, these facts led customers in Ontario and Quebec to purchase foreign natural gas sold at prices cheaper than the gas produced in Western Canada and to use alternative pipeline systems to transport it.[83] In order to recover the capital invested, TransCanada's response was to increase prices for transportation services.[84] Hence, the level of gas carried over TransCanada's Mainline system was declining.[85] Even more, shippers did not want to renew their long-term transportation contracts.[86] As a result, TransCanada's Mainline transmission assets were left underused.[87]

Given the above, TransCanada requested the modification of the conditions of service and the price design to minimize the adverse consequences of the facts described above.[88] This carrier's proposal created multiple interrelated issues.[89]

Parties tried to implement these modifications through a prolonged negotiation process held between 2009 to 2011.[90] They sought to reach an agreement applicable for three years.[91] After several rounds of negotiation, TransCanada reached an agreement with some interested parties but in every occasion the agreement was contested by others.[92] Consequently, the Regulator asked TransCanada to submit the application for the 2012-2013 period in order to allow the company to face the facts affecting the long-term financial viability of this pipeline system.[93] Therefore, the Regulator adjudicated on the disputes created by TransCanada's proposal.[94]

---

[81] *Ibid* at 8.
[82] *Ibid* at 1, 8. The new sources of natural gas came from the Marcellus and Utica basins in the United States.
[83] *Ibid* at 1, 8.
[84] *Ibid* at 13, 43–45.
[85] *Ibid* at 1, 8.
[86] *Ibid* at 8, 12.
[87] *Ibid* at 8, 43–45.
[88] *Ibid* at 1–3, 14–15, 244.
[89] *Ibid* at 251
[90] *Ibid* at 1–3, 244, 246, 251.
[91] *Ibid* at 246.
[92] *Ibid* at 15, 244.
[93] *Ibid* at 1–3, 244.
[94] *Ibid* at 244.

Parties could not agree on how to deal with this long-term price issue given that it had implications which transcended the three-year term of the settlement they were trying to achieve.[95] Specifically, parties could not agree on which party should bear the costs of transmission assets which had allegedly become no longer useful.[96] In fact, TransCanada proposed to transfer to shippers the risk of these assets.[97] In contrast, some shippers argued that this risk should be borne by TransCanada and ultimately by its shareholders.[98] Congruent with that position, shippers argued that part of the costs should be disallowed to reflect merely the costs of the assets which TransCanada effectively used to provide transmission services.[99]

TransCanada contended that the rate of return which the Regulator authorized over the years had not indemnified that company for the risk of underutilization of the Mainline assets.[100] Consequently, the company argued that if the carrier had to assume that risk, then the carrier would be unable to recover the costs regarded prudent at the time of investing in transmission assets.[101] In light of that, TransCanada maintained that if the Regulator denied the recovery of the cost of underutilized assets, then the Regulator would be confiscating part of the capital invested.[102]

Some intervenors in that process opposed TransCanada's proposal and its supportive legal arguments.[103] For some intervenors the rate of return approved over the years had already covered TransCanada's growing long-term risk of underutilization.[104] Hence, shippers had no obligation to pay additional compensation for business risks which that company knew since 2001.[105] Other participants in the regulatory process

---

[95] *Ibid* at 8, 14–15, 26, 34–37, 42–43, 244. TransCanada's proposal reflected some the agreements derived from the negotiation process. However, the regulator had to adjudicate. The pages cited, read together, show that TransCanada's restructuring proposal only partially reflected some agreements with shippers. One of the issues that parties could not solve by themselves was the treatment of the underutilized assets.
[96] *Ibid* at 34–36.
[97] *Ibid* at 42–45.
[98] *Ibid* at 34–36, 251.
[99] *Ibid* at 26, 35–36.
[100] *Ibid* at 34.
[101] *Ibid* at 26–29, 34.
[102] *Ibid* at 35.
[103] *Ibid* at 34–36.
[104] *Ibid*.
[105] *Ibid* at 36.

affirmed that the Regulator's legal mandate did not require them to cover the carrier against all the facts which could affect the survival of a pipeline system.[106] Still others contended that TransCanada' shareholders and shippers should share the risk of underutilization.[107]

Furthermore, parties had diverging views on the factual situation which explained the issue in dispute.[108] In fact, TransCanada's position revealed that the discussion involved the very definition of when transmission assets become stranded.[109] On that point, TransCanada categorized the situation as the materialization of fundamental risk.[110] In contrast, while some intervenors described the situation as stranded assets, others view it as reflecting some underutilization of assets or the result of the shippers' decision to abstain from renewing transportation contracts.[111] Still other intervenors believed that the underutilization of assets was a matter of degree.[112]

In contrast, the Regulator categorized that situation as the result of a combination of decreasing supply and demand for natural gas and growing pipeline competition.[113] The combination of these business risks had left some transmissions assets either underused or not used altogether.[114]

Parties could not find a solution for this long-term issue.[115] First, the parties were unable to agree on the of degree of actual and future underutilization of transmission assets.[116] In that respect, some intervenors considered that it was necessary to wait and see whether that company could recover some traffic in the long term.[117] They suggested

---

[106] *Ibid*.
[107] *Ibid*.
[108] *Ibid* at 29, 34–36.
[109] *Ibid* at 28–30.
[110] *Ibid* at 34. I explained the concept of fundamental risk in Chapter 4.
[111] *Ibid* at 34. These intervenors included market participants with different natural gas needs, namely the Canadian Association of Petroleum Producers (CAPP), the Industrial Gas Users Association (IGUA), and the Association of Power Producers (APPRO). They also included utility companies serving final consumers—for instance, Market Area Shippers, which represents Enbridge Gas Distribution, Union Gas Limited, and Gas Metro (ibid at v–vii, 35–36).
[112] *Ibid* at 29.
[113] *Ibid* at 42–45.
[114] *Ibid*.
[115] *Ibid* at 34–36.
[116] *Ibid*.
[117] *Ibid*.

that regulatory intervention was necessary to assess whether that risk had become a reality and what should be done about it.[118] In addition, they indicated that the solution to the issue would require the evaluation of the remaining useful life of the assets.[119]

The asymmetry of information between the parties

The degree of underutilization of the Mainline System relied on information and analysis mostly under TransCanada's control.[120] First, TransCanada prepared a study which looked at traffic during the 2000-2020 period.[121] Second, TransCanada's traffic study relied on public as well as on confidential information obtained from shippers.[122] Third, according to the Regulator, TransCanada's traffic study revealed more than the aggregation of that information.[123] As a matter of fact, the company's study involved estimations of future supply of natural gas produced in western Canada and demand for that product in the rest of Canada.[124] Moreover, TransCanada evaluated alternative scenarios based on multiple factors.[125] In this respect it is unclear whether TransCanada submitted the detailed study to shippers during the negotiation process.[126] What is clear is that TransCanada submitted the study to the Regulator during the adjudication process and modified it twice.[127]

In view of the above, it can be argued that the asymmetry of information between TransCanada and its shippers explains why the parties were unable during the negotiation process to reach a settlement on the treatment of the long-term risk of stranded assets.[128]

---

[118] *Ibid* at 30.
[119] *Ibid*.
[120] *Ibid* at 17–25.
[121] *Ibid* at 17–18.
[122] *Ibid*.
[123] *Ibid* at 17.
[124] *Ibid* at 18–20.
[125] *Ibid*.
[126] *Ibid* at 17, 244.
[127] *Ibid* at 17.
[128] As TransCanada argued, the carrier's ability to make estimations reflects its autonomy to conduct its businesses. In TransCanada's views, it is the carrier rather than the regulator that evaluates the context in which the pipeline system operates and makes decisions to pursue the goals. TransCanada said its autonomy is overruled by the Regulator only when it is proven that the carrier has used its discretion to take unjustified advantage of shippers. See NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-2-2004, Phase I* (2004 Mainline Tolls and Tariffs

5.4.2 The reasons for regulatory intervention to prevent the transfer to shippers of the costs of stranded assets

In *Decision RH-003-2011* the Regulator clarified the factors which determine the existence of the fundamental risk.[129] As indicated in the fourth chapter, the factors are mainly whether the current and expected level of traffic could leave some assets permanently underused and whether shippers do not use them in any circumstance.[130] Hence, the Regulator indicated that only if it is proven that all these factors are met, then the Regulator can disallow the costs associated with transmission assets no longer used.[131]

In contrast, TransCanada's study proved that natural gas traffic over the Mainline system could increase from 2013 to 2020 and hence transmission assets would be useful again.[132] In addition, TransCanada's forecast indicated that shippers could obtain security of supply and other benefits.[133] Moreover, TransCanada proved that the prices could allow it to compete and recover the costs.[134] As a result, the Regulator did not disallow any of TransCanada's costs given that the factors determining the existence of fundamental risk had not been met.[135] Therefore, the conclusion was that TransCanada's Mainline system would be financially viable in the long term only if TransCanada's forecast of traffic would become real.[136]

In brief, the above shows that the regulatory intervention was necessary to ascertain whether the long-term risk of stranded assets had materialized.[137] That is why

---

Application, September 2004) [*NEB Decision RH-2-2004, Phase I*] at 10, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/334963/A08344-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Tolls_and_Tariff_%E2%80%93_RH-2-2004_Phase_I.pdf?nodeid=334859&vernum=-2>. That TransCanada opinion is consistent with the regulatory premise— that it is incumbent on the carrier to make decisions to ensure the economic viability of its pipeline system.

[129] *NEB Decision RH-003-2011, supra* note 3 at 43.

[130] *Ibid*.

[131] *Ibid* at 42–45.

[132] *Ibid* at 45.

[133] *Ibid* at 45.

[134] *Ibid*.

[135] *Ibid*.

[136] *Ibid* at 45.

[137] *Ibid* at 42–45.

parties' negotiation were unsuitable to deal with the issue of the economic viability of the TransCanada's Mainline system.

Parties can legally share the risk of stranded assets

The unsuitability of parties' negotiation to deal with the issue of stranded assets is not absolute. That view is derived from the Supreme Court decision in *Ontario (Energy Board) v Ontario Power Generation Inc,* 2015 SCC 44 as I will explain below.

Before doing that, it is necessary to note that TransCanada's proposal raised a related issue which is relevant to understand whether in a negotiation process shippers can prevent the carrier from attempting to transfer the costs of stranded assets.[138]

In *Decision RH-003-2011*, adopted in March 2013, the Regulator approved a fixed price for several years.[139] The Regulator's purpose was to enable TransCanada to respond to an evolving competitive context to recover its costs.[140] In the Regulator's view a fixed price for several years would allow TransCanada to help prevent the fundamental risk.[141] That would be achieved because fixed prices could attract new customers by creating price certainty.[142] In that respect, the Regulator found that since 2004 the degree of fundamental risk had increased and would continue to grow.[143] For that reason, the Regulator indicated that making TransCanada's income stable through fixed prices would facilitate parties sharing that increased risk.[144] Although the fundamental risk had not become a reality in 2013, the Regulator was willing to facilitate parties sharing that risk.[145] Therefore, the Regulator's decision to fix prices to incent parties to share the potential consequences of the fundamental risk leads me to think that the Regulator's position according to which the carrier should bear the fundamental risk was not a categorical statement, rather a qualified one.

[138] *Ibid* at 163–164.
[139] *Ibid*.
[140] *Ibid* at 45, 163–164.
[141] *Ibid* at 163–164.
[142] *Ibid*.
[143] *Ibid* at 164.
[144] *Ibid*.
[145] *Ibid*.

In any event, any current interpretation of that regulatory position on that risk must be examined based on the Supreme Court's view adopted in the 2015 decision cited above on the relationship between the prudent and the used and useful principles in utility regulation.[146] In the Court's view, when Parliament has granted a utility regulator discretion to assess whether a price proposal is just and reasonable, the utility regulator is allowed to choose how to fulfill that mandate.[147]

Based on this interpretation of that kind of legal mandate in utility regulation, the Court held that the regulator is allowed to look at the facts which happens after the utility company made the decision to incur some costs.[148] Hence, even if the utility regulator approved some costs as prudent at a given point in time, the regulator can disallow them afterwards.[149]

Nevertheless, the Court held that when the legal mandate involves fairness and reasonableness, the regulator has to take into account two considerations when it approves prices.[150] First, the utility company must be able to attract new investment to be able to supply services in the long term.[151] Second, the regulator must look at the interests of both the utility company and its customers.[152] In that regard, the Court's position is that if a utility company made some decisions and then becomes unable to reduce realized costs, then for fairness reasons the regulator can divide these costs between the utility company and its customers.[153] Therefore, the application of the Court's view to a situation of stranded assets implies that the regulator can divide between the utility company and customers the costs of assets which are underused or not used at all, as Professor Bankes commented.[154]

---

[146] *Ontario (Energy Board) v. Ontario Power Generation Inc, 2015 SCC 44, [2015] 3 R.S.C 147, [Ontario Energy]* at paras 102–104. This Supreme Court decision was adopted in 2015 after the regulator's *NEB Decision RH-003-2011, supra* note 3, which was adopted in March 2013.
[147] *Ibid* at para 103.
[148] *Ibid*.
[149] *Ibid* at para 104.
[150] *Ibid*.
[151] *Ibid*.
[152] *Ibid*.
[153] *Ibid* at para 112.
[154] Nigel Bankes, "The Regulatory Treatment of Stranded Assets in Alberta" (15 October 2015), online (pdf of blog post): *The University of Calgary Faculty of Law Blog* <https://ablawg.ca/wp-content/uploads/2015/10/Blog_NB_UAD_oct2015.pdf> at 5. He examined the implications of two Supreme Court

It must be noted that in principle, as the Regulator recognized, parties can achieve a balance of their interests by negotiation.[155] However, as a matter of fact the assessment of whether a given degree of underutilization of transmission assets constitutes a fundamental risk is a matter of degree which required regulatory intervention based on expert judgement.[156] Now, as a matter of principle, the Court's views regarding fairness when the Regulator seeks to disallow costs have one implication.[157] That is, the fair and reasonable allocation of that risk between the pipeline company's shareholders and shippers also requires regulatory intervention to prevent the transfer of that risk to vulnerable customers.[158] Given the novelty and complexity of the issue, the parties' negotiation were unsuitable for dealing with the long-term risk of stranded assets. Nevertheless, that complexity does not exclude the possibility that parties can try to achieve an agreement compatible with the interpretation of the Court. Therefore, the Regulator should make it clear whether it agrees with the Court so that parties can share the risk in question.

5.5 The peril of a negotiated settlement

Summary of the case

To facilitate the comprehension of the peril, I will synthetize first the Regulator's *Decision RH-001-2018 in TransCanada Pipeline Limited, Application for Approval of 2018-2020 Mainline Tolls* which illustrates the peril. Then, I will describe the context of this decision and explain the peril in more detail.

TransCanada made a proposal contrary to the rules agreed in a settlement and the principle of intergenerational equity to deal with an event which occurred after that settlement was negotiated and approved by the Regulator.[159] The event was that during

decisions, namely *Ontario Energy, supra* note 146 and *ATCO Gas and Pipelines Ltd v Alberta (Utilities Commission), 2015 SCC 45* [*ATCO Gas*]. In his view, these judicial decisions recognize that the regulator cannot pass all the risks of assets no longer used onto the utility company.

[155] *CER Decision RH-001-2019, supra* note 2 at 11.

[156] *NEB Decision RH-003-2011, supra* note 3 at 43.

[157] *Ontario Energy, supra* note 146 at paras 102–104.

[158] *NEB Decision RH-003-2011, supra* note 3 at 43.

[159] *NEB Decision RH-001-2018, supra* note 35.

the term of the settlement natural gas traffic increased.[160] At the time parties reached the settlement they anticipated that such a risk could happen but did not foresee the magnitude of the increase in traffic. Hence, neither the parties nor even the Regulator adopted a rule to deal with this business risk.[161]

Despite that, TransCanada had to manage the consequences of the event. Hence, TransCanada submitted a proposal to the Regulator based on the argument that the course of action proposed was compatible with the way parties agreed to share business risks.[162] In contrast, in the Regulator's view, the way parties agreed to share business risks was inapplicable to deal with the event.[163]

The Regulator concluded that the carrier's proposed course of action was contrary to the principle of cost causation that requires preventing one generation of shippers from bearing the costs caused by another.[164] That practice was characterized as intergenerational inequity which involves one form of cross-subsidization.[165] Unlike the carrier, the Regulator did consider the increase in natural gas traffic as a relevant fact.[166] Therefore, the Regulator intervened to prevent the carrier from allocating that business risk between present and future shippers in a way contrary to the principle of intergenerational equity.[167] Below I will describe the peril of parties' negotiation in more detail.

[160] *Ibid* at 12.
[161] *Ibid* at 19.
[162] *Ibid* at 4.
[163] *Ibid* at 19.
[164] *Ibid* at 16
[165] *Ibid* at 17–18.
[166] *Ibid*.
[167] It is worth clarifying that the business risk in this case is different from the fundamental risk discussed earlier. In fact, the fundamental risk involves a traffic reduction that makes some transmission assets obsolete. In contrast, the case under analysis involves a traffic increase. This clarification is relevant because, as described earlier, the Regulator, thus far, has not appeared to recognize the feasibility that parties agree to share the fundamental risk. Yet, in the case under discussion, parties did share the risk of a traffic increase.

The Regulator approved a negotiated settlement reached in 2014.[168] In that settlement, the parties agreed that some rules applied during 2013-2030.[169] The settlement included the price design for 2015-2020.[170] In addition, the Regulator required TransCanada to submit an application in 2017 for the price design applicable during 2018-2020.[171] In response to that requirement, TransCanada and some of its shippers agreed on a price design for the 2018-2020 period but several interested parties opposed the agreement.[172] Therefore, the Regulator intervened.[173] The relevant issue in dispute for the present purposes was how to distribute the balance of an account agreed to by the parties in 2014.[174] This account was part of the settlement which the Regulator approved that year.[175]

The purpose of the account was to reflect the differences between (i) TransCanada's estimated costs and revenue for the period 2015-2020, and (ii) the actual costs and revenue for that period.[176] The parties agreed that after deducting from the balance the amount they regarded as an incentive, the remaining balance should be used according to the conditions of the settlement and the regulatory approval.[177] In particular, the parties agreed that if the account balance was positive, then TransCanada revenue should be reduced.[178] Hence, the carrier should reduce prices for shippers as the balance implied that shippers had paid prices above the relevant costs.[179] The parties estimated that the revenue ought to be reduced by $174 million in 2018, $168 million in 2019 and

---

[168] *NEB Decision RH-001-2018, supra* note 35 at 1. This settlement was approved outside the *Negotiated Settlement Guidelines 2002 supra* note 76, because TransCanada negotiated mainly with three interested parties. In this Decision the Regulator merely referred to the approval of the Settlement by the NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-001-2014* (2015–2030 Tolls and Tariffs Application—Part IV, December 2014) pp 93,95,99 online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/955803/2397890/2585806/2585804/A65154-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_2015-2030_Tolls_and_Tariff_%E2%80%93_RH-001-2014.pdf?nodeid=2585408&vernum=-2>

[169] *NEB Decision RH-001-2018, supra* note 35 at 1.

[170] *Ibid*.

[171] *Ibid*.

[172] *Ibid* at 1–2.

[173] *Ibid* at 2.

[174] *Ibid* at 3.

[175] *Ibid* at 4. This account was called Long-Term Adjustment Account.

[176] *Ibid* at 4, 15.

[177] *Ibid* at 15.

[178] *Ibid* at 4.

[179] *Ibid* at 7–8.

$162 million in 2020 considering the business context when the agreement was made.[180] Nevertheless, the balance amounted to $1.1 billion by the end of 2017.[181] The origin of that unforeseen revenue for TransCanada was that natural gas traffic during 2015 and 2017 was greater than expected.[182]

It must be noted that TransCanada's Mainline operated based on three segments for financial purposes.[183] These segments were the Prairies (which covers the area from Empress in Alberta, Saskatchewan and Manitoba), the Northern Ontario Line and the Eastern Triangle (formed by North Bay, Toronto and Ottawa which are three locations in Ontario).[184]

TransCanada's proposal was to refund gradually the account balance pursuant to the settlement and the regulatory approval.[185] Accordingly, the carrier's proposal sought to distribute that balance in line with the residual useful life of the transmission assets.[186] Thus, the implication of that proposal was that the period for refunding the $1.1 billion would be 46 years rather than the period from 2018 to 2020.[187] The shippers who would receive most of that value would be the users of the Eastern Triangle segment.[188]

In TransCanada's view that proposal reflected the balance of interests which the parties achieved in the settlement.[189] TransCanada argued that the proposal to distribute the account balance led the shippers to have certainty on price.[190] In TransCanada's view, the term for refunding any amount in excess of the cost caused should be consistent with the term for recovering any amount below the cost caused.[191] In TransCanada's opinion, this interpretation of the settlement reflected the compromise the parties achieved in the negotiation process between the business risks the carrier accepted to take and the

[180] *Ibid* at 4–5.
[181] *Ibid* at 4.
[182] *Ibid* at 12.
[183] *Ibid* at 7.
[184] *NEB Decision RH-003-2011, supra* note 3 at 5.
[185] *NEB Decision RH-001-2018, supra* note 35 at 4.
[186] *Ibid*.
[187] *Ibid*.
[188] *Ibid*.
[189] *Ibid*.
[190] *Ibid* at 4–5.
[191] *Ibid* at 4.

compensation agreed for it.[192] In fact, the settlement contemplated the possibility of refund for shippers but in different degrees across the segments of the Mainline.[193]

Some interested parties opposed TransCanada's proposal.[194] For instance, the Canadian Association of Petroleum Producers (CAPP) affirmed that TransCanada's proposal relied on the segments of the Mainline to determine the proportion of the refund.[195] In CAPP's opinion, that criterion for refunding was unacceptable because the useful life of the transmission assets and hence the way in which TransCanada depreciated them varied across the segments of the Mainline.[196] Therefore, TransCanada's proposal would make shippers using the Prairies and northern Ontario segments pay the costs created by users of the Eastern Triangle.[197]

According to CAPP, TransCanada's proposal created an issue of intergenerational inequity.[198] In CAPP's opinion, the account balance reflected an excess in revenue derived from prices paid by all users of the Mainline system during the 2015-2017 period.[199] For that reason, the refund could not be made in favor of future shippers.[200] Rather, TransCanada should make the refund in favor of shippers who had paid that amount between 2015 and 2017.[201] In addition, TransCanada should provide the refund between 2018 and 2020 and in the same proportion in which the excess of income was generated in each segment of the system.[202]

In contrast, other interested parties supported TransCanada's proposal.[203] For instance, shippers mainly using the Eastern Triangle contended that during the negotiation process they assumed business risks and costs in exchange for some

[192] *Ibid*.
[193] *Ibid* at 18.
[194] *Ibid* at 5–12.
[195] *Ibid* at 6
[196] *Ibid*.
[197] *Ibid*.
[198] *Ibid*.
[199] *Ibid*.
[200] *Ibid*.
[201] *Ibid*.
[202] *Ibid*.
[203] *Ibid* at 12–13.

benefits granted to users of other segments of the Mainline system.[204] Other interested parties affirmed that the settlement contemplated the distribution of the account balance but only after 2021.[205] Therefore, in order to dispose of the account balance, the events which had occurred after the settlement was reached, should not be taken into account.[206]

TransCanada responded to the arguments posed against its proposal. According to TransCanada, the balance of interests which parties negotiated could not be modified in light of the events which occurred after the settlement was approved.[207] As a matter of fact, the account balance could not be predicted and hence that balance did not constitute a significant change in the business context.[208] Accordingly, the price increase that shippers using the Eastern Triangle paid between 2015-2017 created additional income which served to mitigate TransCanada's lower income in the Prairie segment of the Mainline system.[209] Furthermore, TransCanada indicated that the negative and positive balances in the account in question emerged from the regulatory decision to fix prices for six years.[210] That is why in a given period the prices paid did not necessarily correspond to the costs required to provide pipeline services.[211] Therefore, in TransCanada's view the proposal did not create intergenerational inequity.[212]

The Regulator's decision

The Regulator denied TransCanada's proposal.[213] In its view, the principle of cost causation implied that users of a pipeline system should pay the costs created for that use.[214] The Regulator recognized that such payments are made during a long period which implies that there is some degree of transfer of costs between generations of

[204] *Ibid* at 13. Those interested parties included shippers operating as gas distributors in Eastern Canada—notably Enbridge Gas Distribution, Energir L.P., and Union, which are users of the Mainline system.
[205] *Ibid* at 13.
[206] *Ibid*.
[207] *Ibid* at 14–15.
[208] *Ibid* at 15.
[209] *Ibid*.
[210] *Ibid*.
[211] *Ibid*.
[212] *Ibid*.
[213] *Ibid* at 16.
[214] *Ibid* at 16–17.

shippers.[215] Nevertheless, the Regulator held that the legal mandate made it necessary to minimize this form of cross-subsidization between different generations of shippers.[216]

The Regulator applied the principle of intergenerational equity to solve the issue.[217] The Regulator indicated that shippers paid prices above the costs during 2015 and 2017 as a result of the approved price design.[218] Thus, shippers should receive the refund.[219] If TransCanada could take 46 years to refund the account balance, the principle of intergenerational equity would be infringed.[220] In addition, the Regulator indicated that TransCanada had to be able to compete with pipeline rivals and increase the level of use of transmission assets.[221] Consequently, the refund would facilitate TransCanada's ability to compete.[222] In that context, the Regulator held that intergenerational equity considerations were above the ones based on certainty.[223] Based on these considerations, the Regulator ordered TransCanada to refund the total of the account balance between 2018 and 2020.[224] The distribution of that refund was ordered to be made to each Mainline segment as proposed by CAPP.[225] In that respect, the Regulator noted that the order did not imply a review and modification of prices legally paid from 2015 to 2017.[226]

The Regulator recognized two facts relevant for the decision.[227] First, it recognized that the unexpected account balance during 2015-2017 was derived from a change in the circumstances prevailing at the time the parties negotiated a settlement in 2014.[228] Second, the Regulator recognized that neither parties nor its review of the settlement led them to adopt a rule to deal with that change.[229] Given these facts, the Regulator applied

---

[215] *Ibid* at 17–18.
[216] *Ibid*.
[217] *Ibid* at 16–17.
[218] *Ibid* at 17.
[219] *Ibid*.
[220] *Ibid*.
[221] *Ibid* at 19.
[222] *Ibid* at 18–19.
[223] *Ibid* at 18.
[224] *Ibid* at 17–18.
[225] *Ibid* at 20.
[226] *Ibid* at 17.
[227] *Ibid* at 19.
[228] *Ibid*.
[229] *Ibid*.

the principle of intergenerational equity.[230] Thus, it held that whatever its view at the time of approving the settlement, the facts indicated above made it necessary to intervene to ensure that prices met the legal mandate.[231]

Finally, it can be said that the asymmetry of information between the Regulator and TransCanada explains the peril. In fact, to solve the issue the Regulator required additional information from TransCanada.[232] At the request of CAPP and other intervenors in the hearing, the Regulator asked TransCanada twice to provide information.[233] In that respect, the Regulator found that TransCanada did not provide evidence to support the methodology proposed to distribute the account balance.[234] That is the reason why the Regulator's decision relied on CAPP's proposal.[235]

5.6 Other benefits of parties' negotiation

The Regulator's *Decision of April 17, 2020, on TransCanada's Application for the Approval of the 2021-2026 Negotiated Settlement* reveals that negotiation created the benefits which I describe below.[236]

Parties' negotiation prevented the abuse of TransCanada's market power

In December 2019 TransCanada applied under CERA and the *Negotiated Settlement Guidelines* for the regulatory approval of a unanimous settlement negotiated between 2018 and 2019.[237] Specifically, the parties agreed on the conditions of service of the TransCanada's Mainline system and the revenue requirement for the term 2021-2026.[238]

One of the components of the revenue requirement was the rate of return.[239] As I explained in the second and third chapters, that issue traditionally required intervention

[230] *Ibid*.
[231] *Ibid*.
[232] *Ibid* at 2.
[233] *Ibid*.
[234] *Ibid* at 18.
[235] *Ibid* at 18, 20.
[236] *CER Letter Decision, April 2020, supra* note 15 at 1.
[237] *TCPL, Mainline Settlement Application*, *supra* note 27 at 1.
[238] *Ibid*.
[239] *Ibid* at 10.

which led the Regulator to develop and apply the fair return standard to prevent the carrier from charging shippers more than the cost of capital derived from that standard.[240] Parties agreed on that component without the need of regulatory intervention to prevent the potential abuse of TransCanada's market power.[241]

Parties' negotiation created certainty

Parties' negotiation on the revenue requirement for the 2021-2026 period created certainty.[242] In fact, TransCanada argued that shippers would have certainty on the prices they would pay during that period.[243] The Regulator, in turn, recognized that the settlement would ensure that the revenue proposed would allow TransCanada to recover its costs during the term of that agreement.[244] As a result of the review of the negotiation process and the settlement the Regulator accepted the intervenors' arguments that the settlement would create certainty for them.[245]

Parties' negotiation prevented cross-subsidization

The parties also agreed to set different prices for two separate segments.[246] That practice is called segmentation.[247] Thus, TransCanada would continue to bring natural gas to all segments traditionally served by the Mainline system.[248] However, the parties agreed that prices for moving gas within the Prairies would differ from the prices applicable in the Eastern Triangle to reflect differences in costs between these segments.[249] Hence, whenever TransCanada would carry natural gas across several segments the applicable price would be the aggregate of the prices for carrying gas using

---

[240] NEB*, Reasons for Decision, TransCanada Pipeline Limited, RH-2-2004, Phase II* (2004 Mainline Tolls and Tariffs Application, April 2005) [*NEB Decision RH-2-2004, Phase II*] at 16–17, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/365090/A09636-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Cost_of_Capital_%E2%80%93_RH-2-2004%2C_Phase_II.pdf?nodeid=365091&vernum=-2>.
[241] *Ibid*.
[242] *CER Letter Decision, April 2020, supra* note 15 at 3.
[243] *TCPL, Mainline Settlement Application*, *supra* note 27 at 5, 16.
[244] *CER Letter Decision, April 2020, supra* note 15 at 3.
[245] *Ibid*.
[246] *TCPL, Mainline Settlement Application*, *supra* note 27 at 5, 7-8.
[247] *Ibid* at 7–8.
[248] *Ibid*.
[249] *Ibid*.

all the segments.[250] Despite the difference in the prices payable by shippers between segments, this agreement was reached without disputes on cross-subsidization.

Parties' negotiation created incentives for cost reduction

The parties created incentives for TransCanada to reduce costs.[251] In that regard, the parties agreed to divide the gains resulting from actual income over and above the expected income in each year of the settlement.[252] Conversely, they would divide the losses if the revenue obtained was below the level expected.[253] That kind of agreement constitutes a benefit because when the Regulator adjudicates it is mainly concerned with ensuring that shippers pay the costs caused rather than with cost reduction.[254]

Factors which explain the benefits of parties' negotiation

The Regulator approved the settlement as a reflection of the balance of the parties' interests achieved by negotiation.[255] In fact, in the negotiation process the parties were focused on how to meet their needs and interests.[256] On this point, TransCanada's application lacked any indication of the parties' discussions about regulatory principles during the negotiation process. Similarly, the Regulator did not refer to any assessment made on the prudence of the costs recoverable through prices and the fairness of the rate of return agreed. Rather, the Regulator found that the settlement fulfilled the conditions and the information requirements related to the settlement as established in the *Negotiated Settlement Guidelines*.[257] Consequently, the Regulator concluded that the settlement would determine prices compatible with the legal mandate.[258]

---

[250] *Ibid*.
[251] *TCPL, Mainline Settlement Application*, *supra* note 27 at 5,7, 12–13. *CER Letter Decision, April 2020, supra* note 15 at 1, 3.
[252] *TCPL, Mainline Settlement Application*, *supra* note 27 at 12–13.
[253] *Ibid*.
[254] CER Regulation of pipeline traffic, tolls and tariffs (12 February 2021), sections Negotiated Settlements and Toll Design, online: *Canada Energy Regulator* <https://www.cer-rec.gc.ca/en/about/who-we-are-what-we-do/responsibility/regulation-pipeline-traffic-tolls-tariffs.html#:~:text=The%20CER%20regulates%20pipeline%20tolls,in%20tolls%2C%20service%20or%20facilities>.
[255] *CER Letter Decision, April 2020, supra* note 15 at 2–3.
[256] *TCPL, Mainline Settlement Application*, *supra* note 27 at covering letter.
[257] *CER Letter Decision, April 2020, supra* note 15*; Ibid* at 2.
[258] *Ibid* at 2–3.

Based on the above, the first factor which explained the benefits of certainty, the creation of incentives for cost reduction and the prevention of cross-subsidization is the countervailing power derived from the level of participation in the negotiation process. In fact, the parties took two years to reach the settlement after numerous meetings held between the carrier, interested parties, shippers, government officials and industry associations.[259] Ultimately, the negotiating parties endorsed the settlement unanimously.[260] Even more, as part of the review process the Regulator invited the interested parties to comment on the settlement.[261] In response to that invitation, several parties submitted comments during the review process and all of them were in support of the settlement.[262]

The second factor explaining the benefits is that the parties negotiated based on the experience gained over the years from operating under regulatory oversight.[263] That experience helped the parties to develop further the rules agreed on in prior regulatory proceedings.[264]

In addition, TransCanada explained that the success of the negotiation process was the result of sharing confidential information.[265] In particular, TransCanada affirmed that the degree of participation of multiple interested parties in the negotiation process was the result of the access to that information.[266] This fact facilitated the achievement of the balance of interests for all of them.[267]

5.7 Conclusion

The parties preferred to use negotiation given that this process created benefits in terms of certainty: the carrier was certain about the revenue requirement and shippers

[259] *TCPL, Mainline Settlement Application*, *supra* note 27 at 6.
[260] *Ibid* at 1.
[261] *CER Letter Decision, April 2020, supra* note 15 at 2.
[262] *Ibid*. The interested parties were the Canadian Association of Petroleum Producers, Shell Canada Energy, the Alberta Department of Energy, Centra Gas Manitoba Inc, The Industrial Gas Users Association, Enbridge Gas Inc, and Encana Corporation.
[263] *TCPL, Mainline Settlement Application*, *supra* note 27 at 4. The background of those negotiation shows how the settlement reached was facilitated by multiple decisions that involved regulatory intervention in different degrees.
[264] *Ibid*
[265] *Ibid* at 6.
[266] *Ibid*.
[267] *Ibid*.

were certain about the prices payable. In addition, the parties created incentives for cost reduction. Furthermore, in some cases the parties prevented discussions about cross-subsidization. Moreover, parties agreed on the rate of return without discussions about the potential abuse of the carrier's market power.

However, the Regulator had to intervene because a negotiated settlement in other cases could not prevent the carrier from trying to use cross-subsidization to compete unfairly with rival carriers and from attempting to transfer to shippers the cost of stranded assets. In addition, the Regulator intervened to prevent the carrier from making one generation of shippers pay the costs created by another. These drawbacks and perils of parties' negotiation can be explained in terms of the asymmetry of information between the carrier and the Regulator.

Having described and explained the drawbacks and perils of the negotiation process, what remains to be examined is how the Regulator manages them which I will described in the sixth chapter.

CHAPTER 6
HOW THE REGULATOR MANAGES THE DRAWBACKS AND PERILS

6.1 Purpose and central argument of the chapter

The purpose of the present chapter is to describe how the Regulator manages the drawbacks and peril of parties' negotiation. In the previous chapter, I indicated that the asymmetry of information between the carrier and the Regulator is the critical aspect which prevents the Regulator from scrutinizing the price design parties agreed to in a settlement. Therefore, to describe the management of the drawbacks and perils, it is necessary to describe how the Regulator minimizes the asymmetry of information.

Central argument of the chapter

The Regulator manages the drawbacks and perils of the parties' negotiation process mainly based on the carrier's burden of proof to obtain from the carrier greater information disclosure.[1] Thus, when the settlement is unopposed, the Regulator requires information pursuant to the *Negotiated Settlement Guidelines* to assess the overall balance of the interests reached.[2] However, when there is opposition to the settlement the Regulator also asks the carrier for disaggregated information on the issue which led the interested parties to oppose that balance.[3] Thus, the Regulator also requires information outside the *Negotiated Settlement Guidelines*.[4] That was the case with the

---

[1] *NEB Revised Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs*, 12 June 2002 [*Negotiated Settlement Guidelines 2002*] at paras (iii)-(iv), online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/157025/208496/A02885-1_NEB_Decision_%E2%80%93_Guidelines_for_Negotiated_Settlements_of_Traffic%2C_Tolls_and_Tariffs_%28A0E4C1%29.pdf?nodeid=208497&vernum=-2>
The Regulator requires from the carrier overall information pursuant to para (iii) and disaggregated information under para (iv). The Regulator also requires information outside the *Negotiated Settlement Guidelines 2002*. That is the case when the negotiation process alone is unsuitable to prevent some carriers' conduct. See *NEB Examination Decision 2018, supra* note 4 at 5–8, illustrates that point.

[2] *Negotiated Settlement Guidelines 2002 supra* note 1 at para (iii).

[3] *Ibid* at para (iv).

[4] NEB, *Letter Decision* (Examination to Determine Whether to Undertake an Inquiry of the Tolling Methodologies, Tariff Provisions and Competition in Northeast British Columbia, 8 March 2018) [*NEB Examination Decision 2018*] at 5–8, Online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/3225050/3338199/3488659/A90483-1_NEB_-_Letter_Decision_-_Parties_-_Inquiry_of_the_Tolling_Methodologies%2C_Tariff_Provisions_and_Competition_-_NE_BC_-_A6A9Y3.pdf?nodeid=3490855&vernum=-2>.

information requested in the *Examination Decision 2018* which I examined in the previous chapter.[5] The Regulator used that information to facilitate a subsequent negotiation process, which gave shippers access to the carrier's detailed cost data and to the reasons explaining why and how the carrier managed the pipeline system.[6]

Alternatively, as illustrated by Decision *RH-003-2011*, if the parties could not solve an issue by negotiation, then the Regulator adjudicated to solve the disputes.[7] In such cases, the Regulator could evaluate the evidence, based on its expertise in the pipeline business, to determine whether the fundamental risk had become a reality.[8] Hence, the Regulator was able to determine that there were no stranded assets at the time.[9]

In such cases, the Regulator may also use the *Toll Information Regulations* to obtain explanations regarding the differences between the carrier's forecast data used to approve prices for a given test year and the actual costs, traffic, capital, revenue requirement and rate of return for the test year.[10] These Regulations are applicable when the prices derived from the settlement are based on cost of service.

6.2 How the Regulator manages the drawback of parties' negotiation to deal with the issue of stranded assets

In *Decision RH-003-2011*, the Regulator recognized that the 2009-2011 negotiation held between TransCanada and the interested parties did not result in a settlement; accordingly, TransCanada was required to submit a proposal for regulatory consideration.[11] Once the Regulator identified the preliminary list of issues, TransCanada

---

[5] *Ibid.*
[6] *Ibid* at 5–8.
[7] NEB, *Reasons for Decision, TransCanada Pipeline Ltd, NOVA Gas Transmission Ltd, and Foothills Pipe Lines Ltd, RH-003-2011* (Business and Services Restructuring Proposal and Mainline Final Tolls for 2012 and 2013, March 2013) [*NEB Decision RH-003-2011*] at 246, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/665035/711778/941262/939799/A51040-1_NEB_-_Reasons_for_Decision_-_TransCanada%2C_NOVA_Gas_and_Foothills_-_2012_and_2013_Final_Tolls_-_RH-003-2011.pdf?nodeid=939800&vernum=-2>.
[8] *Ibid* at 43.
[9] *Ibid* at 43, 221.
[10] *Toll Information Regulations SOR/79-319* [*Toll Information Regulations*] at ss 3,5 online: (pdf) <https://laws-lois.justice.gc.ca/PDF/SOR-79-319.pdf>.
[11] *NEB Decision RH-003-2011, supra* note 7 at 244.

provided information on the cost of service of the Mainline system.[12] In the course of the regulatory process the Regulator asked TransCanada twice to submit additional information.[13] Moreover, the Regulator gave intervenors the opportunity to contest that evidence.[14] In addition, TransCanada amended the estimation of traffic originally submitted.[15] Based on that, during the public hearing several expert witnesses appeared to testify on the issue of the fundamental risk.[16] In light of the evidence discussed, the Regulator concluded that the expected increased traffic on TransCanada's Mainline meant that these assets would still be useful.[17] Hence, the Regulator concluded that TransCanada would be allowed to adapt to a changing business context.[18] Therefore, the Regulator managed the drawback in question by adjudicating based on cost of service as a default method.[19]

6.3 How the Regulator manages the drawback when the negotiation process is unsuitable to prevent unfair pipeline competition based on cross-subsidization

As indicated in the previous chapter, under *Examination Decision 2018*, the Regulator requested information to understand how Nova and Westcoast would use depreciation for the recovery of the capital over the useful life of their transmission assets.[20] The context in which that Decision was adopted, which I explained in the previous chapter, suggests that the Regulator sought to facilitate the prevention of cross-subsidization even by negotiation between each of these rival carriers and its shippers subject to the Regulator's review of the settlement.[21]

Nova presented an application in 2019 based on a contested settlement which the Regulator responded to in *Decision RH-001-2019.* Nova's application dealt with several

[12] *Ibid* at 86, 88–89, 251–252.
[13] *Ibid*.
[14] *Ibid*.
[15] *Ibid*.
[16] *Ibid* at 34–36. Some of these experts testified on behalf of TransCanada and some others on behalf of interested parties.
[17] *Ibid* at 45.
[18] *Ibid* at 3.
[19] *Ibid* at 251–252. The Regulator addressed, through an adjudication process, all the conflicts included in the list of issues.
[20] *NEB Examination Decision 2018, supra* note 4 at 5–8.
[21] *Ibid* at 5.

issues.[22] Of interest to this discussion, Nova requested the approval of a modification of the price design and conditions of service.[23] Moreover, Nova requested the approval of a surcharge.[24] In addition, Nova submitted the information which the Regulator requested according to *Examination Decision 2018*.[25]

Nova's proposal of the surcharge involved separate matters.[26] First, Nova proposed a method for calculating a surcharge designed to make feasible the recovery of the cost of building new transmission assets in the North Montney area.[27] This matter was not part of the settlement.[28] Second, Nova sought to use the surcharge as an addition to the price derived from the settlement.[29] This matter had to do with the price for using the existing Nova system and was interpreted by Nova to be part of the settlement.[30]

Westcoast, Nova's pipeline rival, argued that the Regulator should deny the settlement because the surcharge involved cross-subsidization.[31] Nova sought to use the surcharge to recover the costs associated with building the North Montney transmission assets.[32] Hence, if a surplus existed after cost recovery, Nova planned to use this surplus to fund the use of Nova' existing system.[33] For that reason, Westcoast contended that shippers using the North Montney assets would be subsidizing the shippers using the Nova system.[34]

---

[22] *CER*, *Reasons for Decision, NOVA Gas Transmission Ltd, RH-001-2019* (Application dated 14 March 2019 for NGTL System Rate Design, March 2020), [*CER Decision RH-001-2019*] at 1, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/554137/3752363/3752364/3760156/3913151/C05448-1_CER_%E2%80%93_Reasons_for_Decision_RH-001-2019_%E2%80%93_NOVA_Gas_%E2%80%93_NGTL_System_Rate_Design_%20and_Services_-_A7E4S8.pdf?nodeid=3912507&vernum=-2>

[23] *Ibid* at 1–2.

[24] *Ibid*.

[25] *Ibid* at 1.

[26] *Ibid* at 1–2.

[27] *Ibid*.

[28] *Ibid*.

[29] *Ibid*.

[30] *Ibid*.

[31] *Ibid* at 38–39.

[32] *Ibid* at 38.

[33] *Ibid*. In particular, the remaining income would be used to recover the cost of the assets, which made possible the interconnection of both set of transmission assets.

[34] *Ibid* at 39.

The Regulator concluded that Nova's proposal did not create cross-subsidization.[35] In the Regulator's view, shippers who use the North Montney transmission assets would pay the costs derived from these assets.[36] In addition, they would pay a proportion of the costs of the Nova system.[37]

The Regulator did not confine itself to examine the proposal based on the procedural principles established in by the *Negotiated Settlement Guidelines*.[38] Rather, given the opposition to the settlement, the Regulator decided the case through a public hearing.[39] Consequently, the Regulator solved the issue of cross-subsidization based on the evidence on cost of service presented and the principle of cost causation.[40]

6.4 How the Regulator manages the peril

In *Decision RH-001-2018*, the Regulator relied on a public hearing to mitigate the peril, described in the sixth chapter, by employing several measures.[41] First, the Regulator requested from TransCanada disaggregated information on the 2015-2017 revenue obtained above the costs in that period.[42] Second, the Regulator allowed intervenors to submit written evidence on the origin of that amount.[43] After examining the evidence submitted by all the parties and the proposals of intervenors, the Regulator ordered TransCanada to refund to shippers the amount received above the adjusted costs.[44]

---

[35] *Ibid* at 38–39.
[36] *Ibid*.
[37] *Ibid*.
[38] *Ibid* at 11, 37.
[39] *Ibid* at 4–5.
[40] *Ibid* at 30,32, 33, 38–39.
[41] NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-001-2018* (Application for Approval of 2018–2020 Mainline Tolls 13 December 2018) [*NEB Decision RH-001-2018*] at 2, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3119193/3413374/3466681/3723990/A96655-1_NEB_%E2%80%93_Letter_Decision_%E2%80%93_TransCanada_%E2%80%93_2018_to_2020_Mainline_Tolls_-_A6Q0L3.pdf?nodeid=3723583&vernum=-2>
[42] *Ibid* at 2.
[43] *Ibid*.
[44] *Ibid* at 16.

6.5 Other ways in which the Regulator minimizes drawbacks and perils

In *Decision RH-001-2019*, the Regulator provided directions to Nova on how to manage the risk of stranded assets.[45] These directions sought to respond to questions posed by participants related to the management of the long-term viability of Nova's system.[46]

One of these questions had to do with the fundamental risk which could affect Nova's pipeline system.[47] In the Regulator's opinion, that risk was not yet a reality at the time.[48] Despite that, the Regulator explained that any carrier must face two separate but related aspects of the viability of a pipeline system.[49] One is the short-term costs created, which shippers must pay through the prices paid for the services they obtain.[50] The other aspect is the long-term prospect of adapting a pipeline system to a changing business context which means dealing with fundamental risk.[51] The Regulator indicated that managing this long-term risk was incumbent on Nova as it is on any other carrier.[52] Accordingly, one way of managing the fundamental risk is to articulate the use of two instruments.[53] That is, the carrier had to examine the relationship between the actual use of transmission assets which is reflected in transportation contracts made and the way in which the carrier sought to recover through depreciation the capital invested over the useful life of the assets.[54] Regarding depreciation, the Regulator indicated that Nova should regularly examine whether the depreciation of its assets reflects the traffic forecast and the business risks faced.[55]

Based on the foregoing and the fact that Nova planned to build new transmission assets, the Regulator held that Nova must provide an updated depreciation study in

[45] *CER Decision RH-001-2019 supra* note 22 at 45–46.
[46] *Ibid* at 43.
[47] *Ibid* at 43, 45–46.
[48] *Ibid* 3at 45.
[49] *Ibid* at 45–46.
[50] *Ibid*.
[51] *Ibid*.
[52] *Ibid*.
[53] *Ibid* at 46.
[54] *Ibid*.
[55] *Ibid*.

2023.[56] In addition, the Regulator made it clear that Nova had to take action to deal with fundamental risk given that it would affect the long-term financial viability of Nova's system regardless of the duration of the settlement approved.[57]

In addition, the Regulator requested from Nova the following information:[58] First, Nova should provide disaggregated information to shippers to facilitate them making informed choices in the subsequent negotiation process.[59] Part of the Regulator's request sought to make shippers know whether any cross-subsidization was justified.[60] In that regard, the Regulator relied on the *Tolls Information Regulations* to compel Nova to provide regular information on key points of the system where gas enters or is delivered to ascertain the actual use of that system.[61] Second, the Regulator asked Nova to expand the evidence regarding the level of use of transmission assets and the level of expected traffic to comply better with the information requested in *Examination Decision 2018*.[62]

Finally, the Regulator was able to rely on the *Toll Information Regulations* to minimize the asymmetry of information. In fact, any pipeline company which charges prices must provide information to the Regulator every three months.[63] The carrier must provide evidence and explanations for significant variations between the prices charged and the estimates regarding income, assets on which the rate of return was calculated, costs incurred, energy volumes transported, and profits.[64] If the Regulator concludes that the evidence does not explain the variations, then the Regulator can require additional information to scrutinize the causes and consequences of the prices charged.[65] Thus, the

---

[56] *Ibid*.
[57] *Ibid* at 45.
[58] *Ibid* at 50.
[59] *Ibid* at 50–53.
[60] *Ibid* at 15, 48.
[61] *Ibid* at 48, 52.
[62] *Ibid* at 48.
[63] *Toll Information Regulations SOR/79-319* [*Toll Information Regulations*] at ss 3,5 online: (pdf) <https://laws-lois.justice.gc.ca/PDF/SOR-79-319.pdf>. This information is known as Surveillance Report. See CER Regulation of pipeline traffic, tolls and tariffs (12 February 2021), section Surveillance Reporting, online: *Canada Energy Regulator* <https://www.cer-rec.gc.ca/en/about/who-we-are-what-we-do/responsibility/regulation-pipeline-traffic-tolls-tariffs.html#:~:text=The%20CER%20regulates%20pipeline%20tolls,in%20tolls%2C%20service%20or%20facilities>.
[64] *Toll Information Regulations supra* note 63 s 3.
[65] *Ibid* at s 5.

Tolls Information Regulations rely on the carrier's burden of proof to make it possible to understand the differences between the forecast costs approved and the costs of service actually incurred. Therefore, the Regulator and shippers can monitor carrier's actions after the approval of an application based on that information.[66]

6.6 Conclusion

The evidence examined in this chapter reveals that the Regulator managed the drawbacks and perils of parties' negotiation based mainly on the carrier's burden of proof to obtain greater information disclosure. To obtain that information the Regulator relied on three legal instruments: the Negotiated Settlement Guidelines, specific requests for information like the one made in the *Examination Decision 2018* and the *Tolls Information Regulation*. Based on that information the Regulator can intervene when the negotiation process fails or are unsuitable to solve the relevant issues.

[66] *Ibid* at ss 3-5. The *Toll Information Regulations* is applicable when parties agree to determine prices based on the methodology of cost of service, which is a regular practice even in negotiation, as I explained in the third chapter.

CHAPTER 7
CONCLUSIONS AND RECOMMENDATION

7.1 The explanation of the research problem

Based on the foregoing, it is possible to explain the research problem that I posed in the introductory chapter.

The reason why parties sometimes become involved in litigation despite preferring to solve their issues without regulatory intervention is that the negotiation process alone can be unsuitable to police some carriers' conduct. First, a carrier can attempt to transfer to its shippers the risk of stranded assets. This conduct can prejudice the parties' interests because that risk extends beyond the term of the settlement. Second, parties' negotiation cannot prevent the carrier from using cross-subsidization. Thus, that conduct can affect the balance of parties' interests during the term of the settlement. In addition, the carrier's conduct can affect third parties' interests including rival carriers. Moreover, the use of cross-subsidization can also benefit one generation of shippers at the expense of another. The carrier can adopt that action after the Regulator has approved the settlement. Therefore, that conduct constitutes a peril of negotiation.

Carriers have attempted to transfer to shippers the risk of stranded assets and to use cross-subsidization, undeterred by the existence of pipeline competition in a diverse business context in separate geographic areas in Canada. Therefore, pipeline competition cannot eliminate the need for regulatory intervention.

The Regulator seeks to prevent the carrier's conduct because the transfer of risk of stranded assets to shippers is contrary to the principles of used and useful assets and efficiency while cross-subsidization is contrary to the cost-based/user-pay principle.

The drawbacks and perils of parties' negotiation can be explained in terms of the asymmetry of information between the carrier and the Regulator. To manage the drawbacks and perils the Regulator seeks to minimize the asymmetry of information. Accordingly, the Regulator requires disaggregated information beyond the information required by the *Negotiated Settlement Guidelines*. In principle, the information provided under these *Guidelines* mainly serves to put the Regulator in a position to understand the

overall balance of interests which the parties reached. In contrast, the Regulator's requirement for disaggregated information seeks to evaluate specific issues affecting that balance. These issues are mainly associated with whether the carrier seeks the recovery of the capital through the depreciation of stranded assets and whether the carrier attempts to use cross-subsidization. *Examination Decision 2018* and the request for surveillance reports illustrate this point.

7.2 Assessment of parties' negotiation

The use of negotiated settlement as an alternative to cost of service to deal with market failures must be evaluated based on the purpose under CERA.[1] The legal mandate requires the Regulator to achieve just, reasonable and non-discriminatory prices for pipeline services.[2] Moreover, the mandate requires the Regulator to ensure efficiency in the construction and operation of pipelines.[3] In addition, CERA seeks to ensure that regulatory decisions achieve certainty and predictability.[4] Furthermore, the Regulator must ensure that hearings and decision-making processes are fair, inclusive, transparent and efficient.[5]

In practice, when negotiation do not work the Regulator adjudicates based on the principles of efficiency, prudency, used and useful assets, cost-based/user-pay, non-acquired rights, prevention of the abuse of market power, fairness and other regulatory principles described in detail in the third chapter.[6]

---

[1] *Canadian Energy Regulator Act* (S.C. 2019, c. 28, s. 10) [CERA] at s 6 establishes its purpose. However, the regulator has a specific mandate on prices, under ss 11, 230, 231, and 235.
[2] *Ibid* at ss 11, 230, 231, 235.
[3] *Ibid* at s 6(a).
[4] *Ibid* at Preamble.
[5] *Ibid* at s 6(a).
[6] CER, *Reasons for Decision, NOVA Gas Transmission Ltd, RH-001-2019* (Application dated 14 March 2019 for NGTL System Rate Design, March 2020) [*CER Decision RH-001-2019*] at 1–2, online(pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/554137/3752363/3752364/3760156/3913151/C05448-1_CER_%E2%80%93_Reasons_for_Decision_RH-001-2019_%E2%80%93_NOVA_Gas_%E2%80%93_NGTL_System_Rate_Design_%20and_Services_-_A7E4S8.pdf?nodeid=3912507&vernum=-2>.; NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-1-2007* (Gros Cacouna Receipt Point, July 2007) [*NEB Decision RH-1-2007*] at 21–22, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/443945/472730/471076/A16008-1_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Gros_Cacouna_Receipt_Point_%E2%80%93_RH-1-2007.pdf?nodeid=470970&vernum=-2>.

Nevertheless, the Regulator recognizes that when parties' negotiation work the process helps to achieve efficiency.[7] In that respect, the Regulator's review of a negotiated settlement makes it possible for parties to agree on solutions to multiple issues in a manner that both complements and mirrors robust market competition, achieving greater efficiency.[8] For instance, parties' negotiation have been used to incent the carrier to reduce costs.[9] These are some of the benefits of parties' negotiation.

In addition, the Regulator understands that to meet its legislated mandate it must promote the short and long-term financial viability of pipeline systems and prevent the conduct that affects the balance of parties' interests.[10] The evidence examined in this thesis demonstrates that the negotiation process has facilitated the achievement of certainty on the revenue requirement which ensures the financial viability of a given pipeline system.[11] That implies the carrier can expect to recover all prudent costs realized

---

[7] *CER Decision RH-001-2019 supra* note 6 at 2–3. See also CER, *Reasons for Decision, Enbridge PipeLines Inc, RH-001-2020* (Application dated 19 December 2019 for Canadian Mining Contracting, November 2021) [*CER Decision RH-001-2020*] at 74–75, 79–80, online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/155829/3773831/3890507/4038614/4167013/C16317-1_Commission_-_Canada_Energy_Regulator_Reasons_for_Decision_RH-001-2020_%E2%80%93_Enbridge_Pipelines_Inc._%E2%80%93_Canadian_Mainline_Contracting_-_A7Y9R1.pdf?nodeid=4166515&vernum=-2>.

[8] *CER Decision RH-001-2020, supra* note 7 at 80.

[9] CER Regulation of pipeline traffic, tolls and tariffs (12 February 2021), section Negotiated Settlement, online: *Canada Energy Regulator* <https://www.cer-rec.gc.ca/en/about/who-we-are-what-we-do/responsibility/regulation-pipeline-traffic-tolls-tariffs.html#:~:text=The%20CER%20regulates%20pipeline%20tolls,in%20tolls%2C%20service%20or%20facilities>.

[10] The Regulator has sought the short-term financial viability of pipeline systems in NEB, *Reasons for Decision, TransCanada Pipeline Limited, RH-2-2004, Phase II* (2004 Mainline Tolls and Tariffs Application, April 2005) [*NEB Decision RH-2-2004, Phase II*] at 77–78, Online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/334963/A08344-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Tolls_and_Tariff_%E2%80%93_RH-2-2004_Phase_I.pdf?nodeid=334859&vernum=-2>.
The Regulator has promoted the long-term financial viability in NEB, *Reasons for Decision, TransCanada Pipeline Ltd, NOVA Gas Transmission Ltd, and Foothills Pipe Lines Ltd, RH-003-2011* (Business and Services Restructuring Proposal and Mainline Final Tolls for 2012 and 2013, March 2013) [*NEB Decision RH-003-2011*] at 3, 50, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/665035/711778/941262/939799/A51040-1_NEB_-_Reasons_for_Decision_-_TransCanada%2C_NOVA_Gas_and_Foothills_-_2012_and_2013_Final_Tolls_-_RH-003-2011.pdf?nodeid=939800&vernum=-2>.

[11] CER, *Letter Decision, TransCanada Pipelines Limited* (Application for the Approval of the Mainline 2021–2026 Settlement, 17 April 2020) [*CER Letter Decision, April 2020*] at 2–3, online (pdf) CER: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3773158/3891141/3914560/C05780-

and shareholders can obtain a fair rate of return on their investment, considering the risk profile of the investment.[12] Shippers can prevent carrier abuse of market power through a pragmatic negotiation process, avoiding adjudication.[13] Furthermore, the parties' negotiation can also create price certainty for shippers.[14] Certainty is most noticeable when interested parties have endorsed unanimously a negotiated settlement because in that event the degree of regulatory intervention is minimal.

Such certainty allows producers to make their own decisions regarding the development of natural gas resources. It also allows the carrier's downstream customers to rely on a more guaranteed price for transportation services which helps them to take fuller advantage of business opportunities. These are the other substantive benefits of parties' negotiation.

However, the negotiation process is not perfect. It is mainly unsuitable to deal with the long-term issue of stranded assets.[15] This is the most important drawback of the parties' negotiation. In addition, the threat of stranded assets constitutes a major regulatory issue. Hence, it has required regulatory intervention.[16] In addition, the information disclosure remains a main regulatory difficulty.

Meanwhile, from the procedural perspective, the Regulator's review of a unanimous negotiated settlement usually implies approval with minimum regulatory intervention.[17] At other times, the request for greater information disclosure enables the Regulator to review the settlement in question or to adjudicate when some shippers

---

1_CER_%E2%80%93_Letter_Decision_%E2%80%93_TransCanada_%E2%80%93_Mainline_2021-2026_Settlement_-_A7E9E9.pdf?nodeid=3914561&vernum=-2>.

[12] TransCanada Pipelines Ltd, *2021–2026 Mainline Settlement Application* (December 20, 2019) [*TCPL, Mainline Settlement Application*] at 10, online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3773158/3891141/3895154/C03833-1_TCPL_2021-2026_Mainline_Settlement_Application_-_A7C1U1.pdf?nodeid=3895155&vernum=-2>.

[13] *NEB Decision RH-2-2004, Phase II, supra note* 10 at 11–20 illustrates the complexity of determining a fair rate of return through and adjudication process.

[14] *CER Letter Decision, April 2020*, *supra* note 11 at 2–3.

[15] *NEB Decision RH-003-2011, supra* note 10 at 42–45.

[16] *Ibid*; *CER Decision RH-001-2019, supra* note *6* at 45.

[17] *NEB Revised Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs*, 12 June 2002 [*Negotiated Settlement Guidelines 2002*] at para (iv), online (pdf): CER <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/157025/208496/A02885-1_NEB_Decision_%E2%80%93_Guidelines_for_Negotiated_Settlements_of_Traffic%2C_Tolls_and_Tariffs_%28A0E4C1%29.pdf?nodeid=208497&vernum=-2>

oppose it.[18] Furthermore, the Regulator's request for increased carrier information disclosure serves shippers to allow them to make better informed decisions in subsequent negotiations.[19]

The Regulator starts from the premise that it is incumbent on the carrier to choose adjudication or negotiation.[20] Thus, when the Regulator demands greater carrier information disclosure, it improves the ability of shippers to negotiate in subsequent negotiation processes.[21] This form of intervention can serve to minimize the need of intervention via adjudication.

The evidence examined shows that the perils and most of the drawbacks of parties' negotiation have been minimized. Therefore, parties have achieved several benefits in line with the purpose of CERA. The Regulator has achieved the above not merely by leaving the parties to negotiate a private agreement. Rather, given the existence of several market failures in natural gas pipeline transportation (namely, natural monopoly and market power situations, stranded assets, and cross-subsidization) the Regulator intervenes to achieve the purpose of CERA through a review of the negotiation process and the resulting settlement.[22] Moreover, the Regulator adjudicates based on cost of service as a default method and the regulatory principles when negotiation do not prevent conduct contrary to the legal mandate. The Regulator intervention also rests on the carrier's burden of proof to obtain from the carrier information on the specific issues in dispute to minimize the asymmetry of information.[23]

When the settlement is unanimous, the parties' negotiation work with a minimal degree of regulatory intervention. In that respect, the Regulators' review of a settlement seeks to ensure that all interested parties have had an opportunity to participate in the negotiation process and to ensure that the settlement reflects the interests of all interested parties. In contrast, when interested parties oppose the settlement the Regulator preserves its benefits to the extent possible, but solves the specific disputes created by

[18] *Ibid* at paras (iii), (iv).
[19] *CER Decision RH-001-2019, supra* note *6* at 17, 26, 47–48, 50.
[20] *NEB Decision RH-003-2011, supra* note 10 at 246–247.
[21] *CER Decision RH-001-2019, supra* note *6* at 50.
[22] *Negotiated Settlement Guidelines 2002*, *supra* note 17.
[23] *Ibid* at paras (iii), (iv); *CER Decision RH-001-2019, supra* note *6* at 45.

opposition based on regulatory principles. Finally, when negotiation do not work or the carrier attempts to deviate from the settlement reached, the degree of intervention is greater as the Regulator adjudicates based on regulatory principles.

Finally, the benefits, drawbacks, and perils of parties' negotiation and the way in which the Regulator manages the drawbacks and perils, lead me to another conclusion. The use of negotiated settlement to solve price issues in natural gas pipeline transportation reflects what authors call "interest-based negotiation" as indicated in the literature review. Thus, when parties negotiate, they achieve a private balance of interests which is not necessarily a reflection of the substantive regulatory principles. Nevertheless, carrier and shippers are aware that if negotiations fail, then they can resort to litigation so that the Regulator must adjudicate the dispute based on these principles.

7.3 Relevance of the findings to other price regimes particularly the electricity sector

As indicated in the literature review in chapter two, natural gas pipeline transportation has traditionally been categorized as a natural monopoly.[24] In that respect, other utility services including electricity transmission and distribution are regarded as having similar nature.[25] Equally, in these services the regulated company can affect competition by the way in which it apportions costs between rival users which make create problems of cross-subsidization.[26] Hence, these economic activities face market failures. That explains why Alberta *Electric Utilities Act,* for example, subject the price charged for these services to regulatory intervention.[27]

This Act expressly requires the regulator to adopt rules to facilitate the use of negotiated settlement to solve disputes arising from matters subject to it.[28] In that respect,

---

[24] Joseph P Tomain & Richard D Cudahy, *Energy Law in a Nutshell*, 3rd ed, (St Paul, MN: West Academic Publishing, 2017) at 288-289. They argue that a natural gas transmission company has market power. However, other authors affirm that such activity constitutes a natural monopoly. See David M. Newberry, *Privatization, Restructuring, and Regulation of Network Utilities,* First Edition (London: The MIT Press: 2000), at 376.

[25] Sally Hunt & Graham Shuttleworth, *Competition and Choice in Electricity* (Chichester, England: John Willey Sons, 1999) at 21, 230.

[26] Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions*, 1st ed (Cambridge, MA: MIT Press, 1995) Vol 1 at 159-160.

[27] *Alberta Electric Utilities Act*, at s 119(1).

[28] *Ibid*, at s 132.

the Act directly establishes some detailed rules for the use of this method of dispute resolution.[29] Yet, the critical point for the present purpose is that the negotiated settlement requires regulator's approval to have legal force.[30] With that aim, the electricity regulator can request information related to the settlement and must ensure that parties have had the opportunity to participate in the negotiation process.[31] Given the foregoing, in principle it is possible to argue that the findings of this thesis on the benefits, drawbacks, and perils of parties' negotiations and on the way in which the Regulator manages them under CERA may be applicable to the use of that method of dispute resolution in relation to other utility services like electricity transmission and distribution.

7.4 Recommendations

To deal with the stranded assets issue the Regulator needs to develop further clarification as to how it ought to be managed. Specifically, the Regulator should indicate whether and to what extent it is willing to accept that parties other than the carrier share that risk. If risk-sharing is to occur, the Regulator needs to provide a rationale for how and why it ought to occur. As I explained in the sixth chapter, the Supreme Court's 2015 decision in *Ontario [Energy Board] v Ontario Power Generation Inc* recognized that Parliament granted to the Regulator broad discretion on the use of the principles of prudency and used and useful assets. This power can be used to develop rules to address the issue of stranded assets to ensure long-term financial viability of natural gas pipeline transportation systems.

Moreover, such broad discretion grants the Regulator with the ability to experiment with incentive structures. Thus, the Regulator can incent carriers to disclose increased information on the actual use of its transmission assets, their expected lifecycle, and management of depreciation. If carriers are motivated to do so, parties themselves can resolve more issues through the negotiated settlement process with fewer regulatory interventions.

[29] *Ibid*, at s 132-137.
[30] *Ibid*, at s 134(1).
[31] *Ibid*, at s 133(d), 134(3).

The carrier's disclosure of that information can serve to achieve two aims. First, it can put shippers and the Regulator in a better position to determine whether the carrier is trying to transfer the risk of stranded assets which shareholders must bear under the current regulatory view. Second, it can lead shippers to make better informed choices in subsequent negotiation processes. This hopefully will lead carriers to more optimal long-term management of transmission assets. That will benefit carriers and shippers and provide the certainty needed for future economic growth in Canada.

BIBLIOGRAPHY

Legislation

Alberta Electric Utilities Act, S.A 1995, c. E-5.5.

Canadian Energy Regulator Act, S.C. 2019, c. 28, s. 10.

Competition Act [R.S.C., 1985, c. C-34].

National Energy Board Act, R.S.C., 1985, c. N-7.

Toll Information Regulations, SOR/79-319, online (pdf): < https://laws-lois.justice.gc.ca/PDF/SOR-79-319.pdf>.

Rules of Practice and Procedure, (SOR/95-208), online (pdf): <https://laws-lois.justice.gc.ca/PDF/SOR-95-208.pdf>.

Canadian Jurisprudence

Dunsmuir vs New Brunswick, 2008 S.C.C 9, [2008] 1 S.C.R 190.

ATCO Electric Ltd. v. Alberta (Energy and Utilities Board), 2004 Alberta Court of Appeal ABCA 215.

ATCO Gas and Pipelines Limited v Alberta (Utilities Commission), 2015 SCC 45.

British Columbia and Hydro Authority v. West Coast Transmission Company Ltd, [1981] 2 F.C 646 at 655-656 (CA).

Northwestern Utilities Limited v. City of Edmonton, [1929] S.C.R. 186.

Ontario (Energy Board) v. Ontario Power Generation Inc, 2015 SCC 44, [2015] 3 R.S.C 147.

TransCanada PipeLines Ltd. v. National Energy Board, [2004] F.C.A 149.

Trans Mountain PipeLine Company v. National Energy Board, [1979] 2 F.C 118.

Foreign Jurisprudence

Federal Power Commission v. Hope Natural Gas Co, 320 US. 591 (1944).

Bluefield Waterworks & improvement Co Vs Public of West Virginia, 262. US *679 (1923)*

Regulatory Decisions: Alberta Utilities Commission

AUC, *Decision 2014-283: ATCO Electric Ltd. 2012 Transmission Deferral Account and Annual Filing for Adjustment Balances (*Application 1609720, Proceeding 2683, 2 October 2014).

Regulatory Decisions: National Energy Board Decisions

NEB, *Letter about Tolls Settlement, Maritimes & Northeast Pipeline Management Ltd* (Application for Approval of a 2017–2019 Toll Settlement, 1 March 2018), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92842/3300679/3324689/3490725/A90339-1_NEB_-_Letter_-_M%26NP_-_Toll_Settlement_-_Letter_Decision_%26_Order_TG-001-2018_-_A6A7W5.pdf?nodeid=3490068&vernum=-2>.

NEB, *Letter about Settlement, TransCanada Pipelines Limited* (Application for Approval of 2013 to 2030 Settlement Agreement re Hearing Order RH-001-2014, 9 May 2014), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/955803/2397890/2454494/2452876/A5-1_Letter_to_TransCanada_RH-001-2014_-_A3W6G0.pdf?nodeid=2453609&vernum=-2>.

NEB, *Letter Decision* (Examination to Determine Whether to Undertake an Inquiry of the Tolling Methodologies, Tariff Provisions and Competition in Northeast British Columbia, 8 March 2018), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/3225050/3338199/3488659/A90483-1_NEB_-_Letter_Decision_-_Parties_-_Inquiry_of_the_Tolling_Methodologies%2C_Tariff_Provisions_and_Competition_-_NE_BC_-_A6A9Y3.pdf?nodeid=3490855&vernum=-2>.

NEB*, Letter Decision, TransCanada Pipelines Limited, RH-003-2017* (Application for Approval of Dawn Long Term Fixed Price Service, 23 November 2017), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3119193/3224371/3224033/3391730/A88125-1_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Dawn_LTFP_%E2%80%93_RH-003-2017_-_A5X5F6.pdf?nodeid=3392584&vernum=-2>.

NEB, *Reasons for Decision, Imperial Oil Resources Venture Limited and its Partners, GH-1-2004*, Volume 2 (Mackenzie Gas Project, 16 December 2010) online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/338535/338661/659850/658356/A27695-3_NEB_-_Reasons_for_Decision_-_Mackenzie_Gas_Project_-_GH-1-2004%2C_Volume_2.pdf?nodeid=658255&vernum=-2>.

NEB, *Reasons for Decision, Maritimes & Northeast Pipeline Management Ltd, RH-1-2000* (Tolls Application, August 2000), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/155829/3773831/3890507/3901808/3930821/4098801/C13338-6_%28e%29_NEB_Reasons_for_Decision_RH-1-

2000_Maritimes_and_Northeast_Tolls_%282000-08-01%29_-_Chapter_11_-_A7U0E4.pdf?nodeid=4098576&vernum=-2>.

NEB*, Reasons for Decision, Multi-Client Review of RH-R-2-94* (Review of RH-2-94 Cost of Capital, October 2009), online: <https *https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/553405/93101/554572/590939/590600/A24154-1_%E2%80%93_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_Multi-Client_%E2%80%93_Review_of_RH-2-94_Cost_of_Capital_%E2%80%93_RH-R-2-94.pdf?nodeid=590601&vernum=-2>.*

NEB, *Reasons for Decision, NOVA Gas Transmission Ltd, RHW-1-2010* (Rate Design Methodology and Integration Application, August 2020), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/554137/578285/585636/629285/629048/A25890-3_NEB_-_Decision_-_Nova_Gas_%E2%80%93_Toll_Methodology_and_Integration_%E2%80%93_RHW-1-2010.pdf?nodeid=629083&vernum=-2>.

NEB, *Reasons for Decision, TransCanada Pipelines Limited, GH-2-87* (Application for Facilities and Approval of Toll Methodology and Related Tariff Matters, July 1988), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/955803/963233/963565/965818/1038930/C17-7-1_-_Decision_GH-2-87_-_A3L1U5_.pdf?nodeid=1038931&vernum=-2>.

NEB*, Reasons for Decision, TransCanada Pipelines Ltd, NOVA Gas Transmission Ltd, and Foothills Pipe Lines Ltd, RH-003-2011* (Business and Services Restructuring Proposal and Mainline Final Tolls for 2013 and 2013, March 2013), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/665035/711778/941262/939799/A51040-1_NEB_-_Reasons_for_Decision_-_TransCanada%2C_NOVA_Gas_and_Foothills_-_2012_and_2013_Final_Tolls_-_RH-003-2011.pdf?nodeid=939800&vernum=-2>.

NEB, *Reasons for Decision, TransCanada Pipelines Limited, RH-001-2014* (2015–2030 Tolls and Tariffs Application—Part IV, December 2014), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/955803/2397890/2585806/2585804/A65154-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_2015-2030_Tolls_and_Tariff_%E2%80%93_RH-001-2014.pdf?nodeid=2585408&vernum=-2>.

NEB, *Reasons for Decision, TransCanada Pipelines Ltd, RH-001-2016* (Storage Transportation Service Modernization and Standardization Application—Part IV, Tolls and Tariffs, November 2016), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/2927182/2926727/3311222/3083894/A80788-1_NEB_-_Reasons_for_Decision_-_TransCanada_-_Storage_Transportation_Service_-_RH-001-2016.pdf?nodeid=3084214&vernum=-2>.

NEB, *Reasons for Decision, TransCanada Pipelines Ltd, RH-001-2018* (Application for the Approval of 2018 to 2020 Mainline Tolls, 13 December 2018), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3119193/3413374/3466681/3723990/A96655-1_NEB_%E2%80%93_Letter_Decision_%E2%80%93_TransCanada_%E2%80%93_2018_to_2020_Mainline_Tolls_-_A6Q0L3.pdf?nodeid=3723583&vernum=-2>.

NEB, *Reasons for Decision, TransCanada Pipelines Limited, RH-1-2007* (Gros Cacouna Receipt Point Application, July 2007), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/443945/472730/471076/A16008-1_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Gros_Cacouna_Receipt_Point_%E2%80%93_RH-1-2007.pdf?nodeid=470970&vernum=-2>.

NEB, *Reasons for Decision, TransCanada Pipelines Limited, RH-2-2004, Phase I* (2004 Mainline Tolls and Tariffs Application, September 2004), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/334963/A08344-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Tolls_and_Tariff_%E2%80%93_RH-2-2004_Phase_I.pdf?nodeid=334859&vernum=-2>.

NEB, *Reasons for Decision, TransCanada Pipelines Limited, RH-2-2004, Phase II* (2004 Mainline Tolls and Tariffs Application, April 2005), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/586761/309785/335171/365090/A09636-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_Cost_of_Capital_%E2%80%93_RH-2-2004%2C_Phase_II.pdf?nodeid=365091&vernum=-2>.

NEB, *Reasons for Decision, TransCanada Pipelines Ltd, RH-3-2004* (Application for approval to establish a new receipt and delivery point, the North Bay Junction, and for the corresponding tolls for services to and from that point, December 2004), online: <https://docs2.cer-rec.gc.ca/ll-

eng/llisapi.dll/fetch/2000/90465/92833/92843/586892/293604/346558/342912/A08726-1_NEB_-_Reasons_for_Decision_%E2%80%93_TransCanada_%E2%80%93_North_Bay_Junction_%E2%80%93_RH-3-2004.pdf?nodeid=342913&vernum=-2>.

NEB, *Reasons for Decision, TransCanada PipeLines Ltd, RH-R-1-2002* (Review of RH-4-2001 Cost of Capital Decision, February 2003), online (pdf): <https://publications.gc.ca/Collection/NE22-1-2003-2E.pdf>

NEB, *Reasons for Decision, TransCanada Pipelines Limited, Westcoast Energy Inc, Foothills Pipe Lines Ltd, Alberta Gas Natural Gas Company, Trans Québec and Maritimes Pipeline Inc, Interprovincial Pipe Line Inc, Trans Mountain Pipe Line Company Ltd, Trans-Northern Pipeline Inc, RH-2-94 (Cost of Capital, March 1995)*, online (pdf): <http://www.regie-energie.qc.ca/audiences/3690-09/RepDDRGM_3690-09/B-29_GM_Reasons-Decision-RH-2-94_3690_30juin09.pdf>.

NEB, *Reasons for Decision, Trans Québec & Maritimes Pipeline Inc, RH-1-2008* (Cost of Capital for 2007 and 2008, March 2009), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92841/490113/551491/551283/A21378-1_%E2%80%93_NEB_%E2%80%93_Reasons_for_Decision_%E2%80%93_TQM-_Cost_of_Capital_for_2007_and_2008_%E2%80%93_RH-1-2008.pdf?nodeid=551438&vernum=-2>.

NEB, *Report on Nova Gas Transmission Ltd*, GH-001-2012 (Application dated 14 October 2011 for Northwest Mainline Komie North Extension, January 2013), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/666941/737909/914331/914110/A50255-1_NEB_-_Report_-_NOVA_Gas_-_Komie_North_Extension_-_GH-001-2012.pdf?nodeid=913955&vernum=-2>.

NEB, *Report on Nova Gas Transmission Ltd*, GH-003-2015 (Application dated 2 September 2015 for the Towerbirch Expansion Project, October 2016), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/2671288/2819218/3065005/3065109/A79841-1_NEB__-_Report_-_NOVA_Gas_-_Towerbirch_Facilities%2C_Tolling_Methodology_-_GH-003-2015.pdf?nodeid=3065196&vernum=-2>.

NEB, *Report on Nova Gas Transmission Ltd. North Montney Project* File Number OF-Fac-Gas-N081-2013-10 02 Hearing Order GH-001-2014 5 February 2014, online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/915551/1060220/2452264/2413697/A3-3_Hearing_Order_GH-001-2014_-_A3T7V0.pdf?nodeid=2413610&vernum=-2>.

Regulatory Decisions: Canadian Energy Regulator Decisions and Related

CER*, Letter Decision, TransCanada Pipeline Limited* (Application for the Approval of the Mainline 2021–2026 Settlement, 17 April 2020), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3773158/3891141/3914560/C05780-1_CER_%E2%80%93_Letter_Decision_%E2%80%93_TransCanada_%E2%80%93_Mainline_2021-2026_Settlement_-_A7E9E9.pdf?nodeid=3914561&vernum=-2>.

CER, *Reasons for Decision, Enbridge PipeLines Inc, RH-001-2020* (Application dated 19 December 2019 for Canadian Mining Contracting, November 2021), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/155829/3773831/3890507/4038614/4167013/C16317-1_Commission_-_Canada_Energy_Regulator_Reasons_for_Decision_RH-001-2020_%E2%80%93_Enbridge_Pipelines_Inc._%E2%80%93_Canadian_Mainline_Contracting_-_A7Y9R1.pdf?nodeid=4166515&vernum=-2>.

CER, *Reasons for Decision, NOVA Gas Transmission Ltd, RH-001-2019* (Application dated 14 March 2019 for NGTL System Rate Design, March 2020), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/554137/3752363/3752364/3760156/3913151/C05448-1_CER_%E2%80%93_Reasons_for_Decision_RH-001-2019_%E2%80%93_NOVA_Gas_%E2%80%93_NGTL_System_Rate_Design_%20and_Services_-_A7E4S8.pdf?nodeid=3912507&vernum=-2>.

TransCanada Pipeline Limited, *Letter about Application for the Approval of the Mainline 2021–2026 Settlement with the Tolls Task Force* (20 December 2019), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92833/92843/3773158/3891141/3895154/C03833-1_TCPL_2021-2026_Mainline_Settlement_Application_-_A7C1U1.pdf?nodeid=3895155&vernum=-2>.

Other CER and NEB Materials

CER, “CER Regulation of Pipeline Traffic, Tolls and Tariffs” (12 February 2021), online: *Canada Energy Regulator* <https://www.cer-rec.gc.ca/en/about/who-we-are-what-we-do/responsibility/regulation-pipeline-traffic-tolls-tariffs.html#:~:text=The%20CER%20regulates%20pipeline%20tolls,in%20tolls%2C%20service%20or%20facilities>.

NEB, *Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs* (Discussion and Draft Revised Guidelines, 30 January 2002), online: <https://docs2.cer-rec.gc.ca/ll-

eng/llisapi.dll/fetch/2000/90463/157025/142122/Letter_%28A0C7Y1%29.pdf?nodeid=142123&vernum=-2>.

NEB, *Revised Guidelines for Negotiated Settlements of Traffic, Tolls and Tariffs* (12 June 2002), online: <https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/157025/208496/A02885-1_NEB_Decision_%E2%80%93_Guidelines_for_Negotiated_Settlements_of_Traffic%2C_Tolls_and_Tariffs_%28A0E4C1%29.pdf?nodeid=208497&vernum=-2>.

NEB, "Energy Information Program – Glossary" (1 April 2021), online: *Canadian Energy Regulator*, online: <https://www.cer-rec.gc.ca/en/data-analysis/glossary/>.

Government Materials

Government of Canada, Competition Bureau, "Abuse of Dominance: Enforcement Guidelines" (Ottawa: Competition Bureau, 2019), online (pdf): *Government of Canada* < https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/CB-ADEG-Eng.pdf/$file/CB-ADEG-Eng.pdf>.

NEB, British Columbia (BC) Oil and Gas Commission, Alberta Energy Regulator, and BC Ministry of Natural Gas Development, *Energy Briefing Note: The Ultimate Potential for Unconventional Petroleum from the Montney Formation of British Columbia and Alberta* (November 2013), online (pdf): <https://www.cer-rec.gc.ca/en/data-analysis/energy-commodities/natural-gas/report/ultimate-potential-montney-formation/the-ultimate-potential-unconventional-petroleum-from-montney-formation-british-columbia-alberta-energy-briefing-note.pdf>.

Non-Parliamentary Materials

CER, *Filing Manual: Guide P—Tolls and Tariffs (ss. 225-240 of CER Act)* (Calgary: Canadian Energy Regulator), online (pdf): <https://www.cer-rec.gc.ca/en/applications-hearings/submit-applications-documents/filing-manuals/filing-manual/filing-manual.pdf>.

NEB, *Canada's Pipeline Transportation System 2016* (Ottawa: National Energy Board, 2016), online (pdf): *Government of Canada* <https://www.cer-rec.gc.ca/en/data-analysis/facilities-we-regulate/2016/canadas-pipeline-transportation-system-2016.pdf>.

Other Secondary Materials

Baldwin, Robert, Martin Cave & Martin Lodge, *Understanding Regulation, Theory, Strategy and Practice*, 2nd ed (New York: Oxford University Press, 2012).

Bankes, Nigel, "The Regulatory Treatment of Stranded Assets in Alberta" (15 October 2015), online (blog): *Ablawg* <https://ablawg.ca/wp-content/uploads/2015/10/Blog_NB_UAD_oct2015.pdf>.

Bonbright, JC, *Principles of Public Utilities Rates*. (New York: Columbia University Press, 1961).

Cearley, Reed W & Daniel H Cole, "*Stranded Benefits Versus Stranded Costs in Utility Deregulation*" in Daniel H Cole & Peter Grossman, eds, *The End of a Natural Monopoly: Deregulation and Competition in the Electric Power Industry* (Oxford: Routledge, 2003) 158.

Collins Hugh, *Regulating Contracts,* First Edition (Oxford: Oxford University Press, 2002).

Cooter, Robert & Thomas Ulen, *Law and Economics*, 5th ed (Boston: Pearson, 2008).

Cooter, Robert & Daniel Rubinfeld, "*Economic Analysis of Legal Disputes and their Resolution*" (1989) 27 J Economic Literature 1067, cited in Joseph Doucet & Stephen Littlechild, *"Negotiated Settlements: The development of legal and economic thinking*" Utilities Policy 14 (2006)

Doucet, Joseph & Stephen Littlechild, *"Negotiated Settlements: The Development of Legal and Economic Thinking" (*2006) 14 Utilities Policy 266.

Doucet, Joseph & Stephen Littlechild, "Negotiated Settlements and the National Energy Board in Canada" (2009) 37 J Energy Policy 4633.

Galbraith, John Kenneth, *American Capitalism: The Concept of Countervailing Power,* (New York: M E Sharpe, Inc, 1980).

Gellhorn, Ernest, William E. Kovacic & Stephen Kalkins, *Antitrust Law and Economics in a Nutshell*, 5th ed (St Paul, MN: Thomson West, 2004).

Gomez-Ibanez, Jose A, *Regulating Infrastructure: Monopoly, Contracts and Discretion,* (Cambridge, MA: Harvard University Press, 2003).

Gray, Horace M, "*The Passing of the Public Utility Concept"*, in American Economic Association, *Readings in the Social Control of Industry*, (Philadelphia: The Blakiston Company, 1942), 283-284, cited by Kahn, Vol II at 2-3.

Hunt, Sally & Graham Shuttleworth, *Competition and Choice in Electricity,* (Chichester: John Wiley & Sons Ltd, 1999).

Joskow, Paul L, "Regulation of Natural Monopoly," in A Mitchell Polinsky & Steven Shavell, eds, *Handbook of Law and Economics,* Vol 2 (Amsterdam: North Holland, 2007) 1227.

Kahn, Alfred E, *The Economics of Regulation, Principles and Institutions*, (Cambridge, MA: The MIT Press, 1995).

Kaplow, Louis & Carl Shapiro, “Antitrust” in A Mitchell Polinsky & Steven Shavell, eds, *Handbook of Law and Economics,* Vol 2 (Amsterdam: North Holland, 2007) 1073.

Klein, Michael, “Network Industries” in Dieter Helm & Tim Jenkinson, eds, *Competition in Regulated Industries* (Oxford: Oxford University Press, 1998).

Levin Ronald M & Lubbers Jeffrey S., *Administrative Law and Process in a Nutshell,* Sixth Edition (St Paul MN: West Academic Publishing, 2017).

Maloney, Michael T & Raymond D Sauer, “A Principled Approach to the Stranded Cost Issue” (1998) 11:3 The Electricity Journal 58.

McNollgast, “The Political Economy of Law” A Mitchell Polinsky & Steven Shavell, eds, *Handbook of Law and Economics*, Vol 2 (Amsterdam: North Holland, 2007) 1651.

Newberry, David M. *Privatization, Restructuring, and Regulation of Network Utilities,* First Edition (London: The MIT Press: 2000)

Ogus, Anthony, *Regulation: Legal Form and Economic Theory* (Portland: Hart Publishing, 2004).

Polinsky, A Mitchell & Steven Shavell, *Handbook of Law and Economics,* Vol 2, (Amsterdam: North-Holland, 2007).

TC Energy, “Mainline Tariff” online: *TC Energy: Customer Express* <http://www.tccustomerexpress.com/891.html>.

Tirole, Jean, *Economics for the Common Good,* (Princeton: Princeton University Press, 2017).

Tomain, Joseph P & Richard D Cudahy, *Energy Law in a Nutshell,* 3rd ed (St. Paul, MN: West Academic Publishing, 2017).

Vickers, John, “Regulation, Competition and the Structure of Prices” in Dieter Helm & Tim Jenkinson, eds, *Competition in Regulated Industries* (Oxford: Oxford University Press, 1998).

Wang, Zhongmin, “Settling Utility Rate Cases: An Alternative Ratemaking Procedure” (2004) 26:2 J Regulatory Economics 141.