LETTER DECISION

File: OF-Tolls-Group2-E092-2010-01
26 May 2011

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Dear Mr. Davies and Mr. Kahler:

Hearing Order MHW-1-2010
Cenovus Energy Inc. (Cenovus)
Application Regarding the Express Pipelines Ltd (Express) Husky Lateral
Pursuant to Sections 71(3), 59 and Part IV of the *National Energy Board Act* (NEB Act)

The National Energy Board (the Board) has considered Cenovus' application dated 10 August 2010 (Application) in the MHW-1-2010 proceeding. Following are the Board's decision and reasons.

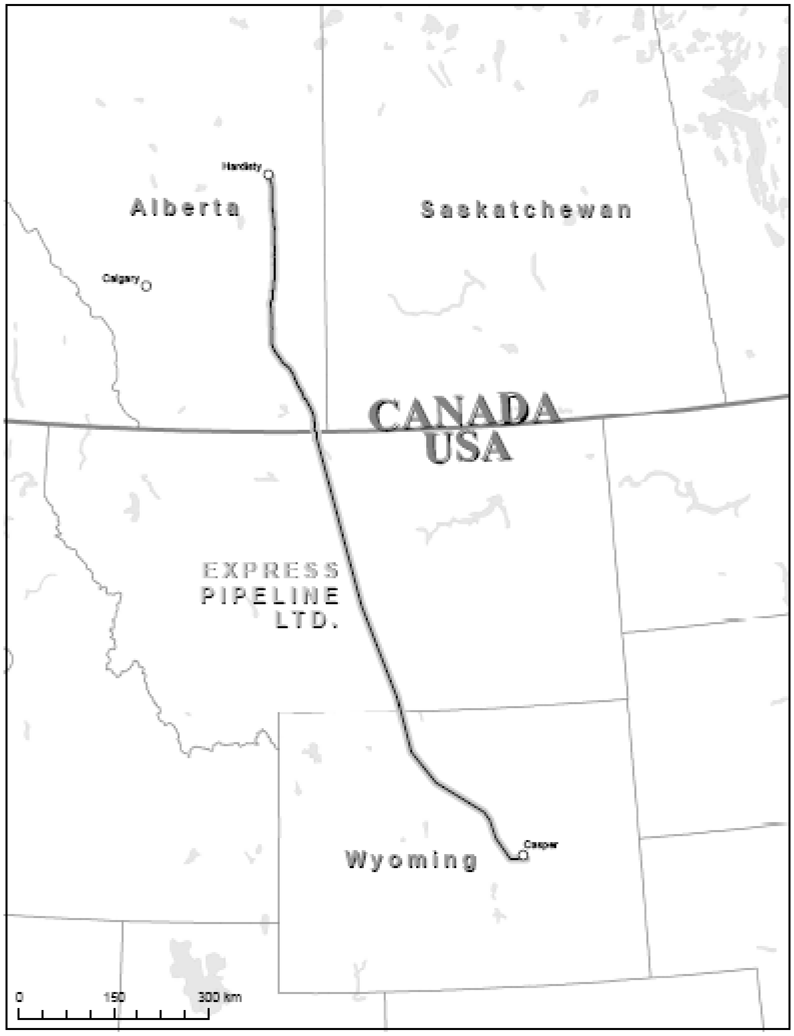
Background

In June 1996, the Board approved the Express Pipeline System facilities including laterals, the market-based toll methodology and proposed initial tolls in OH-1-95. Facilities referenced in Board Certificate OC-40 included interconnecting facilities at the Husky Terminal (Husky Lateral). See Figure 1 for a Map of the Express Pipeline System.

Express was granted Group 2 status by the Board, meaning it would be regulated, for financial purposes, on a complaint basis. Its tolls were therefore not to be filed for approval but would be reviewed if any shipper filed a complaint. Originally, shippers signed 5, 10, or 15-year contracts for service on the Express Pipeline. Additional 10-year contracts were signed for an expansion that went into service in 2005.

On 18 June 2010, the Husky Lateral was taken out of service by Express following an integrity inspection. At that time, Express advised shippers that it would not replace the pipeline without a "connection agreement", by which Cenovus and other shippers from the Husky Terminal would be required to pay for the cost of the replacement through increased tolls or a capital contribution.

Figure 1: Map of the Express Pipeline System*



*This map was created by Board Geographic Information Systems (GIS) specialists using GIS data on file with the Board.

On 10 August 2010, Cenovus filed an application for Orders:

- pursuant to subsection 71(3) of the NEB Act, requiring Express to provide pipeline facilities to transport oil from the Husky Terminal to the Express Terminal;
- pursuant to section 59 of the NEB Act confirming that the costs of providing the pipeline facilities are to be borne by Express;
- pursuant to Part IV of the NEB Act, establishing a just and reasonable rate for the current service being provided by Express to Cenovus on the Express Pipeline;
- pursuant to subsection 19(2) of the NEB Act, making the existing rate payable by Cenovus for service on the Express Pipeline interim; and
- such further and other relief as Cenovus may subsequently request or the Board may consider appropriate.

The Board issued toll Order TOI-04-2010 on 15 October 2010, granting the request for interim rates. Following comments from ConocoPhillips Canada Resources (ConocoPhillips), Frontier Oil and Refining Company (Frontier), Express, and Cenovus, the Board set down the Application for a written hearing process with final oral argument under Hearing Order MHW-1-2010.

The Board identified the following issues for discussion in the MHW-1-2010 proceeding:

1. Whether the Board should direct Express, pursuant to subsection 71(3) of the NEB Act, to provide pipeline facilities to transport oil from the Husky Terminal to the Express Terminal:
   (a) Whether there is a demonstrated need for the pipeline;
   (b) Whether the requested new facilities are in the public interest; and
   (c) Whether there would be an undue burden on Express should it be required to provide the applied-for facilities.
2. Whether the cost of replacing the Husky Lateral should be borne by Express or other parties.
3. (a) What service is currently being provided by Express to Cenovus; and
   (b) Whether the tolls for the current service are just and reasonable.

Subsection 71(3) Order

In its Application, Cenovus requested an Order pursuant to subsection 71(3) of the NEB Act, requiring Express to provide facilities to transport oil from the Husky Terminal to the Express Terminal.

In responding to an Information Request on 18 March 2011, Express committed to completing construction of the Husky Lateral replacement regardless of the Board's decision in this proceeding. On 23 March 2011, Express sent a letter to the Board advising that construction to replace the Husky Lateral would commence on 28 March 2011. Express also stated that it would allow shippers to resume deliveries to Express via the Husky Lateral upon completion of the Husky Lateral replacement and subject to the payment of applicable tolls.

Cenovus subsequently stated that an Order under subsection 71(3) of the NEB Act was not required based on Express' commitments and assuming the replacement of the Husky Lateral is completed in a timely manner. Other intervenors adopted a similar position.

> ***Views of the Board***
>
> Based on the commitments made by Express and the positions taken by the parties in this proceeding, the Board is of the view that an Order pursuant to subsection 71(3) of the NEB Act is not required at this time. If the replacement of the Husky Lateral does not proceed to completion as committed to by Express, parties may request relief from the Board.

Who Should Bear the Cost of Replacing the Husky Lateral

In its Application, Cenovus requested the Board to confirm that the costs of replacing the Husky Lateral be borne by Express, pursuant to section 59 of the NEB Act.

Cenovus submitted that the evidence in the OH-1-95 proceeding demonstrates that:

- Cenovus contracted for 15-year service on the Express Mainline and the upstream interconnecting pipelines, including the Husky Lateral.
- The tolls proposed by Express, which were determined by the Board to be just and reasonable, were for service on the Express Mainline and the upstream connecting pipelines, including the Husky Lateral.

Cenovus stated that Express committed to the following:

- The obligation to provide transportation service on the Express Pipeline System, including the Husky Lateral, for a fixed market-based rate. Express thereby assumed the risk to pay the initial and ongoing capital and operating costs necessary to provide the service.
- Tolls which would provide certainty over the contract term.

Cenovus submitted that Express should continue to honour these commitments.

Cenovus refuted Express' position in this proceeding that tolls do not include service on the Husky Lateral with the evidence of Mr. Drader for Express in OH-1-95. Cenovus submitted that the evidence of Mr. Drader confirmed that the costs of the interconnecting pipelines at Hardisty were included in the Express Pipeline System tolls.

Cenovus argued that the contract does not say that service to be provided by Express is limited to the mainline and that if the toll on the Husky Lateral was meant to be zero at the time of OH-1-95, Express should have filed a tariff to evidence that. Cenovus submitted that the definition of the Express Pipeline System in the Rules and Regulations referenced in the Transportation Service Agreements (TSAs) included the interconnecting pipelines such as the Husky Lateral.

Cenovus also submitted that, while the replacement of the Husky Lateral will involve a new piece of pipe, it is not a new lateral as it will replace an existing piece of pipe that was approved in OH-1-95. Cenovus further stated that subsection 71(1) of the NEB Act requires a company operating an oil pipeline to transport on its facilities all oil offered to it. According to Cenovus, if Express were to take away the service previously provided via the Husky Lateral, Express would need to apply for relief from its subsection 71(1) obligations.

Cenovus submitted that, under section 59 and Part IV of the NEB Act, the Board has authority to determine that the costs of replacing the Husky Lateral are to be borne by Express, and to interpret the TSAs and make Orders applicable to the contracted service. Cenovus asserted that having a contract does not supplant the Board's jurisdiction to set just and reasonable tolls for the service provided.

The positions of Cenovus were supported by ConocoPhillips, Suncor Energy Marketing Inc. (SEMI) and Frontier (collectively the Intervenors). These parties requested that any relief granted by the Board should apply to Husky Lateral shippers with both 10 and 15 year contracts. ConocoPhillips and SEMI noted that, in the last three or four years, Express has spent over four million dollars repairing the Husky Lateral, which is an action inconsistent with Express' position that it has been providing free service, whether as a gesture of goodwill or due to an accounting error.

On 18 March 2011, in response to a Cenovus Information Request, Express stated that shippers had not been billed for services on the Husky Lateral due to an oversight. During oral argument Express also stated that the toll for service on the Husky Lateral was initially set at zero because there were constraints on the total that could be charged as the market then would only accept a mainline rate of $1.35 per barrel.

Express submitted that:

- Approving the mainline and lateral facilities in OH-1-95 under Part III of the NEB Act does not dictate the tolling for those same facilities.
- There is nothing in Chapter 4 of the OH-1-95 decision which discusses tolls on the laterals.
- Parties shipping on the new Husky Lateral should be required to pay the appropriate market-based toll for such service as is consistent with industry practice.
- There was no need for the Board to be involved in this matter as the parties will decide appropriate tolling and negotiate in the same manner as was done for the mainline. These tolls would be negotiated between Express and the Husky Lateral shippers. Express would decline service to any party wishing to gain access to that lateral without a separate tolling agreement.

Express argued that the evidence in the OH-1-95 proceeding is irrelevant to this proceeding as the final TSAs and the final Rules and Regulations in the Tariff form the contract which binds the parties.

Section 3.1 of the TSA states that the "Shipper shall tender to Express at the Receipt Point and Express shall provide transportation service". The Rules and Regulations in the Tariff define the receipt point as the Express inlet meter at Hardisty, Alberta. Express submitted that the provisions of the contract make it clear that the transportation service relates only to petroleum tendered by the shipper at the receipt point and tolls are not invoked until the crude oil passes the receipt point. The receipt point is on Express property and therefore, according to Express, any service upstream of the Express property, including the Husky Lateral, is not included in the current contracts. Express submitted that its evidence during OH-1-95 that the custody transfer meter would be located at the Husky Terminal was based on preliminary design drawings. It said the actual "as built" drawings confirm that Express does not have any meters located at the Husky Terminal.

Express asserted that its practice to exclude the cost of service on the Husky Lateral from the tolling for the Express Pipeline is consistent with standard industry practice. Express cited Enbridge's break-out of terminalling and tankage charges from its mainline tolls as an example. ConocoPhillips and SEMI replied that Enbridge is not a good comparator for industry practice as Enbridge is a common-carrier pipeline and it does not have the long-term TSAs and fixed toll arrangements that Express has.

Express stated that it would normally fund maintenance capital and operating costs incurred on the Husky Lateral through internally generated funds. However, the replacement of the Husky Lateral, approximately fourteen years after the pipeline commenced service, is an unusual circumstance which would not have been anticipated. Express submitted that the complete replacement of the Husky Lateral is akin to the construction of a new lateral and would be funded as a new capital project by Express.

Express agreed that, arguably, the contracts with shippers did not address a facilities replacement scenario and that laterals could have been addressed in greater detail. Express also stated that the trigger for Express' position that shippers should now be charged a toll above zero for the Husky Lateral was the need for a new capital expenditure.

Express submitted that the Board cannot legally ignore or go beyond the "four corners" of the contracts (TSAs and Rules and Regulations) it signed with shippers because the contract terms are clear and unambiguous. It said that the Board has legal authority to interpret contracts between shippers and Express but that interpretation must be incidental to the Board's rate-making jurisdiction. Express also cautioned against relying on the extracts from a narrow portion of the evidence of Express witnesses during the OH-1-95 proceeding.

In response to Express' argument, Cenovus submitted that it was never advised of the relocation of the custody transfer meter nor was it advised that service on the Husky Lateral would be taken away.

Views of the Board

The Board has broad authority under section 59 and Part IV of the NEB Act to regulate the services and tolls on facilities under its jurisdiction. In the case of the Express Pipeline, this includes the Husky Lateral.

The Board is of the view that:

- The evidence from OH-1-95 is pertinent to this matter because it described the service provided to shippers and the risks taken by Express. While Express cautioned against relying on extracts of its own sworn evidence from OH-1-95, it did not refute that the evidence cited by Cenovus was as stated in the OH-1-95 hearing transcript;
- The placement of a meter does not override the clear intention of the parties as described in OH-1-95;
- A contract can inform the Board's decision, but it does not supplant the Board's jurisdiction under Part IV of the NEB Act to set just and reasonable tolls for the services that are provided;
- The contracts, made up of TSAs and Rules and Regulations, did not specifically address unexpected facilities replacement or the Husky Lateral in detail. The Board notes the interpretation advanced by Cenovus and the Intervenors is consistent with OH-1-95;
- Express' evidence about industry practice is not helpful as operating and tolling circumstances vary among pipelines; and

- Until the Husky Lateral was taken out of service, Express had accepted the risks associated with initial and ongoing capital and operating costs necessary to provide service on the lateral.

The Board is persuaded by Cenovus' and the Intervenors' argument that provision of service on the Husky Lateral is included in the current tolls being paid by Husky Lateral shippers. The Board does not find merit in Express' submission that it provided service to Husky Lateral shippers free of charge for thirteen years.

The Board accepts the evidence of Cenovus that affected shippers were not expressly advised of the relocation of the custody transfer meter nor were they told that service on the Husky Lateral could be taken away. As Express acknowledged, the only reason payment from Husky Lateral shippers is being requested now is because of the need for replacement facilities. In keeping with the Board's Memorandum of Guidance - Financial Regulation of Pipeline Companies under the Board's Jurisdiction (A23677) issued to all pipeline companies on 17 November 2009, if Express determined that principles from OH-1-95 were in need of revision, it should have provided its shippers and interested parties with sufficient information to determine whether a complaint was warranted.

Therefore the Board concludes that Express is responsible for bearing the cost of replacing the Husky Lateral.

Service and Just and Reasonable Tolls

Pursuant to Part IV of the NEB Act, Cenovus requested the Board to establish a just and reasonable rate for the service provided by Express to Cenovus for the period in which the Husky Lateral was not in service.

Cenovus provided evidence from Drazen Consulting Group, Inc. (Drazen) and submitted that:

- The tolls on Express and the Husky Lateral are market-based and are therefore value-based.
- Until the Husky Lateral is replaced, the toll should be reduced by 24 cents per barrel (24¢/bbl).
    - This amount was supported by the fact that Express proposed to charge Husky Lateral shippers as much as 24¢/bbl for shipping on the Husky Lateral once it was replaced.
    - An alternative arrangement to ship Western Canada Select (WCS) crude oil was tried for a brief time by shipping from the Husky Terminal on an Enbridge line to the Express Terminal, at a cost of 24¢/bbl payable to Enbridge.
- If the cost of the service is valued at 24¢/bbl, then the value of not having the service would be the same.

Initially, Cenovus and the Intervenors submitted that the refund should apply to contracted volumes but later stated that the refund could apply to average historical volumes actually shipped on the Husky Lateral.

Frontier stated that, prior to the Husky Lateral being taken out of service, it had delivered WCS and Lloyd Blend crude oil to Express via the Husky Terminal. Since the Husky Lateral was removed from service, Frontier has also been shipping limited volumes of WCS through an Enbridge line to the Express Terminal at a cost of 24¢/bbl. Frontier agreed with Cenovus that the toll should be reduced by this amount. Frontier described losses it has incurred due to the Husky Lateral being out of service:

- Lower refining value of products due to using Cold Lake Blend instead of WCS as a feedstock.
- Deficiency payments on throughput it cannot deliver into Express since the Husky Lateral has been out of service.

Frontier requested the Board to relieve it from any deficiency payments resulting from take-or-pay obligations.

ConocoPhillips and SEMI submitted that they delivered WCS to Express via the Husky Terminal. Since the Husky Lateral has been out of service, both companies stated that they have had to pursue alternative supplies for downstream markets. ConocoPhillips and SEMI agreed with Cenovus that:

- The service provided on the Express system since the Husky Lateral was taken out of service was of inferior value.
- The shippers who have been deprived of service on the Husky Lateral should receive a refund on tolls paid.

ConocoPhillips and SEMI stated that reducing the toll by 24¢/bbl would result in a reasonable toll for the current diminished service and that any relief granted by the Board in the form of a toll reduction should be applied equally to all Express shippers utilizing the Husky Lateral.

Express reiterated that the transportation service provided to Cenovus and other shippers pursuant to the approved Tariff and Rules and Regulations relates solely to service on the mainline and not the laterals. The toll for such service is market-based and the price for service on the Husky Lateral is likewise subject to negotiations. Express stated that the Husky Lateral represents approximately 0.1% of the total length of the Express Pipeline and 0.3% of the length of Express Canada. The current toll for Super Heavy Crude for service from the Express Terminal to the furthest delivery point on the Express Pipeline is $1.807US/bbl; 0.1% of this toll is less than 0.2¢/bbl.

Express stated that if the Board were to order a refund, it could be based, at best, on historical shipments over the Husky Lateral and the 0.2¢/bbl.

Concerning Frontier's submissions on deficiency payments resulting from take-or-pay obligations, Express stated that there was no legal authority for the Board to address this or other consequential damages stated by Frontier.

Views of the Board

The Board has determined that the toll being charged on the Express Pipeline includes service on the Husky Lateral. As this service is not currently being provided, tolls for Husky Lateral shippers are not just and reasonable.

The Board notes Cenovus' and Frontier's evidence that they paid a toll of 24¢/bbl for the use of Enbridge facilities as an alternative to Husky Lateral service. The Board also notes that Express itself offered service on the replacement lateral at a rate of up to 24¢/bbl. Accordingly, the Board accepts that 24¢/bbl represents a fair value for service on the Husky Lateral, and finds that, pursuant to Part IV of the NEB Act, a just and reasonable rate would be the interim tolls minus 24¢/bbl.

Pursuant to subsection 64(a) of the NEB Act, the Board directs Express to refund to the Husky Lateral shippers an amount of 24¢/bbl for the period from 14 October 2010 until service resumes on the Husky Lateral, based on the following:

- Step 1: Calculate the average daily shipments over the Husky Lateral for each shipper for the period of 1 January 2007 to 31 May 2010,
- Step 2: Calculate the number of days from 14 October 2010 until resumption of service on the Husky Lateral,
- Step 3: Multiply 24¢/bbl by the average daily shipments and then by the number of days to get the total refund.

The Board recognizes that there is a need for the Husky Lateral well beyond the end of the current contract terms and that a good long-term relationship among the parties is in the best interests of all involved. Should parties reach a commercial solution by 31 August 2011, the previous steps need not apply.

The Board directs that the tolls for Husky Lateral shippers remain interim until 31 August 2011 or the parties reach agreement. Tolls will cease to be interim on 1 September 2011, or on the date parties advise the Board that an agreement has been reached, whichever is earlier.

Frontier has not persuaded the Board to direct relief from take-or-pay arrangements and deficiency payments. Such matters are part of commercial arrangements between the relevant parties. Therefore the Board is not granting Frontier's request for relief from deficiency payments.

Disposition

For these Reasons, the Board orders/directs that:

- Pursuant to section 59 of the NEB Act, the costs of replacing the Husky Lateral are to be borne by Express;
- Pursuant to subsection 71(1) of the NEB Act, Express is directed to provide service on the replacement Husky Lateral to the current Husky Lateral shippers when service resumes, whether or not a new agreement is in place;
- Pursuant to Part IV of the NEB Act, a just and reasonable rate from 14 October 2010 until service resumes on the Husky Lateral is the interim tolls minus 24¢/bbl for the Husky Lateral shippers;
- Absent an agreement between the parties by 31 August 2011, pursuant to subsection 64(a) of the NEB Act, the Board directs Express to refund to the Husky Lateral shippers an amount of 24¢/bbl for the period from 14 October 2010 until service resumes on the Husky Lateral, based on the following:

  Step 1: Calculate the average daily shipments over the Husky Lateral for each shipper for the period of 1 January 2007 to 31 May 2010,
  Step 2: Calculate the number of days from 14 October 2010 until resumption of service on the Husky Lateral,
  Step 3: Multiply 24¢/bbl by the average daily shipments and then by the number of days to get the total refund; and
- Tolls for Husky Lateral shippers will remain interim until 31 August 2011 or the date parties advise the Board that an agreement has been reached, whichever is earlier. If no agreement is reached by parties, tolls will become final on 1 September 2011.

R. J. Harrison, Q.C.
Presiding Member

G Habib

G. A. Habib
Member

L. Mercier
Member

Calgary, Alberta
May 2011