NATIONAL ENERGY BOARD
CANADA

IN THE MATTER OF CERTAIN APPLICATIONS FOR PROJECTS IN THE MACKENZIE DELTA AND THE MACKENZIE VALLEY AREA OF THE NORTHWEST TERRITORIES (COLLECTIVELY CALLED THE "MACKENZIE GAS PROJECT" OR "MGP") BY IMPERIAL OIL RESOURCES VENTURES LIMITED ON BEHALF OF ITSELF AND OTHERS (COLLECTIVELY, THE "APPLICANTS" OR "PROPONENTS");

AND IN THE MATTER OF NATIONAL ENERGY BOARD ("BOARD" OR "NEB") HEARING ORDER GH-1-2004;

AND IN THE MATTER OF BOARD FILE NUMBERS 3200-J205-1, 2620-C-19-7, 2620-C-20-7 AND 2520-C-19-4

PRE-FILED EVIDENCE OF PARAMOUNT RESOURCES LTD.

JUNE 1, 2005

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1 INTRODUCTION

1. Paramount Resources Ltd. ("Paramount") is an Alberta corporation with headquarters in the City of Calgary, Alberta and operations in western and northern Canada and in the United States. It is engaged in the exploration for and production of petroleum, natural gas and their by-products. Paramount currently has various activities in the Canadian North. Specifically, it produces gas in the Liard area, oil and gas in the Cameron Hills area and has an active exploratory drilling program in the Sahtu Region of the Northwest Territories ("NWT").

2. Of more importance and relevance to this application before the National Energy Board is the fact that Paramount and its partner (Apache Canada Ltd.) are in their fourth year of active exploration in the Sahtu Region (K'ahsho Got'ine and Tulita districts) of the NWT. Paramount's exploration activities in the K'ahsho Got'ine district are nearest the community of Colville Lake which is approximately 147 Km north of Norman Wells and 165 Km northeast of Fort Good Hope. Over the past several years, Paramount has been the most active of the independent Canadian producers drilling in the NWT.

3. The Mackenzie Gas Project will facilitate the development of natural gas, and its by-products in the NWT. Paramount has prepared its evidence to address the key development issues that are essential for commercial realization of those natural gas and associated liquid reserves which are capable of connection to the MGP.

The following paragraphs provide a brief description of Paramount's history, current activity, future development and positions on key issues in the NWT.

1.1 Paramount NWT History and Experience

4. Paramount has been an active explorer for oil and natural gas in the NWT for over two decades, and has amassed significant land holdings in the NWT. Its holdings are concentrated in the Liard and Cameron Hills areas, and the Tulita and K'ahsho

Got'ine districts. In addition to the commitment to explore, Paramount has developed a core competence and knowledge base to work successfully in Canada's North.

5. Paramount developed the necessary resources and received the regulatory approvals to construct and operate the Shiha Pipeline and associated gathering facilities to place its Liard area assets into production in April 2000. Thereafter, Paramount developed oil and gas production in the Cameron Hills area. Recently, Paramount has expanded its NWT operating base through the acquisition of the Liard West production area and has become the Area Operator.

6. Paramount continues to develop its NWT prospects and has recently completed its fourth year of exploration activities in the K'ahsho Got'ine and Tulita districts by completing a five well drilling program. Paramount remains optimistic that a new basin can be opened in the Sahtu region. Significant effort is still necessary to establish commercial reserves required to proceed with the regulatory and environmental processes. The local communities have been supportive of the exploration activities, and Paramount's next steps will be developed in concert with them prior to advancing the regulatory process.

7. Paramount's regulatory, developmental, and operational competencies and experience, together with its relationships and commitment to the NWT, will ensure that the production and transportation infrastructure, required to connect to the MGP, is constructed in an environmentally and socially responsible manner.

1.2 Paramount's Sahtu Developments

8. With respect to any natural gas and associated liquids resources it locates in the Sahtu, Paramount expects to construct its own production, field gathering, processing and the related interconnecting pipeline facilities.

9. Without economic and non-discriminatory access to both the proposed MGP natural gas and NGL pipelines, Paramount's alternative would be to construct its own natural gas and liquid pipeline systems, parallel to the MGP. That

alternative, however, is unlikely to be the most economical, orderly, environmentally responsible and efficient approach, assuming that the MGP is constructed and placed into operation.

1.3 Outline of evidence

10. With the goal of ensuring the provision of fair, equitable and non-discriminatory access, this evidence will address the following issues:

- Certainty of Timing
- Pipeline Access
- Appropriate Regulatory Oversight
- Appropriate Dispute Resolution
- Cost Recovery Methodologies
- Toll Design
- Contract Capacity Allocation
- Tariffs and Precedent Agreements
- Operating Code of Conduct

2 CERTAINTY OF TIMING

11. Paramount clearly appreciates the complexity of this process and the need to provide for a timetable that is supportive of a comprehensive review of the MGP application. While Paramount has a number of concerns and issues related to this application and proposes certain changes in the pages that follow, it believes that it is in all parties' best interest that the MGP facilities be approved by the requisite regulatory authorities and that construction proceed, subject to the modifications as outlined in this evidence.

12. The MGP proponents have been exploring (and expending significant monies) for natural gas and its by-products. As previously stated, Paramount has also been exploring for the past four years in the Sahtu. It is critical to Paramount that developments in the Mackenzie Valley are not unduly delayed. While there may be other options for oil and natural gas producers if this Application is delayed, or

dismissed, Paramount believes it is in the best interest of the North that the project be approved to allow orderly development and to minimize duplication of facilities.

2.1 Window of Opportunity

13. There is a unique window of opportunity to develop the MGP facilities and allow for development of the petroleum resources in the NWT. Forecast supply and demand conditions for natural gas in North America are such that natural gas from the Mackenzie region will face a minimum of competition. Existing natural gas production from conventional supplies in North America is at best only expected to keep level, while demand, particularly for electricity generation, is expected to increase. Furthermore, unlike the proposed Alaska natural gas reserves, natural gas deliverability can be fully integrated into this market with a minimum of "lumpiness" due the relatively smaller initial deliverability.

14. Following 2012, additional gas is expected in the form of the Alaska project and a significant number of LNG projects proposed for various regions in Canada and the United States. These projects, with their substantial threshold gas volumes, may cause adverse market integration for a delayed MGP project.

15. This application represents a significant first step in developing the natural gas and associated liquid reserves of the northern regions of the NWT, and every effort should be focused on getting this backbone system implemented, built and operating in a timely manner.

3 PIPELINE ACCESS

16. In the context of access, the facilities may be divided into the three major operating components - natural gas pipeline, the natural gas liquids (NGL) pipeline and upstream facilities. Paramount's comments will address the first two. It is critical to Paramount's Sahtu development that there be reasonable, equitable and economical access to both the natural gas and NGL pipelines.

17. The applicants have applied for the NGL pipeline under the *Canada Oil and Gas Operations Act* ("COGOA"). In Paramount's view, COGOA was developed at another time, for another purpose and cannot reasonably be construed as intended to apply to a significant facility like the NGL pipeline. It contains none of the usual regulatory provisions dealing with access, tolls or reporting requirements. If the NGL pipeline is approved under COGOA, none of the well-understood and transparent rules would apply. It represents a legislative anomaly which, in Paramount's view, must be recognized and addressed.

18. It is incumbent on the NEB to consider the requirements of the third party shippers, such as Paramount, for reasonable, equitable and economic access to both pipelines. Given the nature of the resource, access to the natural gas pipeline will be essentially meaningless without similar access to the liquids pipeline. An acceptable recourse procedure is required under which the NEB or similar body adjudicates any dispute regarding access to these facilities. It is noteworthy that the NEB recognized that access to these facilities was an important issue and included it for consideration in these proceedings.

19. One of the fundamental tenets of a market-responsive oil and natural gas industry, as developed in the mid-1980s, is the need for equitable, fair and open access to markets in a non-discriminatory manner. The oil and natural gas producing industry, in which the Applicants have been active and leading participants, has advanced this principle. It is vital that the major facility components of the MGP, where alternative facilities represent a less economic and efficient approach, provide open access as understood on major North American pipelines.

20. (a) Paramount has reviewed the document attached to the response IR GNWT 2.1-1 entitled *Mackenzie Valley Gathering System Access Process*. While it believes this is a first step regarding development of an access procedure, Paramount has a number of concerns as set out below:

    (i) The timelines regarding communication and recourse to the Board appear excessive.

(ii) The Applicants propose that they retain the ability to examine the NEB decision and Joint Review Panel recommendations prior to committing to construction of the MGP. In contrast, the draft Access Process requires a third party shipper to unconditionally commit to moving forward, regardless of the terms of any Access Order or Fee Order.

(iii) The Access to a Functional Unit appears to place any shipper who obtains access through a complaint procedure as a second-tier shipper compared to the producers/owners through contribution for incremental capital and capacity allocations, etc.

(iv) The requirement for payment of fees similar to owners, but without ownership of any facilities, appears unfair.

(v) Confidentiality of the Access Orders and NEB Decisions relating to them run counter to the concept of open access.

(b) Paramount remains to be convinced, on the basis of filings to date, that the NGL pipeline operated pursuant to COGOA, taken with procedures proposed by the Applicants, will provide for the fair, equitable and non-discriminatory access to third party shippers that this project and northern development require.

3.1 Appropriate Regulatory Oversight

21. The Applicant has filed for the following facilities under COGOA:

- Production wells
- Field gathering pipelines
- Gas Conditioning Facilities (water separation, etc)
- Raw Gas Gathering laterals (connecting the gas conditioning facilities to the raw gas transmission pipeline
- Raw gas transmission pipelines (larger diameter pipeline connecting the different gathering laterals to the Inuvik Gas Processing facilities)

- Inuvik Gas Processing Plant
- MGP NGL Pipeline

Under the *National Energy Board Act* ("NEB Act"), the Applicant has filed for:

- MGP Natural Gas Pipeline

22. As previously stated, one of the key elements of a market-responsive oil and natural gas industry is the need to ensure fair access to those facilities where it is unlikely competitive options are available or feasible. Further, it is critical that, regardless of whether there is the potential for competitive alternatives, adequate information and data needs to be filed in the public domain so that potential third party shippers can make an assessment and decide whether all shippers are being treated in an equitable manner.

23. The degree of disclosure of financial and contractual information that is required to be filed under COGOA is far less than the level of detailed information that is required to be filed under the NEB Act.

    As an example, little or no financial operational information has been filed on the record regarding the tolls, tariffs and cost of service for the NGL pipeline, even though there can be no natural gas production without the associated petroleum liquids.

24. It is crucial that both the natural gas and the NGL pipeline be regulated by the NEB in a manner than provides that third party producers have access to this pipeline on an equitable basis to that of the producer/owners, ensuring that there is no undue discrimination regarding access, tolls and tariff conditions. The comments in the following sections apply to both the MGP natural gas and NGL facilities, unless specifically identified.

3.2 Authority to Compel Access

25. (a) The NEB has significant authority not only to assist in assuring access to pipelines under its jurisdiction, but also to compel service.

(b) Under Part IV of the NEB Act, the following sections address access issues.

> "Duty of pipeline company
>
> 71. (1) Subject to such exemptions, conditions or regulations as the Board may prescribe, a company operating a pipeline for the transmission of oil shall, according to its powers, without delay and with due care and diligence, receive, transport and deliver all oil offered for transmission by means of its pipeline.
>
> Orders re transmission of gas, etc.
>
> (2) The Board may, by order, on such terms and conditions as it may specify in the order, require the following companies to receive, transport and deliver, according to their powers, a commodity offered for transmission by means of a pipeline:
>
> (a) a company operating a pipeline for the transmission of gas; and
>
> (b) a company that has been issued a certificate under section 52 authorizing the transmission of a commodity other than oil
>
> Extension of facilities
>
> (3) The Board may, if it considers it necessary or desirable to do so in the public interest, require a company operating a pipeline for the transmission of hydrocarbons, or for the transmission of any other commodity authorized by a certificate issued under section 52, to provide adequate and suitable facilities for
>
> (a) the receiving, transmission and delivering of the hydrocarbons or other commodity offered for transmission by means of its pipeline,
>
> (b) the storage of the hydrocarbons or other commodity, and
>
> (c) the junction of its pipeline with other facilities for the transmission of the hydrocarbons or other commodity,

> if the Board finds that no undue burden will be placed on the company by requiring the company to do so."

It should be noted that the NEB has ruled that NGL constitute oil for the purposes of the common carriage provisions found in subsection 71(1).

26. COGOA contains no such authority. In fact, a review of COGOA shows authority over design, construction and operations of pipelines, but no mention of any authority regarding tolls, tariffs, financial matters or access by a third party.

27. Access to the NGL pipeline is an issue in this proceeding. As noted, under COGOA neither the NEB nor any other regulator has powers to ensure or compel access to the NGL pipeline. There needs to be an acceptable recourse procedure whereby the NEB or similar body adjudicates any dispute regarding access to the NGL pipeline, particularly if the Applicants are uncooperative or unwilling to provide acceptable access.

28. Not only is there a need for an acceptable recourse method dealing with access, there needs to adequate disclosure of information and data on the NGL pipeline respecting tolls, tariffs, etc. that will ensure the Applicant is providing fair, equitable and nondiscriminatory access to the NGL pipeline and charging just and reasonable tolls.

29. That the question of access is important and a matter in the public interest is supported by prior Board decisions. For example, in its RH-2-98 decision (a B.C. Gas Utility, now Terasen, case), the Board said at page 12:

> "**Access**
>
> Access to pipelines is governed by subsection 71(2) of the NEB Act. Natural gas pipelines have historically been contract carriers. However, the Board can require, on terms and conditions specified in an order, a company operating a pipeline to receive, transport and deliver gas for a shipper when the pipeline company refuses service. Basically, the decision to issue such an order is a public interest determination after considering the relevant facts."

30. It is interesting to note the Board's comments regarding its mandate as stated in its Decision RH-3-2004 (*TransCanada North Bay Junction* case) at page 7:

> "In striving for economic efficiency, the Board is of the view that the impacts on customers with limited options as well as the impacts on existing infrastructure are relevant considerations. This is consistent with the Board's mandate which, in practice, includes both the concept of 'protecting' and 'enabling'. Protection suggests that proposals be assessed in light of their impacts on existing systems, customers and market conditions. Enabling suggests that pipelines and other market participants should have the tools to compete effectively and fairly."

31. Furthermore in support of the position that the NEB has the capacity and ability to ensure effective access to the proposed MGP NGL system, the Board's Decision in MH-4-96 regarding access to the Interprovincial Pipe Line Transportation System (now Enbridge Pipelines) at pages 13 and 14, is instructive:

> "There remains a broad regulatory issue, namely the continued lack of further public access for NGL to the IPL system, which is of importance to the Board and to the Canadian NGL industry: to the Board as a matter of principle; and to the industry because the movement of NGL by IPL's pipeline is clearly the most cost-effective means of transportation between western and eastern Canada and to certain export markets. Yet a series of commercial and regulatory decisions over many years has led to the development of physical and regulatory impediments to access for NGL to the lowest cost system.
>
> …
>
> While the Board's decision in this case is intended to alleviate the immediate obstacles faced by PanCanadian, which seeks to become a new shipper of record of NGL, the Board considers that, over time, others may wish to obtain the same, or similar, rights in order to compete effectively in the NGL market. *In this connection, the Board has a responsibility to ensure that conditions of access to oil or other pipelines facilitate the operation of broad market forces here as in other parts of the hydrocarbon sector of the economy and that the most efficient and effective energy transportation services are available to all potential shippers of NGL*." (emphasis added)

32. Effective access to the NGL pipeline must include the ability to have disputes between the MGP group and potential shippers resolved. A shipper will be in a weaker negotiating position given that the NGL pipeline will likely be a monopoly carrier. There needs to be an effective and efficient mechanism to ensure the orderly development of the NWT petroleum and natural gas reserves so that the market functions properly in a competitive manner.

As a matter of business and regulatory policy, Paramount supports full NEB regulation of the NGL pipeline.

33. As the Board stated in the TransCanada North Bay Junction case and as quoted above, - "***Enabling suggests that pipelines and other market participants should have the tools to compete effectively and fairly."*** (Emphasis added). Assuming the Board's ability to adjudicate such matters, the Board should use its enabling mandate by fully regulating the NGL transmission system to ensure fair, equitable and nondiscriminatory access to this system. The question remains - does the Board have the legal ability to make such adjudication?

34. It is clear and acknowledged by the Applicants in response to I.R. GNWT 2.1, that under COGOA, the Board has no express mandate to deal with these matters. COGOA theoretically could be amended, but legislative amendment is always time consuming and problematic, and in the circumstances surrounding this application, unrealistic.

35. An argument could be advanced that the Board could use its conditional order powers to provide for access and economic regulation of the kind applicable to the natural gas pipeline. That invites argument, both in law and principle, about the Board's conditioning powers. Further, it is a rather blunt instrument and, in Paramount's view, a far simpler solution is evident.

36. (a) In Paramount's view (which will be dealt with by counsel in final argument or an earlier process to deal with the point as the Board deems appropriate) the natural gas pipeline and the NGL pipeline are an integrated

system designed to move gas and associated liquids to interprovincial and international markets. The fact that the NGL pipeline is, itself, located wholly within the NWT, does not alter the fact that it is essential and integral to the exploitation and marketing of NWT gas resources, and to this project. With regard to issues of access, tolls and tariffs and disclosure of financial information and reporting, the Board's jurisdiction ought to be, and is, the same for the NGL line as with respect to the natural gas pipeline. In other words, the NGL pipeline should be deemed to be applied for under the NEB Act.

(b) The Applicants have cited the Board's Shiha decision, which involved a Paramount project, as support for a COGOA application. A careful reading of that decision however shows clearly that it does not. The Board merely stated that certain facilities should be applied for under COGOA but gave no reasons for its decision. On the other hand, the Shiha pipeline, which has the capability to transport and gather raw natural gas in the Liard area, and which admittedly crosses provincial/territorial borders, is under the NEB Act. In Shiha, in determining that certain facilities were governed by COGOA, the Board was dealing with gathering facilities, not a pipeline which was an essential and integral part of a transmission system(s) subject to NEB regulation. Lastly, Paramount would note that it is only because of the design chosen by the Applicants, doubtless for valid reasons, that there are separate gas and NGL pipelines proposed for the MGP.

4 COST EFFECTIVENESS – NATURAL GAS AND NGL PIPELINES

37. (a) In developing evidence respecting the appropriate tolls and tariffs for MGP natural gas and NGL pipelines, Paramount has been guided by fundamental ratemaking and service principles. In this regard, the Board's comments in the

recent TransCanada North Bay Junction case (RH-3-2004), beginning at page 7, are instructive.

(b) Specifically:

- **Requirements of the NEB Act**: "… notably, the requirement that tolls must be just and reasonable, and must not be unjustly discriminatory."
- **Cost Causation**: "… tolls should be guided by the principles of cost-causation and user pay."
- **Economic Efficiency**: "In striving for economic efficiency, the Board is of the view that the impacts on customers with limited options as well as the impacts on existing infrastructure are relevant considerations. This is consistent with the Board's mandate which, in practice, includes both the concept of 'protecting' and 'enabling'. Protection suggests that proposals be assessed in light of their impacts on existing systems, customers and market conditions. Enabling suggests that pipelines and other market participants should have the tools to compete effectively and fairly."
- **Prevention of Abuse of Market Power**: "In the Board's view, this implies the prevention of discriminatory pricing, of inappropriate barriers to the efficient functioning of the market, and of favourable treatment of affiliates. … Market power must not be allowed to be abused, in terms of both substance, which would need to be proven, and, in terms of appearance and perception.
- **Open Access and Transparency**: "The Board reiterates the oft-repeated principle that shippers are to know in advance of negotiations the terms and conditions of access to a pipeline. … the Board is guided by the principle that transparency with respect to the relationship between a regulated entity and its affiliates is important."
- **Innovation**: "Past Board decisions that did not support a specific proposal do not necessarily indicate that given current and expected market conditions, the same decision would be reached today."

This evidence has already extensively addressed the access issue. In the following paragraphs MGP's tolling and tariff proposals, and the Operating Code of Conduct issue, will be dealt with.

4.1 Cost Recovery Methodologies

38. The methodology proposed by the Applicants, while based upon a fixed test year concept, is quite different than which exists for other major pipeline companies operating in Canada. Under Section 7.2 of the Precedent Agreement, and in corresponding sections of the firm tolling agreement, the firm tolls for each year will be forecasted and charged to shippers on a monthly demand basis. The Applicants propose a deferral account for all changes in forecasted cost estimates that will be added to the following year with a return added to the deferred accounts. In effect, 100% cost recovery is virtually assured with little or no risk of non-recovery of actual costs incurred.

39. Furthermore, the Applicants have placed the onus on the shipper to file a complaint regarding the prudence and level of any costs in setting the annual tolls, as compared to the Applicants' filing of an annual revenue requirement for their new cost of service. In essence, the Applicants have filed for a Variable Cost of Service Methodology (CSM) as opposed to a Fixed Cost of Service Methodology (FCSM) or Fixed Toll Method (FTM), using a fixed forward test year. This concept might be appropriate without third party shippers, as the producer/owner shippers would be relatively indifferent to tolling costs since they are also the owners of the MGP. However, with the introduction of third party independent shippers, such as Paramount, that will be competing for markets, it is contrary to the concept of an open access pipeline system for there to be no opportunity for a review of costs, as well as placing the responsibility of demonstrating the prudence of such costs on the independent shippers.

40. The VCSM as advanced by the Applicants uses firm contracted capacity in the determination of monthly charges, as opposed to recovering costs based upon actual monthly volumetric use.

41. Leaving labels aside, the Applicants propose to collect their actual costs (capital and operating) in subsequent years regardless of the amounts forecasted, and with little oversight by the NEB. This methodology is not generally used in the current

regulatory environment, primarily due to the lack of incentive in controlling costs. It is this last point that has been the major reason the VCSM has been rejected in Canada for nearly all major pipeline systems. While Alliance currently uses VCSM, it is a substantially different project than that proposed by MGP. In addition, Alliance and its owners took significant risks associated with cost overruns and losses in contracted demand.

42. As the Board has stated in its Decision RH-5-83 in rejecting the VCSM approach used by Westcoast Transmission (now Duke) at page 7:

> "The VCSM has the disadvantage of lacking incentives to improve efficiency and effectiveness, and reliance must be placed on the "professionalism" of the management and staff, since any savings effected, while reducing the cost of service, do not improve the profits. Although the FTM in theory has inherent incentives to greater effectiveness and efficiency, the use of deferral accounts has tended, in other circumstances, to reduce those incentives to some extent."

The Board went on to decide at page 8:

> "Therefore, the Board concludes that, while there may be no significant advantages to the pipeline company from the FTM, there are benefits to its users."

43. While the prior discussion has focused on the tolling proposed for the MGP natural gas pipeline, Paramount believes that similar treatment for the proposed NGL pipeline should exist. To the extent the Applicants propose VCSM for the NGL pipeline, Paramount has the same concerns.

44. The Applicants have applied for a full all-events cost of service approach which results in little or no risk of non-recovery of the actual costs incurred. Fairness and transparency require that a third party shipper, such as Paramount, have sufficient disclosure of the incurred costs and the opportunity in a public forum, if necessary, to adequately assess the actual costs prior to the commencement of operations of the proposed facilities. At this time, it remains uncertain as to how the annual cost of service/revenue requirement will be examined once the pipeline is in operation.

45. While the Applicants have said that the costs will be trued up to account for actual costs in a process which seems to contemplate a public hearing, there is no clear statement by the Applicants that they are prepared to have a full public cost of service proceeding subsequent to the construction of the facilities. Paramount supports a public hearing process that would occur on a regular basis, whether annually or over some specific negotiated period (say 3 to 5 years). Greater certainty regarding the regulatory process is required to review and assess the reasonableness of the applied-for cost estimates, as well as the subsequent review and assessment of the prudence of the actual incurred costs, both capital and operating, and thereafter on an ongoing basis.

46. Particularly having regard to the current MGP ownership arrangements and the lack of a properly applied-for Operating Code of Conduct (discussed later in this evidence), the tolls established and approved by the NEB for the natural gas and NGL pipelines should be on a fixed-forward-test year basis similar to all other Group 1 pipelines.

4.2 Toll Design

47. The Applicants have proposed a postage stamp methodology for tolls on the gas pipeline with a discount to 80 per cent of the postage stamp toll for shippers south of Inuvik. It appears that the 80%-factored toll has been based upon a supply inlet to the pipeline near the proposed Little Chicago Compressor station, south of which lies approximately 80% of the distance between Inuvik and the Alberta border. At this time, while it is uncertain where Paramount gas and NGL volumes in the Sahtu will connect, it will likely be well south of the Little Chicago Compressor Station. As such, it is Paramount's position that the 80% pipeline toll for gas volumes south of Inuvik is somewhat arbitrary and may be unreasonable.

48. Paramount recommends that the tolls be based upon a volume-distance methodology, as opposed to the MGP postage stamp methodology coupled with the proposed discounts. Volume-distance tolling methodology is the traditional methodology used on long-haul pipelines in Canada, and Paramount supports it.

It best reflects the fair allocation of the pipeline capital and operating costs and will provide MGP with the flexibility to incorporate any future project along the pipeline route.

49. With respect to the NGL pipeline, the Applicants have not provided much in the way of tolling information. Paramount is aware of no reason why volume-distance toll methodology should not apply to the NGL pipeline.

50. In addition, as a term of any tariff, Paramount would expect to receive at the Norman Wells outlet of the NGL pipeline a like volume and quality of NGL as Paramount provided at the MGP entry point.

51. While the postage stamp tolling methodology is an acceptable method to determine tolls for some pipelines, it is not the preferred methodology for a long haul large diameter, natural gas transmission system. The accepted methodology for transmission systems operating in Canada has been volume adjusted for distance.

52. The volume-distance method (modified in some cases by zone tolling) is used for transmission on the TransCanada system, the Enbridge Liquid systems, including the oil and liquid pipeline commencing at Norman Wells, the Terasen TransMountain Pipeline system, and the Westcoast system. It is interesting to note that when postage stamp tolls were proposed on Westcoast Zone 3 (Transmission North) the Board had the following to say in its Decision RH-6-85 at page 30:

> "The Board finds that Zone 3 provides primarily a transmission function and, for that function generally, costs should be allocated on the basis of volume, adjusted for distance. The Board was not persuaded by the argument of Westcoast that there were significant differences in the functions of Zone 3 and 4 that warranted different treatment in the allocation of costs. Accordingly, the Board shall require Westcoast to allocate costs in Zone 3 on a volume distance basis similar to that employed for Zone 4. Under this allocation method Westcoast shall first derive appropriate allocation units based on CD and sales adjusted for distance, and

> total costs allocated to Zone 3 will be apportioned on the basis of these allocation units."

While the Board has since accepted industry compromises to change Zone 3 to a postage stamp, it has maintained that in principle Zone 3 should be allocated its costs on a volume-distance basis.

53. The one notable exception where the NEB accepted a postage stamp methodology for a large diameter mainline natural gas transmission system was the Maritimes & Northeast System. However, the postage stamp methodology recommended by the Joint Public Review Panel (and subsequently accepted by the NEB) was integrally linked to a pipeline lateral policy, whereby delivery laterals to markets within the Maritimes would be rolled in, provided the laterals met various economic and market conditions. In effect, the postage stamp methodology was adopted to facilitate the social and economic goals of the Maritime Provinces.

As the JRP on the Maritimes & Northeast case stated in its findings at page 70:

> "Because of the importance the Panel places on use of Sable gas in the Maritimes, it is inclined to look at the toll design and lateral policy as a package. The Panel was attracted to the M&NPP's postage stamp toll design methodology and Lateral Policy on the basis that it would provide a solid economic foundation for the pipeline in its early years and the greatest potential for the development of the Maritimes market through M&NPP's Lateral Policy."

The JRP when on to say,

> "The postage stamp toll design is also appropriate given the pipeline will be reversible for reliability of service and will be capable of transporting gas from the U.S. grid into the M&NPP pipeline."

54. As indicated by the JRP in its recommendations, the Maritimes & Northeast toll postage stamp methodology can be seen as integral to the development of the Maritimes market through the Lateral Policy, and based on the greenfield nature of the market and dependence on only one large source of product with the pipeline being fully reversible to protect the Maritime markets.

55. Given the nature of the MGP natural gas and NGL pipelines, the particular circumstances encountered in the Maritimes & Northeast case do not apply, and the postage stamp methodology should be rejected. The volume-distance methodology should be applied to both the natural gas and NGL transmission facilities.

56. It is recognized that distance based tolls can be developed by using point-to-point or a zonal methodology, and given the advancements in computer and financial modeling, a point-to-point methodology should not add to the complexities of a tolling model. However, Paramount would not be opposed to the development of multiple zones based upon, for example, the location of the applied-for compressor station (for the natural gas system) and pumping station locations (for the NGL pipeline), or some other reasonable method.

4.3 Natural Gas Capacity Allocation beyond 800 MMcf/d

57. The Applicants have submitted that companies such as Paramount operating in the Sahtu would have tolls that may be less than those from the Delta Region. Paramount believes that Sahtu volumes should be treated on an equal basis regarding access to the incremental pipeline capacity (above the initial contracted 800 MMcf/d) as the shipper-sponsored producers, and the potential producers presently exploring in the Delta Region. Paramount does not believe that pipeline access should be queued on any basis that considers the level of revenues derived by the tolls paid, or tie-in location on the pipeline.

4.4 Tariffs (Precedent Agreement, etc)

58. Paramount is concerned about a number of the principles outlined in the tariffs respecting demand charge credits and the application to the customer tolls. As well, Paramount is concerned with the ability of the Applicants to unilaterally terminate the project depending upon the NEB Decision. No such termination rights are proposed for third party shippers who execute a Precedent Agreement.

59. Paramount has already expended considerable capital on exploration in the Sahtu and expects to spend considerable additional capital related to the development of production, gathering, processing and transportation facilities. These activities are dependent on the Applicants' proceeding with construction and operation of the project, yet with no certainty or obligation by the MGP Applicants to proceed.

60. Paramount appreciates that events can transpire that could create a claim of force majeure. However, Paramount does not believe it is acceptable that the Applicants continue to collect a return on equity or depreciation during the period of Force Majeure.

61. While the Applicants have filed tariff information and copies of the Precedent Agreement (PA) for the gas pipeline, it is clear from the IRs submitted by interested parties, particularly potential third party producer-shippers, that there are substantial remaining disagreements regarding various tariff conditions and tolling methodologies. Further as previously indicated, there is every likelihood that natural gas production in the NWT will have associated petroleum liquids requiring full use of the proposed NGL pipeline.

62. Because the Applicants have filed under COGOA, they have determined they are not required to file on the public record similar tariff and tolling information regarding the NGL pipeline.

63. It is worth noting that the Board in its Decision GH-2-87 (TransCanada PipeLines tolls case), Chapter 10, at page 92 stated the following,

> "The Board, however, considers it essential that *all* terms and conditions of access to a pipeline be clearly reflected in the tariff in order to ensure that there are no undue services restrictions imposed by the pipeline companies involved in the marketing or producing sectors of the natural gas industry. In the Board's view, prospective shippers are entitled to know the conditions of access to a pipeline system in advance of contract negotiations, as this knowledge will allow market participants to make informed supply and market decisions thereby contributing to the efficient functioning of the natural gas market."

64. It is not surprising that (i) given the lack of information and the apparent unwillingness of the Applicants to provide tolling and tariff information on the NGL pipeline; (ii) given the lack of agreement on tariff and tolling methodologies on the natural gas pipeline; (iii) given the lack of filing of an Operating Code of Conduct, no third parties have yet signed any PA, on the terms as presently filed.

65. In order to mitigate the potential business risks associated with the Applicants' termination rights, Paramount has considered an independent examination/feasibility of a NGL pipeline and natural gas pipeline system from the K'ahsho Got'ine district to the existing Enbridge pipeline and to the TransCanada gas pipeline system to accommodate the transportation of the Sahtu production.

66. At this time, the preferred option to Paramount is to connect to the applied for MGP natural gas and NGL facilities. Paramount believes that it is in all parties' best interest that the MGP facilities be constructed and fully utilized. Development of additional, potentially underutilized facilities would only add to the environmental impacts in the NWT.

5 OPERATING AND AFFILIATE CODE OF CONDUCT

67. The Applicants have indicated in responses to information requests regarding their proposed Operating Code of Conduct the following:

- They seek to merely file the Operating Code of Conduct as a reference and do not believe the Board is required to approve the actual Operating Code of Conduct.

- That they and in particular their operating owner, Imperial, will continue to transfer staff between the pipeline and related facilities and the owners' producing and operating companies and,

- They do not plan on submitting the Operating Code of Conduct related to the management and operations of the pipeline systems for review until after a Board decision.

68. The Applicants' position is inappropriate and does not meet the minimum operating standards in relationship to potential third party customers for a regulated pipeline in Canada. The Operating Code of Conduct should have been filed with the application and at the very least it should be submitted prior to the commencement of the actual hearing so that interested parties can provide their comments. Since the Applicants have not provided information on an acceptable Code of Conduct, the following paragraphs provide some of the key principles that Paramount believes should be considered, and expected in an Operating Code of Conduct by MGP.

69. Key parameters in developing an Operating Code of Conduct are as follows:

- Mitigation of market power and promoting fair competition
- Prevention of unduly preferential treatment
- Prevention of cross-subsidization
- Transfer pricing
- Governance of separation of business
    - Sharing of employees and other resources
    - Separate operations and financial
    - Separate management
    - Physical separation
- Confidentiality
- Compliance plan, Audit and Penalties
- Dispute Resolution
- Regulatory Oversight

5.1 Mitigation of market power and promoting fair competition

70. Other than the percentage ownership by the Aboriginal Pipeline Group ("APG") which may be as much as one-third, ownership in the MGP is held by three major international producers. Based upon the facilities ownership and the fact that these producers are in direct competition with third party producer-shippers for markets, it is critical that an Operating Code of Conduct be fully placed on the record.

5.2 Prevention of unduly preferential treatment

71. One of the key tenets in the design of operating codes of conduct is the concept of monopoly power by the owners of the proposed MGP facilities. The Ontario Energy Board has indicated, relative to utilities under its jurisdiction, that the principal objective of the Code is to enhance a competitive market while saving ratepayers harmless from the actions of gas distributors, transmitters and storage companies with respect to dealings with their affiliates. In view of the highly competitive nature of the oil and natural gas industry, it is vital that third party shippers competing with the producer/owners of the MGP facilities be treated on an equitable basis.

5.3 Prevention of cross-subsidization

72. Codes of Conduct also provide the mechanisms and methodologies related to the design of an acceptable transfer pricing mechanism to ensure services provided by any of the affiliates of the MGP are on commercial terms. Since it is recognized services will be provided by the producer/owners of the MGP because some economies of scale will exist in the use of these services, a Code of Conduct will provide the acceptable mechanisms and methodologies for transfer pricing between MGP and its affiliates.

5.4 Governance of separation of Business

73. The primary issues relating to separation of the MGP business operations are:

- Sharing of employees and other resources
- Separate operations and financial systems
- Separate management
- Physical separation

74. While MGP has indicated it plans on physically separating the operations of the MGP, it has indicated that it desires to share employees and other resources with its producer/owners. Furthermore, as applied for, MGP has proposed a complete integration of its Mackenzie Valley operations under one management and staffing for both non-regulated and regulated operations. Without proper guidelines and codes of conduct, it will be very difficult for third party shippers to be assured that there is no cross-allocation of costs between the various operations within MGP.

5.5 Confidentiality

75. The MGP has requested confidential reserve and other information from potential shippers, like Paramount. Given the nature of the ownership arrangements of MGP, and the prospects of potential transfer of staff between the producer/owners and the MGP, it will be critical that the confidentiality of information provided by producers, like Paramount, be respected by the pipeline and not passed on. Paramount is not questioning the integrity of MGP employees, but strongly believes a Code of Conduct will reinforce the need to preserve confidentiality.

5.6 Compliance plan, Audit and Penalties

76. With any Code of Conduct there needs to be a review of the compliance of the MGP staff by an independent third party.

5.7 Dispute Resolution

77. As with any commercial operation that is dealing with customers, a dispute resolution mechanism must be developed so that customers have an acceptable means to be able to resolve any dispute. Recourse to the NEB or some other third party arbitrator must be part of the Operating Code of Conduct.

5.8 Regulatory Oversight

78. The position of the Applicants that they will not file their Operating Code of Conduct until after they receive the Board's decision, runs counter to the positions advanced by both the NEB and the Federal Energy Regulatory Commission ("FERC") in the United States.

79. The NEB in its decision RH-2-2004 (Phase 1) at page 9 stated the following regarding the need for a revised Code of Conduct for TransCanada PipeLines:

> "Open Access and Transparency
>
> The Board reiterates the oft-repeated principle that shippers are to know <u>in advance of negotiations</u> the terms and conditions of access to a pipeline. This ensures transparency and puts the pipeline and its customers on an equal footing in negotiating a business arrangement.
>
> Another element of transparency <u>relates to the planning for the future of a pipeline system</u>, and to the possibility of cross-talk between a regulated entity and an affiliate operating in a more fully competitive environment. In dealing with this type of issue, the Board is guided by the principle that transparency with respect to the relationship between a regulated entity and its affiliates is important." (emphasis added)

80. Further, as noted by the FERC respecting its December 21, 2004 "Standards of Conduct for Transmission Providers" at page 26, paragraph 46:

> "As noted by Petitioners, the Commission previously stated that some of the Standards of Conduct requirements may not apply until the Transmission Provider has been staffed and begins to perform transmission functions. However, when a Transmission Provider begins soliciting business or negotiating, it is engaging in transmission functions and is subject to the Standards of Conduct requirements. The Commission's goal is to ensure that the newly formed pipeline will provide non-discriminatory treatment and limit its ability to unduly favor its Marketing or Energy Affiliates. If the Commission defers applying the Standards of Conduct, a newly formed pipeline might share employees or information with its Marketing or Energy Affiliates giving these affiliates the ability to obtain preferential service or treatment."

81. This is not a new issue. Regulators have required pipeline companies under their jurisdiction to file Codes of Conduct. Paramount has reviewed the recently developed Codes of Conduct for the Maritimes & Northeast Pipeline and TransCanada's Alberta system. It believes that these Codes of Conduct, developed in conjunction with industry participants, provide the MGP with a good framework for the development and implementation of a Code of Conduct. The Applicants should be able to develop an appropriate Operating Code of Conduct prior to the commencement of the actual hearing.

6 SUMMARY OBSERVATIONS ON MGP APPLICATION

Paramount concludes its evidence by summarizing its key positions, grouped under key ratemaking and regulatory principles enunciated by the NEB.

82. **Requirements of the NEB Act**: "… notably, the requirement that tolls must be just and reasonable, and must not be unjustly discriminatory."

- o While the applied-for variable cost of service methodology may meet these requirements on a minimum basis as they relate to the natural gas pipeline, the same cannot be said of the NGL pipeline. That said, Paramount does not agree with the proposal for reasons discussed above, and recommends a fixed cost of service methodology, with periodic reviews in which reasonableness and prudence may be tested.

83. **Cost Causation**: "… tolls should be guided by the principles of cost-causation and user pay."

- o As indicated in this evidence, the applied for postage stamp, even with the 80% application, is not appropriate for the MGP and does not reflect costs, which are largely distance-related. Further, no specific circumstances exist suggesting departure from well accepted volume-distance methodology. Paramount recommends the use of the volume-distance methodology, with or without zones, as appropriate.

84. **Economic Efficiency**: "In striving for economic efficiency, the Board is of the view that the impacts on customers with limited options as well as the impacts on existing infrastructure are relevant considerations. This is consistent with the Board's mandate which, in practice, includes both the concept of 'protecting' and 'enabling'. Protection suggests that proposals be assessed in light of their impacts on existing systems, customers and market conditions. Enabling suggests that pipelines and other market participants should have the tools to compete effectively and fairly."

- Given the lack of detailed financial and contractual information, coupled with the proposed postage stamp toll, MGP is not advancing a pipeline financial model that provides for an economic, efficient, competitive natural gas and associated liquid supply to be developed. Further, given the application to have the NGL pipeline built and operated under COGOA, and previously discussed reasons as to why the NEB should regulate the NGL pipeline, the NEB needs to enable this recommended change.

85. **Prevention of Abuse of Market Power**: "In the Board's view, this implies the prevention of discriminatory pricing, of inappropriate barriers to the efficient functioning of the market, and of favourable treatment of affiliates. … Market power must not be allowed to be abused, in terms of both substance, which would need to be proven, and, in terms of appearance and perception."

- Given the overwhelming dominance of the three major producer/owners of the MGP system, it is critical that the Board order MGP to provide an Operating Code of Conduct as soon as possible and in any event no later than the commencement of the oral section of this proceeding.

86. **Open Access and Transparency**: "The Board reiterates the oft-repeated principle that shippers are to know in advance of negotiations the terms and conditions of access to a pipeline. … the Board is guided by the principle that transparency with respect to the relationship between a regulated entity and its affiliates is important."

- The Applicants have not submitted a facility application that provides transparency or openness regarding access and tolls and tariffs. In contrast, their position on a number of issues, including access to the NGL pipeline, and a Code of Conduct, is a throwback to a past era of closed negotiations, with terms and conditions imposed by the pipeline operator.

87. **Innovation**: "Past Board decisions that did not support a specific proposal do not necessarily indicate that given current and expected market conditions, the same decision would be reached today."

- The fact is that this Application contains few, if any, innovative measures, that might be viewed as helpful in facilitating northern resource development by parties other than the producer owners. With Paramount's proposed enhancements on NEB regulation for the NGL pipeline, revised toll and tariff proposals and increased transparency, including a Code of Conduct, the project would provide further economic benefits to the North.