
NORTHERN PIPELINE AGENCY

**ANNUAL REPORT
1991-1992**

Canada



Northern Pipeline Agency
Canada

Administration du pipe-line du Nord
Canada

ANNUAL REPORT

1991-1992

© Minister of Supply and Services Canada 1992
Cat. No. C88-1/1992
ISBN 0-662-59437-1

Ottawa, Ontario,
December 31, 1992.

Dear Sir:

I present herewith the Annual Report of the Northern Pipeline Agency for the fiscal year ending March 31, 1992, together with the report of the Auditor General on the accounts and financial transactions of the Agency for the same period, for submission by you to Parliament as required under Sections 13 and 14 of the *Northern Pipeline Act*.

Yours sincerely,

A handwritten signature in cursive script, reading "Donald W. Campbell".

Donald W. Campbell,
Commissioner,
Northern Pipeline Agency.

The Right Honourable Joe Clark, P.C., M.P.,
President of the Queen's Privy Council,
Minister Responsible for Constitutional Affairs,
And Minister Responsible for the Northern Pipeline Agency,
House of Commons,
Ottawa, Ontario.

Table of Contents

	Page
Overview	1
Major Developments Involving The Alaska Highway Gas Pipeline Project	3
The Prebuild	3
The Western Leg	
– U.S. Developments	3
– The California Conflict	4
– Canadian Developments	5
– The Altamont Pipeline Proposal	5
The Eastern Leg	
– U.S. Developments	6
– Canadian Developments	7
Mackenzie Delta Gas	7
The Continuing Procurement Controversy	8
The Proposed Abrogation of the 1977 Canada-U.S. Pipeline Agreement and Termination of Underlying U.S. Legislation	9
Operations of the Canadian and U.S. Regulatory Agencies Responsible for the Pipeline	11
Finance, Personnel and Official Languages	12
Finance and Personnel	12
Official Languages Plan	12
Appendix	13
Report of the Auditor General of Canada	13

Office of the Agency

Mr. Donald W. Campbell, Commissioner,

Lester B. Pearson Building,

125 Sussex Drive,

Ottawa, Ontario.

K1A 0G2

Tel.: 993-7466

Fax: 998-8787

ALASKA HIGHWAY NATURAL GAS PIPELINE PROJECT



Overview

Plans for substantially expanding the capacity of the Western and Eastern Legs of the Alaska Highway Gas Pipeline to transport increased exports of Canadian natural gas to western and mid-western U.S. markets continued to move forward during the fiscal year 1991-1992.

The driving force behind this expansion has been an increase in U.S. demand for Canadian gas that has been under way since 1986. In 1991, total U.S. consumption of natural gas increased by a modest 2.8 per cent to 544 billion cubic metres (19.2 trillion cubic feet), but exports of Canadian gas rose by around 16 per cent to 47.8 billion cubic metres (1.69 trillion cubic feet – tcf). This followed an increase in Canadian gas exports to the United States the previous year of more than 7 per cent. As a result of this growing flow across the border, the National Energy Board reported that there was little spare capacity remaining in any of Canada's major gas pipelines.

In the meantime, however, various plans for providing market access to U.S. reserves at Prudhoe Bay in Alaska, Canadian reserves in the Mackenzie Delta, and the reserves of both countries offshore in the Beaufort Sea remained in abeyance pending a hoped-for strengthening in total U.S. demand for natural gas and a significant increase in gas prices.

South of the border, the major expansion of the Western Leg proposed to accommodate an increase in design capacity to California and the Pacific Northwest of more than 25.9 million cubic metres per day – 916 million cubic feet per day (mmcf/d) commencing November, 1993, received final approval from the Federal Energy Regulatory Commission (FERC) in October, 1991. While extensive construction commenced very quickly thereafter, the proposed increase in Canadian gas exports to California that underlies the project came under a cloud as a result of a continuing dispute between the California Public Utilities Commission (CPUC) and a number of Canadian participants – the federal, Alberta and British Columbia governments, the National Energy Board and gas producers.

Altamont Gas Transmission Co. (Altamont) put forward a separate proposal to build a new pipeline system for the delivery of some 20.8 million cubic metres of Canadian gas a day (736 mmcf/d) to western U.S. markets, principally in California. While Altamont initially planned an in-service date of November 1, 1993, Altamont subsequently extended the date by a year because of its perception of a weakening in the California gas market. Altamont also was confronted by a question raised by the National Energy Board as to whether the connecting pipeline to be constructed by NOVA Corp. of Alberta for the delivery of Canadian gas came under federal jurisdiction.

In the case of the Eastern Leg, U.S. sponsors finally secured approval in the spring of 1992 from the FERC for a modified expansion of the Northern Border Pipeline System that would involve increased Canadian gas exports of 6.8 million cubic metres a day (240 mmcf/d).

In Canada, a possible impediment to proposed expansions of both the Eastern and Western Legs was raised as a result of an action commenced in the Federal Court by Altamont in June 1991. That potential hurdle, which involved a number of jurisdictional and other issues, was removed when Altamont withdrew its case in December, 1991.

Through the approval of Addendum 4 to the System Design Report by Kenneth W. Vollman, Administrator and Designated Officer of the Northern Pipeline Agency, in mid-April, 1991, and the subsequent approval by the National Energy Board of new facilities associated with the extraction of natural gas liquids, the way was cleared for the proposed expansion of the Eastern Leg of the system in Canada through the installation of two new compressor stations and modification of a third compressor station in Alberta. (The planned expansion of the Western Leg obtained the necessary regulatory approval to enable it to proceed from the Northern Pipeline Agency in May, 1992, concurrent with the National Energy Board's approval of a companion expansion by Alberta Natural Gas Co. Ltd.)

The issue of procurement for the pipeline remained a matter of contention between Canadian and U.S. authorities. In addition to exchanges of correspondence on the matter, Michael J. Bayer, the U.S. Federal Inspector, and Donald W. Campbell, Commissioner of the Northern Pipeline Agency, met in Ottawa in early December, 1991, for mutual consultations on their respective concerns.

For its part, the Northern Pipeline Agency continued to press its concern over the failure of the U.S. side to implement the provisions of the 1980 Canada-United States Agreement on the procurement of designated items in the case of the major expansion of the Western Leg and the only limited application of these provisions in the case of large diameter valves and fittings required for the more limited expansion of the Eastern Leg south of the border. On behalf of the U.S. Administration, the Federal Inspector for the first time contended that the Procurement Program Foothills Pipe Lines Ltd. is required to implement in keeping with the provisions of the *Northern Pipeline Act* is contrary to the provisions of both the 1988 Canada-U.S. Free Trade Agreement and the General Agreement on Tariffs and Trade.

All of the foregoing developments over the course of the fiscal year tended to be overshadowed, however, by the report Mr. Bayer submitted to President George Bush in mid-January, 1992, recommending termination of the 1977 Canada-U.S. Pipeline Agreement and the ancillary Procurement Agreement of 1980, together with revocation of the underlying U.S. legislation – the *Alaska Natural Gas Transportation Act* (ANGTA) of 1976. The then-Federal Inspector contended the remainder of the Alaska Natural Gas Transportation System (ANGTS) was unlikely to be built in the next 20 years and that, in any case, it should be left to market forces to determine the sponsors and route of any pipeline that might eventually be constructed.

In a later exchange of notes, the Canadian government asserted that implementation of the Federal Inspector's recommendation would be contrary to the obligations of the United States to Canada and the U.S. government offered assurances that it was not its intent to abrogate its bilateral agreements unilaterally.

In subsequent weeks, the Administration proposed to eliminate the Office of the Federal Inspector (OFI) and transfer its responsibilities to the Secretary of Energy. (In early April, 1992, Mr. Bayer submitted his resignation as Federal Inspector to the President effective as of mid-month.)

Major Developments Involving The Alaska Highway Gas Pipeline Project

The Prebuild

As noted in the last and many previous annual reports, U.S. and Canadian authorities concluded during the latter part of 1977 that it would be desirable to "prebuild" the Western and Eastern Legs that would carry gas from Prudhoe Bay on the North Slope of Alaska from their connecting juncture with the trunk line at Caroline, Alberta, to western and mid-western U.S. markets. From Caroline, which is 105 km (63 mi) north of Calgary, the Eastern and Western Legs extend for a distance of 2 992 km (1,858 mi). Pending the completion of the second stage of the system, it was planned that these two legs would be utilized initially to transport surplus Canadian gas for export to American markets. The Western and Eastern Legs came into service in the early 1980s, but market conditions have remained inadequate to support completion of the second stage of the project to provide access to U.S. reserves at Prudhoe Bay.

A steady resurgence in U.S. demand for natural gas, particularly for Canada's own growing surplus, during the latter part of the 1980s led to the formulation of plans for substantially expanding the capacity of the prebuilt Western and Eastern Legs in both Canada and the United States. Following is an update on some of the more significant developments during the course of the fiscal year (and, in some cases, developments of more recent date).

The Western Leg

– U.S. Developments

In October, 1991, the Federal Energy Regulatory Commission (FERC) removed the final hurdle to an expansion of the facilities of the Pacific Gas Transmission Co. (PGT) in order to increase imports of Canadian gas to markets in California and the Pacific Northwest by 24.7 million cubic metres per day (872 mmcf/d). This expansion in the existing capacity of the Western Leg south of the border from its existing level of 8.5 million cubic metres daily (300 mmcf/d) is being achieved both through the addition of compression and looping of both the PGT line to California and the connecting pipeline in California owned by its parent company, the Pacific Gas and Electric Co. (PG&E). The overall PGT/PG&E expansion involves the addition of some 1 350 km (845 mi) of pipe and 57 megawatts (76,000 horsepower) of compression at an estimated cost of U.S. \$1.6 billion. Installation of the additional facilities was well under way during the remainder of the fiscal year, with the increased gas flows scheduled to commence by November 1, 1993.

Even as it moved toward completion, however, the proposed increase in Canadian gas exports over the expanded Western Leg system still faced potential problems of uncertain dimensions on two fronts: A developing conflict between the California Public Utilities Commission (CPUC) and Canadian governments at the federal and provincial level, together with the National Energy Board and Canadian gas producers, and; the potentially competitive project proposed by the Altamont

Gas Transmission Co. and its Canadian subsidiary, Altamont Gas Transmission Canada Ltd., which will be outlined in the following section dealing with Canadian developments involving the Western Leg.

As noted in the 1990-91 annual report, the proposed expansion of the Western Leg in the United States took on a new complexion with the announcement in September, 1991, that TransCanada PipeLines Ltd. (TCPL) had reached an agreement to purchase PGT from its PG&E parent. TCPL also said it planned to purchase PGT's 49 per cent interest in the Alberta Natural Gas Co., which transports gas from the Alberta border through South B.C. to the international border. In addition, TransCanada indicated an interest in purchasing the Alberta and Southern Gas Co. (A&S), the Canadian gas purchasing arm of PGT that acts on behalf of PG&E. In December, 1991, TCPL announced that it had decided against purchasing A&S. (In mid-April, 1992, TransCanada indicated that it intended to put its planned purchase of PGT from PG&E on hold pending resolution of the dispute between Canada and the California Public Utilities Commission. In early July, 1992, however, TCPL completed the purchase of PGT's 49 per cent equity in ANG.)

- The California Conflict

The complex issues surrounding the controversy between the CPUC and Canadian federal and provincial authorities go back to a decision by the National Energy Board in 1989. The Board approved what was in effect the long-term extension of a licence granted to the Alberta and Southern Gas Co. Ltd. (A&S), a wholly-owned subsidiary of PG&E, to export 116.4 billion cubic metres (4.1 tcf) of Canadian gas to the northern California market over an 11-year period.

At the time of the Board's consideration of the A&S application, strong support was expressed by the CPUC. A change in the CPUC's stance became apparent in mid-1990, however, when the Commission ordered PG&E, ultimate purchaser of gas from A&S, to renegotiate its long-term contracts in order to obtain gas at prices comparable to those prevailing in Alberta, as opposed to higher base prices for Alberta gas that reflected the cost of alternative gas supplies in the California market (excluding transportation costs), even though the Canadian gas was highly competitive with these other alternative sources. Subsequently, the Commission issued directives aimed at promoting direct purchase of Canadian gas on a short-term basis by California shippers (described as "capacity brokering"), the effect of which was to undermine the long-term A&S contracts that underpinned the licence extensions approved by the NEB in 1989 and jeopardize the investments made in Canada to fulfil them. While the CPUC initially applauded an Access Agreement made by the commercial parties that allowed 25 per cent of the gas being supplied under the A&S licence to be opened up to direct purchase between shippers and A&S producers, the Commission subsequently directed PG&E to implement full capacity brokering on PGT by October, 1992, or within 60 days of a FERC rehearing order authorizing capacity brokering, whichever was later.

In late May, 1991, the Canadian Petroleum Association (CPA) submitted an application to the National Energy Board requesting that it review its earlier decision to extend the A&S export licence in light of measures adopted by the CPUC, which it claimed were contrary to the market-based policies governing trade in natural gas that were previously adopted by the Canadian and U.S. governments. The CPA subsequently filed an amended application with the Board in November, 1991, requesting that it take immediate action to counteract the effects of the November decision by the CPUC with respect to capacity brokering. Early in February, 1992, the NEB issued certain interim orders that had the effect of requiring prior approval of the Board for any increased exports under existing short-term export orders and new short-term exports of Canadian gas via the PGT/PG&E pipelines.

(Following conclusion of its hearing on the CPA application, the Board stated in its Reasons for Decision issued in June, 1992, "that it cannot condone or ignore the impact of regulatory actions taken by other jurisdictions which fundamentally change the basis upon which it was persuaded to issue a licence and which imposes changes within its jurisdiction." It was the Board's view that a longer transition period was needed to allow commercial parties to negotiate contractual

arrangements. Among other things, the NEB replaced its interim measures with new orders that prohibited all short-term exports of Canadian gas destined for shipment to the northern California market that were not already contracted for sale by A&S to northern California.

(While a meeting in July, 1992, between the President of the CPUC and Alberta's Minister of Energy again appeared to lay the basis for settlement of the dispute, this agreement subsequently collapsed. Shortly afterwards, the CPUC issued an "Order to Show Cause" to PG&E that required it to investigate potential sources of additional supplies for the California market in light of the possible unreliability of Canadian gas sources during the approaching winter. On the Canadian side, Alberta's Minister of Energy countered with a warning that the province might refuse to authorize the removal of the new gas volumes contracted for California if the dispute were not satisfactorily resolved. In September, 1992, the planned increase in gas exports via the expanded PGT/PG&E system faced a new hurdle as a result of a CPUC decision requiring PG&E to charge incremental tolls for new shippers on its expanded system – as opposed to tolls based on the rolled-in costs of its total system – while at the same time prohibiting those new customers from using PG&E's existing northern California facilities.)

– Canadian Developments

During the course of the fiscal year, the National Energy Board and the Northern Pipeline Agency worked together to discharge regulatory responsibilities within their respective jurisdictions in connection with the proposed expansion of the Western Leg of the Alaska Highway Gas Pipeline (AHGP) in South B.C. required to supply the proposed increase in exports to California and the Pacific Northwest through the PGT/PG&E system.

In the case of the NEB, this involved consideration of the application by the Alberta Natural Gas Co. (ANG) to add new compressor units and modify existing facilities at three of its compressor stations in order to increase compression by 42 megawatts (56,250 horsepower). The cost was estimated at nearly \$82 million. At the same time, the Designated Officer of the Northern Pipeline Agency had before him a proposed Addendum 4 to the System Design Report from Foothills Pipe Lines Ltd., sponsor of the AHGP and holder of a pipeline certificate deemed to have been granted under the *Northern Pipeline Act*. This involved joining together the existing four Foothills loops on the ANG system in South B.C. with the installation of an additional 77.5 km (54.4 mi) of 1 067 millimetre (42") diameter pipe at an estimated cost of \$104.6 million. This additional pipe – together with the increased compression provided by ANG – would provide the expansion in capacity of the system in South B.C. required to increase throughput from 6.8 million cubic metres of gas a day (240 mmcf/d) to 31.5 million cubic metres daily (1.1 bcf/d). A substantial expansion of the NOVA system in Alberta costing some \$312 million would also be required to gather and deliver the increased volumes of gas to the Alberta-B.C. border. Following submission of the respective applications, the Board and the Agency established a joint process for soliciting any additional information required and for receiving written submissions in connection with the review undertaken by the NEB.

(In May, 1992, the Board issued its Reasons for Decision in connection with approval of the ANG application and the Designated Officer of the NPA also approved the addendum to the System Design Report submitted by Foothills, which constituted authorization for the company to proceed with its part of the proposed expansion of the Western Leg of the AHGP. In its Reasons for Decision, the Board said it was "satisfied that the ANG expansion facilities would be used at a reasonable level over their economic life and that the associated demand charge would be paid." The Board concluded, therefore, that the project would serve the Canadian public interest.)

– The Altamont Pipeline Proposal

As pointed out in the previous section and noted in the last annual report, the proposed expansion of the Western Leg of the AHGP in Canada and the United States was challenged by the proposal of the Altamont Gas Transmission Co. to transport a substantial volume of Canadian gas to California markets through the installation of a new pipeline that would join with the existing

system of Kern River Gas Transmission Co. at Opal in Wyoming. In response to a widespread perception that only one of the two projects was economically viable, the Alberta government in October, 1991, requested its Energy Resources Conservation Board to conduct a "Call for Information" in an effort to bring together relevant information required to weigh the merits of each proposal while foregoing any conclusion on the part of the Board itself. (That report was made public in June, 1992.)

In early 1991, the FERC approved Altamont's proposal to build a 1 000 km (620 mi) pipeline from the Canadian border near Wild Horse, Alberta, to join with the Kern River system for the delivery of up to 20.8 million cubic metres a day (736 mmcf/d) of Canadian gas to California and other western markets. In late July, 1991, Altamont Gas Transmission Canada Ltd. (Altamont Canada) filed an application with the National Energy Board seeking authorization to build a 300-metre pipeline at the Canadian border to link together a lateral to be constructed by NOVA Corp. for the delivery of Alberta gas and the Altamont line in the United States to join with the Kern River system. In an accompanying letter, Altamont requested the Board to conduct a comparative hearing to consider at the same time the competing application for expansion of the Western Leg in South B.C. in order to "select the project which best serves the Canadian public interest", a request that was denied by the NEB.

The announcement by the Board in November, 1991, that it would consider the Altamont application on its own merits and independently of the ANG expansion application, subsequently led Altamont to withdraw its earlier application to the Federal Court challenging previous decisions by the Board and the Northern Pipeline Agency with respect to the latter case.

(In June, 1992, the NEB announced its intention of considering a preliminary question of jurisdiction arising from the Altamont Canada application by means of written submissions from interested parties. The issue raised by the Board posed the question as to whether the 217 km (135 mi) pipeline to be constructed by NOVA immediately upstream to deliver Alberta gas to Altamont Canada's link at the Canada-U.S. border should also be subject to federal jurisdiction under the principles of constitutional law. The Board concluded that it was required to form a judgment on this issue in order to determine whether the Altamont Canada application, which seeks exemption from the requirement to obtain a certificate of public convenience and necessity to construct a pipeline, is one that the Board could legally grant to the company. Under the *National Energy Board Act*, the NEB may not grant such an exemption for pipelines exceeding 40 km (25 mi) in length.

(While Altamont strongly contested any suggestion that the NOVA lateral came under federal jurisdiction, it also requested the National Energy Board in July, 1992, to review and stay its decision approving the installation of increased compression by the Alberta Natural Gas Co. Ltd. (ANG) as part of the proposed expansion of the Western Leg in South B.C. Altamont contended that, as a matter of fundamental justice, the Board should also consider whether or not a question of jurisdiction existed in the case of NOVA facilities upstream of the B.C.-Alberta border. In a ruling in September, 1992, the Board concluded that there were insufficient grounds to review the original decision approving the ANG expansion. As a result, the application was dismissed and no stay was granted. At the time of writing, the Board had not issued a decision on the jurisdictional question.

(In mid-1992, Altamont announced that it had decided to delay for a year the original in-service date of November, 1993, because of what it perceived as a developing weakness in the California market.)

The Eastern Leg

- U.S. Developments

Since the latter part of the 1980s, the Northern Border Pipeline Co., sponsor of the Eastern Leg of what is known in the United States as the Alaska Natural Gas Transportation System (ANGTS), formulated a variety of plans for expansion of its operations south of the border. Proposals put

forward in 1990 and subsequently amended in early 1991 contemplated extension of the system from its existing terminus at Ventura, Iowa, to Tuscola, Ill., a distance of some 612 km (378 mi), and an increase in throughput volumes of some 21.24 million cubic metres daily (750 mmcf/d). Under pressure from the Federal Energy Regulatory Commission (FERC) to demonstrate that firm markets existed for the proposed increase in throughput capacity or face dismissal of its application, Northern Border filed a scaled-down expansion plan in July, 1991. This involved utilizing the extension of the system from Ventura to Harper, Iowa, a 238 km (147 mi) line that it had previously agreed to acquire from the Natural Gas Pipeline Co. of America.

Through the installation of additional compression capacity, Northern Border proposed to provide an increase in throughput on the system of some 8.87 million cubic metres a day (387 mmcf/d). Of that amount, around 6.8 million cubic metres daily (240 mmcf/d) would involve increased Canadian exports delivered through Foothills' Eastern Leg in Alberta and Saskatchewan. The balance of the increased flows would come from domestic U.S. sources. The modified expansion proposed by Northern Border was approved by the FERC in the spring of 1992, with the additional flows scheduled to begin in November, 1992.

- Canadian Developments

During the course of the fiscal year, work continued to proceed with the expansion of the Alberta segment of the Eastern Leg in Canada as provided for in Addendum 5 to Foothills' System Design Report, which was approved by the Northern Pipeline Agency's Designated Officer in April, 1991. As outlined in the last annual report, this involved the installation of two new compressor stations in Alberta, Stations 363 and 365, and modification of an existing station, No. 367, at Jenner, Alberta. In addition, the National Energy Board in June, 1991, approved installation of a partial third train required in connection with Foothills' decompression-recompression facilities that are associated with the natural gas liquids extraction plant at Empress, Alberta.

The expansion was undertaken in response to a request from NOVA for firm transportation of some 16.35 million cubic metres of gas a day (577 mmcf/d) through the Alberta segment of the Eastern Leg. This expansion would increase its daily delivery volumes from 42.41 million cubic metres (1.5 bcf) to 58.76 million cubic metres (2.07 bcf). Initially, NOVA required this additional gas for delivery to TransCanada PipeLines at the Alberta-Saskatchewan border. Subsequently, however, it was determined that 6.8 million cubic metres a day (240 mmcf/d) would be delivered to the Saskatchewan segment of the Eastern Leg to supply the increased demand for gas exports to be shipped through the Northern Border system south of the border commencing in November, 1992. This higher throughput was capable of being provided on the Eastern Leg in Saskatchewan with only minor modification of existing compressor units.

Mackenzie Delta Gas

Plans for the delivery to market of Canadian gas reserves in the Mackenzie Delta region of the Northwest Territories essentially remained on hold during the fiscal year. As noted in the Agency's previous annual report, federal government approval of the licences that the National Energy Board proposed in the summer of 1989 to grant to Esso, Gulf and Shell for the export of 260 billion cubic metres (9.2 tcf) of Canadian gas over a 20-year period beginning in 1996 was withheld until it was satisfied that environmental factors had been properly taken into account.

In mid-March, 1991, a consortium of six companies announced that they had signed a Statement of Principles to provide a basis for planning the development of a pipeline to transport gas from the Delta to southern markets. This consortium is made up of the three major owners of Delta gas and three pipeline companies - Interprovincial, Polar Gas and Foothills. The latter company, sponsor of the Canadian segment of the Alaska Highway Gas Pipeline (AHGP), earlier had submitted an application to the NEB proposing construction of a pipeline running south from the Delta to join with the proposed second-stage trunkline of the AHGP near Boundary Lake, close to the border of northern B.C. and Alberta. Since its announcement of March 1991, no further

information has been provided by the consortium with respect to the size, routing or capacity of the pipeline it intended to propose.

During the course of the past fiscal year, the National Energy Board continued its review of the potential environmental impact of the projected export of Delta gas in keeping with the guidelines laid down under the federal environmental assessment and review process. (In July, 1992, the Board issued a report that concluded there would no adverse environmental effects associated with the actual export of Delta gas. Such impacts as there might be would result from the production, processing, transportation and distribution of the gas. But the Board considered it "premature and impractical" to attempt to assess those environmental considerations until the required applications had been submitted to the appropriate authorities. The Board noted that it had been required to take into account in its deliberations a judgment issued by the Federal Court of Appeal in July, 1991, involving Quebec Hydro, which held that the NEB's jurisdiction over exports – in this case of electricity – did not extend to facilities for the production of the commodity for export.

The Continuing Procurement Controversy

Canada's concern regarding implementation of the 1980 bilateral agreement governing the procurement of certain designated items for the pipeline began to develop in the late 1980s. Around that time, it became increasingly apparent that the U.S. sponsors of the Eastern and Western Legs were proposing to bypass these agreed procurement procedures, with the concurrence of the then-Acting U.S. Federal Inspector, in the case of proposed increases in the capacity of their respective systems. It was argued on the U.S. side that these expansions were not really a part of the Alaska Natural Gas Transportation System (ANGTS), a claim that was said to be reinforced by the fact that neither of the sponsors had elected to seek regulatory approval under the terms of the *Alaska Natural Gas Transportation Act*.

These procedures – which cover procurement of large-diameter pipe, compression units and large diameter valves and fittings – were adopted in the first place at the urging of the U.S. government as one means of helping to achieve one of the major objectives that it had originally pressed to have spelled out in the 1977 Canada-U.S. Pipeline Agreement. This was the commitment of both governments to take steps to ensure that the supply of goods and services for the project would be obtained "on generally competitive terms".

Following his appointment as Federal Inspector in October, 1990, Michael J. Bayer met subsequently with his counterpart, Donald W. Campbell, Commissioner of the Northern Pipeline Agency, in Ottawa in February, 1991, to discuss this and other issues. Mr. Bayer indicated at the time that he considered it desirable the procurement procedures be implemented on the U.S. side, as they had been in connection with expansions of the system in Canada, and expressed his intention of seeking voluntary compliance by the U.S. sponsors.

As noted in the 1990-91 report, Mr. Bayer subsequently advised Congress in May, 1991, that since each of the proposed expansion projects substantially tracked the planned second phase of the ANGTS, the sponsors had agreed to comply with the procurement procedures "wherever feasible". As a result, the Federal Inspector stated, the procurement issue had been resolved to the "mutual satisfaction" of both Canada and the United States.

A subsequent exchange of correspondence in August and September, 1991, between the heads of the two agencies, however, made it clear that procurement remained a matter of contention. Mr. Bayer sought consultations with respect to his concern over a questionnaire included by Foothills in bidding documents covering procurement of certain designated items, a document that sought information related to an evaluation of potential Canadian industrial and/or economic benefits from the proposed procurement. In reply, Mr. Campbell indicated that he also wanted to undertake consultations with respect to his continuing concerns regarding the lack of effective implementation of the procurement process on the U.S. side. He observed that Mr. Bayer's claim in his earlier report to Congress that the procurement issue had been resolved to the

mutual satisfaction of both sides rather overstated the case from Canada's perspective. The Commissioner pointed out that procurement in connection with expansion of the Western Leg south of the border had passed the point where the established procedures could be instituted in any meaningful way. During subsequent consultations in Ottawa in December 1991, Mr. Campbell pointed out that he still had not been informed either about the status of procurement for the proposed expansion of the Eastern Leg as it related to the agreed bilateral procedures or about the implications of the conditional undertaking of the Eastern Leg sponsors to comply with the provisions of the bilateral agreement. In the event, the only case in which the procurement procedures were fully complied with in connection with procurement of designated items for expansion of the two systems involved the purchase of valves and fittings required on the Eastern Leg. Mr. Bayer disclosed that the only other designated item required for the proposed expansion of that segment of the system – additional compression units – had long since been purchased by Northern Border, sponsor of that segment of the pipeline in the United States.

For his part, Mr. Bayer said that consultations with a number of U.S. departments and agencies had led him to the conclusion that the Procurement Program adopted by Foothills in compliance with the requirements of the *Northern Pipeline Act*, of which the questionnaire on Canadian benefits to which he objected formed a part, was contrary to the provisions both of the 1988 Canada-U.S. Free Trade Agreement (FTA) and the General Agreement on Tariffs and Trade. During the course of the meeting, Mr. Campbell undertook to consider and respond to the contention advanced by the Federal Inspector. Replying to a subsequent letter from the Commissioner with respect to his report to the President in mid-January, 1992, recommending termination of all U.S. commitments to the ANGTS, including those to Canada, Mr. Bayer wrote in mid-February that the procurement issue he raised during their previous meeting "exists quite independently of the status of my Office or its underlying authorities. Our position was grounded in the GATT and the 1988 Canada-U.S. Free Trade Agreement, not the 1977 or 1980 ANGTS Agreements."

(In June, 1992, the Commissioner wrote to the Office of the Federal Inspector in response to the question of the validity of the Foothills' Procurement Program raised during their earlier consultations by Mr. Bayer, who by that time had already resigned his position. Mr. Campbell pointed out that the 1977 Pipeline Agreement between the two governments stated in its preamble that they supported the project out of a desire "to advance the national economic and energy interests and to maximize related industrial benefits of each country..." At the same time, he continued, the Agreement also stipulated that each government would endeavour to ensure that the supply of goods and services for the project was undertaken "on generally competitive terms."

(Under the provisions of the *Northern Pipeline Act*, Mr. Campbell noted, Foothills was required to maximize the industrial benefits available to Canada within the ambit of the second objective – that procurement be undertaken on generally competitive terms. "On consideration, it is our judgment that the Procurement Program adopted by Foothills is entirely in keeping with the provisions of the 1977 Agreement between our two governments and fully in compliance with the existing provisions of the GATT." By the same token, he said, it was also the Canadian view that the Procurement Program was in keeping with the Free Trade Agreement, a conclusion that was reinforced by the fact that U.S. negotiators of the FTA took no exception to the provisions of the *Northern Pipeline Act* nor the program adopted in keeping with its requirements.)

The Proposed Abrogation of the 1977 Canada-U.S. Pipeline Agreement and Termination of Underlying U.S. Legislation

Questions about the continuing need to maintain the Office of the Federal Inspector to oversee the implementation of the Alaska Natural Gas Transportation Project (ANGTS) were first raised publicly by Congressman Philip R. Sharp, Chairman of the House Subcommittee on Energy and Power, in a letter to the Federal Inspector in October, 1991. Given the long delay in completing the project with the extension of the pipeline to provide access to Alaska gas at Prudhoe Bay, Mr. Sharp questioned whether the Office of the Federal Inspector (OFI) should continue to remain

operational. If there were certain functions that should be maintained, he suggested, they could perhaps be carried out on a less costly basis by some other arm of the federal government.

In a lengthy reply, Mr. Bayer appeared to argue that a case could be made for maintaining the role of the OFI and expressed doubt as to whether any significant saving could be made by transferring its functions elsewhere. In any case, he added, any change in the existing legal and regulatory structure should not be made without extensive consultation with the Canadian and Alaskan governments and consideration of other possible ramifications. In response to a similar letter from Mr. Sharp, however, James D. Watkins, the Secretary of Energy, subsequently wrote that he agreed with the Chairman's conclusion "that the OFI is no longer a needed organization within the Executive Branch." He proposed that the authority then being exercised by the OFI should be transferred to a branch of his own department.

Given the foregoing developments, the submission by Mr. Bayer of a report to President Bush dated January 14, 1992, recommending abrogation of the 1977 Canada-U.S. Pipeline Agreement and the ancillary 1980 Procurement Agreement, abolition of the Office of the Federal Inspector, repeal of the underlying U.S. legislation and withdrawal of all the legal rights extended to the U.S. sponsors of the ANGTS, came as something of a surprise to observers on both sides of the border.

The Federal Inspector based his recommendations on a number of conclusions. He said that since the project was adopted in 1977, times had changed and the assumptions on which it was based had proven to be "absolutely incorrect". During the intervening years, the reserves of gas discovered in the conventional areas of the lower 48 states and of Canada had turned out to be far larger than anticipated, while the price of gas remained far below predicted levels. In the same period, the U.S. government had cleared away legal hurdles to the export of North Slope Alaskan gas in liquefied form to Pacific Rim countries through approval of the Trans-Alaska Gas System (TAGS), a development that challenges assumptions about the marketability of Prudhoe Bay gas and the availability of those suppliers for the ANGTS, Mr. Bayer asserted.

It was, he said, unlikely that the proposed ANGTS pipeline would be extended to the Alaskan North Slope at any time within the next 20 years. In fact, it was more likely that the first Arctic gas to be tapped would be by a pipeline transporting Canadian gas reserves in the Mackenzie Delta southward along the Mackenzie Valley. In any case, the Federal Inspector argued, in future reliance should be placed on market forces rather than governmental decrees to determine when, where, by whom and at what cost a pipeline to Alaska should be built. He acknowledged that construction of any future pipeline from Alaska across Canada would require the consent of Canadian authorities, but maintained that this "would not be fundamentally different than the current situation for other pipeline projects that propose to transport Canadian gas to the U.S."

The Federal Inspector referred in his report to the need to consult with the Canadian government, among other interests, with respect to his recommendations. He did not suggest, however, that termination of the 1977 Canada-U.S. Pipeline Agreement should be contingent on Canadian consent to such action and, in fact, observed that Canada "will likely oppose elimination of ANGTS." While he suggested abandonment of the ANGTS might have certain advantages for Canada, particularly the elimination of competition from Alaskan gas for its own reserves in the Mackenzie Delta, he indicated that Canadian authorities would be anxious to maintain the rate structure that was adopted to encourage prebuilding of the Eastern and Western Legs for the initial purpose of transporting surplus Canadian gas to U.S. markets.

In a note submitted to the State Department in mid-February, 1992, regarding the Federal Inspector's report, the Canadian government said it "expects that the United States will continue to honour its obligations under the 1977 Agreement of principles and subsequent assurances given to the Government of Canada with respect to the pipeline. Any action giving effect to the above-noted recommendations would be contrary to the obligations of the United States and would not be acceptable to Canada." (The 1977 Pipeline Agreement between the two countries stipulated that it would remain in force for 35 years from the date of signing and thereafter was terminable on 12 months' notice.) In early April, the U.S. government responded to the Canadian note with the assurance that it was not its intent "to abrogate unilaterally" its bilateral agreements. "In order

to further our bilateral cooperation in this area, and in view of market conditions which have changed substantially since the 1977 and 1980 Agreements were negotiated," the U.S. note continued, "the United States believes it would be useful for the two governments to jointly review the continued relevance of policies established as a result of the Alaska Natural Gas Transportation Act. This review might take place under the auspices of the Energy Consultative Mechanism (the means inaugurated several years ago to provide for periodic bilateral consultations on energy matters)."

Operations of the Canadian and U.S. Regulatory Agencies Responsible for the Pipeline

The main focus of the Northern Pipeline Agency during the period covered by this report was on matters already outlined earlier. These included overseeing the expansion by Foothills of the Eastern Leg in Alberta through the addition of two new compressor stations and modification of a third so as to ensure that they complied with all established engineering, environmental, socio-economic and other terms and conditions. The Agency was also engaged in consideration of the application by Foothills for authority to expand substantially the capacity of its system in South B.C. in conjunction with the proposed expansion in compression to be provided by the Alberta Natural Gas Co., a matter that was at the same time before the National Energy Board for its review. In addition, bilateral issues continued to occupy the NPA's attention. These included the continuing contention over the matter of procurement for the project and the recommendation by Michael J. Bayer, the Federal Inspector, to the President in mid-January regarding the abrogation of bilateral agreements with Canada regarding the pipeline and the termination of underlying U.S. legislation.

As noted in the previous annual report, The Right Honourable Joe Clark, for a number of years the Secretary of State for External Affairs, on April 21, 1991, became the Minister responsible for the Northern Pipeline Agency, as well as President of the Privy Council and Minister responsible for Constitutional Affairs. He succeeded the Honourable Don Mazankowski, the Deputy Prime Minister, who was appointed Minister of Finance after having served for some time as President of the Privy Council, Minister of Agriculture and Minister responsible for the Northern Pipeline Agency.

Donald W. Campbell continued to serve during the fiscal year as Commissioner of the NPA as well as Deputy Minister of International Trade and Associate Under-Secretary of State for External Affairs. Kenneth W. Vollman, a Temporary Member of the National Energy Board, served also as Administrator and Designated Officer of the NPA. (Following expiration of his term in September, 1992, Mr. Vollman was succeeded by Roy Illing, a Member of the National Energy Board who, as Deputy Minister of Energy for British Columbia, served for some years as that province's representative on the Federal-Provincial Consultative Council established under the *Northern Pipeline Act*.)

The Northern Pipeline Agency continued to be indebted to the National Energy Board for making available on a contractual basis the services of its staff to provide the Agency with all of the technical information and advice required to discharge its regulatory responsibilities. Staff of the Board also continued to provide administrative support services to the NPA. The Board is reimbursed for all of these services by the Agency, which in turn are recovered from Foothills in the same manner as other Agency costs.

(In the United States, the most notable development involving the Office of the Federal Inspector (OFI) was its unexpected demise, which was the culmination of developments outlined earlier in this report. In early April, 1992, Mr. Bayer submitted his resignation as Federal Inspector. The following week, the Bush Administration proposed the suspension of further funding for the agency during the 1992 fiscal year and elimination of all funding as of the following fiscal year. In October, 1992, the U.S. Congress approved a massive energy bill, which – among many other things – provided for repeal of existing provisions establishing the OFI and the transfer of the responsibility and authority of that office to the Secretary of Energy.)

Finance, Personnel and Official Languages

Finance and Personnel

Section 13 of the *Northern Pipeline Act* provides for an annual audit of the accounts and financial transactions of the Agency by the Auditor General of Canada and for a report thereon to be made to the Minister. Section 14 of the Act requires the Auditor General's report to be laid before Parliament together with the Minister's annual report on the operations of the Agency. To comply with these requirements, the report of the Auditor General of Canada on the accounts and financial transactions of the Northern Pipeline Agency for the year ended March 31, 1992, is reproduced as an appendix.

Estimates for 1991-92 provided \$472,000 for the operation of the Agency. Expenditure for the year totalled \$179,000. At year end, only one full-time employee was on staff. The National Energy Board provides administrative support as well as technical information and advice, for which the Agency reimburses the Board.

Section 29 of the *Northern Pipeline Act* provides for recovery of the costs of the Agency from the company constructing the pipeline in accordance with regulations made under subsection 55(2) of the *National Energy Board Act*. During the year, 156,000 was recovered from Foothills in keeping with the provisions of the *Northern Pipeline Act*, of which \$100,000 related to prior year costs. In addition, \$30,400 in Yukon easement fees were collected. All amounts were credited to the Consolidated Revenue Fund.

Official Languages Plan

Although the Northern Pipeline Agency is a separate employer under Part II of the *Public Service Staff Relations Act* and is not subject to the *Public Service Employment Act*, the language policies and procedures established for other government departments and agencies have generally been applied. In addition, the Agency conforms as fully as possible with the provisions of the *Official Languages Act*.

In order to allow members of the public to comment on the linguistic aspect of services provided, enquiries may be made by telephoning (613) 993-7466 or by writing to the Office of the Northern Pipeline Agency, Lester B. Pearson Building, 125 Sussex Drive, Ottawa, Ontario, K1A 0G2.



AUDITOR GENERAL OF CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

AUDITOR'S REPORT

To the Minister responsible for the
Northern Pipeline Agency

I have audited the statement of net recoverable expenditure and receipts of the Northern Pipeline Agency for the year ended March 31, 1992. This financial statement is the responsibility of the Agency's management. My responsibility is to express an opinion on this financial statement based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, this financial statement presents fairly, in all material respects the net recoverable expenditure and receipts of the Agency for the year ended March 31, 1992 in accordance with the accounting policies set out in Note 2 to the statement.

A handwritten signature in black ink, appearing to read 'D. Meyers'.

D. Larry Meyers, FCA
Deputy Auditor General
for the Auditor General of Canada

Ottawa, Canada
November 30, 1992

NORTHERN PIPELINE AGENCY

Statement of Net Recoverable Expenditure and Receipts for the year ended March 31, 1992

	<u>1991-92</u>	<u>1990-91</u>
Net recoverable expenditure		
<u>Expenditure</u>		
Professional and special service	\$ 79,972	\$151,559
Salaries and employee benefits	67,600	88,652
Employee contingency plan	-	43,074
Rentals and office accommodation	19,905	19,941
Office equipment	3,942	-
Information	3,725	-
Travel and communications	2,445	3,099
Material, supplies and maintenance	<u>1,685</u>	<u>1,792</u>
Total expenditure funded by parliamentary appropriations (Note 3)	179,274	308,117
Less: Non-recoverable portion of employee benefits	<u>6,324</u>	<u>13,176</u>
Net recoverable expenditure (Note 4)	<u>\$172,950</u>	<u>\$294,941</u>
<u>Receipts</u>		
Recovery of net recoverable expenditure from Foothills Pipe Lines Ltd. (Note 4)	\$156,327	\$268,346
Easement fees	<u>30,400</u>	<u>30,400</u>
	<u>\$186,727</u>	<u>\$298,746</u>

Approved by:



Commissioner



Senior Financial Officer

NORTHERN PIPELINE AGENCY

Notes to the Statement of Net Recoverable Expenditure and Receipts for the year ended March 31, 1992

1. Authority and objective

The Agency was established in 1978 by the Northern Pipeline Act. The objective of the Agency is to facilitate the efficient and expeditious planning and construction of the Alaska Highway Gas Pipeline in a manner consistent with the best interests of Canada as defined in the Act.

The Agency's expenditure is funded by parliamentary appropriations. However, in accordance with the Act and the National Energy Board Cost Recovery Regulations, the Agency is required to recover all its annual operating costs from the companies holding certificates of public convenience and necessity issued by the Agency. Currently, Foothills Pipe Lines Ltd. is the sole holder of such certificates.

Receipts are deposited to the Consolidated Revenue Fund and are not available for use by the Agency.

Reduction of Activity

On May 1, 1982, the United States sponsors for the Alaska Highway Gas Pipeline and Foothills Pipe Lines Ltd. announced that the target date for completion had been set back until further notice and all parties were to scale down their activities.

2. Accounting policies

Expenditure

Expenditure includes the cost of work performed, goods received or services rendered prior to April 1, except for the costs of the employees' contingency and termination plans which are charged to expenditure when paid. Capital acquisitions are charged to expenditure in the year of purchase. Expenditure also includes costs incurred on behalf of the Agency by government departments.

Receipts

Receipts are recorded on a cash basis.

Employee contingency plan

Senior and certain other key employees who remain with the Agency until completion of their responsibilities and whose service exceeds two years are entitled to an allowance of 13% of accumulated salary received upon separation.

NORTHERN PIPELINE AGENCY

Notes to the Statement of Net Recoverable Expenditure and Receipts for the year ended March 31, 1992 (Cont'd)

3. Expenditure funded by parliamentary appropriations

Expenditure for the year was funded as follows:

	<u>1991-92</u>	<u>1990-91</u>
Parliamentary appropriations		
Privy Council		
Vote 30-Program expenditure	\$472,000	\$530,000
Statutory-Contributions to employee benefit plans	<u>18,000</u>	<u>27,000</u>
	490,000	557,000
Amount not required	<u>310,726</u>	<u>248,883</u>
Net appropriation used	<u>\$179,274</u>	<u>\$308,117</u>

4. Account with Foothills Pipe Lines Ltd.

	<u>1991-92</u>	<u>1990-91</u>
Net recoverable expenditure	<u>\$172,950</u>	<u>\$294,941</u>
Less: Current year recovery	156,327	268,346
Less: Current year recovery applicable to prior year	<u>100,064</u>	<u>73,469</u>
	<u>56,263</u>	<u>194,877</u>
Balance recoverable at year-end	<u>\$116,687</u>	<u>\$100,064</u>

Recovery of expenditure from Foothills Pipe Lines Ltd. is based on quarterly billings.

5. Related party transactions

The expenditure includes the cost of services by other federal government departments and agencies. These costs aggregate \$76,781 (1990-91 \$101,879). Professional and special assistance and office accommodation represent the main services provided by the related parties.