NORTHERN PIPELINE AGENCY

ANNUAL REPORT 1997-1998

Canada

Northern Pipeline Agency
Canada

Administration du pipe-line du Nord
Canada

ANNUAL REPORT
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Ottawa, Ontario,
December 31, 1998.

Dear Sir:

I present herewith the Annual Report of the Northern Pipeline Agency for the fiscal year ending March 31, 1998, 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,

Robert G. Wright,
Commissioner,
Northern Pipeline Agency

The Honourable Sergio Marchi, P.C., M.P.,
Minister for International Trade and
Minister Responsible for the Northern Pipeline Agency,
House of Commons,
Ottawa, Ontario.

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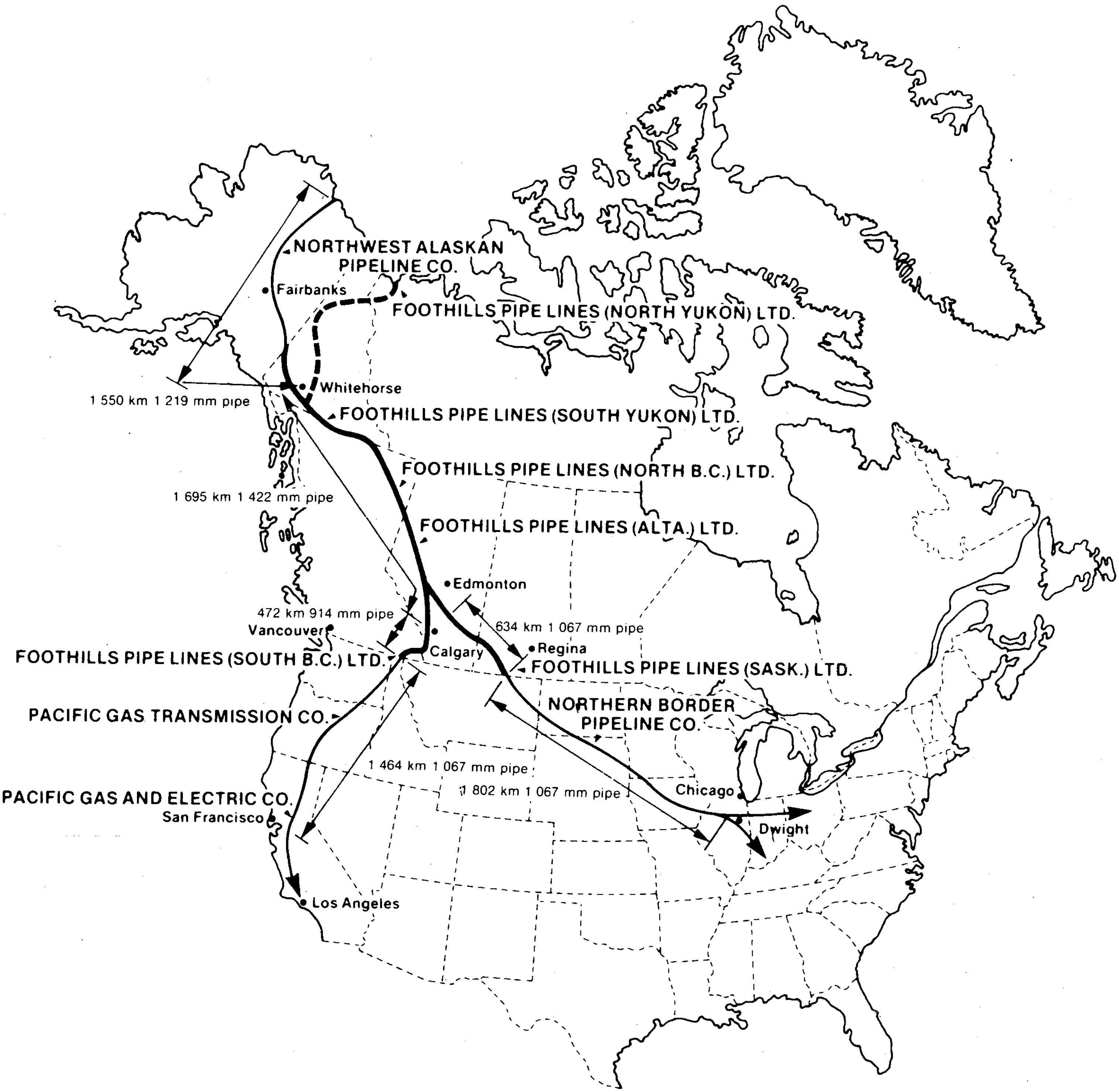
Office of the Agency
Mr. Robert G. Wright, Commissioner,

Lester B. Pearson Building,
125 Sussex Drive,
Ottawa, Ontario.
K1A 0G2
Tel.: 993-7466
Fax: 998-8787

ALASKA HIGHWAY NATURAL GAS PIPELINE PROJECT



Overview

Even as work was launched on expansion of the Eastern Leg of the Alaska Highway Gas Pipeline during the latter part of the fiscal year 1997-98, a major change was beginning to emerge in the industry perception about the extent to which Canadian gas reserves were being locked out of lucrative mid-western U.S. markets because of a shortage of export pipeline capacity.

In contrast to the previous few years of growing producer complaints about being forced to forgo a premium of $1 or more per thousand cubic feet due to restricted access to mid-western U.S. markets, there was mounting concern in some quarters about a potentially growing shortage of deliverable Canadian gas to fill the greatly expanded pipeline capacity either approved or proposed.

Evidence of this significant reversal of perceptions began to emerge during the 77-day hearing before the National Energy Board (NEB) of the application by Alliance Pipeline Ltd. to build an entirely new line from northeastern British Columbia and northwestern Alberta to the Chicago area. The 3 000 km (1,999 mi) main line, together with extensive gas-gathering laterals, would have a capacity to transport 37.5 million cubic metres of gas daily (1.33 billion cubic feet a day – Bcf/d) - and 140,000 barrels of natural gas liquids a day – to the U.S. market.

During the hearing, Foothills Pipe Lines Ltd., sponsor of the Alaska Highway Gas Pipeline in Canada (known as the Alaska Natural Gas Transportation System or ANGTS south of the border) contended that currently deliverable gas supplies would fall significantly short in filling both existing pipeline capacity and the large increase in additional capacity that would be created as a result of expansions already authorized and the proposed expansion that would result from approval of the Alliance project.

(Alliance officials acknowledged that in the short term there could be some shortage of supply of gas to meet total demand. But they submitted a study which concluded that only a small fraction of existing conventional reserves would need to be drawn down to meet all foreseeable demand over the next 20 years.

(Subsequently, however, other concerns began to be voiced with respect to the ability of gas producers to find, produce and deliver sufficient new reserves required to replace depleted supplies and meet growing new demands to fill expanding pipeline capacity. One firm, First Energy Capital Corp., estimated that producers would have to drill and tie in more than 30,000 wells over the following five years. That would require drilling an average of some 6,350 wells per year, which compares with the record of 4,856 wells drilled in 1997. While some analysts and many producers expressed confidence the industry would be able to meet the demand, others expressed concern that the relatively low level of drilling during 1998 would continue so long as oil prices and the cash flow of petroleum producers remained low.

(In the fall of 1998, the Canadian Gas Potential Committee, made up of senior geologists and engineers and headed by former National Energy Board Chairman Roland Priddle, estimated that a five-fold increase in gas discoveries would be required over the next several years to keep pace with demand. The Committee emphasized that Canada was not running short of gas supplies. But it concluded that new reserves would come mainly from smaller pools than in the past and from new sources such as methane gas from coal seams.

(During the hearing before the NEB, Foothills agreed with Alliance that the latter's proposed project represented a "paradigm shift". For the first time, they recognized, pipeline capacity out of the Western Canada Sedimentary Basin (WCSB) would exceed natural gas deliverability.

(This in turn, Foothills argued, would create a previously unknown competition for supply of gas between pipeline companies. While not opposing the certification of Alliance, Foothills contended that the economic regulation of existing pipelines, including regulations governing tolls and tariffs, must be lightened to provide a level playing field in this new competitive world. The NEB declined to consider this proposal because it went beyond the scope of the hearing. But the Board noted that existing pipelines could at any time submit a separate application dealing with such issues.

(In its Reasons for Decision approving the Alliance Project, issued in late November, 1998, the National Energy Board acknowledged that the opening of this new pipeline could cause some short-term supply problems. But it agreed with the Alliance sponsors that over the long term there would be sufficient deliverable gas to meet domestic and export demand.

("In summary, the Board recognizes that the approval and construction of the Alliance Pipeline Project could result in pipeline capacity leading supply for a period of time," the report said. "The 'lumpiness' of investment in a project such as this, along with the related shipper commitments to Alliance, may result in some temporary offloading from other pipeline systems, necessitating some period of refill. However, it is inherent in the nature of any greenfield pipeline that the investment must be large enough to take advantage of economies of scale. The Board accepts that Alliance has made a credible case that, on a long-term basis, overall supply will be sufficient to sustain reasonable utilization rates of the Alliance Pipeline and other pipeline systems transporting natural gas from the WCSB.")

Old Plans Revised, New Plans Devised to Meet Changing Market Conditions

In the face of a changed outlook for the supply and demand for Canadian gas in mid-western U.S. markets, some pipeline companies found themselves compelled to revise previous plans, while others were formulating new plans to supply what they estimated to be emerging new markets. Following is an outline of some of those changes that were of particular relevance for the Canadian industry.

TransCanada PipeLines

One of the companies most affected by changing market conditions was TransCanada PipeLines. Following two previous downward revisions, TCPL joined a consortium of three companies that in February, 1997, applied to the Federal Energy Regulatory Commission (FERC) for approval of a so-called Viking Voyageur Pipeline. As proposed, this consisted of a 1 280 km (800 mi)-line to transport a minimum of 34 million cubic metres of gas a day (1.2 Bcf/d) and possibly as much as 57 million cubic metres daily (2 Bcf/d) from Emerson, Manitoba, to Joliet, Illinois.

(In April, 1998, however, one of the U.S. partners in the project dropped out, leaving TCPL and its remaining partner to adopt a greatly scaled-down plan. A senior TCPL official explained at the time that the supply of gas was not available to support the host of proposed expansions in pipeline capacity to transport Canadian gas to mid-western markets. In July, TCPL and its remaining partner announced plans for a Voyageur pipeline from the Chicago Hub near Joliet, Illinois, to serve markets in northern Illinois and Wisconsin. In November, 1998, it was disclosed that this revised Voyageur project was being scrapped because of a lack of shipper interest.

(In April, 1998, TCPL also announced that it planned to invest nearly $1 billion expanding the capacity of its domestic system during 1999 to deliver gas to Eastern Canadian markets and for export. The company said that an increase in capacity of 11.8 million cubic metres daily (417 MMcf/d) in 1998 would be followed by a further proposed increase of 7.8 million cubic metres a day (275 MMcf/d) in 1999. In September, however, TransCanada filed a revised application that pared planned 1999 capital expenditures by some $576 million. The company said its revised program would still provide for an increase in capacity of 5.9 million cubic metres of gas a day (208 MMcf/d), but nearly half of that amount would be provided through transportation swaps.)

Alliance Pipeline

During the planning stage over the past two years, Alliance officials rejected proposals put forward by NOVA and TransCanada that the company make use of their existing systems as a means of reducing costs and duplication of facilities. Late in the 1997-98 fiscal year, however, extensive discussions aimed at resolving growing conflict within the industry between gas producers and pipeline companies led to agreement on a new accord in early April, 1998 (see below). (The agreement, which appeared to be prompted at least in part as a response to changing market conditions affecting all parties, provided among other things that duplication of facilities should be minimized through the adoption of a new policy on interconnections. One immediate result of the accord was an undertaking by pipeline companies such as TCPL and NOVA to "modify" their opposition during NEB hearings to the Alliance project.

(In keeping with the accord, Alliance officials disclosed in the fall of 1998 that they were negotiating with three pipeline companies about the possibility of dropping plans for construction of certain gas-gathering lateral lines and instead utilizing existing facilities of the other companies. In the event of failure to reach agreement on interconnections, gas producers have undertaken to cover the stranded costs of the former NOVA system for five years.)

Foothills/Northern Border

Open Seasons were conducted during the course of the fiscal year by both the Canadian and U.S. sponsors of the Eastern Leg of the Alaska Highway Gas Pipeline or ANGTS – Foothills and Northern Border - as part of what they called Project 2000. (In May, 1998, it was announced that requests had been received for an increase in Foothills' capacity to deliver Canadian gas to the U.S. border near Monchy, Saskatchewan, by 1.6 million cubic metres a day (58 MMcf/d). For Northern Border's part, bids in the United States called for a similar increase in deliverable capacity from the border to Ventura, Iowa. From Iowa to Illinois, increased capacity of 5.5 million cubic metres daily (195 MMcf/d) would be required, while a proposed new extension to North Hayden, Indiana, would require capacity for a further 15.4 million cubic metres a day (545 MMcf/d). This additional gas required for the eastern segment of Northern Border would be provided through a restructuring of existing gas receipt and delivery points.

(In June, 1998, it was announced that Northern Border planned to join forces with three other pipelines to build a new line to serve markets in Northern Illinois and Wisconsin. The so-called Illinois-Wisconsin Express Project would have the capacity to transport 18.4 million cubic metres (650 MMcf/d) from Joliet, Illinois. In early November, 1998, it was announced that this project was being put on hold indefinitely.)

The New Accord Between Gas Producers and Pipelines

In response to far-reaching changes in market conditions, gas producers and pipeline companies – as indicated above - launched discussions late in the fiscal year aimed at overcoming the growing strains that had developed among gas producers and pipelines over the past few years. The outcome was the announcement of an agreement in early April between TransCanada, NOVA Corp. and NOVA Gas Transmission Ltd., the Canadian Association of Petroleum Producers (CAPP), and the Small Explorers and Producers' Association of Canada (SEPAC).

The primary objective of the new accord was to "promote a competitive environment, greater customer choice, and alignment of interests" in the Western Canadian Sedimentary Basin.

George Watson, President and Chief Executive Officer of TCPL, characterized the accord as a recognition of "changes taking place in the energy marketplace". Norman McIntyre, Chairman of CAPP, said the agreement "recognizes the importance of aligning the interests of producers and pipelines to improve the competitive position of the basin."

In addition to paving the way for an agreement between Alliance and other pipeline companies aimed at reducing duplication of available facilities, the accord also led to the removal of producer opposition to the proposed merger between TCPL and NOVA's non-chemical interests.

The Merger of TransCanada and NOVA

In January, 1998, it was announced that the respective boards of TCPL and NOVA Corp. had approved a merger between the two companies based on an exchange of shares. The new company, to be called TransCanada, would split off the chemical side of NOVA's business. The merger had particular implications for Foothills Pipe Lines Ltd. with the transfer of its 50 per cent share ownership from NOVA to the new TransCanada PipeLines Co. In the past, some degree of competition for mid-western U.S. markets has existed between Foothills and TransCanada even though TCPL has a 49 per cent interest in the Saskatchewan segment of Foothills. The other 50 per cent ownership of Foothills is held by Westcoast Energy Inc.

Agreement of Foothills' Shareholders

As one means of ensuring that Foothills fulfilled all of the commitments made by its sponsors, sub-section 21(6) of the *Northern Pipeline Act* stipulated that every certificate issued to the company was subject to the condition that the Shareholders Agreement could not be amended or terminated without the prior approval of the Governor in Council and the National Energy Board.

On December 8, 1997, the shareholders approved an amendment that, in effect, eliminated the automatic termination of their agreement on December 31, 1997. A few days later, Robert Pierce, Chairman and Chief Executive Officer of Foothills, wrote to the Commissioner of the Northern Pipeline Agency and the then-Vice-Chairman of the National Energy Board requesting that they take the necessary steps to secure the respective approval of the Governor in Council and the NEB. Subsequently, however, the legal advisors of the Board and the Agency gave their opinion that the whole matter had become moot because the proposed amendment eliminating the automatic termination date had not been approved by the Governor in Council and the Board before that deadline. They contended that federal authorities had the opportunity to be aware of the automatic termination provision in the Shareholders Agreement and, by implication, must have accepted it. Under those circumstances, the terms of the Agreement took precedence over the stipulation in the *Northern Pipeline Act* that the Agreement could not be terminated without the approval of the Governor in Council and the NEB.

(Because of the focus on resolving the many issues raised in connection with the merger between the pipeline arm of NOVA and TCPL that was announced in January, 1998, the two shareholders of Foothills did not address the issue raised by legal counsel for the Agency and the Board until several months later. In the fall of 1998, however, the shareholders took issue with the legal opinion received by the Board and the Agency, contending that the provision in the *Northern Pipeline Act* prohibiting termination of the Agreement without the prior approval of the Governor in Council and the Board overrode any contrary provision in the Agreement. Moreover, they argued that termination of the Agreement was neither in the interest of Foothills nor of federal authorities. During a meeting of lawyers for Foothills with the NPA's legal advisor in October, 1998, it was agreed following consultation with a senior Justice Department authority on administrative law that the provisions of the Act should prevail and approval of the Governor in Council sought for the amendment of the Shareholders Agreement be ratified.)

Expansion of the Eastern Leg

Submission by Foothills of a wide variety of socio-economic, environmental and engineering plans for approval of the Designated Officer of the Northern Pipeline Agency (NPA) preceded the beginning of work in January, 1998, to expand the capacity of the Eastern Leg of the Alaska Highway Gas Pipeline in Canada.

The expansion would increase the capacity of the Eastern Leg in Saskatchewan by some 19.8 million cubic feet a day (700 MMcf/d) and that of the entire system in Canada to 93.5 million cubic metres daily (3.3 Bcf/d). The project involves replacement of the existing compressor unit at Piapot, Saskatchewan, enlargement (with NEB approval) of the decompression/recompression facilities at Empress, Alberta, in connection with the removal of natural gas liquids, a short looping of pipe in Alberta and looping of 111.8 km (70 mi) of pipe in Saskatchewan. Estimated cost of the project is $169 million. It is due to come into service in December, 1998.

Complementing the expansion by Foothills was a major expansion and extension being undertaken by Northern Border Pipeline Co., sponsor of the Eastern Leg in the United States. This involves the addition of new compressor units, 295 km (182 mi) of looping from the border to Harper, Iowa, and an extension to the Chicago area of 395 km (243 mi).

Foothills Joins Consortium to Study Export of North Slope Gas to the Pacific Rim

In an effort to facilitate the export of North Slope Alaskan gas to Pacific Rim countries, the Alaska Legislature adopted legislation during the fiscal year termed the *Alaska Stranded Gas Development Act.* The objective of the Act was to encourage private interests to explore the possibility of exporting North Slope gas to Pacific Rim countries. (Following several months of discussion, it was announced that a consortium had been formed to undertake a four-year, $100-million study of the feasibility of building a gas conditioning plant at Prudhoe Bay, transporting the North Slope gas to the south coast via a 1 300 km (800 mi), high-pressure pipeline, then converting the gas to liquid, and shipping it by specially-designed vessels to the Pacific Rim.

(After the lead partner, ARCO Alaska Inc., which has a 37 per cent interest in the project, the second largest interest – 22 per cent – is held by Foothills Pipe Lines. Among other participants are CSX Corp., which through its subsidiary, Yukon Pacific Corp., several years ago proposed creation of a Trans-Alaska Gas System (TAGS) to undertake a similar venture.

(For some years, Foothills and TransCanada PipeLines have been the sole members of the consortium once made up of a number of major U.S. pipelines that was created to undertake the Alaskan segment of the Alaska Natural Gas Transportation System. Several years ago, Foothills, joined by the Canadian government and other U.S. sponsors of the ANGTS, strongly opposed a series of approvals by successive U.S. Administrations that enabled TAGS to proceed if economic conditions permitted, which was never the case. At the time, Foothills and the Canadian government argued that through the 1977 Canada-U.S. Pipeline Agreement the United States had implicitly dedicated existing proven reserves to support the ANGTS project.

(In support of its revised position, Foothills officials emphasized that the North Slope Gas Project remained only a feasibility study – not a commitment to undertake export of North Slope gas. They maintained they still supported the ANGTS project and raised the possibility that sufficient reserves – discovered and undiscovered – existed on the North Slope to support both projects.

(Foothills pointed out that if the export project were to proceed and a pipeline built south from Prudhoe Bay, it could even hasten the day when the ANGTS project became feasible. This was the case because of the possibility of an ANGTS pipeline utilizing expanded facilities of the export line to Fairbanks before swinging southeastward along the general route of the Alaska Highway. Such a course would undoubtedly significantly reduce the potential cost involved if the ANGTS pipeline were being built from scratch.)

The Regulatory Authorities

The Honourable Sergio Marchi, Minister for International Trade who was also appointed Minister responsible for the Northern Pipeline Agency in June, 1997, continued in that position throughout the fiscal year.

Robert G. Wright, Deputy Minister for International Trade in the Department of Foreign Affairs, continued to serve also as Commissioner of the Northern Pipeline Agency. Kenneth W. Vollman, Administrator and Designated Officer of the Agency and Vice-Chairman of the National Energy Board, who is based in Calgary, became Acting Chairman of the Board during the fiscal year. (In mid-July, 1998, he was appointed Chairman of the NEB.)

(In the United States, the Honourable Federico Pena, who became Secretary of Energy in mid-March, 1998, resigned his office as of the end of June, 1998. He was succeeded by the Honourable Bill Richardson, who as Secretary of Energy also inherited the responsibilities formerly exercised by the Office of the Federal Inspector.)

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, 1998, is reproduced as an appendix.

Estimates for 1997-98 provided $254,000 for the operation of the Agency. Expenditure for the year totalled $162,000. 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 section 24.1 of the *National Energy Board Act*. During the year, $98,000 were recovered from Foothills Pipe Lines Ltd., the Canadian sponsor. In addition, $30,400 in Yukon easement fees were collected from Foothills, of which $2,800 were remitted to the Government of the Yukon Territory. Amounts collected 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.

Appendix

AUDITOR GENERAL OF CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

AUDITOR'S REPORT

To the Minister for International Trade

I have audited the schedule of expenditures and receipts of the Northern Pipeline Agency for the year ended 31 March 1998. The expenditures and receipts are calculated as described in note 2 to the schedule. This financial information is the responsibility of the Agency's management. My responsibility is to express an opinion on this financial information 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 information is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial information. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial information presentation.

In my opinion, this financial information presents fairly, in all material respects, the expenditures and receipts of the Agency for the year ended 31 March 1998 in accordance with the accounting policies set out in Note 2 to the schedule of expenditures and receipts.

Donald M. Young, FCA
Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada
15 May 1998

NORTHERN PIPELINE AGENCY

Schedule of Expenditures and Receipts

for the year ended March 31, 1998

	1998	1997
Expenditures		
Salaries and employee benefits	$75,503	$ 68,958
Professional and special services	56,270	32,697
Rentals and office accommodation	20,270	19,590
Information / printing and publishing services	4,230	3,198
Material, supplies and maintenance	3,232	2,625
Transportation and communications	2,471	2,345
Repair and upkeep	345	969
Capital assets	-	1,269
Total Expenditures	$162,321	$131,651
Receipts		
Recovery of expenditures (Note 2)	($ 98,432)	($ 87,502)
Net easement fee	(27,594)	(27,594)
Total receipts	($126,026)	($115,096)

The accompanying notes are an integral part of this statement.

Approved by:

Commissioner

Senior Financial Officer

NORTHERN PIPELINE AGENCY

Notes to the Schedule of Expenditures and Receipts

for the year ended March 31, 1998

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 expenditures are 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.

Easement fees are collected on behalf of Indian and Northern Affairs Canada in the amount of $30,400, and the Yukon Government's share paid is $2,806.

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 scaled down their activities.

2. **Accounting policies**

Expenditures

Expenditures include the cost of work performed, goods received or services rendered prior to April 1, except for the cost of the employees' contingency and termination plans which are charged to expenditures when paid. Capital acquisitions are charged to expenditures in the year of purchase.

Receipts

Receipts are recorded on a cash basis.

Recovery of Expenditures

Expenditures are initially recovered by calendar year based on the proration of the Agency's fiscal year budgets. An adjustment to actual cost is made in the subsequent year's billings.

NORTHERN PIPELINE AGENCY

Notes to the Schedule of Expenditures and Receipts

for the year ended March 31, 1998

3. **Commitment and Contingency**

Lease commitment

The Agency has entered into a five year occupancy lease, which expires during 1999, with Public Works and Government Services Canada, for its office space in Ottawa, Ontario.

Future minimum lease payments are as follows:

1998-99	$ 18,699

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 upon separation of 13% of their gross salary earned during their period of service.

4. **Related party transactions**

The expenditures include $64,898 (1996-97: $43,280) for the cost of services by other federal government departments and agencies incurred in the normal course of business. Professional and special services and office accommodation represent the main services provided by the related parties.