

Negotiated settlements in Canada

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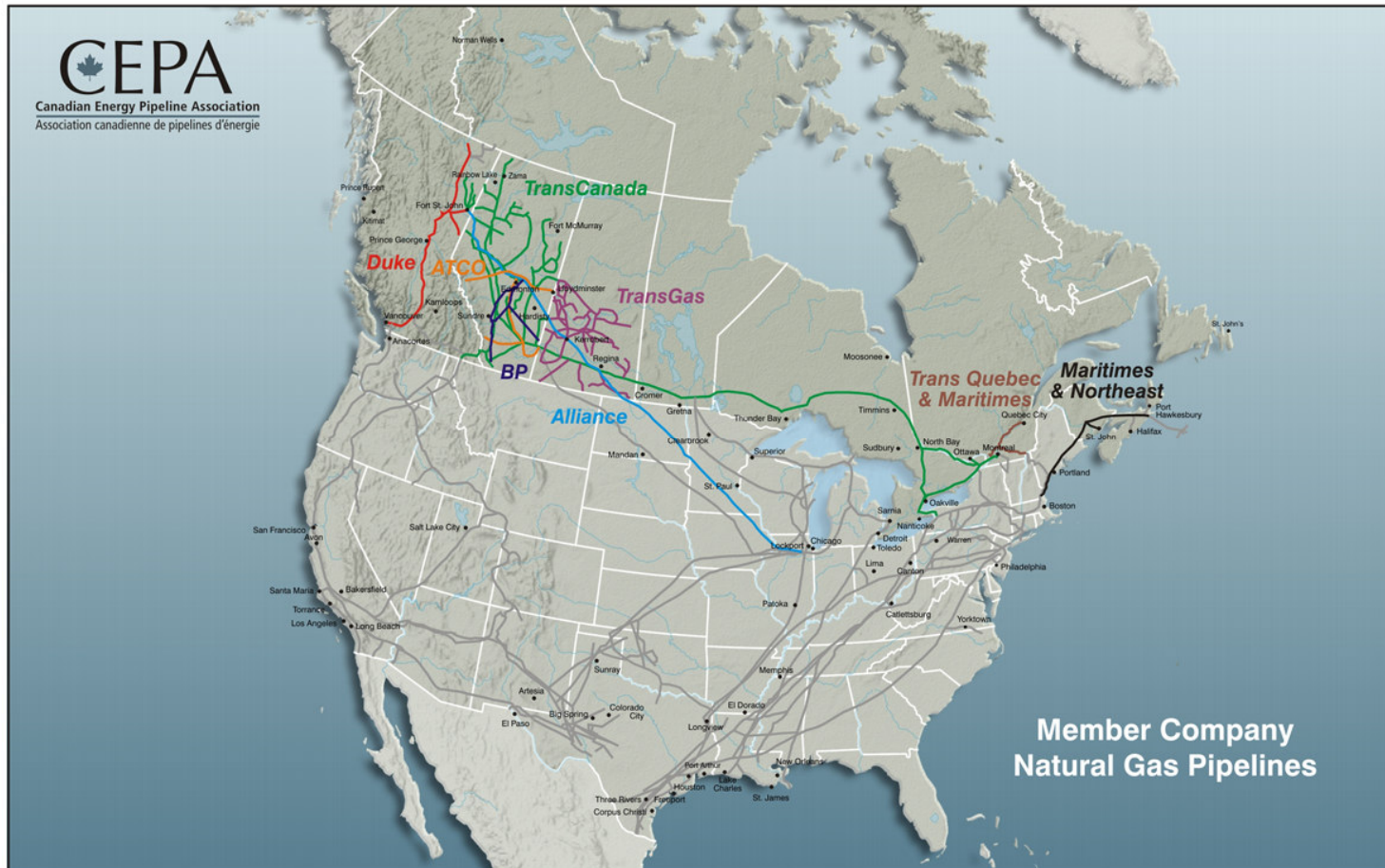
Outline

- National Energy Board in Canada
- The change over time
- What are negotiated settlements
- What is their extent
- What difference do they make
- What regulatory policy is conducive
- Conclusions and implications

National Energy Board

- Regulates international and inter-provincial oil & gas pipelines in Canada since 1959
- 3 oil pipelines
- 5 gas pipelines (2 opened 2000)
- Limited overlap/competition between pipelines
- but not zero, and choice of destination

Gas Pipelines



Toll issues

- NEB deals with construction of lines, energy exports, frontier activities
- Our main interest here is pipeline tolls
 - Prices for transmission of oil and gas
 - Associated terms & quality of service parameters
- Tolls account for 3% of NEB applications
- But for 43% of NEB hearing days
 - More go to hearing and hearings take longer
- But picture has changed over time

NEB toll hearings

	Avg annual number	Avg dur'n (days)	Avg hearings days/year
1985-1994	4.0	16.6	66.3
1995-2005	2.3	7.4	16.9

Toll hearing days one quarter of previous level
What caused this change?

Negotiated settlements

- Conventional regulatory process involves litigation of each case
 - Testimony, cross-examination, judgement etc
- There is an alternative process:
- Negotiation between utility and interested parties/stakeholders
- Settlements agreed (if successful)
- Presented to regulator for approval
- Which may or may not be forthcoming
 - Reduces need for hearings – but is that all?

Effect of settlements?

- Conventional view: settlements reduce cost and time of normal regulation
- But achieve broadly same outcome
- More recent evidence: not so
 - Wang: FERC
 - Littlechild: Florida PSC
- Settlements follow different process and yield different outcomes
- Including outcomes otherwise unattainable

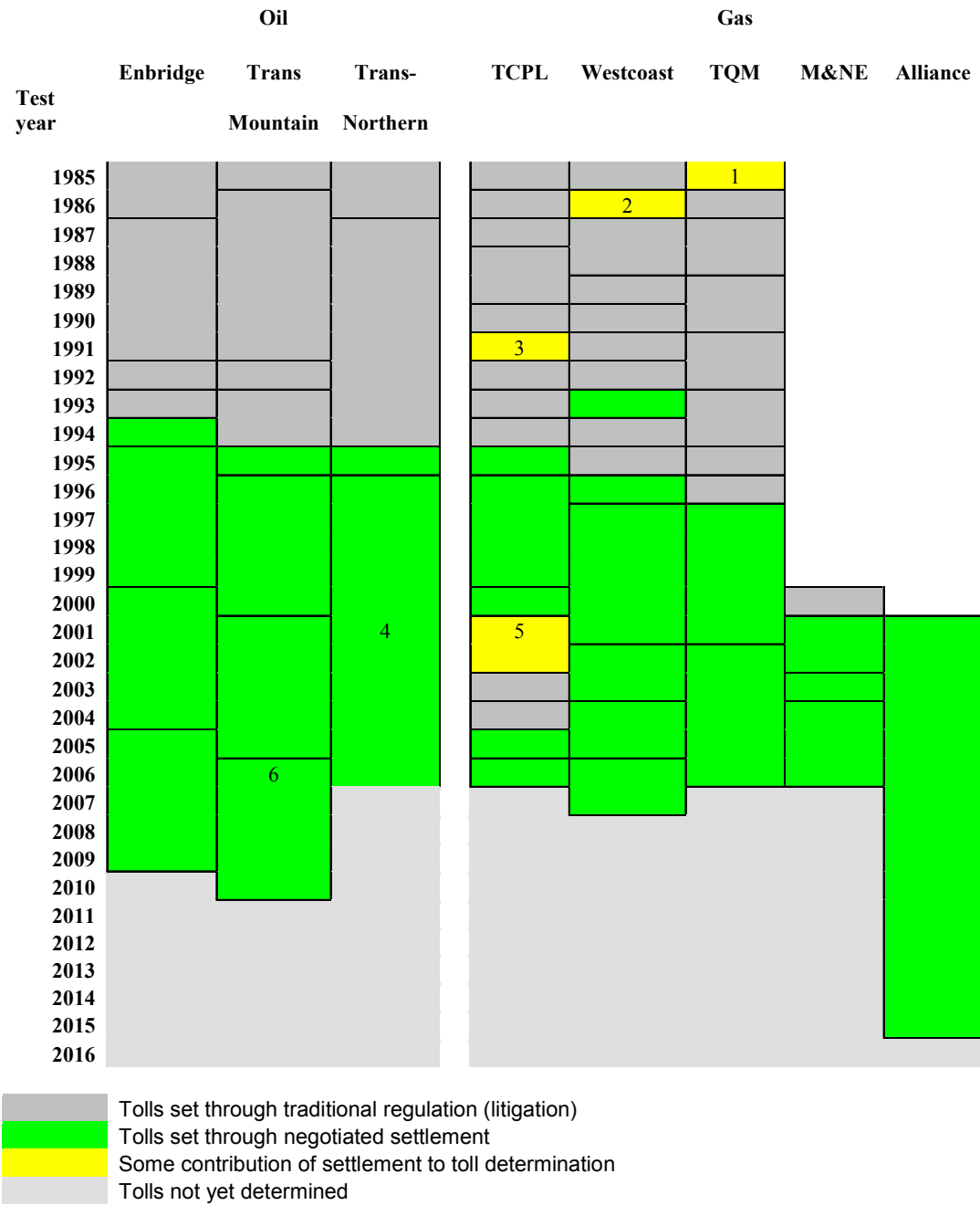


Figure 3:
Settlement activity
since 1985

Source: NEB toll decisions

Impact of settlements

- Settlements have almost completely superceded litigation since 1995 (for tolls)
 - Exception TCPL 2001-4 reflects argument with NEB rather than objection to settlement
- Settlements are typically longer
 - Gas litigations generally annual
 - Now settlements up to 5 years or more
- Multi-year incentive regulation
 - Not otherwise possible for litigation to commit parties not to seek to reopen cases

Nature of settlements

- Scope of settlements has been varied
 - tariffs, opex, ROE, service quality, capex programs (as well as multi-year incentives)
- transition to light-handed regulation
 - allowing individual settlements with utility
 - price discovery regime to facilitate new entry
 - complaint-handling procedures
 - complaint-based regulation only for NEB
- improvements in industry relations
 - productivity, service design, communications

Reasons for success

- The aim was not just cost-saving
 - In fact settlements take time and effort
- Parties could negotiate mutually beneficial outcomes
 - Better and more far-reaching than could expect NEB to deliver
- NEB was always sympathetic
- But change of NEB policy important

Role of NEB

- 1985, 1986 cherry-picking by NEB discouraged settlements
- 1988 Guidelines sought to encourage them
 - But not convincing
- 1994 Revised Guidelines effective
 - Normally accept unopposed settlements
 - Not judge whether each element reasonable, but whether process OK: open, informed, agreement
 - ‘consensus of affected parties a good measure of the public interest’

Generic cost of capital decision

- Everyone fed up with repeated repetitive hearings on cost of capital
- Generic Cost of Capital decision 1994
 - Fix benchmark formula for all companies, observed parameters simply updated annually
- This facilitated settlements
 - removes main item of disagreement (0-sum game)
 - removed pipeline market power
 - focus on areas of potential agreement (+ve sum)
 - left scope to agree premium for better service, innovative products etc

Conclusions

- Negotiated settlements have transformed the approach to oil and gas pipeline regulation in Canada since 1995
- Mutually beneficial outcomes
 - More innovative and better industry relations
- Need research on experience elsewhere
 - Settlements have been problematic in some places
- Scope to apply this concept in UK & EU?
 - Can present utility price control process survive?