Canada Energy Regulator Régie de l'énergie du Canada

Canada Energy Regulator Cost Recovery Regulations Regulatory Proposal

Canada

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Purpose

The purpose of the Regulatory Proposal (Proposal) is to seek feedback on the design of the Canada Energy Regulator (CER or Regulator) cost recovery regulations. The CER is soliciting feedback on this Regulatory Proposal for a period of 30 days, until 30 November 2021.

Background

Establishment of the Canada Energy Regulator

In August 2019, Bill C-69, An Act to enact the *Impact Assessment Act* and the *Canadian Energy Regulator Act* (CER Act), to amend the *Navigation Protection* Act and to make consequential amendments to other Acts, came into force.

Subsection 87(1) of the CER Act states that the Regulator may, with the approval of the Treasury Board, make regulations:

(a) providing for fees, levies or charges that are payable for the purpose of recovering all or a portion of any costs that the Regulator considers to be attributable to the carrying out of its mandate, including costs related to applications that are denied or withdrawn; and

(b) providing for the manner of calculating those fees, levies or charges and their payment to the Regulator.

Under this regulation making provision in the CER Act, the CER can recover all of its costs associated with conducting its activities as the Regulator. This provision provides a mechanism for Canada to recover the CER's costs, approved through Parliamentary appropriations, from the regulated industry. The CER is currently recovering costs via the *National Energy Board Cost Recovery Regulations* (Existing Regulations).

Regulatory Development Considerations

The following sections describe the objectives guiding the CER's Proposal, as well as the elements of cost recovery that will be specified in regulations.

Objectives for Evaluating Cost Recovery Proposals

Below are the regulatory objectives that have been used to evaluate the Proposal for the cost recovery scheme to be used in the regulations:

a) *Alignment with Legislation: The CER Act provides that the Regulator may recover costs for all or a portion of any costs that the Regulator considers to be attributable to carrying out its mandate.*

b) *Effective Recovery: The regulations must be effective in enabling the CER to recover the costs associated with carrying out its mandate.*

c) *Equitable Recovery: The interests of CER stakeholders should reasonably be balanced to achieve fair and equitable cost allocation.*

d) *Operational Simplicity: The cost recovery method should be sufficiently easy to understand and implement.*

e) *Predictability/Certainty: The costs should be reasonably predictable by industry, for inclusion in company budget/cost planning.*

f) *Robustness: The cost recovery mechanism should be able to respond to changes in circumstances over time.*

g) *Flexibility: The approach should provide for some flexibility in its application, potentially allowing for different cost recovery methodologies, as well as fees charged, to possibly reflect the different commodities of regulated companies (for example, oil/gas pipelines versus power lines versus commodity pipelines).*

Elements and Methodology of the Cost Recovery Scheme

The following elements and the overall methodology approach of the cost recovery scheme were considered for the Proposal:

A. Recovering costs directly from project applicants who are not currently regulated by the CER and for project applications that are denied or withdrawn;

B. Modernizing the fixed levies recovered from small and intermediate companies;

C. Relief; and

D. Cost recovery allocation and methodology approach.

At this time, the CER will not be seeking cost recovery under other federal legislation such as the *Canada Oil and Gas Operations Act*, the *Canada Petroleum Resources Act,* or for offshore renewable energy projects. The CER will continue to exempt border accommodation pipelines.[1]

[1] Border accommodation pipelines are pipelines that are constructed for the transportation of natural gas across a border that have an outside diameter of less than 100 mm, carry gas at pressures of not more than 700 kilopascals, and have a capacity of less than 500 m^3 per day.

A. Recovering costs directly from project applicants who are not currently regulated by the CER and for project applications that are denied or withdrawn

Under the *National Energy Board Act* (NEB Act) (previous legislation) and the Existing Regulations, applicants that were not regulated by the National Energy Board (NEB) (former regulator), and who submitted an application to construct a pipeline, international or interprovincial power line were required to pay a greenfield levy that was equal to 0.2 per cent of the estimated cost of the construction of the project if their application was approved.[2] If the application was denied or withdrawn, the NEB had no mechanism to recover the costs of the project review. The proposed regulations will allow the CER to cost recover directly from all applicants who are not already regulated by the CER that submit applications to construct and operate physical projects, including those whose applications are denied or withdrawn.[3]

Regulatory Proposal:

When recovering costs for project reviews (i.e., applications to construct or operate a pipeline, international or interprovincial power line), exclude companies who are regulated by the CER and from whom costs are already recovered based on existing regulated assets. Applicants who are not currently regulated by the CER will pay a non-refundable levy of 0.2 per cent of the construction costs (greenfield levy), which may be adjusted during the course of the application assessment and following construction, if the application is approved. For cost recovery purposes, the new levy would be applied in the same manner as the existing greenfield levy. As the new levy is paid, the costs within the affected commodity pool will be readjusted within the 3 year billing cycle to reflect the addition of the new monies.

- Interim Levy – Since large projects could take multiple years to complete after approvals are given, provision could be made for the payment of an interim levy based on the estimated cost of construction found in the application or such other amount as the Commission of the CER (Commission) may determine based on its assessment of the application.
- Application Denied/Withdrawn – If the application is not approved or is withdrawn by the applicant, the most recent 0.2 per cent estimate of the construction cost will be the levy paid by the applicant to the CER.
- Project not Constructed – If the project is approved and the company does not go forward with construction, the company will be required to pay the interim levy based on the estimated cost of construction found in the application or such other amount as the Commission may determine based on its assessment of the application.
- Project Constructed – If the application is approved, the applicant's levy will be based on the actual construction cost of the project.

[2] *National Energy Board Cost Recovery Regulations*, sections. 5.2 & 5.3.

[3] Unlike its predecessor section 24.1 under the NEB Act, section 87 of the CER Act explicitly authorizes the recovery of "costs related to applications that are denied or withdrawn".

B. Modernizing the fixed levies recovered from small and intermediate companies

Under the NEB Act and Existing Regulations, small and intermediate companies pay a levy of $500 and $10,000 respectively. This was raised to $511 and $10,220 in 2020, due to the applicability of the *Service Fees Act* to the NEB Act. The fixed levy fees had not been reviewed since the regulations were promulgated in 1990. Therefore, the Existing Regulations for the fixed levies do not account for such factors such as inflation. The CER Act provides the opportunity to modernize the regulatory requirements for the fixed levies, and/or the cost recovery methodology applied to companies generally, so that they are allocated to the small and intermediate companies in a more equitable way.

Regulatory Proposal:

In 1990, the recoverable costs (NEB budget plus value of services provided without charge to the NEB) was approximately $25 million. In 2021, the estimate of recoverable costs is $118.5 million. The expanded mandate for the CER, the substantial growth in the CER budget, the impact of inflation over the last 30 years and the significant changes in the structure of the energy industry and its market and economic environment indicate that the approach to cost recovery for small and intermediate companies should be reviewed and revised. For example, over the past nine years:

YEAR	FUNDING INCREASE
2012	Funding to strengthen the capacity to inspect oil and gas pipelines, to promote safety performance and to take actions to address heightened public awareness of pipeline safety
2013	Funding related to the relocation of the office in Calgary
2014	Funding for comprehensive and timely regulatory reviews of mega energy infrastructure projects (Energy East and Imperial Oil)
2015	Funding for safety and environmental protection, and enhanced engagement with Canadians in relation to energy transportation infrastructure
2016	Funding to support interim measures as part of the review of the federal environmental assessment process
2017	Funding for communication and access to information capacity Funding for pipeline safety lifecycle oversight Funding for Indigenous advisory and monitoring committees for energy infrastructure projects
2018	Funding to transition to new impact assessment and regulatory processes
2019	Funding for the reconsideration of the Trans Mountain Project
2020	CER's stabilization & improvement

Levies for large oil and gas pipeline companies are proportionally allocated from a commodity cost pool according to the relative throughput each company has to the total throughput for all companies in that commodity group. The proposed approach is to replace fixed levies for small and intermediate oil and gas pipeline companies with throughput as the metric for determining their costs.

To mitigate situations where oil and gas pipeline companies with one very short CER-regulated pipeline that has extremely high throughput are disproportionally affected, the CER proposes the following: if an oil or gas pipeline company has 10 km or less of CER-regulated pipeline, the company would be expected to pay 5 per cent of their actual throughput cost. All companies with 11 km or more of CER-regulated pipeline are expected to pay the cost of their levy based

on throughput. Please refer to element *C. Relief* for provisions applying to companies with 11 km or more of CER-regulated pipeline.

The following scenarios[4] show the outcomes of testing this approach:

Scenario 1 Oil Companies – Calculation of levies for large, intermediate, and small oil pipeline companies using throughputs, including the recalculation value for companies with 10 km or less of CER-regulated oil pipeline. The following methodology was used:

- A sample of small and intermediate companies was selected randomly from the list of companies cost recovered in 2020 and 2021 by the CER. The companies selected were used to portray a reasonable proportion of companies in each category.
- Hypothetical companies were added as required to make up the complement of small and intermediate companies that were cost recovered each of the given years.
- For the hypothetical companies, volumes were arbitrarily attributed to simulate a range of company sizes within each classification.
- Two years of data were used to generate the model for oil to observe the sensitivity to changes in each year e.g., changes to large company volumes, changes to the number of companies which were cost recovered.
- Using the data obtained, the cost recovery calculations were rerun to observe the impact on levies by using throughputs as the factor for allocating levies to all companies.
- For oil companies the volumetric data comes from CER records and appear to represent the capacity of CER regulated pipelines. This data did not change from 2020 to 2021 in the model.
- Actual throughputs will vary with operating and market circumstances. It is unlikely that pipelines run at full capacity at all times.
- While the data used may not enable an accurate determination of the levies which would be payable under a throughput model, it does provide information about the relative size of the companies sampled and the impact of using throughputs to calculate their levies.
- Companies use a variety of units when reporting volumetric data. The units used were converted to metric units (m^3 or 10^3m^3) using CER conversion factors.

Companies with Oil Pipelines ≥11 km	2021 Estimated Throughput (m^3)	Operating Length (km)	2021 Current Model Est. Levies ($)	2021 Projected Est. Levies Using Throughput ($)
Company A	3,133,639	157	466,829	414,420
Company B	580,304	872	86,450	76,745
Company C	206,239,901	8,790	30,724,287	27,274,999
Company D	9,400,920	1,531	1,400,488	1,243,261
Company E	14,971,834	438	2,230,407	1,980,008
Company F	4,932,581	997	734,824	652,328
Company G	9,556,555	460	1,423,674	1,263,844
Company H	13,237,000	115	1,971,963	1,750,579

[4] The following scenarios are meant to be illustrative only. For this reason, a sample of hypothetical companies has been shown to illustrate the mechanics of the proposed regulations.

Company I	2,675,600	39	398,594	353,845
Company J	10,328,676	1,875	1,538,699	1,365,956
Company K	18,287,260	1,333	2,724,318	2,418,470
Company L	34,390,000	1,233	5,123,200	4,548,039
Company M	8,530,000	893	1,270,744	1,128,083
Company N	2,313,733	33	10,220	305,989
Company O	9,210,131	50	10,220	1,218,030
Company P	522,274	97	10,220	69,070
Company Q	1,044,548	68	10,220	138,140
Company R	9,190,435	43	10,220	1,215,425
Company S	1,082,268	38	511	143,129

Companies with Oil Pipelines ≤10 km	2021 Estimated Throughput (m^3)	Operating Length (km)	2021 Current Model Est. Levies ($)	2021 Projected Est. Levies Using Throughput ($)	2021 Projected Est. Levies for pipelines ≤10 km ($)
Company T	2,611,371	1	511	345,351	17,268
Company U	621,506	2	511	82,194	4,110
Company V	8,534,018	8	511	1,128,614	56,431
Company W	290,152	10	511	38,372	1,919

Scenario 2 Gas Companies – Calculation of levies for large, intermediate, and small gas pipeline companies using throughputs, including the recalculation value for companies with 10 km or less of CER-regulated gas pipeline. The following methodology was used:

- A sample of small and intermediate companies was selected randomly from the list of companies cost recovered in 2020 and 2021 by the CER. The companies selected were used to portray a reasonable proportion of companies in each category.
- For small and intermediate gas pipeline companies, no throughput data or capacity information was available in the CER data banks. To test the throughput concept for these companies, published reports were accessed and the annually reported production amounts were used in the model. The underlying assumption was that, if produced, gas would be transported.
- Hypothetical companies were added as required to make up the complement of small and intermediate companies that were cost recovered each of the given years.
- For the hypothetical companies, volumes were arbitrarily attributed to simulate a range of company sizes within each classification.
- Two years of data were used to generate the model for gas to observe the sensitivity to changes in each year e.g., changes to large company volumes, changes to the number of companies which were cost recovered.
- Using the data obtained, the cost recovery calculations were rerun to observe the impact on levies by using throughputs as the factor for allocating levies to all companies.
- Companies use a variety of units when reporting volumetric data. The units used were converted to metric units (m^3 or 10^3m^3) using CER conversion factors.

Companies with Gas Pipelines ≥11 km	2021 Estimated Throughput (m3)	Operating Length (km)	2021 Current Model Est. Levies ($)	2021 Projected Est. Levies Using Throughput ($)
Company A	14,392,793	2,289	3,480,162	2,750,821
Company B	651,287	142	157,481	124,477
Company C	37,076,000	1,062	8,964,937	7,086,146
Company D	1,592,718	878	385,117	304,408
Company E	123,630,000	24,170	29,893,600	23,628,769
Company F	7,276,000	655	1,759,329	1,390,625
Company G	52,395,000	14,123	12,669,054	10,013,988
Company H	22,381,147	2,905	5,411,737	4,277,594
Company I	4,134,256	259	10,220	790,159
Company J	108,704	193	10,220	20,776
Company K	11,076,422	25	10,220	2,116,980
Company L	7,507,292	43	511	1,434,830
Company M	16,288,967	165	511	3,113,227
Company N	857,858	35	511	163,958
Company O	443,027	30	511	84,673

Companies with Gas Pipelines ≤10 km	2021 Estimated Throughput (m3)	Operating Length (km)	2021 Current Model Est. Levies ($)	2021 Projected Est. Levies Using Throughput ($)	2021 Projected Est. Levies for pipelines ≤10 km ($)
Company P	624,180	5	511	119,296	5,965
Company Q	34,728	3	511	6,637	332
Company R	497,041	1	511	94,997	4,750
Company S	2,067,128	5	511	395,080	19,754
Company T	1,513,334	1	511	289,240	14,462

Applying a throughput metric to all oil and gas pipeline companies, rather than just large companies would:

- negate relying on fixed levies that may not align with the state of the economic climate or the amount of regulatory effort associated with small and intermediate companies at any given time;
- mitigate remission issues that may arise from companies changing classification as distinctions between small, intermediate, and large company classes would no longer be required and remissions would be less likely (discussed in more detail in the Relief section below); and

- create a fairer, more robust, and flexible methodological approach that would assure predictability and operational simplicity for all companies as well as reducing administrative burden for the CER.

C. Relief

Under section 4.1 of the Existing Regulations, large oil, gas, or commodity pipeline companies (defined as those with an annual cost of service of at least $10M) may apply for relief in cases where their estimated levies exceed 2 per cent of their estimated cost of service. Under the Existing Regulations, large companies are not required to pay the portion of cost recovery levies that exceed 2 per cent of their estimated cost of service for the year in question. The current relief provision only allows large companies to apply for relief once per year for that specified year.

In making the request, the company must provide an estimate of its cost of service for the year for which it requests the relief. If relief is granted based on an estimated cost of service, the Existing Regulations require that the actual cost of service in respect of that year, be provided the following year. If relief is granted, these excess levies are shared among other large companies of the same commodity. This has a few consequences:

- First, it means that if the cost of service of a large company decreases significantly during the course of the year, such that it becomes an intermediate or small company for cost recovery purposes, that company could potentially have millions of dollars paid into the CER cost recovery framework due to its inaccurate estimation. Under the current scheme there is no mechanism to issue “a refund”, so in practice the levies paid by the large company would be used as a credit against future levies unless a remission order is approved by Treasury Board; and
- Second, the once-per-year relief application cycle which is embedded within a 3 year cycle designed to balance estimated costs (Y1) against actual costs (Y2) with a true-up in (Y3) also has consequences for companies who might bounce back and forth between small and intermediate status, as well as intermediate and large status since the ranges between these categories is so vast.

Regulatory Proposal:

It is proposed that the relief provision process remains the same as described in the Existing Regulations, however the eligibility and criteria for relief would change in the following way:

- the relief provision will apply to all oil and gas pipeline companies with 11 km or more of CER-regulated pipeline as each company will be invoiced on their respective throughputs. Any oil pipeline company or gas pipeline company is not required to pay the portion of a cost recovery charge or administration levy payable that exceeds 2 per cent of the estimate of the rate base[5] for the year in question if:

    (a) in the case of an oil pipeline company or a gas pipeline company, the company files a request for relief with the CER within 30 days after the day on which the notifies the company of the cost recovery charge payable by the company in that year; and

[5] Rate base is generally the amount of capital invested in the pipeline minus the accumulated depreciation. It typically includes net plant in service plus an allowance for working capital. This is the amount on which CER-regulated pipeline companies are authorized to earn a return on.

(b) the request for relief includes the company's rate base for that year. As part of its application, the company must file its audited financial statements in accordance with the *Gas Pipeline Uniform Accounting Regulations* or the *Oil Pipeline Uniform Accounting Regulations*, irrespective of whether they have been exempted from doing so by the Commission.

Rate base was chosen because:

- it more accurately depicts the value of the companies regulated, especially those who are vertically integrated, having cross-jurisdictional regulated assets that form one system; and

- for companies who do not have multiple shippers, rate base is easier to calculate than cost of service.

D. Cost recovery allocation and methodology approach

The Existing Regulations are premised on commodity charging. This means that the costs are allocated to the principal commodities regulated by the CER before being allocated to specific entities within those commodity groups:

- Oil – oil pipelines;
- Gas – gas pipelines;
- Electricity; and
- Commodity pipelines (e.g., water, steam, CO_2) are charged fixed levies.

Allocation of costs to commodity categories is based on time spent by the CER on each commodity. Within each commodity group, costs are shared according to activity levels (throughputs/transmission).

Companies pay their share of recoverable costs in 3 ways:

- Section 5.2 and 5.3 levies, which apply to new companies not already regulated by the CER (sometimes known as "greenfield" levies);
- Fixed levies (small, intermediate companies and other commodities); and
- Proportional levies (large companies). The current cost recovery model is based on a 3 year cycle for balancing out charges.

Regulatory Proposal:

It is proposed that cost recovery continue to be premised on commodity charging. Cost recovery methodology and allocation and will remain the same, except companies will pay their share of recoverable costs in the following ways:

- Applicants who apply to construct an international or interprovincial pipeline or an international or interprovincial power line and who are not currently regulated by the CER will pay a non-refundable levy of 0.2 per cent of the construction costs, which may be adjusted during the course of the application assessment and following construction, if the application is approved.

- All oil and gas pipeline companies will pay levies based on throughput.

    - Any oil or gas pipeline company that has 10 km or less of CER-regulated pipeline, the company is expected to pay 5 per cent of their actual throughput cost.

    - Companies with 11 km or more of CER-regulated pipeline are expected to pay the cost of their proportional levy based on throughput.
- Cost recovery methodology will remain the same for commodity pipeline companies – fixed levies for small, intermediate and large companies.
- Cost recovery methodology will remain the same for power line companies – fixed levies for small and intermediate companies, with proportional levies for large companies based on electricity transmissions.
- Companies with 11 km or more of CER-regulated pipelines whose invoices exceed 2 per cent of their rate base will be eligible to apply for relief for the applicable year.

Cost recovery will remain on a 3 year billing cycle.

Opportunities to Comment

The CER is seeking feedback in writing on the Regulatory Proposal by 30 November 2021. Comments may be provided electronically and sent to the contact information below:

Email costrecoveryregulations@cer-rec.gc.ca

Feedback submitted to the CER will be considered in the development of the regulations, which would also be pre-published in the Canada Gazette, Part I, for a 30-day comment period. Information concerning the Canada Gazette, Part I comment period will be communicated at a later date.

For more information on the Regulatory Proposal or to further discuss its contents, please contact Rumu Sen (rumu.sen@cer-rec.gc.ca) (toll- free 1-800-899-1265).