Negotiated Settlements and the National Energy Board in Canada[a]

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Abstract

In Canada, settlements between oil and gas pipelines and users have largely superseded the litigation of major pipeline toll cases since 1995. Quantitatively, from the first half to the second half of the period 1985-2007 the average number of pipeline toll hearing days in Canada fell by three-quarters. On average, settlements are for more than twice as long as litigated outcomes and have cut regulatory processing times by about one third for gas pipelines and by about two thirds for oil pipelines, with the result that regulatory processing times per effective toll-year have fallen to 13% and 27% of previous levels. Qualitatively, settlements have been used to determine prices, operating and capital cost projections, return on equity, service quality improvements, risk-sharing investments and information requirements. They were the vehicle by which multi-year incentive agreements developed rapidly for all pipelines. They have also been used to introduce light-handed regulation. They have provided a mechanism for fruitful collaboration between pipelines and their customers and have changed attitudes in the industry. Two key actions of the National Energy Board have facilitated settlements: its generic cost of capital decision that removes the market power of the pipeline and enables effective negotiation with users, and its willingness to judge a settlement by the reasonableness of the process leading up to it instead of imposing the Board's own values on the outcome. In law and economics terms, these actions established and clarified the property rights that made negotiated settlement possible.

1. Introduction

The regulation of public utilities in North America conventionally uses a hearing and decision process, sometimes referred to as litigation. Negotiated settlements between public utilities and their customers or users are alternative or complementary to this process. Legal scholars and practitioners have long explained the importance of settlements in coping with the regulatory load and avoiding delay, in saving time and money, and in reducing uncertainty.

The law and economics literature would perhaps find it obvious that settlements are preferred to litigation, because they can achieve anything that litigation can achieve at lower cost, unless the parties had particularly disparate expectations about the outcome of litigation.[1] However, this rationale is unpersuasive in the case of utility regulation, where it is not clear that there is a significant difference between the costs of litigation and settlement, where the parties do not appear to have distinctive expectations or risk aversion, and where the decisions of the regulator may be relatively predictable. Given

[1] "There is more scope for settlement when litigation is costly, negotiations are inexpensive, and the disputants are pessimistic about trial outcomes…. Risk aversion … presumably increases the probability of a settlement. " Cooter and Rubinfeld (1989) p. 1076

the long tradition of utility regulation by litigation, the challenge is to explain why and how settlements have emerged at all.

More recently it is suggested that settlements better serve the needs of the parties, allow greater flexibility and innovation, and can achieve results that lie beyond traditional regulatory authority.[2] Economic research is now confirming this perception.[3] The US Federal Energy Regulatory Commission (FERC) and the Florida Public Services Commission have dealt with a high proportion of regulatory cases by means of settlements. These settlements are not simply a more efficient way of doing the same thing as traditional regulation. Rather, they involve considerable innovation, notably the introduction of price caps, rate moratoria and (at FERC) must-file provisions, and (in Florida) the development of revenue sharing schemes and other incentive mechanisms, that would otherwise have been impossible or at least unlikely. That is, the main purpose of these settlements is not to reduce the cost or risk of litigation or to resolve conflicting expectations, but to secure mutually preferred outcomes that the regulator could not or would not otherwise deliver.

The present paper reinforces this argument by examining the negotiated settlements that have recently been prominent in the Canadian energy sector.[4] It extends previous research in various respects: a) it documents quantitatively the growth of settlements and their impact on hearings and processing of applications; b) it describes how settlements evolved and the form they have taken; c) it shows how the regulatory framework first discouraged then encouraged the development of settlements; and d) it indicates how settlements have generally led to more innovative outcomes in this jurisdiction than at FERC or even Florida notably in one case effecting a transition from active to light-handed regulation. The concluding remarks briefly consider the case of non-participating and contesting parties, and note some possibilities for further research.

2. Institutional Context

2.1 The National Energy Board, the pipelines and users

The National Energy Board (NEB or the Board) is an independent federal regulatory agency established under the National Energy Board Act in 1959.[5] In the current budget year (2008-2009) the Board has a staff of approximately 350 and an annual budget of $47 million (Canadian).[6]

[2] The various contributions to the economic and legal literature are summarized in Doucet and Littlechild (2006a).
[3] Wang (2004), Littlechild (2003, 2009a,b).
[4] See accounts by two recent chairmen of the National Energy Board (Vollman 1996, Priddle 1997, 1999) and further discussion and analysis by Mansell and Church (1995), Miller (1999), Schultz (1999).
[5] For more information on the NEB and the Act, and for other NEB references, see the National Energy Board web site http://www.neb-one.gc.ca. NEB decisions are available electronically on this site. The NEB in Canada is roughly equivalent to the FERC in the US.
[6] Treasury Board of Canada 2008-2009 Reports on Plans and Priorities, available at http://www.tbs-sct.gc.ca/rpp/2008-2009/inst/enr/enrtb-eng.asp .

Active economic regulation of pipeline tolls began in the 1970s. The eight pipelines that are the focus of this study are those Group 1 pipelines that are subject to more active regulation by the Board.[7] Their tolls and tariffs have traditionally been determined through a litigated process involving hearings. In contrast, Group 2 pipelines (plus 4 of the smaller Group 1 pipelines) have been regulated on a "complaint basis" since at least 1985. These pipelines submit tolls and tariffs to the Board, which are automatically accepted unless an objection is filed by a shipper or stakeholder in which case a hearing may take place.

In addition to the pipelines the other interested parties in regulatory issues include producers, shippers and consumers. There are a large number of producers of oil and gas in Canada, the overwhelming majority of which are private. Shippers, who are sometimes producers and sometimes third parties, contract with pipelines for transportation of the oil and natural gas. The relevant consumers include large industrials, local distribution companies and refineries.

2.2 The work of the Board

For the most part, the Board does not initiate cases but responds to "applications" by regulated entities and other parties – for example, for permission to build pipelines and power lines, for changes to pipeline tolls and tariffs, for energy export licences and for oil and gas development in Frontier areas. In the most important cases, the Board will hold oral public hearings in which applicants and interested parties can participate. This is the traditional litigated process applied to utility regulation in North America.[8]

In the case of pipeline tolls and tariffs, which are the focus of the present paper, there would traditionally be a periodic toll hearing for each pipeline where several contentious issues were considered at one time. This was often annually or biennially for the major gas pipelines although tolls for some of the major oil pipelines sometimes ran for several years.

Table 1 summarizes applications dealt with by the Board over the period 1985-2007 in the four broad categories corresponding to the Board's responsibilities. Although slightly incomplete, it presents a clear picture in important respects. The Board deals with over 500 applications annually, slightly more nowadays than in the earlier years. Around three quarters of the recorded applications are for energy exports (mostly short-term natural gas export orders). Applications relating to pipeline tolls and tariffs account for only about 2 per cent of all applications (or at most 4 per cent allowing for data omissions in Table 1).

In practice, the vast majority of applications to the Board are handled without a hearing. However, there is a significant difference by category of application. Table 2 shows the

[7] They comprise 3 oil pipelines: Enbridge (formerly Interprovincial or IPL), Trans Mountain and Trans-Northern, and 5 gas pipelines: TransCanada PipeLines (TCPL), Westcoast, Gazoduc Trans Québec & Maritimes (TQM), Maritimes and North-East (M&NP), and Alliance. The last two commenced operation in 2000.

[8] In other cases where there is sufficient public interest, the Board will instigate a public consultation process and invite written comments before making its decision. In yet other cases, applications and routine filings are dealt with administratively by letter or simply by acknowledgement.

number of hearings and hearing days at the Board. In total, only about 2 per cent of all applications (261/12,390) have gone to hearing. In the toll category, in contrast, the proportion was about one third (69/230) of those applications recorded in Table 1. In consequence, toll hearings accounted for over one quarter (69/261) of all hearings during this period.

Hearings are time-consuming. During the period as a whole, the average duration over all categories was 8 days.[9] Toll hearings have typically lasted about twice as long as non-toll hearings: an average of 12.7 days compared to 6.4 days. Taken with the higher proportion of toll applications that go to hearing, this means that toll applications accounted for over 40 percent (877/2099) of all hearing days during this period.

Thus, although pipeline toll applications constitute only a very small fraction of the total number of applications to the Board, they are much more significant than other categories in terms of the attention they require, at least in terms of the number of hearings and the time these hearings take.

[9] This is in addition to the time required by all parties to request, provide and query information and to prepare the case, and the time subsequently taken by the Board to compile and issue its report, and any time spent in appealing the Board's decision to the Federal Court of Appeal or the Supreme Court of Canada.

Table 1: Applications to the National Energy Board, 1985-2007

Category Year	Construction of Pipelines and Power Lines	Pipeline Tolls and Tariffs+	Energy Exports	Frontier Activities	Total applications
1985	62	5	207	n/a	274
1986	65	4	339	n/a	408
1987	64	6	356	n/a	426
1988	79	4	371	n/a	454
1989	60	5	495	n/a	560
1990	72	8	470	n/a	550
1991	70	6	457	n/a	533
1992	89	4	440	4	533
1993	111	7	520	4	642
1994	115	3	516	3	637
1995	78	9	584	66	737
1996	82	7	*217	15	[321]
1997	94	4	*236	92	[426]
1998	111	2	*239	**	[352]
1999	151	1	*245	93	[490]
2000	129	3	571	142	845
2001	92	11	335	63	501
2002	181	15	548	96	840
2003	184	18	411	100	713
2004	100	27	363	49	539
2005	104	33	423	53	613
2006	33	35	382	48	498
2007	53	13	378	50	494
Total	2,179	230	[9,103]	[878]	[12,390]
Annual Average	95	10	[396]	***73	[539]

Source: NEB Annual Reports supplemented by information from NEB staff
+ Until 2000 the figures for pipeline toll and tariff applications refer only to applications that were considered in a hearing or other public consultation process. They exclude the more routine filings that are included in the data for the other three categories.
* Information not available with respect to short term exports of oil, natural gas, butane and propane
** Information not available
*** Average since 1995 excluding 1998
n/a Not applicable

Table 2: Number of hearings and hearing days at the NEB, 1985-2007

	Pipeline tolls		Non-toll categories		All categories	
Year	**Number of Public Hearings Initiated**	**Total Hearing Days**	**Number of Public Hearings Initiated**	**Total Hearing Days**	**Number of Public Hearings Initiated**	**Total Hearing Days**
1985	4	38	14	128	18	166
1986	5	96	6	82	11	178
1987	5	162	10	51	15	213
1988	3	68	10	57	13	125
1989	4	91	9	60	13	151
1990	4	26	20	143	24	169
1991	5	29	7	21	12	50
1992	5	83	10	34	15	117
1993	3	29	5	14	8	43
1994	2	41	7	47	9	88
1995	7	21	8	40	15	61
1996	3	9	13	61	16	70
1997	3	11	14	128	17	139
1998	0	0	12	121	12	121
1999	1	5	7	26	8	31
2000	2	19	4	10	6	29
2001	3	24	5	16	8	40
2002	1	19	6	35	7	54
2003	1	34	6	41	7	75
2004	2	39	0	0	2	39
2005	2	5	4	17	6	22
2006	3	21	7	63	10	84
2007	1	7	8	27	9	34
Total	69	877	192	1222	261	2099
Average per year	3	38.1	8.3	53.1	11.3	91.2
Average hearing duration		12.7 days		6.4 days		8.0 days

Source: NEB as per Table 1

However, there has been a significant reduction over time in the number of hearings and in the time devoted to them. For example, in the first six years there were 94 hearings and 1002 hearing days, but in the last six years only 41 hearings and 308 hearing days. There was still great variation from year to year. [10]

The change took place about the middle of this period. From the period 1985-1994 to the period 1995-2007, the average number of toll hearings per year nearly halved (from 4.0 to 2.2), and the average duration of a hearing more than halved (from 16.6 to 7.4). In consequence, the average number of toll hearing days per year fell to one quarter of the previous level (from 66.3 to 16.4). For non-toll categories, the change took place a little later, and was a little less marked.[11]

2.3 The impact of negotiated settlements

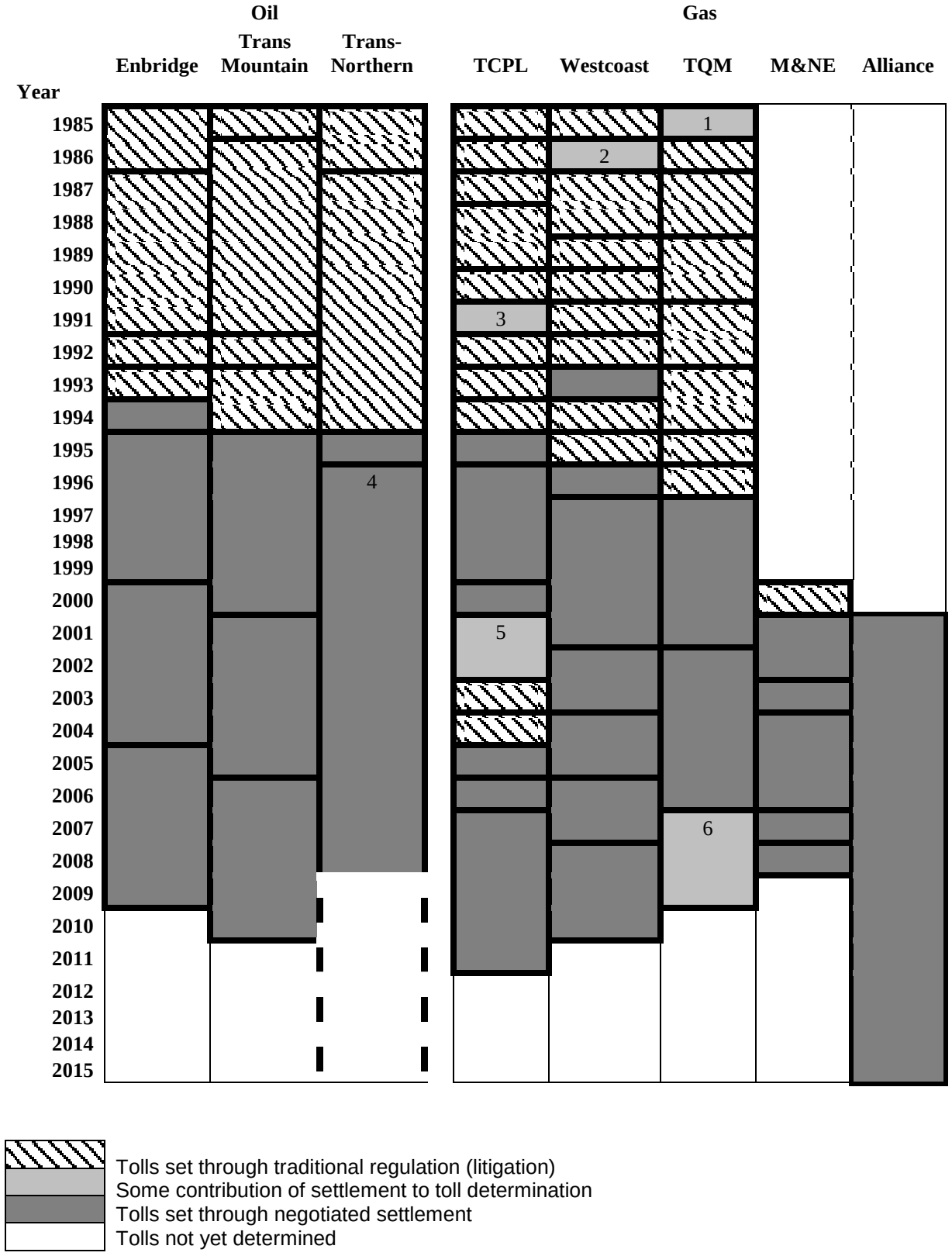
These changes in toll hearings were associated with the development of negotiated settlements. Figure 1 shows the extent to which each pipeline has negotiated settlements over the last two decades, including a few cases where the settlement did not cover all the issues or where the Board did not fully accept the settlement. It brings out clearly the dramatic change around the mid-1990s – as we shall see, essentially, before and after the Board's revised Settlement Guidelines of August 1994. Before then, all tariff applications were litigated; since then, all tariff applications by oil pipelines have been settled by negotiation, and most applications by gas pipelines.

It was noted above that there has been a significant reduction over time in the number of hearings of toll applications. Further examination of NEB data (not presented here) confirms that this reflects the impact of settlements. While 85 percent of litigated cases went to hearing only 16 percent of settlements did so.

[10] For example, for non-toll hearings the average time per hearing was nearly 14 days in 1986 and around 10 days in 1997 and 1998 compared to 3 days or less in 1991, 1993 and 2000. For toll hearings there have been exceptionally long hearings recently as well as in earlier days – for example, 5 pipeline toll hearings averaging over 32 days in 1987 and one taking 34 days in 2003 – compared to an average of 3 days or less in 1995, 1996 and 2005.

[11] From the period 1985-1998 to 1999-2007, the average annual number of hearings per day fell from 10.4 to 5.2, the average duration fell from 6.8 to 5.0 and the average number of hearing days per year fell from 70.5 to 26.1. The explanation for these changes in non-toll hearings lies beyond the scope of this paper.

Figure 1: Litigation and settlement activity at the NEB since 1985



Source: NEB tariff decisions

Legend for numbered notes in Figure 1

1 – TQM 1985 settlement was not wholly accepted by the Board [see section 3.1]
2 – Westcoast 1986 settlement was not wholly accepted by the Board [see section 3.2]
3 – TCPL 1991 TTTF agreement did not include all parties [see section 3.4]
4 – Trans-Northern 1996 – 2000 toll agreement is renewed annually unless there are objections.
5 – TCPL 2001-2002 settlement excluded ROE [see section 4.3]
6 – TQM 2007-2009 settlement excluded ROE [see section 4.3 fn 54]

Table 3 compares the durations and regulatory processing times of litigated outcomes and settlements. The duration of settlements is typically longer than the duration of litigated outcomes, and in both cases typically longer for oil pipelines than for gas. In the decade 1985-1994, the litigations had an average term of 2.70 years for oil and 1.30 years for gas. In contrast, from 1995 onwards, the settlements had an average term of 6.88 years for oil and 3.05 years for gas (or 2.45 years excluding Alliance's 15 year settlement).[12] The average term of a settlement is thus more than twice as long as it used to be.

Table 3 Durations and processing times of litigated and settled outcomes

	Oil pipelines		Gas pipelines	
	Litigated 1985-94	Settled 1995-2008	Litigated 1985-94	Settled 1995-2008
Number of cases	10	8	23	21
Average term (years)	2.70	6.88	1.30	3.05
Average processing time (months)	8.03	2.78	7.35	4.74
Average processing time (months per effective toll-year)	2.97	0.40	5.65	1.55

Source: Figure 1 and NEB tariff decisions.

[12] These calculations include the full duration of the negotiated settlements, extending beyond 2006 where appropriate, but the open-ended Trans-Northern settlement is not taken beyond 2008.

It also takes the Board less time to process a pipeline toll application than a litigated one. For oil pipelines, it took on average 8.03 months to process a toll application under litigation, whereas it now takes 2.78 months with a settlement. For gas pipelines, the average time was 7.35 months with litigation, and is 4.74 months with a settlement. Thus, settlements have cut regulatory processing times by about a third for gas pipeline toll applications and by about two thirds for oil pipeline applications.

Since settlements typically are of longer term than litigated cases, the application processing time is incurred less frequently than with litigated outcomes. With litigation, the oil pipeline applications in this sample typically covered 2.70 years, an average of 8.03/2.70 = 2.97 processing months per effective toll-year. With settlements the average is 0.40 processing months per effective toll-year, a reduction to 13% of the previous level. Similarly, for gas pipelines the average has fallen from 5.65 to 1.55 processing months per effective toll-year, a reduction to 27% of the previous level.[13]

3. Initial settlement activity and Board policy: 1985-1994

3.1 The first negotiated settlement: TQM 1985

On 22 February 1985 the TQM gas pipeline applied for new tariffs. In its decision on this case the Board began by remarking on "the somewhat unusual background".

> The application was notable in that it had the support of several interested parties who had opposed TQM's requests in previous toll applications. TQM had meetings with these parties before the presentation of the application; consequently, an agreement was reached between them on certain matters which would influence the calculation of a just and reasonable toll, and on what would be a just and reasonable toll for TQM's transportation service.[14]

The Board therefore decided to conduct the proceedings by way of written submissions rather than hold a hearing. Despite the fact that "These parties placed on record that they considered the agreement to be an entity comprised of mutually dependent and inseverable matters", the Board performed a point by point analysis of the various issues of the application, which was of course the norm in litigated proceedings. With some minor qualifications the Board's decision in September 1985 was broadly consistent with TQM's application, except that the Board adjusted downwards TQM's applied-for and agreed rate of return on common equity, reducing it from 15.5% to 14.75%.

From the signatories' perspective, the Board had 'cherry picked' the agreement, in violation of their explicit provision. In the light of the Board's later enthusiasm for

[13] These figures do not include time required to process applications for annual updates of tariffs associated with multi-year settlements, but this has become a rather nominal process. Typically, such applications are put to the Board each year, which invites comments that draw no adverse response, and the Board approves the tariff revisions within a month or so.

[14] Decision RH-4-85, p. 1. The supporters included the Canadian Petroleum Association (CPA) and the Independent Petroleum Association of Canada (IPAC) (which later merged to create the Canadian Association of Petroleum Producers, or CAPP), and the provincial government's Alberta Petroleum Marketing Commission (APMC). The Minister of Energy for Ontario opposed the settlement.

negotiated settlements, it seems surprising that it should treat in this way the first agreement put to it. The Board's main concern seems to have been one of principle: it felt the need to determine independently that each of the proposed terms was just and reasonable. What the Board seems to have found particularly unacceptable was that TQM should receive an increase in its return on equity at a time when the cost of equity capital had declined.[15]

3.2 The second negotiated settlement: Westcoast 1986

Westcoast gathers, processes and transports natural gas from Alberta and North-east British Columbia (BC) to customers in southern BC and the northwestern US. In 1983, in response to pressure from shippers, the Board agreed to a review of Westcoast's method of regulation. In its Methodology Decision of April 1985 the Board agreed that there had been significant changes in circumstances in BC, following the adoption of a more competitive gas pricing policy by that province, and ordered Westcoast to file new tariffs as from January 1986 based on a new toll method. In December 1985 Westcoast did so.

The Board emphasised and described at some length "the profound changes in many aspects of its [Westcoast's] business brought about primarily by fundamental policy modifications by governments in both Canada and the US and by an unprecedented and unexpected decline in the price of crude oil".[16] But once again the Board jibbed at the proposed return on equity: the parties had agreed 14 per cent but the Board considered that 13.75 per cent would be a fair and reasonable rate.

It seems that the agreed return on equity emerged as Westcoast accommodated all the various interests in the substantial and complex transition to a new methodology of pricing, instigated largely at the request of the shippers.[17] But the Board still felt, as it had in the TQM 1985 case, that it had to determine for itself that each parameter of the settlement, taken separately, was just and reasonable.[18]

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[15] "TQM applied for a rate of return on equity of 15.5 per cent as compared to the presently allowed rate of 15 per cent. … [t]he expert witnesses for Ontario and TQM stated that the cost of equity capital had declined since 1984 and that their respective recommended rates of return on equity capital were lower for the current test year than was recommended in TQM's 1984 toll proceeding." RH-4-85, pp. 9 – 12.

[16] RH-6-85, August 1986, p. 7. In Canada, federal and provincial governments withdrew completely from natural gas pricing by November 1986, "resulting in what is generally termed market-oriented pricing, and the complementary need for open access transportation including a range of transportation services must be kept in mind." The BC government had also taken a series of far-reaching deregulation initiatives, as had the US.

[17] One correspondent has suggested to us that "During negotiations specific items were adjusted in return for other adjustments in order to obtain an overall settlement. Individual adjustments were not driven by a specific rationale. It was the overall result that was of paramount importance."

[18] The Board acknowledged that the settlement should be given weight. "However, given the Board's mandate, the existence of such a settlement cannot be the sole basis for determining the justness and reasonableness of the rate of return on equity component of the tolls applied for." RH-6-85, p. 87.

3.3 Drivers of change at the NEB

The Board's treatment of these two cases is generally accepted to have discouraged settlements. [19] Yet within a couple of years the Board was actively facilitating settlements, market participants appeared keen to explore the possibility further, and after eight years the Board had reversed its position. What factors led to this change of direction?

An important influence was the change in federal Government policy, which the Board could not ignore. [20] This went beyond the freeing up of commodity markets and, perhaps indirectly, brought about pipeline open access and impacted on the manner of pipeline regulation.[21] Within this new environment several key individuals at the NEB and in industry promoted the development of settlements.[22]

The Board also seems to have been influenced by more practical considerations. Unlike the situation at the FPC and FERC in the U.S., reform does not seem to have been driven by a backlog of cases. But the Board's thoughts were moving in the direction of regulatory reform in the early 1980s, especially on the need for "reasonably expeditious treatment of applications".[23] In 1987 the Board decided to take positive steps to improve the public hearing process, initially by consultation.

[19] Those closely involved with negotiation settlements for much of the NEB history have expressed themselves forcefully to the authors. "The proponents viewed the agreement as 'an entity comprised of mutually dependent and inseverable matters' and felt strongly that it was a package deal which could be accepted or denied as a whole. When the Board cherry-picked the first TQM settlement, the strong message received by the pipelines was that there is absolutely no merit in pursuing further settlements, since there is only downside and no upside." This was later accepted by the NEB. "Not surprisingly, parties concluded that it was not worthwhile to undertake further settlement discussions until there was some clarity and commitment to the settlement process." Vollman (1996) p. 2.

[20] "Tribunals like the NEB have to take account of the policy environment created by the government of the day, while observing strict independence and objectivity in regard to treatment of specific applications. To do otherwise would be to thwart the operation of the democratic process. The Western Accord and the Halloween Agreement were needed for the Board to clear away the regulatory debris accumulated over the previous dozen years and set the industry on a course towards deregulation of commodity markets and eventual light-handed regulation of facilities owned by entities which retain market power, generally because of the natural monopoly characteristics of those facilities." Priddle (1999) p. 543.

[21] "The evolution of deregulation caused a highly regulated market to transform into one which fostered direct sales among willing sellers and buyers, based upon freely negotiated pricing, with transportation being available on an open-access basis. Gone were the days when merchant pipelines such as TransCanadaPipelines Limited bought gas directly from producers and sold it to eastern Canadian gas distributors." Miller (1999) pp. 420-1.

[22] Notably successive Board chairmen Roland Priddle (1986-1997), Kenneth Vollman (1998-2007) and Gaétan Caron (2007 to date), and several industry executives both before and especially after the Board's change of heart in the mid-1990s.

[23] Priddle (1999) p. 542. The frequency and length of hearings was a particular concern. As mentioned, Table 1 above shows that hearings took up 1000 days in the six years 1985 - 1990. In 1986-87 one case alone took 73 days. TransCanada PipeLines Limited (TCPL), 30 September 1986 to 27 February 1987. RH-3-86, May 1987, p. xv.

3.4 Facilitating settlements: the 1988 Guidelines

The 1987 consultation resulted in "a review of 20 regulatory areas which were targeted for improvement by interested parties".[24] Negotiated settlements were the first item discussed. The Board noted strong support for this, though there were diverse views on how settlement should be applied in practice and what role the Board should play.

The respondents' stated rationale for the introduction of settlements was that "Board acceptance of negotiated settlements in toll matters would shorten public hearing time or even eliminate the need for a public hearing, thereby reducing the cost of regulation."[25] Better mutual understanding was also hoped for, and no doubt better customer relationships. (The scope for incentive regulation or other innovations was not mentioned.)

In response to the various private interests, the Board explained that it had a duty to ensure that all tolls were just and reasonable, which required a careful balancing of the interests of the various parties concerned, which was why it conducted its hearings in an open forum. The Board considered that an acceptable settlement process would need to meet the following five conditions:

i) parties affected by a settlement should have a fair opportunity to participate and have their interests recognized and appropriately weighed;
ii) a negotiated settlement process should not fetter the Board's ability and discretion to take into account the full public interest which often extends beyond the immediate concerns of the negotiating parties;
iii) the settlement process must produce adequate information on the public record for the Board to satisfy itself that the negotiated settlement would result in tolls which are just and reasonable;
iv) the Board's role as an independent adjudicator must not be impinged by being a party to the negotiations; and
v) the Board cannot accept "package deal" negotiated settlements consisting of various elements, not all of which might, in the Board's judgment, result in tolls which are just and reasonable.[26]

It commented that "the Board will itself be examining issues as they come before it to determine if they might be candidates for a negotiated settlement, and invites potential applicants [the pipeline companies] to do likewise".

A parallel and helpful development was that of Joint Industry Task Forces (JITFs). They were initially established primarily to resolve matters dealing with operating practices, and were encouraged by the Board by about 1987. They soon began to complement the settlement process.[27] .

[24] NEB (1988) p. 1.
[25] Because the Board allowed for recovery of regulatory costs by pipelines, and these costs ultimately were added to the tolls paid by shippers, shippers may have been more interested than pipelines in reducing explicit regulatory costs. However, both parties had an interest in improving the regulatory process and thereby reducing the use of company resources in the regulatory and hearing process.
[26] NEB (1988) p. 3.
[27] In 1991 TCPL would have presented a JITF report as a negotiated settlement had not certain parties objected because the JITF had not included them. The Board supported the process "as a means of streamlining proceedings". RH-1-91, p. 15.

3.5 The third negotiated settlement: Westcoast 1993

In July 1992 Westcoast Energy applied for new tolls effective January 1993. In October it informed the Board that it had reached settlement with four major users and a week later it identified further parties who supported or did not oppose the settlement.

The settlement embodied two main changes to the initial application. First, Westcoast reduced its operating and maintenance expenses and created a deferral account for unfunded debt, leading to tolls lower than had been applied for. Second, Westcoast agreed to accept the rate of return on equity that the Board would choose to allow for TCPL in the latter's toll case being heard in parallel to the Westcoast case. The cost to Westcoast of these concessions appears to have been low but they benefited shippers and consumers by reducing tolls and shortening proceedings.

This time the Board accepted Westcoast's settlement. Nonetheless its decision still contained an item-by-item examination and commentary on the main components of the conventional rate base calculation. The Board also required Westcoast to file sufficient evidence to support the decision.[28]

3.6 Additional initiatives and the Generic Cost of Capital

The Board now took a more active role in exploring reforms to regulatory procedures. In 1992 it initiated a public discussion on improvements to the traditional cost of service method of regulating pipelines. At an Incentive Regulation workshop in 1993, shippers argued for performance measures and monitoring as a basis for incentive regulation, but pipelines were lukewarm. A later outcome was the requirement for pipelines to file a set of Performance Indicators.

Also in 1993 the Board questioned the appropriateness of the traditional examination of hundreds of 'line items'. It concluded that an overall approach to O&M expenses – specifying a cost envelope – "would give the pipeline company more flexibility to respond to changing market conditions while providing an incentive to strive for more efficient operations." [29]

A particularly significant initiative was the Generic Cost of Capital hearing in March 1994. The Board was concerned about the duplication of evidence in different hearings, and also about the consequences of setting allowed returns at different times. To avoid annual hearings on the cost of capital the Board's aim was to develop an automatic mechanism to adjust the return on common equity. It established an annual basis for

[28] RH-3-92. Some interveners, while supporting the settlement, expressed concerns about the openness and transparency of negotiations and the ability of interested interveners to participate. The Board would have preferred more parties to be involved but accepted that there was a limited timeframe and that other parties had had an opportunity to participate.

[29] "This was another important cultural change because it contributed to more global thinking; a condition which would become even more important under incentive regulation." Vollman (1996) p. 4.

doing this, applicable to all pipelines.[30] This decision was intended to streamline the regulatory process by removing a contentious issue from individual hearings and to reduce the uncertainty in terms of a major cost item. [31] This seems to have struck a chord with many industry participants, who were increasingly skeptical about this aspect of regulatory proceedings.

The Generic Cost of Capital decision is generally considered "important as a building block for the subsequent gas pipeline settlements". [32] One correspondent suggests that it works in two ways. First, it takes off the table the issue of cost of equity, on which parties find it difficult to agree and which constitutes a 'zero-sum game'. Second, it sets a floor to the negotiation since no utility will accept less, so that discussions focus on the potential 'positive-sum game' of what additional value the utility can offer to merit additional revenue.

The law and economics literature suggests another way of putting the point: insofar as divergent expectations may lead parties to litigation rather than settlement, this decision significantly reduces the scope for such different expectations hence reduces the attraction of litigation. It may also be seen as clarifying the values of the property rights of the different parties, which in turn is conducive to negotiation and trade.

3.7 Revised settlement procedures 1994

Despite the publication of the 1988 Guidelines and the other regulatory initiatives, only one settlement had been reached (Westcoast 1993). Shippers and pipelines were generally supportive of settlements, though with different emphases. Subsequent accounts identify two main concerns. One was the Board's rejection of 'package deals'. The other was the Board's inclination to hold hearings even where settlements were reached. Revisions to the Guidelines therefore seemed necessary.

In August 1994 the Board published revised and slightly more detailed Guidelines for negotiated settlements. (NEB 1994). It repeated with some modification its previous five criteria for acceptable negotiated settlements. It expanded on the requirement to produce adequate information on the record.[33] It also introduced two main modifications to address the two concerns mentioned above.

First, the Board added a further procedural step and an assurance. "Upon filing of this information, the Board would invite interested parties to comment on the settlement. Should the settlement not be opposed by any party, the Board would normally be able to conclude that the resultant tolls are just and reasonable and a public hearing would not be required." There was no reference to the possibility of contested settlements.

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[30] RH-2-94.
[31] Caron (1995) p. 9.
[32] Priddle (1999) p. 547. Another correspondent ranks the Generic Cost of Capital decision as 'a watershed' comparable to the 'no cherry picking' promise in the revised Guidelines (see below) in terms of facilitating settlements.
[33] It now specified that the applicant should provide a tabulation of the components of the agreed revenue requirement, the resulting tolls, an explanation of their derivation, and any tariff changes, accompanied by a concise description, explanation and rationale for the resolution of each issue.

Second, whereas the original 1988 Guidelines prohibited package settlements if they included some elements that might not be just and reasonable, the new provision was simply that "the Board will not accept a settlement which contains provisions that are illegal, or contrary to the *National Energy Board Act*."

These amendments did not explicitly preclude the Board from cherry picking in the way that had previously caused problems. Significantly, however, and apparently without further explanation, within eighteen months the Board was adding the additional provision: "When presented with a settlement package, the Board will either accept or reject the package in its entirety."[34]

The net effect was not simply to reinforce the Board's support for negotiated settlements. In effect, the revised 1994 Guidelines reversed the Board's previous position that "the agreement cannot, per se, be the vehicle for determining the justness and reasonableness of the tolls applied for". Henceforth, the Board would judge the reasonableness of a settlement by the reasonableness of the *process* rather than by the reasonableness of the *outcome*.[35] The significance of this change was not lost on commentators and participants.[36] From the perspective of economists, the Board's revised Settlement Guidelines may again be seen as clarifying and indeed establishing the property rights of the parties, which again (per Coase) is likely to facilitate bargaining and mutually beneficial outcomes.

4. The blossoming of settlements: 1994 to the present

4.1 Multi-year incentive agreements

At about this time there was also a change in economic conditions and attitudes in the industry. [37] At the Board's incentive regulation workshop, producers wanted to move to a price-setting system where pipeline owners would face greater incentives to reduce costs – that is, incentive regulation. Perhaps the industry had not initially been enthusiastic

[34] The additional phrase was not used in the Board's earlier decisions on IPL's settlements for 1994 and 1995-9, but has been used since 1996. E.g. NEB 1996-03-01 Reasons for decision Trans Mountain RHW-2-96, p. 5. NEB 1996-06-01 Reasons for decision RHW-3-96 Trans-Northern Pipelines, p. 3.

[35] The then-chairman Roland Priddle put it to the authors this way: "The Board simplified the Guidelines essentially to say: if you the regulated entity advise your whole community that you are going for a negotiated settlement, if you subsequently allow into the negotiations any party that has a demonstrable interest, and if there is broad agreement among parties, then we will consider that the public interest has been upheld and satisfied."

[36] "The acceptance of negotiated settlements is a critical breakthrough in the evolution of light-handed regulation. The breakthrough was the recognition that the consensus of the affected parties as to what was fair and reasonable did not need to be subjected to further scrutiny in accordance with some higher ideal of the public interest that existed in the eye of the regulator. In other words, the consensus of the affected parties was a good measure of the public interest." Schultz (1999) p. 388

[37] "Pipeline companies, which for decades had identified management of the regulatory process as a core competence, were now more concerned about competition and keeping their costs as low as possible to retain business. Users of the pipelines had grown disenchanted with a regulatory process that was costly, time-consuming, and at which they felt they could not win." Vollman (1996) p. 6.

about various reforms urged by the Board.[38] But by the time the Guidelines were updated, the industry had taken the leadership in these matters. There was a general feeling that hearings represented "inefficiency without reward", a zero-sum game to no mutual benefit, and were not conducive to a good relationship between customers and service provider, whereas settlements offered the promise of something better.

The combination of revised Board policy, evolving economic conditions and active industry leadership led to significant new developments. The first manifestation was a settlement for 1994 tolls with IPL (later Enbridge), the largest oil pipeline in Canada, negotiated "in an effort to minimize the time and cost involved in examining IPL's toll application".[39] It defined the "standard" parameters used in the toll making methodology, including rate base, rate of return on different elements and toll design, and contained no explicit incentive mechanism, but IPL was rewarded for focusing on issues important to the other parties[40].

Thereafter, the Board approved a rapid succession of multi-year negotiated settlements.[41] In 1996, over 90% of revenue requirements of Group 1 pipelines were based on these settlements. By 1997 all six of the Group 1 pipelines then subject to active regulation had entered four- or five-year negotiated incentive-based settlements.

The settlements generally included incentives to reduce costs, and provisions to share savings between the pipeline and its shippers, but often went further.[42] The Board was quite explicit that it had not designed the form of these developments, but it clearly favoured incentive regulation and sought to explain how these agreements operate, and how they reduce regulation.[43] It is interesting to note how they differ from regulated outcomes in other jurisdictions.[44]

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[38] Priddle (1999), p. 545.

[39] IPL letter to NEB dated November 22, 1993, submitting the negotiated settlement for 1994 tolls.

[40] The settlement provided for a payment to IPL of $1m over the applied for 1994 revenue requirement, with the justification that IPL was not expected to attain its 1993 allowed rate of return of 11.5 percent, and this increase in the revenue requirement would save the cost of a regulatory review and "permit the Board, IPL and the industry to focus on a timely expansion of ex-Alberta crude pipeline capacity and the pressing matter of crude oil apportionment". IPL letter to NEB dated November 19, 1993, detailing negotiated settlement for 1994 tolls.

[41] On the oil side, in March 1995 IPL signed a five-year incentive settlement covering tolls for 1995-1999. The two other major oil pipelines, TransMountain and Trans-Northern, soon followed suit with five year settlements. On the gas side, TCPL, the largest gas pipeline, settled all revenue requirement issues for 1995 (except the cost of capital which was being dealt with by the Generic Cost of Capital hearing). The parties then agreed a four year Incentive Cost Recovery and Revenue Sharing Settlement for 1996-2000. Westcoast agreed a settlement for 1996 then a five-year incentive-based settlement for 1997-2001. TQM also agreed a five-year incentive-based settlement for 1997-2001.

[42] The introduction to TCPL's 1996-2000 settlement (not necessarily the most advanced example) suggests how far the aims of the parties had evolved beyond shortening hearing times and streamlining regulation. Among the primary objectives of settlements it mentions "to more closely align the interests of the Parties by providing a framework which encourages efficiency gains, cost minimization and maximization of system utilization". Other primary objectives mentioned are lowering costs and tolls while maintaining or improving service quality and the financial integrity of TCPL, and preserving firm shippers' flexibility and ability to utilize their transportation contracts. RH-2-95.

[43] "Incentive regulation has developed mainly through multiyear toll agreements negotiated between pipelines and interested parties…. Such agreements provide for a sharing of the benefits that may result from improved performance by the pipeline. Typically, parties agree to a baseline level for costs which

These multi-year settlements began to change the form of regulation. Approving the annual updating of tolls within the term of an existing agreement was now straightforward. Even new agreements occasioned little or no concern, allowing the Board to accept them within a month or two, including a period for public comment. In effect, settlements transferred the major pipelines from an active to a more passive form of regulation.

4.2 Competition and flexibility: Westcoast's transition to light-handed regulation

In one novel and important pair of settlements, Westcoast and its users quite explicitly designed and achieved a transition to "a new scheme of light-handed regulation", which covered about half of the pipeline's regulated business.

Westcoast's application for 1995 tolls had been dealt with in the traditional way, and it had reached a one-year settlement for 1996 tolls. The break-through was a five-year settlement with the Canadian Association of Petroleum Producers (CAPP) for 1997-2001 tolls. The stated motivation for this settlement was the changing economic and commercial environment. This included significant development of gas resources in the adjacent Northeast BC; Westcoast's declining market share in the face of competition, resulting in higher tolls as costs were spread over a lower demand; shipper dissatisfaction with the rigidity and uncertainty of the existing toll structure; and the inability of Westcoast, under the current regulatory environment, to quickly develop new capacity and respond to customers.[45]

The settlement embodied toll increases, but more importantly a much greater flexibility in pricing. For Westcoast's increasingly competitive gas gathering and processing activities, it provided users with a choice of fixed tolls for 1, 3 or 5 years, adjustments tied to the price of gas, a bidding process for interruptible tolls, a revenue deferral account for differences between actual and base level toll revenues, and tolls for available and incremental capacity to be determined through individual negotiations.[46] In addition, there were agreed changes to accounting policies and procedures (e.g. on depreciation) and agreed principles with respect to service reliability.

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may be lower than what the pipeline applied for under cost of service regulation. Some protection is afforded to the pipeline for uncontrollable cost escalation along with a share of the rewards for keeping costs below the target level. Similar incentives can apply to efforts by the pipeline to increase throughput and revenue." NEB 1997, p. 2.

[44] For example, compared to the incentive price controls determined by UK regulators, the negotiated cost projections appear to be less aggressive in terms of future cost reductions; there seem to be more adjustment factors, risk sharing arrangements and escape clauses; and there is more revenue-sharing, typically on a 50-50 basis.

[45] Westcoast's competitors, subject to provincial rather than federal jurisdiction, could design a plant and put it in service in about nine months.

[46] For Westcoast's less competitive activities, there were simpler but nonetheless innovative provisions for transmission tolls, including 1) the option of a fixed toll for a 5 year period or a toll calculated annually according to a prescribed methodology, 2) basing the revenue requirement for the latter on the previous year's actual costs and a fixed escalation factor, adjusted to share any variance from base revenue requirement, and 3) a bidding process for allocating interruptible service.

The settlement also foreshadowed a new development going beyond the concept of multi-year incentive regulation, namely, a transition to freely negotiated market based arrangements subject to a lighter form of regulation.[47] Westcoast was exceptional among Canadian pipelines in the extent of its involvement in gas gathering and processing activities upstream of the long-distance transmission market. These activities were increasingly subject to competition.[48] Recognition of a number of factors suggesting that Westcoast would not be able to exercise market power gave the parties confidence to proceed.[49]

On 5 March 1998 Westcoast filed its Framework for Light-handed Regulation document which amends the 1997-2001 settlement by providing the mechanism by which Westcoast's tolls for gas gathering and processing services will be based on *individually* negotiated arrangements.[50] It is a quite remarkable document. To illustrate with just a few provisions, the goals of the Framework include to provide shippers and Westcoast the opportunity to negotiate service requirements as in a competitive market, and where possible to rely on commercial arrangements instead of regulatory oversight. The Introduction recognises that shippers are knowledgeable and have information and other options. The Fair-Dealing Policy requires Westcoast not to discriminate and to make information about capacity available to all on a monthly basis. The Contracting Practice provides that terms will be governed by contracts negotiated with individual shippers. "The goal is to permit negotiations to include any item of value that could be the subject of bargaining in a competitive market."

The parties recognised the need for commercial confidentiality, but also "the need for a reasonable degree of price discovery to assist in the operation of a functioning market". To that end they propose that Westcoast would either file all contracts with the Board or indicate the maximum and minimum range for the tolls in each tariff; allow the Board access to contracts for mediation or complaint purposes; and make available quarterly summary data on contract terms. There is provision for a detailed Complaint Process, including optional mediation, arbitration and adjudication by the Board. Westcoast accepts responsibility for the utilization of its gathering and processing assets and for the

[47] "The parties to the Settlement contemplate that by the end of the term of the Settlement, Westcoast and shippers will be freely negotiating market-based arrangements in a manner consistent with the provision of service by Westcoast on a competitive basis such that light-handed, complaint-based regulation would be appropriate….The principles of this new regulatory approach will be the subject of further negotiations, which the parties intend to complete by 31 December 1997 and will be subject to Board Approval; and the parties have also agreed to negotiate the terms of a policy governing the interconnection of the gathering or treatment facilities of third parties with Westcoast's facilities."

[48] In 1995 a report to the British Columbia government suggested that the upstream activities could in fact sustain competition and that " Westcoast was an unnatural monopoly with the consequence that a different approach to regulation was appropriate." See Schultz (1999), who also describes the origins and nature of the Westcoast pipeline system.

[49] These factors included the absence of economies of scale, new technologies and new construction techniques reducing barriers to entry, opportunities to enter based on different customer service needs, increasing actual rivalry, Westcoast competing for new business (and with itself) via a new subsidiary, new processing capacity built outside Westcoast, knowledgeable customers with buying power, limited scope to extract profits and customer pressure to be cost efficient, alternative opportunities in Alberta, and competition from an actual new entrant. Schultz (1999)

[50] Key Documents Related to the Board's Decision on the Framework for Light-Handed Regulation, National Energy Board, June 1998.

stranding of any of those assets, and for the gain or loss on any disposal.[51] There is explicit provision for interconnection.

The Board still has a role in terms of complaints, and can intervene if needed, hence the term "light-handed regulation" meaning 'market regulation' rather than 'deregulation'. But the contrast with conventional regulation is marked. In particular, certain services are henceforth to be provided by negotiated settlements between a pipeline and *individual* shippers. As Schultz (1999, p. 389) observes, "The consequence of such a regulatory model is the potential, and the probability, for greater differences in service arrangements than would be contemplated by traditional approaches to cost of service regulation." Although many of the oil pipeline settlements were innovative in different ways, this settlement fundamentally altered the approach to regulation, and through the whole of the gas gathering and processing 'value chain'. For this reason the same author has referred to this (in correspondence) as "perhaps the most innovative of all deals".

4.3 Non-unanimous and contested settlements

In welcoming the succession of multi-year settlements in the late 1990s, the Board anticipated that litigation to determine tolls would be used more selectively. In fact, the Board was soon called upon to act again.

For each of the ten years from 1985 to 1994 TCPL's tolls had been determined by litigation, generally on an annual basis and taking an average of 32 days per hearing. For 1995 the company and the other parties in the Tolls Task Force (TTF) were able to settle all outstanding revenue requirement issues. (The cost of capital was being dealt with by the Generic Cost of Capital hearing.) For 1996-1999 the parties agreed (via TTF resolutions) on toll design issues and on a four year Incentive Cost Recovery and Revenue Sharing Settlement that incorporated the generic cost of capital formula.

Then the mood seems to have changed. When the Incentive Settlement expired at the end of 1999 the parties found difficulty in agreeing a one year extension for 2000. For the two-year period 2001 and 2002 TCPL and 13 signatories achieved a Services and Prices Settlement of all issues except the rate of return on equity (including capital structure), but the settlement was contested by other parties. After an oral hearing the hearing panel approved the settlement but noted that the Board's 1994 Guidelines did not address the situation of a contested settlement, and recommended that the Board review the Guidelines to examine contested settlements and the potential for the use of Alternative Dispute Resolution (ADR) mechanisms.

Now anticipating a possible lack of agreement between parties in the new competitive environment, the Board updated its 1994 Guidelines in 2002 "with the explicit goal of

[51] If Westcoast is considering disposal it will make the assets available to other potential acquirers. Disposition of assets to its affiliates must be done by competitive bidding. "This contrasts sharply with the traditional cost of service approach in which under-utilization typically falls on the shoulders of the remaining shippers. The Framework thus establishes a new point of reference for risk and reward issues." Schultz (1999) p. 41.

providing flexibility to effectively address contested settlements".[52] The Board also made a few small modifications to reduce the prescriptive nature of the 1994 Guidelines.[53] On the other hand, after the previous presumption that a non-opposed settlement would normally be approved, the Board introduced the qualification that "in unusual circumstances" the public interest might necessitate further investigation.[54]

Whether the lack of agreement between TCPL and other parties was entirely the result of the new competitive environment is debateable. TCPL appears to have been more demanding than other pipelines, which antagonised the other parties. It did not accept the Board's generic cost of capital decision, applied for a higher return than the formula would imply, and repeatedly challenged the Board's conclusions. Moreover, apart from cost of capital, TCPL and other parties did not settle other tariff issues either, so TCPL's 2003 and 2004 tolls were once again determined by the traditional method of litigation. Thus, for about four years (2001 to 2004) TCPL was largely at odds with its stakeholders and with the Board.

Once the cost of capital issues had been resolved, however, the parties seem to have worked to improve relations. TCPL's 2005 and 2006 toll revenues were settled by agreement, and incorporated the generic cost of capital formula. These were not multi-year incentive settlements but the second one included some one-year incentives to efficient fuel consumption and to achieve a variety of specified performance targets. Subsequently, TCPL agreed a five-year settlement for 2007-2011.

4.4 The present state of play

All the major pipelines continue to negotiate with their users and all are still on terms determined by settlements rather than litigation.[55] The scope of settlements continues to expand. Investments in new pipeline facilities have been based on contractually agreed-to

[52] The revised Guidelines provided for the Board to hear the applicant's arguments in favour of the settlement, the views of parties opposed to the settlement, and the applicant's response to the opposition. The Board would then decide whether to approve or deny the settlement or allow it on an interim basis and hold a hearing to deal with the issues raised by the dissenting parties. This approach is less cumbersome and costly than going to litigation, which some would advocate, while still allowing all parties to participate in the decision process. It encourages the applicant to continue to seek a settlement even where not all parties can agree.

[53] In particular, the Board "recognizes that the requirement to provide a detailed breakdown of the revenue requirement may constrain the flexibility of parties in reaching a negotiated settlement and has therefore adopted more flexible wording for the requirement". The applicant now had to provide "an explanation of how the agreed-upon revenue is determined" instead of "a tabulation of the components of the agreed revenue requirement". This is consistent with the Board's commitment to either accept or reject a settlement in its entirety and not cherry-pick.

[54] The Board also raised at this time the possibility of Board staff taking an expanded role in the settlement process. In addition it suggested "that a pipeline company, in submitting its negotiated settlement for approval, should provide reasons as to why agreement could not be reached with all parties on all issues". However, it withdrew both proposals in the light of widespread opposition.

[55] In the oil sector, Enbridge and Trans Mountain have agreed further five-year settlements and Trans-Northern continues to file annual toll revisions consistent with an Incentive Toll Settlement originally made in 1996. In the gas sector, Alliance continues to file annual revisions under its 15 year settlement, Westcoast has agreed a series of two-year and three-year settlements, TCPLhas agreed a five-year settlement, M&NE has agreed a variety of settlements of one to three years, and TQM has recently agreed a three-year settlement of all issues except cost of capital (which has just gone to hearing).

sharing of risks between shippers and pipeline proponents.[56] There have been provisions for maintaining and improving service quality, including the development of detailed metrics associated with quality, predictability and reliability, and associated bonuses and penalties.[57] The record indicates the extent to which the regulatory role can be minimized.[58] Negotiated settlements are also spreading beyond the actively regulated Group 1 pipelines to those pipelines regulated on a complaint basis. This again suggests that the impact of settlements goes beyond reproducing what regulation would otherwise achieve.

No institutional arrangement is ever perfect, of course, and shippers would naturally like lower prices and more innovative services.[59] But all market participants (including shippers) support the principle of negotiated settlements, and have continued to renew them. Settlements are also associated with a successful rather than unsuccessful system of hydrocarbon transportation.[60]

5. Concluding remarks

It is to the credit of the National Energy Board that it has presided over – indeed, actively facilitated - a significant change in regulatory approach. The prime role of the Board is no longer to impose its own view of the public interest. It is to enable well-informed market participants with a demonstrable interest to negotiate satisfactorily on something like equal terms with the oil and gas pipelines. The Board seems to have performed this role remarkably well for some fifteen years. Key elements in the success of the Board's approach were the Revised 1994 Settlement Guidelines and its Generic Cost of Capital decision, which together established and clarified the property rights necessary for the parties to negotiate mutually advantageous settlements. Relevant too was the emergence of a more competitive environment which increased the benefits from a shift from rate of

[56] Miller (1999).

[57] Cf. settlements with Westcoast 1997-2001 and particularly Enbridge since 1995. The last Enbridge settlement (2005-09) indicates the thoroughness and imagination embodied in settlements. The Principles of Settlement between Enbridge and CAPP comprise 76 pages. The total documentation supplied by Enbridge as part of its application runs to some 250 pages. The service metrics comprise 31 of these, plus a further 38 pages specifying service levels.

[58] NEB's response to the documentation mentioned in the previous footnote comprises only 2 pages plus a Schedule. NEB simply related that it acknowledged the application on 19 December 2005, invited comments on 23 December, received no comments or opposition, considered that the revenue requirements and tolls were just and reasonable, and approved them on 27 January 2006.

[59] An NEB survey of shippers' views of pipeline performance reported average scores of 3.02 (out of 5) on whether tolls were competitive and 3.04 on pipeline company's attitude to continuous improvement and innovation, a range from 3.26 to 3.37 on responsiveness, fairness and suite of services, a range from 3.57 to 3.75 on timeliness and accuracy of invoices, provision of operations and commercial information and quality of service, and 4.06 on physical reliability and communications. Satisfaction with collaborative processes and the current negotiated settlement agreement or tariff were rated 3.25 and 3.29. Satisfaction with whether the NEB has established an appropriate regulatory framework in which negotiated settlements can be reached was 3.54. NEB (2006) p. 22 and Appendix Two.

[60] The NEB (2006 p. 37) concludes that there is adequate capacity on existing gas pipelines; capacity is tight on the oil pipeline system but there are a significant number of proposals to build or expand these pipelines; shippers continue to indicate that they are reasonably satisfied with the service provided; and NEB-regulated pipelines are financially sound.

return to incentive price cap regulation, which the Board in its conventional role could not deliver.

This raises the question of when it is appropriate for a regulatory authority to establish such property rights – or delegate such discretion - to the regulated parties. Are more innovative settlements always in the public interest or could they be at the expense of final customers? What about the interests of parties not at the negotiating table and parties who contest the settlement?

The Board's duty includes the promotion of economic efficiency in the Canadian public interest. In an increasingly competitive market it can perhaps assume that the interests of final (downstream) customers are sufficiently protected by the users (producers, shippers and large consumers) and by downstream competition. [61] In other contexts, regulators have drawn on such arguments while explicitly cognisant of the duty to protect the interests of parties not at the table.[62]

What about contested settlements? In the only contested pipeline toll settlement that the Board faced, it concluded that there was no evidence that the settlement was inconsistent with the Act. It revised its Guidelines in the expectation of more contested settlements, but in the event this was not the case. Elsewhere, FERC has applied a set of four tests as an alternative to requiring unanimous agreement.[63]

There is scope for further research on settlements. At the NEB, how does the experience of settlements for Group 1 pipeline toll cases compare with the experience of Group 2 pipeline toll cases and Group 1 non-toll cases? Is the experience replicated at provincial level and if not why not? A systematic comparison of regulatory policies and the extent of settlements in different US jurisdictions would be insightful, including with respect to the encouragement or otherwise of settlements, and treatment of the interests of absent and contesting parties. From a formal perspective, Wang (2004) modelled a two-dimensional decision where the outcomes and tradeoffs were observable rather than those aspects of the FERC settlements that involved rate moratoria and must-file provisions. Such provisions, and the incentive mechanisms that lie at the heart of settlements in Canada and Florida, remain a challenge for proponents of more formal modelling.

[61] This may be the case at FERC too: Wang (2004) reports no explicit consideration of final consumers. In Florida the main party negotiating with the utility has been the Office of Public Counsel (representing small and residential consumers) and numerous larger consumers have been co-signatories of the settlements.
[62] In endorsing capital expenditure plans and other measures agreed between the airport and airline users, the UK Competition Commission (2008) said "We took the view that the airport's airline customers are generally in a much better position than the regulator, the CAA, to suggest what development is needed at the airport, even recognising that these interests might, on occasion, diverge from the interests of future airlines and passengers, whose interests should also be represented." (para 24. p. 8) "We considered whether the interests of potential new airlines at the airport or passengers might deviate from the interests of current airlines in these decisions, but we found no reason to believe that they did." (para 24. p. 8)
[63] Out of 39 cases studied by Wang (2004), 22 were unanimous and 17 were contested. FERC approved the latter on the grounds that in 6 cases the contentions of the contesting parties lacked merit, in 2 cases the contesting parties would not be better off if the case were litigated, in 3 cases the interests of the contesting parties were too attenuated, and in 6 cases FERC approved the settlements for the consenting parties and severed the contesting parties, thereby allowing the latter to litigate their case separately.

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