

ALBERTA ENERGY AND UTILITIES BOARD

Calgary Alberta

FEDERATED PIPE LINES LTD. APPLICATION TO CONSTRUCT AND OPERATE A CRUDE OIL PIPELINE FROM VALHALLA TO DOE CREEK

**Decision 98-12
Application No. 1010762**

1 INTRODUCTION

1.1 Application and Intervention

On 18 September 1997, Federated Pipe Lines Ltd. (Federated) applied to the Alberta Energy and Utilities Board (the Board), pursuant to Part 4 of the *Pipeline Act*, for a permit to construct and operate approximately 27 kilometres of 114.3 millimetre (mm) outside diameter pipeline for the purpose of transporting crude oil from existing facilities located in Legal Subdivision 8, Section 20, Township 76, Range 9, West of the 6th Meridian (Valhalla) to a proposed terminal in Legal Subdivision 4, Section 33, Township 78, Range 8, West of the 6th Meridian (Doe Creek). The oil would be stored in tankage and then injected into the Federated Pipe Lines (Northern) Ltd. pipeline which was under construction, for transmission to Edmonton utilizing connecting downstream pipelines.

On 22 October 1997, the Board received a submission from Peace Pipe Line Ltd. (Peace) objecting to the proposed pipeline on the basis that the three Valhalla batteries to be connected to the proposed pipeline were already connected to Peace's pipeline system which provides crude oil transportation to the same Edmonton markets. Peace requested the Board to review the pipeline application (the Application) to determine if the proposed pipeline would represent needless proliferation.

The attached map illustrates the location of the proposed pipeline, along with Federated's and Peace's existing pipelines in the area.

1.2 Hearing

The Application was considered at a public hearing in Calgary, Alberta on 18, 19, and 20 February 1998 before Board Members B. T. McManus, Q.C., J. P. Prince, Ph.D., and Acting Board Member J. R. Nichol, P.Eng.

The following table lists the participants at the hearing:

THOSE WHO APPEARED AT THE HEARING

Principals and Representatives (Abbreviations Used in Report)

Witnesses

Federated Pipe Lines Ltd. (Federated)
R. M. Perrin

R. C. Osborne
J. D. Webster, P.Eng.
B. W. Peterson

Peace Pipe Lines Ltd. (Peace)
S. C. Lee

W. R. Stedman
J. Church, Ph.D.

Alberta Energy and Utilities Board staff
B. Heggie, Board Counsel
K. Johnston
S. Lee, P.Eng.
G. McLean

The following parties filed submissions, but did not participate in the hearing:

- C Anderson Exploration (Anderson)
- C Confederation of Regions Political Party (Confederation)
- C Crestar Energy Inc. (Crestar)
- C EnerMark Inc. (EnerMark)
- C Imperial Oil Limited (Imperial)
- C Kinetic Resources (LPG) (Kinetic)
- C Norcen Energy Resources Limited (Norcen)
- C Numac Energy (Numac)
- C Petro-Canada Oil and Gas (Petro-Can)
- C Petrorep Resources Ltd. (Petrorep)
- C Rigel Oil & Gas Ltd. (Rigel)
- C Tusk Energy Inc. (Tusk)
- C Western Cree Tribal Council (Western Cree)

1.3 Preliminary Matters

The Notice of Hearing, dated 23 December 1997, included provisions for written interrogatories by Peace. Subsequently, written interrogatories were also submitted by Federated. The Board adopted the written interrogatory process to collect information in addition to that to be filed for the hearing.

Federated filed responses to interrogatories, which Peace deemed to be deficient. On 4 February 1998, Peace submitted to the Board a Notice of Motion requesting the Board to direct Federated to: (i) provide full and adequate responses to information requests about tolls, terms of service, capital costs, and operating costs, and (ii) adjourn the hearing proceedings pending resolution of the matter. The Board deferred consideration of the Notice of Motion until the outset of the hearing, at which time Peace again sought an adjournment until Federated agreed to file full and adequate responses to interrogatories about tolls, terms of service, capital costs, and operating costs. Peace argued that the disclosure of this information was required by all parties in order to

assess whether the applied-for pipeline was economically efficient. Federated argued that it responded to interrogatories to the extent possible in a competitive environment and that disclosure of confidential information should not be compelled.

The Board denied Peace's Notice of Motion, choosing not to compel Federated to provide the requested information. The Board noted that Peace would have the opportunity to argue whether all relevant information necessary for the Board's decision was provided, and if Federated chose not to provide confidential information it would simply run the risk of affecting the outcome of the Application. Federated subsequently chose to provide some, but not all, of the information requested.

2 ISSUES

With respect to environmental issues, the Board notes that Federated filed a Conservation and Reclamation Application with Alberta Environmental Protection (AEP). AEP did not raise any concerns about the proposed project. The Board expects the applicant will satisfy all of AEP's regulatory requirements and obtain all applicable AEP environmental approvals prior to the commencement of any construction.

The Board accepts Federated's confirmation that it has obtained all necessary rights of way for construction of the pipeline and that there are no outstanding technical, safety, or land-related issues. Accordingly, the Board considers the issues respecting the Application to be:

- C the need for the pipeline, and
- C the implications of the decision for the economic environment within which competing pipelines are developed.

3 NEED FOR THE PIPELINE

3.1 Views of the Applicant

Federated argued that it had demonstrated the need for the construction and operation of its pipeline project and that its Application did not represent an unnecessary proliferation of facilities. In explaining this point of view Federated stated:

ARegardless of the definition of 'proliferation', I believe it is fair to suggest that the purpose of the proliferation policy is to require scrutiny of pipeline applications and their denial in circumstances where they make no contribution to the public interest through their construction and operation. This circumstance would arise if: (1) construction of the applied-for pipeline were to sterilize and make redundant facilities in the ground which were capable of providing the same service, and no other benefits could be demonstrated; or (2) such pipelines are built without having first obtained any commitment to their use.@

Federated submitted that it negotiated contracts with three producers: Anderson Exploration, EnerMark Inc., and Petrorep Resources Ltd. (the Valhalla producers), to transport oil from the Valhalla area to Edmonton. These Valhalla producers accepted the terms of service offered by Federated and, in May 1997, concluded 10-year contracts on the proposed pipeline. Federated

contended that it competed fairly with Peace to win the transportation contracts with the Valhalla producers and that all negotiations were carried out at arm's length.

Federated confirmed that the proposed pipeline would be comprised of a 4-inch line with a maximum daily capacity of 1560 m³/d and an expected 1998 daily throughput of 700 m³/d. The load factor was estimated to be approximately 45 per cent. On the basis of the Valhalla producers' reserve estimates of 1 million cubic metres of proven reserves and 2 million cubic metres of proven-plus-probable reserves, Federated estimated that current production levels could be maintained and increased, and that the batteries should continue to produce for at least 10 years, and perhaps as long as 15 or 20 years.

Federated explained that additional need for pipeline capacity might arise from increased volumes being delivered into the Peace system from British Columbia. It pointed out that the prospectus for the Pembina Pipeline Income Fund, issued 15 October 1997, disclosed that Peace had recently entered into a strategic alliance with Northstar Energy Corporation (Northstar), which had commenced construction of an 8-inch pipeline from Taylor, British Columbia to the Peace system at Dawson Creek, British Columbia. The capacity of this pipeline was given as 3021 m³/d. Federated indicated that the Peace system currently had a maximum daily capacity of 6936 m³/d, with an average daily throughput of 5329 m³/d. Federated stated that any redundant capacity on the Peace system as a result of a loss of 700 m³/d to the Federated system would be more than made up by the addition of the Northstar volumes to the Peace system. In fact, Federated submitted that Peace might have to loop its pipeline between Gordondale and LaGlance to accommodate all of the additional volumes.

With respect to its choice of pipe size, Federated explained that generally, nothing smaller than 4-inch lines were typically used in gathering systems and that, in its judgement, a 4-inch line was the appropriate size given the oil volumes and transportation distance. Federated estimated that the capital cost savings of a 3-inch line over a 4-inch line would be approximately \$363 000; however, power savings of a 4-inch line over a 3-inch line would be approximately \$14 000 per year. The net cost of a 3-inch line would be approximately \$260 000 less than the comparable 4-inch line.

In response to questioning, Federated stated:

A . . . we recognize that there will be two pipes serving the same area, and Peace has the capability of moving this product into Edmonton and we'll have the capability of moving it into Edmonton, but there are some quality issues that could come forward that the shippers have at least expressed concern to us about on Peace Pipe; and the way we have set up our system, is that it has the potential of segregating the batches of light oil out of Doe Creek which will, I think, preserve the quality of the oil into Edmonton.@

Federated stated that this increased service flexibility would allow the shipping of crude oil containing 0.3 per cent H₂S, in segregated batches all the way to Judy Creek, at which point it would be commingled with a lube oil stream for shipment to Edmonton. Federated suggested that this service might be of some benefit to producers, but did not provide any evidence to quantify this benefit. Federated stated that producers had already benefited from its Application, since Peace felt obliged to offer a greater range of tariffs in response to Federated's threat of competition. Also, Federated explained how service flexibility would be enhanced in the future as different producers with new reserves in the area would have the choice of services offered by

two competing pipelines. Federated noted that producers were currently paying the power costs to pump oil directly into the Peace line, while Federated's proposal would have the oil go into tankage, with a significant reduction in power costs to the producers.

Lastly, Federated argued that construction of its pipeline project would generate additional benefits, such as aboriginal employment opportunities.

3.2 Views of the Intervener

Peace argued that the proposed pipeline was not needed as the Valhalla batteries were connected to the Peace system, which had sufficient capacity to handle all current and future production.

Peace questioned the need for the proposed pipeline given the estimated 1998 combined production rate of 700 m³/d from the three Valhalla batteries and producers' reserve estimates of up to 2 million cubic metres of proven-plus-probable reserves. Peace calculated that the reserves connected to the Valhalla batteries could be depleted within four years, depending on production rates and the extent of development of probable reserves.

Peace agreed with Federated's description of Peace's existing capacity and current throughput, resulting in spare capacity on the Peace system of approximately 1600 m³/d. Peace acknowledged that the new Northstar pipeline was scheduled to commence operations in March 1998. While it had the capacity to deliver 3021 m³/d to the Peace system, daily throughput was expected to be about 1600 m³/d, which could be accommodated by existing capacity on the Peace system. However, if the Northstar pipeline were to deliver volumes greater than expected, Peace would install a midpoint booster, which could increase the overall maximum daily capacity of its system to 8300 m³/d. The midpoint booster would require an \$800 000 capital expenditure. Peace said that it had no plans to loop the Gordondale to LaGlace pipeline. In summary, with respect to the issue of duplicative capacity, Peace stated: "Peace's existing facilities are sunk investments. They are capable of transporting all existing and potential production efficiently, so any new entry is purely duplicative, leading to an increase in total transportation costs."

Peace submitted that the proposed pipeline would not create additional service flexibility since Peace could already, upon request, batch crude oil containing 0.3 per cent H₂S. Peace also noted that it had not received any complaints from producers about its range of services. Peace argued that because the Valhalla producers had committed to Federated for 10-year terms, these producers would not have the flexibility to switch back and forth between the Federated and Peace systems in order to take advantage of the company posting the lower tolls or offering the more convenient services.

3.3 Views of the Board

The Board notes that an arrangement between Federated and several producers has been made following a process that allowed for competitive proposals from Peace. That arrangement cannot be completed without the proposed pipeline. The Board acknowledges that Federated and Peace agreed that existing capacity could handle current throughput. However, Federated submitted that additional capacity could be needed in the near future based on the Prospectus of the Pembina Pipeline Income Fund, which discussed Peace's alliance with Northstar. Northstar's Taylor to Dawson Creek line was to have a capacity of 3021 m³/d which, if fully utilized, would require some increase in capacity on the Peace system. Peace responded that expected throughput on the Taylor to Dawson Creek line was only 1600 m³/d, which could be accommodated in the existing Peace line. However, the Board notes that this throughput of 1600 m³/d on the Taylor to Dawson Creek line implies a relatively low load factor of just over 50 per cent. This would suggest that additional capacity, in some form, could be needed in the foreseeable future. Therefore, the Board accepts that a need for the pipeline is indicated. Nonetheless, it is likely that, at least in the short term, the proposed facilities might be duplicative thus suggesting they should be considered in light of the Board's guidelines regarding the proliferation of facilities. These guidelines are currently summarized in Informational Letter 91-1 and in volume 2 of Guide 56—the Board's *Energy Development Application Guide and Schedules*, October 1997 Edition.

The Board's policy guidelines relating to the proliferation of facilities are, by design, not entirely definitive. This is to avoid a strict, formulaic interpretation of numbers or distances as justification that a development is, or is not, representative of unwarranted proliferation. The intent of the guidelines is to encourage the industry to carefully consider whether new facilities are truly needed, as well as whether others might be adversely affected. In many situations there is some degree of uncertainty as to whether others may be adversely affected by a development. Preferably in such situations, parties are canvassed thoroughly to ensure that anyone who might be affected has an opportunity to understand the proposed development and have their views heard by the proponent and, if necessary, by the Board.

The proliferation policy was initially put in place to deal with situations where the public interest was potentially at risk because of adverse effects to people or the environment from the construction and operation of surface facilities such as gas processing plants. Such developments generated concerns on the part of the public regarding aesthetics and environmental quality. Those concerns led to an increased regulatory focus on unwarranted proliferation.

While the proliferation policy is related to the Board's mandate to ensure economic, orderly, and efficient development, in the recent past the Board has not generally accepted arguments solely related to proliferation to justify inhibiting competitive development of facilities, particularly where those facilities have had some support from the marketplace. In other words, the Board believes that application of the proliferation policy should not necessarily be allowed to stifle legitimate competitive proposals that have proponents willing to invest private capital and customers willing to enter into contractual agreements for services unless potential effects adverse to the public interest are clear and substantiated. Decisions in such cases depend upon the specific circumstances of each case, including the degree and nature of duplication involved as well as the degree of market support.

In general, pipelines are less likely than surface facilities to trigger the type of proliferation the Board is most concerned to avoid. This does not mean that pipelines are exempt from

proliferation considerations. However, it does mean that the Board's concern regarding unwarranted proliferation is less likely to affect pipeline developments than it is to affect surface facilities. In the case at hand, the environmental implications of the proposed development are negligible, the requirements of AEP appear to have been satisfied, and there was no opposition from members of the public. Therefore, the Board considers that, to the degree proliferation may exist, it is not extensive. In the final analysis, the Board has a relatively weak establishment of need to weigh against a relatively low degree of potential proliferation. The scales do not tip decisively in either direction. Therefore, the Board's decision may turn on the other aspects of the Application.

4 IMPLICATIONS OF THE DECISION FOR THE ECONOMIC ENVIRONMENT WITHIN WHICH COMPETING PIPELINES ARE DEVELOPED

Given the Board's conclusion that neither the need nor the possibility of proliferation are decisive factors, the other issues raised by the Application will be significant. This section addresses the other issues raised in the Application—issues relating to whether this decision should consider and address implications regarding the existence of market power and how it might be addressed.

4.1 Views of the Applicant

Federated stated that approval of the Application would allow it to develop competitive opportunities for shippers who may be paying excessive tolls resulting from the exercise of market power by a monopolistic pipeline operator. Federated stated: "Accordingly, refusal by the Board to approve the Application would compel the Producers to ship on the Peace system at tolls dictated by Peace with no effective avenue for the regulation of those tolls by the Board," the latter being a reference to a decision rendered by the Public Utilities Board in 1994, in which the Board declined to regulate Peace's tolls (Decision E94047, dated 3 August 1994).

Federated likened the circumstances of its Application to a "border skirmish," where two pipeline operators are in close enough proximity at some points along the routes of their respective pipelines so that competition can occur. Federated pointed out that the mere threat of competition was enough to spur Peace to reduce the tolls it charged the Valhalla producers from \$8.66/m³, \$9.91/m³, and \$9.88/m³, respectively, to \$7.75/m³. Federated also submitted that new entrants to a region would have to be in a position to follow through on the threat of competition for it to be an effective market force. In Federated's words, ". . .if the Board denied the pipeline application, for example, then that threat evaporates; and the incumbent pipeline company is back to where it was before. So the threat of competition is really not that significant. You really have to allow competition to occur in order to make pipeline operators efficient."

Although some oil is trucked, rather than piped, to feeder pipelines, Federated pointed out that this occurred only when the volumes are very small. Beyond a relatively low threshold, pipelines were really the only efficient means of transporting oil and, consequently, trucking should not be considered a viable competitive alternative to pipelines.

Federated discouraged the idea of regulating tolls since, in its view, such regulation generally involved a lengthy and expensive review process. Federated suggested that the form of competition represented by this Application could impose sufficient cost discipline on pipelines

to ensure that reasonable tolling principles were applied. Commenting on the ability of a regulatory process to effect appropriate tariffs, Federated stated:

I think the costs would be considerably higher to the industry without this form of competition. I think we've tabled some examples where, in Peace's case, their tariffs have come down significantly since we've shown up in this area, and that's been a benefit to the producing community that move product on Peace's pipeline and also to the resource owner. There have been some very significant benefits; and that's, in our view, anyway, this happened mainly because of competition. Before we came along, Peace could basically charge whatever the traffic would bear and that's not the situation anymore. And I don't think you would get that through regulation. I think you would end up on a cost-plus basis and it could end up costing the industry considerably more than the cost of putting in this relatively minor pipeline.@

Neither did Federated encourage an industry consultative process such as the Joint Industry Task Force on Processing Fees, which resulted in the Jumping Pound-95 set of guidelines for determining gas plant processing fees. Federated suggested that this process:

A . . . was devised to address the requirements of multi-owner discreet facilities. For this reason alone, it may not be appropriate to a single owner multi-dimensional business operating in a competitive environment, nor is Federated convinced that a rigid application of such a formula will result in efficiency. Rather, costs will tend to rise to the extent permitted by the formula. This would be coupled with the additional costs of regulation.@

4.2 Views of the Intervener

Peace testified that its tolls were published and applied consistently to every shipper at each receipt point. The tolls were based on the methodology used prior to Pembina Corporation's purchase of the Peace system in 1991, which methodology was continued by agreement with shippers. The agreement limited Peace's annual revenue to a 7 per cent return on a semi-depreciated rate base.

Peace argued that an economic test would verify whether or not the facility duplication, as proposed by Federated, would be in the public interest. If the decline in tolls, brought about by the newly created competitive environment, was to induce additional resource exploration and development in the area, the value of the incremental reserves additions could be compared to the cost of the duplicative pipeline facilities. If the benefits of competition proved to be greater than the cost of new facilities, Peace argued, then the duplication should be considered to be in the public interest. On the other hand, if the benefits of competition could not be shown to elicit significant resource development, then the duplication of facilities should be considered to be unwarranted proliferation. Further, Peace noted that there was no evidence to indicate that lower tolls would result in incremental production in the area. Peace argued, therefore, that in the absence of any evidence to the contrary, this proposed pipeline should be viewed as unwarranted proliferation.

Peace stated that, should the Application be approved, the longer-term impacts of diverting the Valhalla volumes away from the Peace system would be to increase the average cost of operating

the Peace system. In the event that Peace adhered closely to its existing tolling policy, these costs would be borne entirely by the remaining shippers on the Peace system. However, Peace also suggested that the costs might be divided in some fashion between Peace and its remaining shippers. Peace clarified this possibility to the following extent:

Answer: Af we follow the tariff policy exactly, all of the costs would be borne by our remaining shippers. We divert from the tariff policy in particular cases where local forces dictate that, so in those cases, those costs would be borne by Peace.@

Question: AAnd what would the local forces be that you refer to?@

Answer: At could be local competition or other contractual obligations that we have.@

4.3 Views of the Board

The Board believes that Alberta's feeder pipeline system is susceptible to the exercise of market power. The system is capital intensive with significant scale economies and high entry costs. Both parties to the hearing conceded that there are no alternatives to pipelines—including trucking products to a competitor's facility—that could realistically be viewed as effective forms of competition. Whether potential market power is exercised is another question. The Board notes that the threat of a competitive alternative to Peace's operations in the Valhalla area elicited a response from Peace. Federated's proposal of a new pipeline caused Peace to offer a reduced toll to three battery operators.

Federated posed two possible approaches to how market power in the intra-provincial pipeline sector could be mitigated, either by Aactive rate regulation or effective competition@ However, neither Federated nor Peace favour rate regulation since both parties believe it to be less effective and more costly than the discipline imposed by competition.

While the Board agrees that competitive environments with many buyers and sellers can impose effective price discipline, it is not convinced that this situation with two suppliers of services, namely Federated and Peace, achieves the same scale of benefits as would be realized in a fully competitive environment. Moreover, while full regulation of rates may involve significant costs, there are more efficient approaches to regulation, such as incentive-based regulation and negotiated settlements. The Board is aware that Decision E94047 of the Public Utilities Board, may have left the impression with some parties that a regulatory solution to the problem of market power would not be considered. Without commenting on the circumstances of that decision, it should be made clear that a regulatory solution, under section 101 of the Public Utilities Board Act (PUB Act), will be considered in any situation where the existence of market power is apparent.

The Board also sees value in the potential for competition, even at the scale contemplated here, for imposing some degree of price discipline on the market. The present case involves willing investors and several willing buyers, at least two of which are clearly at arm's length from Federated. There was considerable time and effort devoted to negotiations among producers, Federated, and Peace. The fact that the outcome reflects the choice of the producers carries some weight with the Board. It seems apparent that Peace did not provide a persuasive and timely offer to the producers.

Peace stated its intervention was not based on the fact that it was unsuccessful in negotiations, but rather on its interpretation of Federated's competition, in this instance, as predatory and unlikely to enhance the public interest. It should not be enough for the Board, in Peace's submission, that revenues transferred to producers and to Federated from Peace are sufficient to motivate Federated. Rather, Peace defined the public interest as requiring the observance of incremental profit from Federated's actions, and such incremental profit would only come from reduced transportation rates that led to the development of incremental reserves.

The Board has two concerns with the economic test suggested by Peace. Firstly, and in this case most importantly, the chain of assessments necessary to implement Peace's suggested approach requires information that is not readily available, and some of this information would require extensive estimation. Any judgement that emerged from such a process would be subject to a broad range of possible error. Secondly, the approach inherently suggests a degree of detailed assessment that may not be warranted, could involve significant costs, and would inherently substitute a judgement of the Board, based on uncertain information, for the decisions of market participants who assume real risks. The Board is not persuaded that the potential benefits from such an approach warrant the likely costs involved.

While the Board is not prepared to implement Peace's suggested approach to evaluating new pipeline projects, it does recognize some theoretical validity to the position advanced. In particular, the Board recognizes the potential for numerous short lines to be proposed which, if approved, could result in an increase in average costs of the Alberta pipeline system as a whole with little or no incremental benefit to the system. It is possible that the threat of such competition will be enough to impose discipline on existing pipeline operators in a given area, so that they will ensure customers are satisfied with current arrangements and will not be susceptible to offers related to a new service option. On the other hand, there may continue to be circumstances under which, what Peace described as predatory competition, will be attractive in the short term. The Board does not wish its decisions to encourage that kind of competition, which is adverse to the public interest in the longer term. In this case, Federated refused to provide information on its costs and rates that would have made it easier for the Board to judge the nature of the competitive proposal. The Board accepted that refusal, albeit with some reluctance, because in the specific circumstances of this case, it believed its decision would not require definitive information on rates, but would be based essentially on other factors. However, it should be recognized that the more complete the information available, the better the decision. The Board may not be sympathetic to requests to withhold information in future cases, where such information may contribute to a more complete understanding of the issues.

The potential market power inherent in this particular case could be mitigated by either approval of a competitive proposal, as applied for, or through a review of the tolls under section 101 of the PUB Act. However, competitive proposals are not always available. There are undoubtedly situations in the province that are not susceptible to competitive pressure, simply because the pipeline in question is isolated from a competitive alternative. In such cases, the only regulatory option may be to appeal to the Board's authority to review tariffs.

In the case at hand, which does involve a competitive alternative, the Board could address the potential for market power in either of two ways. One way would be to deny the Application but include a clear message that a subsequent application with respect to rates would be accommodated. The other approach would be to approve the Application while making it clear

that rate regulation is an acceptable alternative in future cases. The Board prefers the latter approach for the following reasons.

\$ First, in this case the sequence of negotiations and the pattern of price reductions over time have led to benefits to some producers, and there is a reasonable presumption that Peace's efforts in the negotiations were conditioned to some extent by the assumption that the regulatory environment favoured its position. Whether that is a correct interpretation or not, the fact remains that Peace did not succeed in the competitive negotiations and a successful intervention would put it in a strong position for any future negotiations. Its strength in those negotiations would stem not from its inherent competitive advantages, but rather from the regulatory bias thus introduced.

\$ Second, the Board sees considerable benefit in acknowledging the possibility that increased competition may act to mitigate market power in some circumstances. Since not all competing applications would necessarily be accepted, the Board hopes that all parties will have an incentive to put reasonable effort into reaching settlements that are fair and efficient, instead of appealing to the regulatory process as an alternative to good-faith negotiation.

While acknowledging some merit in Peace's suggested approach to quantifying the public interest and its objection to predatory competition, the Board must also recognize the practical difficulties of identifying and resolving such issues. Yet Peace's concern that full reliance on competition could result in unnecessary increases to average costs for the pipeline system as a whole has some validity. The Board wishes to ensure this concern, as well as the fact that the Board may not always accept a competitive proposal as a reasonable solution, is recognized by all parties.

The Board acknowledges the industry's efforts over past years to reach negotiated settlements outside the regulatory arena. These efforts have minimized regulatory costs and the Board is reluctant to interfere with this approach because of one set of circumstances that resulted in a hearing. On the other hand, the successful history of negotiation is partly attributable to the fact that there was a perception that a regulatory alternative was always available. The Board interprets the present case as stemming, at least partially, from a belief in the industry that the Board was no longer amenable to applications relating exclusively to rates. Although that may be an understandable perception, it is incorrect. The Board recognizes that the introduction of rate regulation, even for a short addition to the system, could require it to review the entire operation of a subject pipeline. That could involve significant avoidable costs. However, the Board wishes to be very clear that rate regulation for oil pipelines may be considered in appropriate circumstances, and, in some cases, may be viewed as a more appropriate response to perceived market power than new facilities.

In the present circumstances, where arguments establishing need and offsetting arguments positing proliferation are in rough balance, the Board has put some weight on the potential implications for the competitive environment in reaching its decision to approve the Application.

6 SUMMARY AND CONCLUSIONS

The issues raised by this Application and the associated intervention were not easy to resolve. The specific circumstances did not suggest an immediately obvious conclusion. The need for the

pipeline was called into question and it was submitted that a new pipeline in the region could be said to be duplicative of existing facilities and would represent unnecessary proliferation. The Board concluded that a case, albeit not an extremely strong case, had been made to establish need. The duplication argument led the Board to revisit the proliferation policy as it applies to pipelines and to clarify that, although the proliferation guidelines do have some relevance to pipelines, these guidelines have a more direct bearing on surface facilities because of the higher likelihood that surface facilities could have an adverse effect on people or the environment. In this case, the environmental impact of the pipeline is relatively benign and was not an issue at the hearing. The Board ultimately determined that even if there were some duplication of facilities in the short term, it was not clear that such duplication would continue in the long term, given the potential for increased demand for services to carry incremental oil from British Columbia. However, since the above considerations were not decisive, the other issues raised by the Application took on added importance and were determinative of the Board's final decision.

The other issues essentially related to the implications of the decision with respect to potential market power in the pipeline sector, now and in the future, and, more generally, the economic environment within which new pipeline development would occur. The Board considered two options to address those issues. The Board's deliberations were complicated by the need to acknowledge perceptions in the industry apparently based on a previous decision and to clarify the Board's current views on these perceptions. Again, the decision as to which option to adopt was not easy. For reasons cited above, the Board preferred the approach of approving the Application, thereby confirming the real possibility of direct competition, while noting that a regulatory approach involving some form of rate determination would be acceptable in future cases. Given the possibility of rate reviews, new facilities involving some degree of duplication of existing facilities, will not always be viewed as a reasonable answer to perceptions that market power is being exercised.

7 DECISION

Having carefully considered the evidence and representations of Federated and Peace, as well as the written submissions of some producers who have a need to ship oil by pipeline, the Board is prepared to approve Application No. 1010762 and will issue the required permit/license forthwith.

DATED at Calgary, Alberta, on 29 May 1998.

<Original signed by>

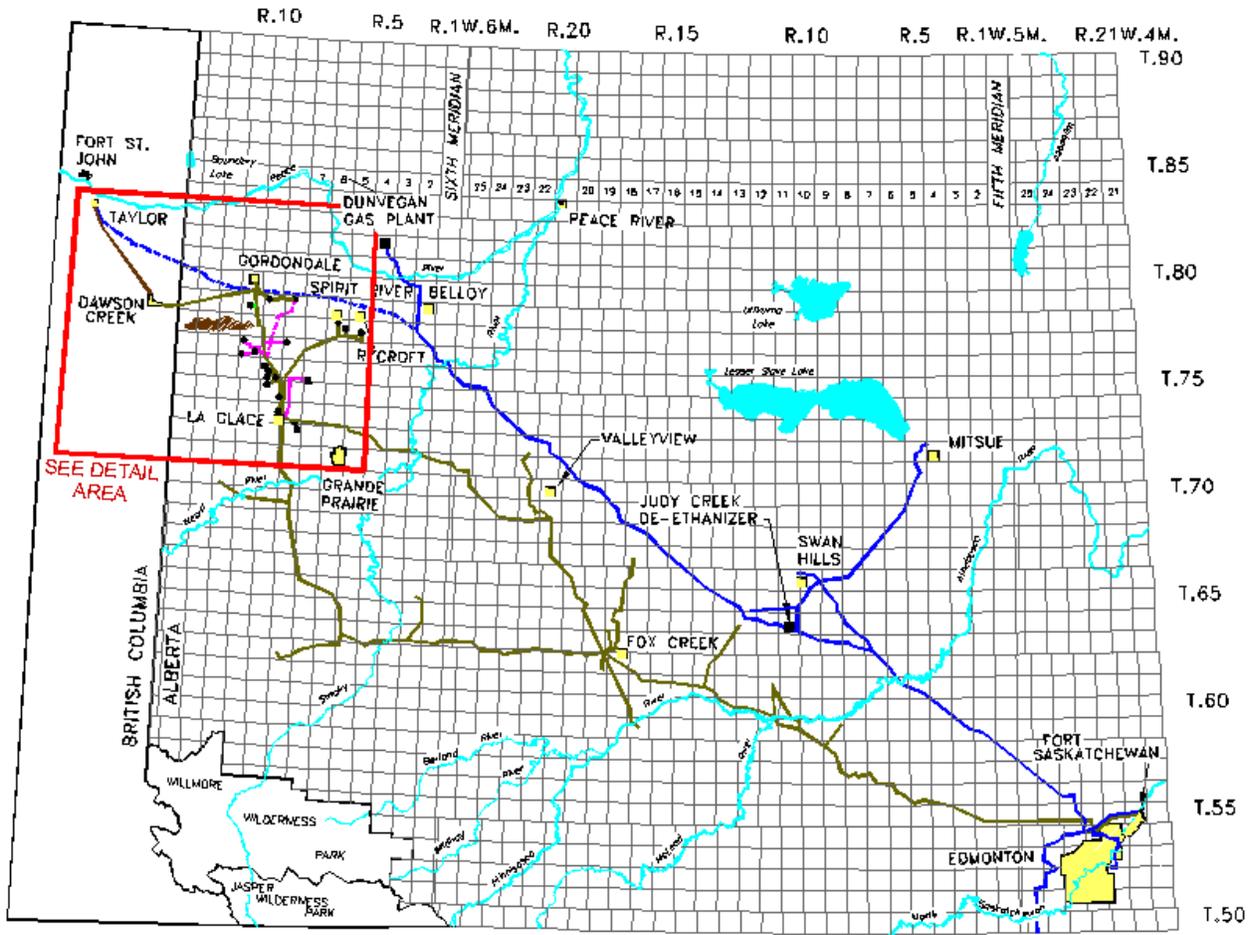
B. T. McManus, Q.C.

<Original signed by>

J. P. Prince, Ph.D.

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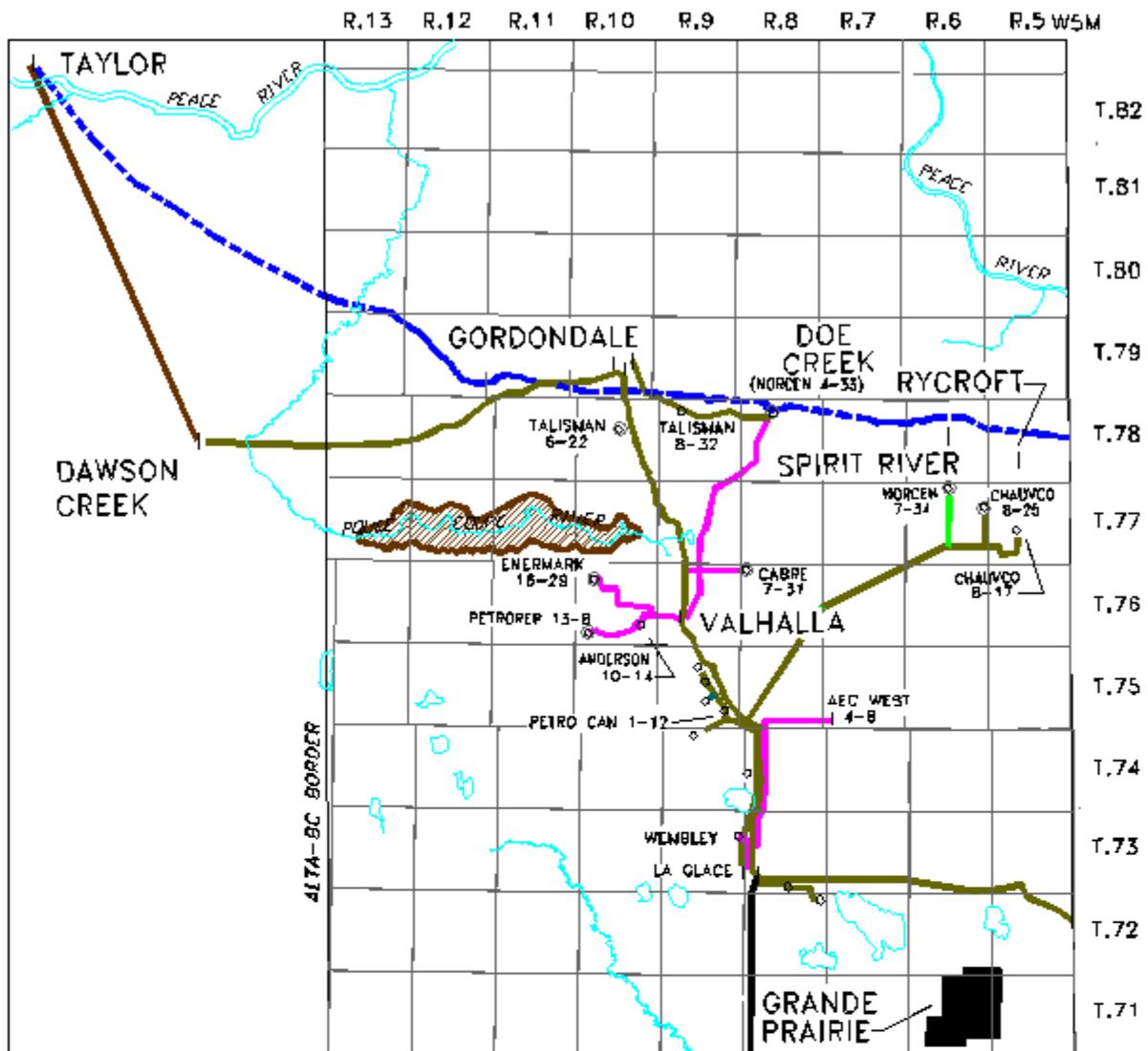
J. R. Nichol, P.Eng.



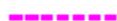
- Legend**
- Federated Crude Oil and HVP Pipelines
 - - - Federated HVP connector under NEB
 - Peace Crude Oil and HVP Pipelines
 - - - Proposed Federated Crude Oil Pipeline
 - Producer Owned
 - Northstar Pipeline
 - Special Places 2000
 - Foothills Candidate Site

FEDERATED PIPE LINES LTD.
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Legend

-  Federated Crude Oil and HVP Pipelines
-  Federated HVP connector under NEB
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FEDERATED PIPE LINES LTD.

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DETAIL AREA