No. 4

Friday, November 27, 1998.

8.30 o'clock a.m.

Prayers.

Question of Privilege

Pursuant to Standing Rule 10, Hon. Mr. Blanchard rose to correct three items of public information: erroneous replies given by the Auditor General to the Leader of the Opposition during the meeting of the Standing Committee on Public Accounts on November 19, 1998; certain information concerning the Evergreen Park School and the New Brunswick Youth Centre; and misinformation on the front page of *The Times-Transcript* under the headline "People pay for road profit".

Hon. Mr. Blanchard then laid upon the table of the House *The Times Transcript* dated November 25, 1998, and *The Times-Transcript* dated November 21, 1998 to which he had referred in his statements.

Point of Order

Hon. Mr. Valcourt rose on a Point of Order requesting that the Speaker refer to the rule which allows a Minister to correct newspaper reports.

Mr. Speaker stated that Standing Rule 10 allows members to correct misrepresentation in newspapers and requires that the documents in question be tabled.

Hon. Mr. Valcourt rose on a Point of Order and requested that Hon. Mrs. Breault table a copy of certain polls that she had referred to on Wednesday last, as the rules of the House require that when a member reads or quotes from a document, the document must be tabled.

Mr. Speaker acknowledged the rule that a Minister is not at liberty to read or quote from a document or paper not before the House without being prepared to lay it on the Table.

The Speaker further stated, however, that a Member should request that a Minister table a document at the time it is being quoted and not several days later.

Petitions

Mr. Mesheau laid upon the table of the House a petition on behalf of residents of Tantramar urging the House to consider prohibiting the annual hunting of bears in the spring. (Petition 1)

Select Committee on Energy

Mr. LeBlanc from the Select Committee on Energy, presented the First Report of the Committee, which was read and is as follows:November 27, 1998

To The Honourable

The Legislative Assembly of

The Province of New Brunswick

Mr. Speaker:

I have the honour to present herewith the First Report of the Select Committee on Energy. The report is the result of the Committee's deliberations on natural gas.

As authorized by the House, the report was filed with the Clerk of the Legislative Assembly on November 5, 1998 and subsequently released to the public. Pursuant to the Committee's order of reference, I am now tabling this report in the House.

I wish to thank all members of the Committee for their diligent work and the many presenters who took the time to make their views known to us.

At this time I wish to express the Committee's concern and disapproval regarding the earlier leak of a draft version of the report.

A front page article in the October 28, 1998 issue of *Telegraph Journal* stated that the newspaper had obtained a 46-page copy of the Committee's draft report on natural gas distribution. The article purported to quote directly from various sections of the report and outlined numerous recommendations contained therein. The article also referred to certain *in camera* deliberations of the Committee. I am tabling with you a copy of this article.

Your Committee is deeply concerned with the unauthorized release of the draft report and apparent breach of confidentiality.

A committee of the House enjoys the right to have its deliberations protected by privilege. This is to ensure that matters can be freely debated and explored and that members are free to express their concerns without the glare of publicity.

The premature disclosure of a committee report and publishing of its contents shows little respect for the institution of Parliament and the important work of this committee.

Respectfully submitted,

Peter LeBlanc, C.A., MLA

Chairman

Ordered that the Report be received and the Committee continued.

The full Report of the Committee as presented is as follows:

November 5, 1998.

To The Honourable

The Legislative Assembly of

The Province of New Brunswick.

Mr. Speaker:

Your Select Committee on Energy has the honour to present herewith its First Report.

The Report is the result of the Committee's deliberations on natural gas.

Your Committee wishes to thank the many individuals and organizations that appeared before the public hearings or submitted written briefs.

Respectfully submitted,

(Sgd.:) Peter LeBlanc, C.A., M.L.A.

Chairman.

The full report of the Committee as presented follows:

EXECUTIVE SUMMARY

With the imminent arrival of Sable Island natural gas in the province, New Brunswick earlier this year embarked on a process to determine how it could best benefit from this fuel, which can be used for industrial, residential and power generation purposes. After holding public hearings, a Select Committee on Energy, appointed by the New Brunswick Legislative Assembly, has produced this report, which examines the implications of natural gas for the province and makes recommendations to the provincial government on how the gas should be regulated and distributed. Throughout the report, the theme is to encourage the proper and expeditious development of natural gas in New Brunswick, and to do it in such a way as to make gas available in the province to the widest extent possible, and to the maximum benefit of its people.

The committee recognizes that construction of lateral transmission lines off the main pipeline is fundamental to extending natural gas throughout the province. In the event that markets for Northeastern and Northwestern New Brunswick are inadequate to meet the economic threshold test for lateral construction under the National Energy Board's lateral policy, the committee recommends that the provincial government provide a contribution in aid of construction to enable the laterals to be built. In addition, access to natural gas for all of New Brunswick, including the Northeastern and Northwestern parts of the province, should be a key criterion in evaluating proposals for any distribution franchise. It is recognized that some subsidies or incentives may be necessary for laterals that may not otherwise be economically justified. We do recommend that the New Brunswick Government aggressively seek financial support from the federal government to extend gas availability in the province. The committee does not, however, recommend a broad policy of government subsidies or incentives.

The committee recommends that all consumption of natural gas in the province should be regulated under a broad definition of gas distribution and under provincial jurisdiction. Prospective "anchor load" customers should be granted a single end-user franchise for a term of 20 years, or for the term of their firm service agreement with the pipeline company, whichever is less. For this, they would pay an annual fixed franchise fee, part of which would be used to support the increased activities of the regulatory Public Utilities Board.

In the committee's view, creation of the single end-user franchise makes it possible for the pipeline company, Maritimes & Northeast, to proceed with building lateral gas transmission lines off the main pipeline. In addition to the "single-user" and "general" classes of franchise, the committee also recommends establishing a "local producer" class, recognizing that there appears to be real potential for developing indigenous supplies of natural gas in New Brunswick in the future.

An important role in achieving maximum benefits of natural gas for the province will be played by the Public Utilities Board, which will require increased staff and additional technical expertise. The committee recommends the PUB be given flexibility in the methods it uses to determine a distribution company's charges to consumers. The board should also have authority over such matters as revenue cycle services, supplier of last resort, load balancing, and the possible use of incentives in regulation.

Concerning the matter of market power, the committee is aware that the potential exists for exercising undue influence on the market if a holder of a distribution franchise is also involved in another segment of the energy business. To ensure this does not happen, and in the interest of encouraging rapid development of a competitive market for natural gas and other forms of energy in New Brunswick, the committee recommends the regulatory authority establish comprehensive standards of conduct for the industry, including non-discriminatory access to distribution services.

During its hearings, the committee heard from New Brunswick municipalities, who, while welcoming the possibility of natural gas in their midst, expressed concerns about the financial implications for them resulting from such things as pipeline construction, utility cuts, and emergency response training. The committee is sympathetic to these concerns and recommends that existing legislation be amended to protect municipal interests. Municipalities should be allowed to recover their additional costs and to offer cost-effective services to the local distribution companies.

Because natural gas is the cleanest fossil fuel available, its use will result in substantially lower emissions of sulphur dioxide, carbon dioxide and nitrous oxides from industries and electrical generating stations. Lower air emissions will provide the entire province with environmental benefits.

To pave the way for natural gas distribution, various provincial statutes will have to be amended, and these are listed in the report, along with a recommendation that a comprehensive review be undertaken. To keep abreast of changes in the natural gas industry, especially technological ones, establishment of a Centre for Excellence is proposed, to be located in New Brunswick and to serve the province and adjacent jurisdictions. Potential funding sources for the centre are listed.

With completion of this preliminary stage in developing a natural gas industry in New Brunswick, it is recommended the government proceed to Stage II, in which a Request for Proposals is issued, and bidders are invited to formally seek distribution franchises. This report reviews some of the matters related to Stage II, including the length of terms for franchises, the number of franchises that might be awarded, whether "bundled" or "unbundled" service is preferable, and the required contents of development proposals.

The Select Committee on Energy will next begin hearings and deliberations on restructuring the electric industry in New Brunswick. As the report notes, natural gas will be a highly relevant component of these discussions.

Current Energy Use in New Brunswick

[See original for graphs indicating Current Energy Use in New Brunswick.]

INTRODUCTION

When it comes to natural gas, New Brunswick is what is known as a "greenfield" market, meaning it has essentially no existing gas distribution facilities. Because natural gas has not been generally available here, the province has been denied the economic opportunities that could accrue from having access to this clean, less expensive fossil fuel. But now, with the development of the gas fields surrounding Sable Island, off Nova Scotia, and the imminent construction of a pipeline, which will deliver natural gas to New Brunswick, the province recognizes that it is standing at the threshold of a new and important stage in its historic evolution.

Accordingly, the Government of New Brunswick decided to undertake a thorough, open and transparent examination of all issues relating to energy. It asked the 53rd Legislative Assembly to create a Select Committee on Energy with a broad mandate. This includes an examination of the future of the electric utility industry in New Brunswick, which it will begin shortly. But its first task was to look into the implications of the arrival of natural gas in the province. In the first stage of this process, an Expression of Interest and Consultation document was issued, and interested parties were invited to express their opinions at public hearings. In the next stage, this information will be used by the New Brunswick Department of Natural Resources and Energy to develop a Request for Proposals, the response to which will be evaluated, and negotiations begun with selected bidders.

The Select Committee on Energy held its first meeting on July 29, 1998, and adopted a tight timetable for public hearings, consultations and preparation of its report on natural gas. Subsequently, nine days of hearings were held in Fredericton, Saint John, Moncton, Bathurst and Edmundston. (A schedule of hearing dates and presenters is included as Appendix A. A list of individuals and organizations who did not appear but submitted written briefs is included as Appendix B.) This report is the result of that process. It presents the committee's views on the public policy and legislative issues surrounding natural gas in New Brunswick, and it provides guidance on issues that should be addressed as part of the process for awarding gas distribution franchises in the province.

TOWARDS A NATURAL GAS INDUSTRY IN NEW BRUNSWICK

Historical Perspective

Even before natural gas was available by pipeline in North America, there was a small gas distribution industry. This essentially consisted of local enterprises which manufactured gas from coal and oil. But, because of its chemical composition, this manufactured gas had a relatively low energy value, and so its distribution and use were limited to small geographic areas. The first of these local distribution companies, or LDCs, were established in places like Baltimore and Boston. The first Canadian distribution company was Consumers Gas in Toronto, established in 1847.

The first natural gas was produced as a by-product of crude oil and was considered a waste product. While oil, a liquid, was easy to store and transport to markets, even in small quantities, there was no way economically to store natural gas during the early years of oil production. So, it was generally flared or burned at the wellhead.

Later, the industry realized natural gas could be a valuable source of energy1but only where customers could access it economically. This led to construction of the first pipelines to deliver it to market. Not until the 1930s, however, were techniques developed for building and operating high-pressure natural gas pipelines such as we have today.

In 1947, oil was discovered in the Leduc oil field of Alberta, and this became a significant event in the development of the Canadian gas industry. It led to discoveries of gas that demonstrated abundant quantities existed that could be commercially developed. Initially, the Alberta Conservation Board, which had been established nearly a decade earlier to regulate gas and oil operations in the province, developed relatively conservative estimates of the amount of gas that could be exported. But eventually it was realized that the available supply of natural gas in Alberta far exceeded the demand in that province.

In 1951, Parliament created TransCanada PipeLines in order to give Alberta natural gas producers access to markets in Ontario and Quebec. Construction of the pipeline began in 1956 and was completed in 1958. The following year, Parliament created the National Energy Board, acting on the recommendation of the Borden Commission, which identified the extent of potential gas reserves in Canada.

The major early customers of TransCanada included Quebec Natural Gas Corporation (the predecessor to Gaz Metropolitain in Montreal), Consumers Gas in Toronto, and Union Gas in Southwestern Ontario. The involvement of Union Gas, in particular, is noteworthy because that company has large storage facilities, enabling it to receive and store substantial volumes of gas during summer and thereby allowing the TransCanada system to operate more efficiently. The TransCanada system terminates near Montreal. The TransQuebec-Maritime system, a joint venture involving TransCanada and Gaz Metropolitain, extended service from near Montreal to Quebec City.

With the disappearance of federal pipeline incentives under the National Energy Plan in the 1980s, the opportunity for extending a pipeline farther East was lost. Consequently, Atlantic Canada has never had access to Western Canadian natural gas with which to develop its local industry and provide an alternative energy source for homes. Indeed, the single exception to the absence of natural gas in New Brunswick has been in Moncton, where it became available from local production in the early 1900s. As recently as 1974, Moncton Utility Gas had 810 customers, but the company ceased local production in 1991.

Today, Alberta produces 83 per cent of Canada's natural gas supply, with British Columbia and Saskatchewan supplying the balance. The total Canadian production is six trillion cubic feet (TCF) per year, of which about half is exported. These export volumes have allowed Western Canadian producers to realize economies of scale in production, resulting in lower domestic prices, while also adding strength to the Canadian economy. Now, with the development of the gas fields around Sable Island, consumers in the Maritime Provinces will have their first opportunity to receive significant quantities of natural gas.

In the United States, although the federal government had created a regulatory commission, a predecessor to today's Federal Energy Regulatory Commission (FERC), as early as the 1930s, it wasn't until after the Second World War that the natural gas industry began to grow rapidly. Significant improvements in pipeline technology and an increase in demand for energy in the post-war period provided the impetus for developing pipelines. In addition, pipelines built during the war to carry oil from the Gulf of Mexico to U.S. East Coast markets were converted to natural gas use, providing a relatively low cost gas transportation link into major U.S. East Coast markets.

In New England, natural gas became available in the mid-1950s. Because pipeline natural gas was substantially less expensive than manufactured gas and because its heating content was about double, existing local distribution companies (LDCs) expanded their systems dramatically; their capacity to deliver energy doubled as natural gas replaced manufactured gas.

The Natural Gas Industry Participants and their Interests

In New Brunswick, the following participants will have key roles in developing the natural gas industry:

- The Government of New Brunswick.
- The Sable Island producers.
- The owners of the Maritimes & Northeast Pipeline.
- Potential New Brunswick customers for natural gas.
- Northeastern U.S. customers for natural gas.
- The Government of Canada.
- Potential developers of Local Distribution Companies.

In this section of our report, we provide a general description of the respective interests of these participants.

The Government of New Brunswick

Discovery of commercial quantities of natural gas in the area of Sable Island, and the subsequent proposal to build a pipeline to deliver this gas to markets in the Northeastern U.S., offer an opportunity to develop a natural gas distribution business in New Brunswick. The government is committed to making decisions that provide the maximum overall benefit to the citizens of the province. The government wishes to achieve:

- Maximum availability of natural gas in the province.
- Timely development of a natural gas infrastructure.
- Development of an effective regulatory framework for the gas distribution business.
- Increased competition in the energy market.
- Access for indigenous natural gas.
- Regional price equity.

- Maximum economic benefits in New Brunswick.

The Sable Island Producers

The Sable Offshore Energy Project (SOEP), a consortium of Mobil Oil Canada Properties Limited, Shell Canada Limited, Imperial Oil Resources Limited, and Nova Scotia Resources Limited, invested $3.2 billion between 1980 and 1995 in exploration and related activities on the Scotian Shelf. To support these offshore activities, the Government of Canada invested an additional $1.4 billion.

The producers are investing further to construct offshore development platforms, wells, and pipelines to transport gas from the offshore platforms to the onshore gas processing facilities. Other onshore facilities will be required to remove impurities from the gas stream and extract valuable liquid petroleum products (ethane, propane, and butane) generally found in raw natural gas.

The Sable Island producers will receive no revenues from their investments until they are able to market their gas. Obviously, this will not occur until production begins and the pipeline is operating. Although they have no guarantees, the producers have assumed the risk of their investments because they expect eventually to achieve revenues from gas sales sufficient to cover their costs and generate a reasonable return for their shareholders.

The Owners of the Maritimes & Northeast Pipeline

The M&NE Pipeline owners are also willing to make a sizable investment ($1 billion Canadian) to construct a pipeline to transport the gas from the onshore facilities to the market because they, too, believe they can earn a reasonable return on their investment. To make a pipeline project economic, it is necessary to have the pipeline carry relatively large volumes of gas. The size of the market in the Maritimes is not, by itself, sufficient to justify the large cost of constructing offshore production facilities or the inter-provincial pipeline system. However, the New England markets are large enough to justify construction. Moreover, once a pipeline is built to reach the New England markets, constructing laterals to serve New Brunswick markets becomes more economical. However, revenues from operation of the laterals must support their construction and operation.

Accordingly, the M&NE Pipeline is interested in building the New Brunswick laterals based on economics. Under the lateral policy approved by the National Energy Board, the pipeline will build laterals only if revenues are sufficient to offset costs, including a return on investment. It is also possible that a contribution in aid of construction[1] may be required from the pipeline customer in order for the revenues from the project to meet the threshold toll test, which limits the extent to which U.S. shippers will subsidize the construction of the Canadian laterals. The proposed laterals are therefore contingent upon customers committing to long-term service from the pipeline and paying the pipeline's cost. Naturally, there is a limit to what proposed customers will be willing to pay for gas. This limit is determined by the market price of their alternative fuel and cost of conversion. Without the large anchor industrial loads (including power generation) participating in the lateral projects, it is very unlikely the M&NE Pipeline will be willing to construct the laterals. Thus, the lateral policy improves opportunities for enhanced market penetration throughout the province. Without laterals, a potential local distribution company (LDC) located away from the main pipeline would have to build its own facilities to connect to the main line. This would substantially increase its cost and make developing its business difficult.

Potential New Brunswick Customers for Natural Gas

Existing New Brunswick industrial companies are interested in reducing their costs of energy with a competitively priced, environmentally superior fossil fuel. But industry will convert to natural gas only if it makes economic sense. And the same is true for prospective residential and commercial customers. Therefore, natural gas cannot be considered an "essential service" in the same manner as water, sewer service, and electricity.

Industrial customers considering conversion to gas will weigh several factors. One is the cost incurred to convert their existing energy equipment to burn natural gas or the cost to install new gas-fired equipment. In addition, industrial customers need to know the cost of purchasing and transporting gas to their facility.

Industrial customers will compare these costs with the cost of their current fuel. If the savings from using gas instead of the current fuel more than offset the costs of conversion within a reasonable time period, then the industries are likely to make the change. If the gas savings do not offset the conversion costs, potential customers are unlikely to switch fuels.

Industrial customers considering natural gas are also likely to retain their oil-firing capability if they have no compelling reason to use gas exclusively. This provides them with additional flexibility. Once they have installed the gas-firing capability, they can make their short-term energy purchase decisions based on whichever fuel has the lowest operating cost. If the commodity cost of gas delivered to their facility is higher than the cost of their alternative fuel, they could simply switch over to the alternative fuel and avoid the higher cost of gas. Then, when the delivered cost of gas becomes lower than the cost of the alternative fuel, they will switch back to gas. This flexibility allows the industrial customer to minimize its fuel costs.

Customers who can switch from natural gas to alternative fuels on short notice are generally referred to as "interruptible" customers. Customers who do not have access to an alternative fuel are generally referred to as "firm" customers. Pipelines and LDCs design their systems so that they can meet all firm requirements under virtually all conditions. Natural gas companies serve interruptible customers only if they have capacity available after meeting their firm customers' requirements.

Industrial customers with dual-fuel capabilities generally do not purchase firm pipeline capacity, because firm capacity requires a customer to pay for the capacity (through a demand charge) whether or not it is used. However, New Brunswick industrial customers may be willing to sign firm pipeline contracts for the following reasons:

- M&NE might not build laterals to serve the industrial customers without firm, long-term contracts for pipeline transportation service; and
- The dual-fueled industrial customer may be able to sell its gas supplies on cold days as "supplemental" supplies to third parties willing to pay a premium for these supplies.

Industrial customers with access to firm gas supplies and alternative fuel capability may sell their gas to other markets at any time. Generally, they do this if the price for gas is higher than the cost of alternative fuel. Since the industrial customer would want to sell the gas to the party offering the highest price, this market could be very competitive, particularly if there are a large number of potential buyers and sellers.

On the other hand, small commercial and residential customers who convert to natural gas and are served by an LDC are unlikely to retain their alternative fuel capability because it is impractical for them to switch back and forth between fuels. Therefore, the distribution company (or the marketer that serves the distribution company's firm customers) must be able to serve these customers' full requirements. In most regulatory environments, LDCs who also have a merchant (sales) function have an obligation to serve all firm loads under virtually all situations. LDCs generally maintain a small surplus of available capacity in order to do so.

Northeastern U.S. Customers for Natural Gas

The gas market in most parts of the Northeastern U.S. is mature: a relative balance currently exists between supply and demand for the fuel. If Sable Island gas is to compete in the traditional Northeastern U.S. market, it has to be competitively priced with gas delivered to New England from existing sources.

An interesting new development is the restructuring of the electric generation market in New England. As a result, several new gas-fired electric generating facilities are expected to be constructed there. Some 3,000 MW of gas-fired capacity is already either under construction or in the process of being financed, and by 2002, a total of about 5,000 MW is expected to be in service. The new generating units are required to meet new electric load requirements, to replace old inefficient oil-fired units, and to replace nuclear generating units being retired.

Although adequate supply and capacity exist to meet current needs of the New England gas market, there is not enough to satisfy the emerging gas-fired electric generating market. It needs access to reliable and competitive gas supplies. So this is the primary market the Sable Island producers and the M&NE Pipeline are targeting in New England. They are fully aware that it would be more expensive to serve this potential market by expanding pipeline capacity from the Gulf Coast or Western Canada.

The Government of Canada

The federal regulatory authority dealing with energy-related issues is the National Energy Board (NEB). Established in 1959, it is accountable to Parliament through the Minister of Natural Resources. Among its activities, the NEB regulates construction of pipelines that cross provincial and national boundaries as well as the rates and services offered by the inter-provincial pipelines.

Over the years, the NEB has established policies that have supported development of the Canadian natural gas industry. Under NEB policies, TransCanada, the major inter-provincial pipeline that transports gas from Alberta to Eastern markets, has been able to expand its capacity and charge all customers, new and old, the same average rate based on the locations where they receive their gas. In the United States, the Federal Energy Regulatory Commission (FERC) generally requires interstate pipelines that expand their pipeline systems to charge higher incremental rates to new customers if the cost of expansion is significantly higher than the cost of the existing capacity. The NEB policies have encouraged expansion of TransCanada to serve markets in Ontario and Quebec and have encouraged development of energy resources for the export market. This has resulted in lower prices to natural gas consumers in Ontario, Quebec, and the United States, as well as greater revenues for the Alberta producers.

The NEB has adopted a lateral policy for the M&NE Pipeline project that is intended to encourage development of a gas infrastructure to serve the needs of potential natural gas customers in the Maritimes Provinces. Under the NEB policy, the cost of extending laterals from the main transmission line to the markets served by the laterals will be averaged with the costs for the main line transportation, provided this main line toll does not go above 60 cents per million British thermal units (MMBtu). This limit is called the threshold transportation toll.

In other words, if a lateral is built to Saint John, a customer (an LDC, marketer, or direct industrial customer) located in the city will pay the same transportation rate as a customer located directly on the main line. Without the lateral policy, the customer would have to pay the additional cost to transport the gas from the main line to its meter. This additional transportation charge would have to be paid to the party constructing the lateral pipeline, and would be significantly higher than under the NEB lateral policy. The policy is intended to encourage construction of more laterals, provided they can meet the threshold toll test. It does make the average cost of using the main line slightly higher than would otherwise be the case, but it provides the Maritimes Provinces with greater access to gas.

The result of the NEB lateral policy is to have export shippers absorb a significant part of the cost for construction and operation of the New Brunswick and Nova Scotia laterals, because the main line shippers include shippers transporting gas to the U.S. This is an opportunity, then, for New Brunswick and Nova Scotia to obtain greater benefits from the pipeline than they might otherwise.

Under the NEB lateral policy, if revenues from construction of one lateral exceed the cost of constructing the lateral, this additional revenue can be used to help fund construction of another lateral serving the same shipper that might not otherwise meet the threshold toll test.

Also, under the NEB lateral policy, it is possible for a large end-user to be served directly by the pipeline, without the gas being transported through a local distribution system. Under existing provincial rules, gas passing through a local distribution system would be subject to the jurisdiction of the provincial regulatory authority, which would regulate the types of services offered and the rates charged by the LDC.

The Potential Developers of Local Gas Distribution (LDC) Companies

A number of companies have indicated an interest in establishing a franchise for distributing natural gas in the province. They are, naturally, interested in making a profit from this business. The success of their ventures will depend on their ability to serve customers' requirements at rates customers are willing to pay. Most potential bidders have expressed a preference for "light-handed" government regulation that will provide the flexibility they need to respond to changes in the market, while also allowing for responsible governmental review of their activities.

Economic Considerations in Pipeline and LDC Operations

Concerns Relating to the Recovery of Fixed Costs

It is important to recognize that pipelines and gas distribution systems generally require the companies building them to make large capital investments. These facilities are generally usable over a relatively long period of time. Apart from the cost of the gas itself, most of the transportation companies' costs are fixed and are not affected by the volume of gas transported. For example, debt coverage, property taxes, insurance, company payroll, fringe benefits, rents, and other general and administrative costs do not change, regardless of how much gas is moved. But the large amount of fixed costs does make the average or unit cost of providing service extremely sensitive to the volume of gas transported.

Thus, when a pipeline company or LDC builds a new pipeline or extends its existing system, it is important for the new facility to be built at the proper size. A project too large for the loads it will serve will have high average unit costs, making it difficult for the company to get customers to switch from their alternative fuels. Only by increasing its gas volumes will the pipeline or LDC be able to lower its average cost. If, on the other hand, the project is undersized, it will have to be subsequently expanded, which is more costly than building a system of sufficient size in the first place.

To reiterate: the unit cost of transporting gas decreases as volumes increase. This occurs in two ways. First, for any given pipeline size, the average cost is minimized when the maximum potential volumes are transported through it. For example, if we assume that the annual cost of transporting 1 MMBtu/day of gas for 365 days is $365 with no variable cost, the average cost is $1.00/MMBtu [($365/year) / (365 MMBtu/year)]. This rate for calculating the average cost of transporting the maximum annual contract quantity of gas is referred to as the 100 percent load factor rate. However, if the customer transported only half the maximum annual volume, or 182.5 MMBtu, the fixed cost would still be the same $365/year, but the average cost would be $2.00/MMBtu [($365/year) / (182.50 MMBtu/year)]. This would be a 50 percent load factor rate.[2]

Second, although it costs more to build a larger diameter pipeline than a smaller one, the increase in maximum flow rate for the larger pipeline is greater than the increase in cost. This means that the unit cost of a larger pipeline is less than the unit cost of a smaller pipeline. A study by the University of Calgary, for example, showed the increase in cost between a 20-inch pipeline and a 24-inch pipeline would be about 31 percent, while the 24-inch pipeline would be able to deliver 55 percent more gas.[3] The figures change, depending on the sizes of pipeline being compared, but in all cases studied, the cost increased by a lower percentage than the volume percentage increase. This is a very important factor in designing pipeline projects and laterals. It reinforces arguments presented by companies at the public hearings that the large industrial loads are a very important factor in the economic viability of constructing laterals.

Basic Business Risk of the LDC

Again, the pipeline industry typically requires a very large capital investment to install a new pipeline, which has a long economic life. Therefore, in deciding to construct and finance a pipeline project, a company exposes itself to a considerable amount of business risk.

Building a pipeline or an LDC is similar to buying a new house. The project sponsors must put some equity at risk and must also borrow additional money to pay for the construction. Banks will not loan the money without reasonable assurance that the company will be able to pay it back over the term of the loan. In the case of a gas pipeline or LDC, a company's ability to repay the investment will be determined by whether or not it can sell the transportation service it provides at a price high enough to repay the loan and cover its expenses.

Competitive businesses start and fail all the time. However, it is unusual for a gas distribution company to fail. Traditionally, gas distribution companies have been among the most stable of businesses, largely because of governmental regulation, which permits prices that cover costs plus a return on investment. However, the risks associated with starting a new gas distribution company are much greater than running an existing, mature distribution company. For a new LDC, achieving profitability will likely take a relatively long time. In determining who should be awarded a gas distribution franchise, the government should evaluate a bidder's overall business plan and evaluate the company's ability to finance the business over the long term.

OBJECTIVES

As noted earlier, the Government of New Brunswick has several policy objectives for establishing a gas distribution system in the province. In this section, we discuss these objectives.

Maximum Availability of Natural Gas

Construction of the M&NE Pipeline provides New Brunswick with its first opportunity to introduce natural gas as a major source of energy in the province. The anchor support for the pipeline is the U.S. export market. The NEB's lateral policy provides an opportunity to construct the pipeline facilities under terms that are favourable to the province. These terms will assist in delivering gas to locations not along the main pipeline. This is the first step in providing access to natural gas for a larger segment of the New Brunswick population.

However, it will not be possible to economically justify building pipeline and gas distribution facilities in all areas of the province in the immediate future. One reason is that 60 percent of the residential heating market is currently served by electric baseboard heat. The cost of converting from electric resistance heating to gas heating is very high, making it difficult for homeowners to make the investment. These high conversion costs are likely to delay or preclude natural gas penetration into some areas of the province.

The committee recognizes that facilities will likely be built first to serve large anchor loads. However, main line and lateral facilities built to serve large industrial demands make it more economical subsequently to serve nearby commercial and residential customers. The specific decisions as to whether a particular area will receive gas service will depend on several factors, including economics, location of potential new loads, and lateral costs. The committee urges the New Brunswick Government to promote agreements between anchor customers and M&NE pipeline so that laterals could be built under the pipeline's current lateral policy at the earliest possible date. Construction of these laterals so they can be priced on a "rolled-in" basis, that is, averaged with the cost of main line construction, as explained earlier, is viewed as essential to meeting the goals of achieving maximum availability of gas in the province.

In the event that natural gas markets for Northeastern and Northwestern New Brunswick are inadequate to meet the economic threshold test for lateral construction under the lateral policy, the New Brunswick Government should be prepared to provide a contribution in aid of construction to enable the laterals to be built. In addition, access to natural gas for all of New Brunswick, including the Northeastern and Northwestern parts of the province, should be a key criterion in evaluating proposals for any distribution franchise.

Timely Development of a Natural Gas Infrastructure

It will take time for commercial and residential natural gas markets to develop. Some potential developers, however, appear willing to take steps to speed up the process. The committee is encouraged by remarks at the hearings that indicate broad subsidies will not be necessary. The government's primary interest in this process is the expeditious development of a natural gas industry. The committee does not recommend a broad policy of governmental subsidies or incentives, but recognizes that some subsidies or incentives may be necessary for laterals that would not otherwise be economically justified under the terms of the M&NE lateral policy.

Development of an Effective Regulatory Framework for the Gas Distribution Business

In recent years, it has become understood that not all aspects of the natural gas industry are natural monopolies requiring governmental regulation. In some parts of the industry, the forces of the market can provide sufficient protection for customers. Other areas, such as distribution, require continued governmental regulation as natural monopolies.

Substantial reforms in the area of governmental regulation in many jurisdictions have made the process less cumbersome and more effective. The major reform has been the evolution from traditional cost of service regulation, which is based largely on historical cost information, towards incentive regulation, which is based largely on performance standards. As a "greenfield" market, New Brunswick has the opportunity to choose the gas distribution regulatory process that is most effective for its situation.

Increased Competition in the Energy Market

With the introduction of a new source of energy to the province, inter-fuel competition will increase. This has the potential to provide energy cost savings throughout the New Brunswick. There is however, a need to ensure "arm's-length" separation when companies are in the business of marketing more than one form of energy. This is particularly important in today's market, where there is increased consolidation of energy companies and the development of energy providers marketing not one but all forms of energy. Any issues of market power must be adequately addressed to ensure that the benefits of an additional source of energy are available on competitive terms throughout the province.

Access for Indigenous Natural Gas Supply

The provincial government wishes to encourage the development of commercially viable sources of natural gas in New Brunswick. The committee's recommendations in this report will, if followed, ensure no artificial barriers will deter moving this gas to the competitive market.

Regional Price Equity

The committee is concerned that similar end-users (residential, commercial, industrial) in different areas of the province may face different prices. We are, however, confident that the bidding process will minimize these differences. We want to ensure that any differences in rates reflect true cost differences or are the products of competitive market forces.

Maximizing Economic Benefits in New Brunswick

New Brunswick wishes to maximize economic benefits from development of Sable Island gas and the M&NE Pipeline systems. Pipeline laterals and distribution facilities will not be constructed unless they are economical. Market forces will determine the extent to which natural gas penetrates the New Brunswick market. Carefully developed government programs may be able to create broader access to gas, but these programs have costs that must also be fully considered.

DEVELOPMENT OF SABLE ISLAND GAS

Development of the gas industry in New Brunswick will depend on a number of factors, including the price of alternative fuels, availability and accessibility of laterals, the cost to convert existing facilities to gas, the amount of capital available for investment, the general level of economic activity in the market area, and the level of uncertainty associated with government policy options. Several points, however, can be made regarding its likely evolution, based on industry experience.

There are natural stages for development of the industry in frontier areas.

First, there must be a discovery of commercially significant resources. Producers must determine that enough gas is available to justify the construction of production, processing, and offshore pipeline facilities.

Second, there must be an economical way to transport the gas to a market. Producers often form joint ventures with pipeline companies to construct the pipelines required to deliver the gas to market. Mobil, which is one of the major Sable Island producers, is also a major owner of the M&NE Pipeline, along with Westcoast Energy, a major Canadian pipeline and distribution company and Duke Energy, a major U.S. pipeline. The Sable Island development project and the M&NE Pipeline are both justified based initially on the New England market.

The third stage is construction of pipeline laterals to serve major industrial or anchor loads. The M&NE Pipeline has determined that it is economical to build a lateral to the Saint John area under the NEB-approved lateral policy. The proposed Saint John lateral is based on long-term contracts with transportation customers willing to pay the pipeline rate. However, the anchor load customers have stated that they are not willing to pay additional distribution charges. The ability to construct additional laterals to serve loads in the Northeastern and Northwestern parts of the province may be tied, therefore, to the ability of the Saint John lateral to provide revenues that can be used to support other laterals under the policy.

The final stage is development of LDCs that are directly connected to the main line or laterals. These distribution franchises tend to serve a large number of small customers. The key to establishing LDCs is to have a concentration of potential retail gas customers in an area where there is access to competitive supplies. Laterals constructed to serve large industrial loads may provide just such an opportunity to serve nearby population centers, which alone would not economically justify building the laterals.

The lateral proposed for the Saint John area would not be as economic if built outside the lateral policy because it would become an incremental cost added to the mainline transportation toll. But once the Saint John lateral is built, it becomes more economically feasible to establish a distribution company in the Saint John area to serve the residential and commercial markets. Beyond that, in order to be effective, the LDCs will need to convert customers from their existing fuels. This would be even more difficult if the LDCs had to pay for the cost of the lateral in addition to the cost of the mainline transportation.

Allowing direct access to large industrial customers would provide the opportunity for volumes on the laterals to flow as soon as they could connect to the end-users. This could also happen if single end-user franchises were permitted. Since it will take longer for the LDCs to develop their markets and attract load, this is an important factor in the economics of building and operating the laterals. Once the laterals are constructed, the LDCs could build their systems using the laterals as the backbone of their supply system and contract for additional gas as their loads grew over time.

KEY ISSUES

This section of the report provides an analysis of key issues presented to the committee and provides the basis for the committee's recommendations on these issues.

Lateral Policy and Pipeline Access

As noted, the NEB has approved the M&NE Pipeline lateral policy. Under this policy, the pipeline will build laterals if revenues from them are sufficient to cover their construction and operating costs. A single or "postage stamp" rate will be charged all shippers using the main line or laterals in Nova Scotia and New Brunswick. Without this policy, customers taking service from a lateral would pay a main line charge and a separate charge for use of the lateral. The policy is in effect until the pipeline proposes its first main line expansion. After that, it may or may not disappear.

The committee recognizes that M&NE's lateral policy provides substantial benefits to the province. These benefits should not be jeopardized. To summarize, the key factors associated with them include:

- Construction of laterals moves the reach of the pipeline and the its postage stamp toll farther into the province, with the cost underwritten by all main line shippers, most of whom are export shippers.
- Laterals will be built only if there are sufficient loads and revenues from the laterals to cover the pipeline's lateral costs.
- The lateral policy provides a limited window of opportunity, because it is in place only until the first main line expansion. Given the growing load in the United States, main line expansion will likely be required in the near future.
- A discounted toll (4 percent) for New Brunswick is in effect only for the first three years of pipeline operation.
- If M&NE goes into service without contracts signed to justify the laterals, the Sable Island producers will move to sell the capacity in available markets, which are likely to be in the U.S. This will probably be done under long-term contracts. Thus, a delay in deciding the lateral issue could cost the province this initial capacity opportunity.

The committee strongly believes the benefits offered by the lateral policy will be essential to the timely construction of facilities to serve the Northeast and Northwest regions of the province, and it encourages the New Brunswick Government to actively promote agreements between anchor load customers and M&NE Pipeline sufficient to justify construction of the laterals.

The committee also believes that government should ensure that natural gas becomes available to Northeastern and Northwestern New Brunswick as soon as possible. In the event that natural gas loads for these markets prove inadequate to meet the economic threshold toll test for lateral construction under the M&NE lateral policy, government should be prepared to provide a contribution in aid of construction to enable the pipeline to be built. In addition, access to natural gas for all of New Brunswick, including Northeastern and Northwestern parts of the province, should be a key criterion in evaluating proposals for any distribution franchise.

As a result of laterals being constructed by the inter-provincial pipeline, an important related issue is created which the committee must address - direct access. Direct access is the connection of a customer to either the inter-provincial pipeline or a lateral without using a distribution system. Bypass is a different issue. It occurs when a customer of an existing distribution system seeks to connect directly to the inter-provincial pipeline. If allowed, bypass causes the distribution company and the rest of its customers to bear the costs of any facilities installed to provide service to the bypassing customer. Since no distribution systems currently operate in New Brunswick, bypass is not yet an issue. However, direct access is an important issue.

The committee is aware that the M&NE pipeline has signed agreements with prospective major industrial customers to provide these customers with direct access to delivered natural gas from a lateral in exchange for the customers' obligation to pay the cost of constructing the lateral. Without the industrial customers' willingness to commit to the pipeline contracts, it is unlikely the pipeline company would construct laterals.

Some potential LDC developers stated they would not be able to develop LDCs to serve commercial and residential customers unless large industrial customers were required to take their service from the LDC. These parties said it was necessary to have a distribution company set a meter between the pipeline and the end-user so that the LDC could collect transportation revenue from the large customers. Other potential LDC developers said they could develop distribution operations without requiring the large industrials to take service from the LDCs. These proponents stated they would be willing to compete for some of the large industrial business, but they anticipated that the potential margins from these customers would be very small as a result of inter-fuel competition.

For their part, some large industrial customers stated they would not be willing to pay the cost of the pipeline if they were also obligated to pay distribution charges to an LDC. These customers, who currently burn fuel oil, need to be able to take service directly from the pipeline in order to make converting to gas economical. Natural gas would make sense only if savings were sufficiently large to offset conversion costs and provide ongoing savings.

The committee feels obligated to take a position on the issue of whether, and to what extent, direct access will be allowed for large industrial or anchor load customers. If direct access is allowed without any modification, these customers would take service under rates regulated by the NEB, and the provincial government would not have jurisdiction over the transaction. In this case, no revenue would be available from the large customers to help develop the gas distribution business in New Brunswick.

If, on the other hand, direct access were prohibited, large industrial customers would have to take service from LDCs. Since LDCs have not yet been established, the industrial customers have no way of knowing how much the LDC would charge for the service. Industrial customers cannot commit to the contracts that the pipeline needs to build the laterals unless they know what their total costs will be and whether converting to gas will be economical. If the LDC attempted to charge the industrial customer anything other than a nominal rate, the industrial customer may not be willing to convert to gas in the first place.

The committee understands that anchor customers are essential to construction of laterals within New Brunswick. Without anchor customers, it is very unlikely there will be laterals, and without laterals, gas availability will be severely limited in the province. The imposition of distribution charges on anchor loads could threaten the economic viability of their conversions and, consequently, the viability of the laterals.

The committee also realizes that it would be very difficult for parties to bid for distribution franchise rights without knowing if the anchor loads will be customers of M&NE or the distribution franchise. Further, the anchor load customers need stable and predictable rates to justify their conversion commitments. The committee understands that it is necessary to preserve the economic benefits the anchor load customers have negotiated with the pipeline without relinquishing provincial jurisdiction.

Accordingly, the committee recommends that all consumption of natural gas in the province be included under a broad definition of gas distribution in order to bring these activities under provincial regulation. It further recommends that prospective anchor load customers be granted a single end-user franchise for a term of 20 years, or the term of their firm service agreement with the pipeline, whichever is less. The single end-user franchises would be required to pay an annual, fixed franchise fee, which, among other uses, would help cover the increased costs of regulatory activities by the Public Utilities Board (PUB).

Establishing Franchises

To implement the above recommendation and to facilitate a competitive bidding process for distribution franchises, the committee proposes the following course of action:

- Draft legislation that defines natural gas distribution as the receipt, transportation, or consumption of natural gas delivered from a federally regulated pipeline or intra-provincial gas gathering or transmission system.
- Require that any party wishing to distribute gas must do so only through a franchise awarded by the province.
- Establish three classes of franchises - general, producer and single end-user.
- Make all three classes of franchises subject to provincial regulation. All franchises will pay an annual franchise fee and be required to supply any information required by the PUB to fulfil its statutory mandates.
- Establish an annual fee for all general and producer franchises based on the annual revenues of the franchise holder, while the single end-user annual fee should be a fixed fee. The annual fees would be intended to cover, among other things, the PUB's increased costs, which will arise as the PUB appropriately increases its responsibilities to respond to the challenges of the new industry.

Types of Franchises

A **general franchise** is awarded for the distribution of gas in a defined incorporated or unincorporated area to more than a single customer.

A **producer franchise** is awarded for gas produced in New Brunswick. The producer franchise should allow locally produced gas to be distributed to one or more end-users not served by an existing franchise.

A **single end-user franchise** is awarded where the distributor is the end-user and the end-user is directly connected to an inter-provincial pipeline.

The franchise fees charged to single end-user franchise holders should be fixed to provide for economic certainty over the life of the franchise, should carry an annual minimum that ensures that small - to medium-sized end-users will find value in being served by an LDC, and should not be so high as to jeopardize the development of laterals built by the pipeline.

The single end-user franchise should be made available only for gas taken off a pipeline for the direct consumption of the holder of the franchise. To preserve the integrity and value of general franchises, holders of a single end-user franchise will not be permitted to distribute gas to any other end-user. The term of this type of franchise will be the lesser of 20 years or the term of the customer's firm service agreement on the federally regulated pipeline. Single end-user franchises will pay no additional distribution charges above the M&NE Pipeline toll. They will, however, be subject to an annual fixed franchise fee.

An annual fee for all general and producer franchises should be established, based on the annual revenues of the franchise holder, while the single end-user annual fee should be a fixed fee. The annual fees would be intended to cover, among other things, the PUB's increased costs, which will arise as the PUB appropriately increases its responsibilities to respond to the challenges of the new industry.

The recommendation to create three separate classes of franchises provides provincial jurisdiction over the large industrial customers and promotes a practical and reasonable balance of interests regarding access to the pipeline. The committee also recommends that prior to the regulatory body issuing a single end-user franchise, it should be clear that the franchise is consistent with the objective of maximizing gas penetration in New Brunswick.

Future Laterals and Lateral Expansions

The committee has considered whether the policy articulated above should be different for new laterals or the future expansion of existing laterals. As long as M&NE's current lateral policy is in effect, it clearly benefits the province to have M&NE build the laterals. The committee also recommends that government provide a contribution in aid of construction where a lateral under the M&NE lateral policy has a revenue shortfall in meeting the economic threshold toll test. If, in the future, the lateral policy is no longer in effect, new facilities will be built by a distribution franchise holder under the jurisdiction of the province. The PUB should have the authority to decide on the appropriate rate to be charged on any facilities built by a distribution franchise holder.

Regulation

The committee recommends the PUB have flexibility in addressing issues under its jurisdiction. The PUB will also need expertise to decide those issues. It does have the authority to take evidence and consider all the facts on the technical, policy and legal matters. Accordingly, the committee proposes broad policy guidelines to the PUB and the Legislature for seven subject areas:

- Cost of service and incentive regulation
- Bundled and unbundled services
- Market power
- Revenue cycle services
- Supplier of last resort
- Load balancing
- Incentives for distribution system expansions

Cost of Service and Incentive Regulation

The issue to be addressed here is whether the PUB should be empowered to adopt forms of regulation other than traditional ones based on cost of service. Under this traditional form of regulation, a utility's revenue requirement is the sum of its operating costs, depreciation expense, taxes, and a return on investment. The latter is calculated by multiplying the utility's rate base (the company's net investment) by the rate of return approved by the regulatory body, and the total revenue requirement is allocated among the various services provided by the utility. The problem with this form of regulation is that it is essentially "cost plus," and therefore provides little incentive for cost control. Moreover, the inevitable cost of regulation is ultimately borne by the customer.

Recently, the telecommunications, railroad, gas, electric, and other regulated industries have begun to experiment with incentive regulation. There are various forms of incentive regulation, including price or revenue caps, indexed rates, and benchmarking. [4]

The common purpose of these methods is to break the connection between the utility's cost and its revenue requirement. For example, under indexed rates, the utility's revenue requirement increases each year by the rate of inflation less a productivity offset. This increase is allowed, regardless of changes in the utility's actual costs. Therefore, to earn, or exceed, its target return on investment, the utility must control its costs. Breaking the tie between the revenue requirement and costs forces the utility to behave more like a company in a competitive environment. In most cases, the regulatory body also prescribes some quality of service standards, which are necessary to ensure that any cost savings are not made at the expense of the utility's service to its customers.

Regulatory authorities have also used rate structure to achieve public policy goals. Examples include economic development rates and incentive rates. This type of initiative is usually for a limited period of time, with a goal of encouraging the development of a particular form of energy. Again, the link between costs and rates is broken under this alternative form of ratemaking.

The PUB should be given the authority to use its discretion in choosing the form of regulation appropriate for determining the revenue requirement and rates of a particular utility. This will require revision of the current statutes governing the PUB's activity. These statutes are predicated on the use of cost of service regulation, which was the standard when they were written. It should be emphasized that the goal of traditional or incentive regulation is the same _ to be fair to the consumer and compensatory to the utility. But compensatory does not mean the utility is guaranteed a return on its investment. It means, rather, that the utility is given a fair and reasonable opportunity to earn that return. Adoption of this regulatory approach will not jeopardize the objective of providing the consumer with the lowest reasonable rate.

The committee also recommends the PUB be given flexibility to establish rates for various customer classes, recognizing the province's social objectives and policies. Policies, such as the expansion of the distribution system, can be targeted through rate design initiatives, as could initiatives to help low income users or promote energy efficiency.

Bundled and Unbundled Services

Traditionally, distribution service has been provided on a so-called "bundled" basis, where the distributor is both the transporter and the merchant of the gas. The customer has no choice in who supplies the gas to the distributor and is also relieved of the responsibility for contracting for, ordering, and balancing a supply of gas. These functions are performed by the utility and the costs are passed on to the customer.

Lately, however, the development of the energy markets in the United States and Canada has led regulators to the conclusion that, in the long term, the merchant role is not appropriate for regulated electric and gas utilities. The new model is to regulate the true "natural monopoly" function - transportation - and let the competitive market forces "regulate" the merchant service. Thus, electric and gas utilities in many jurisdictions are in the process of relinquishing the merchant role, and becoming solely transporters of energy. That leaves retail service providers (marketers), who operate in a competitive environment, without price or rate regulation, to perform the merchant role.

A new or "greenfield" distribution utility, on the other hand, faces a different competitive environment than a mature distribution utility. As several of the applicants argued, a bundled service offering may make for an easier conversion from an existing energy use, particularly in the early years of development. Also, end-users vary widely in their knowledge of the energy markets and their desire or ability to deal with marketers.

The committee recommends that, in the Stage II Request for Proposals process, the government express a preference for distribution companies providing fully unbundled service, and that the merchant service be provided by unregulated third parties or by an affiliate of the LDC. And all bidders for distribution franchises should be required to propose standards of conduct, the goal of which will be non-discriminatory access and service to all users of the distribution system. Moving immediately to this form of service is intended to promote the development of a competitive energy commodity market, and to offer customers a choice of energy suppliers. The committee also recommends, however, that the Stage II Request for Proposals permit bidders to propose a bundled regulated service for a limited number of years (e.g., 3-4 years), if the bidder believes that this proposal will better meet the province's goals for development of the natural gas market. Such proposals should specify how long the bundled service will be offered and the benefits of this approach. Bidders should also be placed on notice that they will face a high barrier to any request for the recovery of stranded costs when the LDC is required to ultimately convert to fully unbundled service.

Market Power

One of the province's basic policy objectives is to provide increased competition in the energy market. The availability of natural gas will tend to make the energy market more competitive, but competition could be restrained if market participants are allowed to exercise market power. Currently, companies are active in several different segments of the energy market. There is nothing necessarily wrong with this as long as a company does not abuse the corporate relationship to gain a competitive advantage.

Before pipelines offered unbundled transportation, they owned all the gas that was transported through their systems. And in the early days of pipeline deregulation, it became clear that pipelines were reluctant to transport gas destined for a third party that competed with the gas the pipeline was trying to sell to its customers. Similar situations arose when distribution companies began to unbundle their systems.

The basic approach to encouraging competitive markets is to require "open access" transportation, where all gas, whether sold by a pipeline, a distribution company or a third party, will be transported under the same rules and procedures. In addition, standards of conduct have been developed that specify the way in which companies must deal with affiliates in conducting business. For example, a regulated distribution company cannot share customer information with a marketing affiliate unless these data are available to all marketers; further, distribution companies cannot offer transportation discounts to customers based on whether or not they purchase gas from an affiliate.

The committee recommends that standards of conduct be established by the regulatory authority to address any potential market power issues. At a minimum, these standards of conduct should include non-discriminatory open access to distribution services, forbid the sharing of customer information between the LDC and its affiliates, require that all utility information is accessible by all interested parties through the regulatory process, prohibit sharing of employees between the affiliate and the distribution utility, and require maintenance of separate offices and systems.

If questions remain about the effects of inter-affiliate dealings on the level of competition in the energy market, a market power test should be instituted when considering whether a distribution franchise should be awarded to a party engaged in the oil, coal, electric or natural gas production or transmission business. Any company with an affiliate engaged in any of these activities would be required to identify the steps they would take to reduce the possibility of the exercise of market power and would be required to file periodic reports on their affiliated transactions and activities.

Revenue Cycle Services

Revenue cycle services are services such as meter reading, billing, customer inquiry services, credit and collection services, etc. that have traditionally been part of bundled LDC services and now, as LDCs unbundle their service offerings, are sometimes offered by third-party vendors.

The committee is not in a position to determine what types of services distribution companies should provide and which services third-party vendors should provide. In a start-up operation, there may not be sufficient competition to have third-party vendors provide the required services. The committee recommends that the issues of which revenue cycle services the distribution companies should provide and which services should be provided by third parties be left to the PUB's discretion. For purposes of the Stage II Request for Proposals, bidders should be permitted to submit proposals with revenue cycle services being performed on either a bundled or a competitive unbundled basis.

Supplier of Last Resort

The supplier of last resort is an issue for distribution companies planning to leave the merchant function. In the traditional LDC environment, the LDC was the only seller of gas on its system. Now, for those LDCs which decide to unbundle their service and exit the business of selling gas at the retail level, there is usually an issue of who will serve those customers not choosing an alternative supplier or, for some reason, are not offered service by any of the active marketers on the system.

The committee suggests the PUB be given the authority to deal with this issue as it arises. For bids submitted on a fully unbundled basis, respondents to the Request for Proposals should be required to describe how they propose to assure end-users that they will be able to secure merchant service in the unregulated market. For bids requesting the use of interim bundled service, the respondent should be required to describe how the transition to fully unbundled service would occur, and how customers would be transferred or assigned to marketers.

Load Balancing

On any given day, the amount of gas actually used on a distribution system will vary from the amount of gas forecast and scheduled to be used. So, the operators of the system need to have a way of controlling it so that it remains in balance. (Minor load variations can usually be managed within the daily tolerance ranges of the pipeline.) A number of different approaches can be taken by distributors to manage the balancing. Some relatively large customers who have dual-fuel capability may, for example, be willing to switch fuels on short notice to assist the distribution company in managing imbalances. These companies would have to negotiate agreements that would benefit them and the distributor.

Accordingly, the committee recommends that respondents to the Stage II Request for Proposals describe how they expect to operate their systems and how they expect to manage daily imbalances.

Incentives for Distribution Systems Expansions

The committee recognizes that each bidder in the Stage II Request for Proposals process will have different approaches to developing and expanding its system. We recommend that the Stage II Request for Proposals require all bidders to specify their expansion policies and the incentives that they propose to use in developing and expanding their systems.

Franchises

The Province of New Brunswick wants to ensure that natural gas distribution service is made available to the largest possible number of New Brunswick citizens and businesses and that an effective regulatory program can be developed to protect the public interest. In the presentations offered by participants in the public hearing process, a number of positions were advocated, ranging from the establishment of a single franchise to serve the entire province to encouraging multiple franchises.

Advocates of a single general franchise for the province claimed that awarding a single general franchise is the best way to provide for equal rates and services throughout New Brunswick. They suggested multiple general franchises would mean there would likely be a potentially confusing array of services and rates offered by distributors. They pointed out that, if there were a single general franchise and a single set of rates for the whole province, the regulatory burden would be minimized. But, without a single general franchise, a single distribution rate throughout the province was highly unlikely.

These advocates of a single general franchise noted that the total number of potential natural gas customers in New Brunswick is relatively small, and that allowing multiple small general franchises would make it unlikely that any one distributor would be able to generate substantial economies of scale in its operation. This would lead to higher rates. In other provinces, a small number of large distributors operate, instead of a large number of small ones. The current trend in utility organization is toward consolidation of companies in order to generate maximum cost savings.

Some participants indicated they were interested in serving loads only in specific areas. One, for example, was primarily interested in customers near the Maine border. But other potential bidders did not appear interested in serving these particular markets. Two participants supported the concept of allowing local producers the opportunity to distribute directly to end-users, if this were the most economical way of reaching those customers. And there are clearly some areas that might be served by particular potential distributors that are unlikely to be served by developers of a single franchise for the province.

The committee feels it is not in a position to determine, at this time, whether a single franchise or multiple franchises would be most advantageous for the province. The decision can be best made when bidders have had the opportunity to complete the Stage II process. Therefore, the committee recommends that the province allow bidders to bid both on the basis of serving the entire province and on individual areas of it.

Local Gas Production

Several companies engaged in the exploration and development of indigenous gas in New Brunswick made presentations before our committee. They emphasized the potential value of these reserves to the province. One pointed out that it has already spent more than $6.5 million in Atlantic Canada on applied geology-geophysics, administration and drilling, and has budgeted over $8 million for next year. This proponent said that, if its current estimates prove correct, millions of dollars would be invested within the province on gas development.

Local production of natural gas can work in conjunction with the development of the Sable Island gas and the M&NE Pipeline to provide maximum benefits to New Brunswickers. And it is recognized that providing a suitable investment and regulatory environment would further encourage exploration for natural gas here. We feel local producers should be encouraged to make investments to develop their reserves and should have access to markets on a non-discriminatory basis. They should be allowed to access any pipeline or LDC for transporting indigenous gas to market. Where a distribution network is not yet in place, local producers should be given the opportunity to compete with a potential distributor in constructing a system that would supply natural gas to the area (i.e., a local- producer class of franchise). A local producer wishing to connect to a pipeline would, of course, be obliged to meet pipeline gas quality standards. The company would also be responsible for the direct costs of connecting to the LDC and the cost of the transportation service under the LDC tariff.

Municipal Involvement in Gas Development

Municipalities in New Brunswick are interested in the development of natural gas. They want businesses to enjoy this competitive, cleaner fuel. In appearances before the committee, they stressed that they should not, however, be expected to bear additional municipal costs as a result of the construction of a natural gas distribution system. These possible additional costs include damage to streets and other municipal property as infrastructure is built, hiring of persons with gas industry knowledge and experience, and increased emergency measure costs. Municipalities emphasized the economic development advantage and urged consideration of policies that would maximize the availability of gas throughout the province.

An important message heard repeatedly from municipalities was that the potential costs they might absorb during construction, pipeline installation and regular operations are significant, and they were concerned about having control over those costs and a method of recovering them. Resident taxpayers take on the financial burden and the inconvenience that results from utility cuts, construction, pipeline relocation, record-keeping, damage and liability issues. Furthermore, as a new fuel source, natural gas distribution will require public safety education, emergency response personnel training and specialized equipment to effectively respond to gas-related incidents. Municipalities feel strongly that these additional costs should not be at the expense of municipal taxpayers.

Municipalities suggested, and the committee agrees, that the province should have legislation similar to other provinces where natural gas is distributed. This would allow the municipalities to obtain revenue or recover costs from a utility. The legislation would provide for compensation for a utility's use of municipally owned property. At a minimum, operating agreements will be required between utilities and the municipalities to ensure that a fair and equitable relationship is developed.

Our committee recommends that existing legislation be amended to clearly enhance rights of municipalities relative to the use of local streets and other municipal real property, the ability to charge property taxes for such easements, and the ability to recover all direct and indirect costs relating to the natural gas infrastructure or to receive revenue from the utility. Municipalities should also have the ability to offer services for a fee.

Impact of Gas Industry Development on Electric Restructuring

There are obvious relationships between the natural gas industry and the electric industry. Natural gas is a major source of fuel for generating electricity in many markets, and with the construction of the M&NE Pipeline, New Brunswickers will have the opportunity to use natural gas for that purpose. Natural gas is also used for heating in residential and commercial markets, where it competes with oil as well as electricity.

The NEB-approved lateral policy is effective until the pipeline proposes its first main line expansion. Given the expected increase in demand for gas for electric generation in New England and the fact that

Sable Island gas is an economical way of serving this market, the time that New Brunswick has to benefit from the lateral policy could be very short. The committee, therefore, recommends that the New Brunswick Government move quickly to implement policies, including possible aid to construction, that lead to construction of the maximum number of laterals in the shortest possible time. Large industrial loads, as stated previously, are the keys to obtaining these laterals under the policy.

In the longer term, it will be important for the province to deal directly with the relationship between natural gas and electrical restructuring. New gas-fired facilities are proposed to generate electricity for the export market. As well, using gas to fuel new generation facilities to compete in New Brunswick's electric generation market could have a direct impact on NB Power's stranded costs. The Select Committee intends to address these issues in its review of electric market restructuring and examination of options.

OTHER ISSUES

Environmental Benefits of Natural Gas

Natural gas is the cleanest fossil fuel available. Burning natural gas results in lower levels of sulfur dioxide (SO_2), carbon dioxide (CO_2), nitrous oxides (NO_x) and particulate matter than either oil or coal, which, when used in the production of electricity and for industrial purposes, reduce air quality. This is particularly relevant in East Saint John, where oil is used at the Irving refinery and by NB Power and where topography and climate also contribute to raising ground-level concentrations of SO_2.[5]

Heavy oil emits three times the SO_2 that natural gas does, while CO_2 emissions are 1.5 times and NO_X emissions are 5 to 15 times higher from heavy oil than from natural gas.[6] Any conversions from oil to natural gas, either directly or to produce electricity, would be, therefore, a positive step in reducing harmful air emissions.

Westcoast Energy is preparing to develop NB Power's Courtenay Bay No. 3 generating unit as a gas-fired system. Although the rated capacity of the plant will not change with re-powering of the unit, its operations will. Westcoast is planning to sell the plant's capacity to NB Power for the five winter months and to increase existing operations at Courtenay Bay to accommodate exporting power into the Northeastern United States for the remaining seven months. The Courtenay Bay No. 3 project will displace No. 6 fuel oil with 45,000 MMBtu/day of natural gas. Air emissions are projected to decrease by 10,000 tonnes of SO_2, 200,000 tonnes of CO_2, and 1,500 tonnes of NO_X during the five months of winter operation. Steam sales to Irving Paper will reduce emissions further, which should help to improve air quality in Saint John throughout the year. These reductions in air emissions will assist the province in its goal of reducing overall emissions of greenhouse gases.

Required Changes to Legislation

The following Acts of the Province of New Brunswick affect some aspects of the natural gas industry in New Brunswick:

- *Assessment Act*, R.S.N.B. 1973, c. A-14
- *Gas Distribution Act*, S.N.B. 1981, c. G-2.1
- *Gas Public Utilities Act*, S.N.B. 1982, c. G-2.2
- *Municipalities Act*, R.S.N.B. 1973, c. M-22
- *Pipe Line Act*, S.N.B. 1976, c. P-8.1
- *Public Utilities Act*, R.S.N.B. 1973, c. P-27

The province has legal and legislative jurisdiction over the distribution of gas in New Brunswick. This jurisdiction extends over every aspect of gas distribution from the "city gate" connection with the federally regulated main line or lateral right up to the meter on the consumers' premises. The jurisdiction includes regulation of safety, technical construction standards, franchise agreements, and fees and charges made by an LDC.

While the committee does not wish to comment in detail on the present coverage and possible amendments that may be required under each of the Acts, the areas that need to be addressed include: providing for different types of franchises and fees, for unbundling, for flexibility in ratemaking, and PUB cost recovery.

The City of Moncton raised a question about the validity of the natural gas distribution rights of Moncton Utility Gas, a utility that stopped serving customers in 1991. The committee recommends legislation be introduced that would terminate these rights without compensation.

The committee is also concerned that existing statutes may need to be amended to protect the interests of municipalities. Amendments should provide for clearly enhanced rights for municipalities relative to the use of local streets and other municipal real property, the ability to charge property taxes for distribution property, and the ability to recover all direct and indirect costs relating to the natural gas infrastructure, minus any property tax revenue. If municipalities have the capabilities to provide services to the LDC, such as meter reading services, the municipalities should be able to offer the services for a fee.

The committee recommends a comprehensive review of these pieces of legislation. Such a review should be conducted once the government has agreed on the policies it will adopt for the establishment and operation of the natural gas industry in New Brunswick.

Centre for Excellence

The committee heard testimony on the need to be fully informed of the new applications, technology adaptations, development, and commercialization of natural gas. This testimony also focused on the need for a natural gas technology centre to train fire fighters and provide safety and certification to accommodate this new industry. A Centre for Excellence for gas could also assist in achieving maximum penetration of, and benefits from, this new fuel in New Brunswick.

We understand that Canadian and U.S. trade organizations, including the Canadian Gas Association, the Gas Research Institute, and the American Gas Association, are addressing key issues in the industry. But we also recognize the need to ensure these areas of research and development meet the needs of New Brunswickers and Maritimers. We are also well aware that the opportunities and challenges posed by the industry in New Brunswick, Maine, and Nova Scotia are very similar, and that a Centre for Excellence could serve all three jurisdictions.

Accordingly, the committee recommends a Centre for Excellence be established to draw upon the resources of the natural gas industry and key stakeholders to address this new form of energy in the province. The committee sees New Brunswick playing the lead role in establishing a centre in the province by working with key parties to plan and fund research and development that would have particular application to New Brunswick and adjacent jurisdictions. The committee calls for setting up an action committee to outline the research and identify sources of funds. Among the potential sources of funds are the Canadian Gas Association, the Sable Island Producers, the Government of Canada, M&NE, franchised distribution companies in New Brunswick, the American Gas Association, and the Gas Research Institute.

The committee further recommends that the action committee report back to the government with a detailed plan by February 1, 1999. Finally, the committee suggests the topic of a Centre for Excellence be addressed in the Stage II Request for Proposals evaluation.

CONCLUSIONS AND RECOMMENDATIONS

Summary of Key Issues

Lateral Policy and Pipeline Access

The committee recommends that all consumption of natural gas in the province be included under a broad definition of gas distribution in order to bring these activities under provincial jurisdiction. It further recommends that prospective anchor load customers be granted a single end-user franchise for a term of 20 years, or the term of their firm service agreement with the pipeline, whichever is less. The single end-user franchises would be required to pay an annual, fixed franchise fee, which will, among other uses, help cover the increased costs of regulatory activities by the PUB.

The committee emphasizes the importance of timing in maximizing benefits to New Brunswickers under the NEB-approved M&NE lateral policy. Hearings before the NEB on the Saint John lateral will take place before the provincial government has the opportunity to award distribution franchises. The issue of whether anchor customers will have to pay additional distribution charges to an LDC will arise within the context of the lateral hearings.

The committee recognizes the significance of the role that the anchor loads play in the construction of the original pipeline laterals. Without the anchor loads, the laterals will not be constructed. Without the laterals, it is very unlikely that distribution companies will be established unless they are very close to the main line.

Even with the use of the M&NE lateral policy, there may still be a shortfall in natural gas market loads to meet the economic threshold toll test for parts of the province such as the Northeast and Northwest. In this event, governments should provide a contribution in aid of construction to ensure that the laterals are constructed.

The result is that anchor load customers will be able to preserve the "economics" of direct access, but will be subject to provincial regulation.

By creating the single end-user franchise, it becomes possible for the pipeline to proceed with the construction of laterals. Commitments to construct laterals must be made before the development of general distribution franchises can be considered.

The committee strongly supports maximizing economic benefits to New Brunswickers from the opportunities created by the Sable Gas Project. The committee suggests that the Stage II process evaluate all bidders' approaches to maximizing the environmental and economic benefits to the people of New Brunswick.

Future Laterals and Lateral Expansions

The development of future laterals and expansion of existing laterals will necessarily take place within the context of NEB policy applicable at the time the lateral project is proposed. The current lateral policy provides benefits to the province that the provincial government will continue to support. The province should also recognize that a contribution in aid to construct may be required to meet the economic threshold toll test for some laterals. The PUB will be responsible for making regulatory decisions regarding future LDC laterals and lateral expansions.

Regulation

Cost of Service and Incentive Regulation

The committee recommends that the PUB be given flexibility in the methods it can use in determining the distribution company's charges to consumers. The PUB should be given discretion to use either traditional cost of service or incentive regulation methods. This discretion should preserve the goals of fairness to consumers and fair compensation to the distributor.

Bundled and Unbundled Services

The committee recommends that the Stage II Request for Proposals state a preference for an unbundled system, where the sale of the gas commodity is separated from the distribution service throughout the province. Distributors should be permitted to have affiliates that can make the commodity sales throughout the province. All bidders for distribution franchises should be required to propose standards of conduct, the goal of which will be non-discriminatory access and service to all users of the distribution system.

The committee also acknowledges that there may be valid reasons to allow a bundled service in the early years of development. Bidders may propose bundled service offerings for a limited number of years (e.g., 3-4 years). Bidders doing so must specify how long the bundled service will be offered and the benefits of this approach. There will be a strong presumption against the recovery of any "stranded" costs related to the bundled service when the service is eventually unbundled.

Market Power

The government and the committee want to ensure the expeditious development of a competitive market for natural gas and other sources of energy in New Brunswick. The committee is aware of the potential for the abuse of market power if the holder of a distribution franchise is also engaged in another line of the energy business.

The committee recommends that standards of conduct be established by the regulatory authority to address any market power issues. At a minimum, these standards of conduct should include non-discriminatory access to distribution services, forbid the sharing of customer information between the LDC and its affiliates, require that all utility information be accessible to all interested parties through the regulatory process, prohibit sharing of employees between the affiliate and the distribution utility, and require maintenance of separate offices and systems.

If questions remain about the effects of inter-affiliate dealings on the level of competition in the energy market, a market power test should be instituted when considering whether a distribution franchise should be awarded to a party engaged in the oil, coal, electric or natural gas production or transmission business.

Other Regulatory Issues

The committee has recommended an appropriate expansion of the PUB's responsibilities. These new responsibilities will require an expanded workforce and entail increased costs. The committee recommends that the PUB's revenues required to cover the expenses related to the regulation of natural gas be collected from the distribution franchises. General and producer franchises should be assessed a fee based on a percentage of revenues. Single end-user franchises should be assessed a fixed annual fee.

The committee recommends that other issues relating to revenue cycle services, supplier of last resort, load balancing and incentives are matters best left to the expertise of the PUB. Bidders should address these issues as appropriate in the Stage II Request for Proposals process.

Franchises

The committee has concluded that three classes of franchises should be established: single end-user, local producer, and general franchise. A single end-user franchise should be required for any end-user that takes direct service from the pipeline. The committee has concluded that the number of general franchises will be determined in the Stage II competitive bidding process.

Local Gas Production

The committee is very encouraged by the potential for indigenous gas to play an important role in New Brunswick's energy future. It is important that a system be created to promote its development. Furthermore, the committee supports the indigenous gas producers' non-discriminatory access to the distribution system and the M&NE Pipeline. It is recognized that the producer is responsible for meeting pipeline and distribution quality specifications. All bidders in Stage II will be required to demonstrate how they would provide open access transportation service for local gas producers.

Municipal Involvement in Gas Development

The committee recommends that existing legislation be amended to protect municipal interests. To the extent that distribution companies impose additional costs on municipalities, the municipalities should be allowed to recover their additional costs. The committee expects that LDCs will work closely with municipalities to minimize local disruption and maximize access to distribution service. Municipalities may also be in a position to offer cost-effective services to the LDCs.

Impact of Gas Industry Development on Electric Restructuring

The committee recognizes that, in an ideal world, it would be desirable for the development of the gas industry to take place in conjunction with the restructuring of the electric industry in New Brunswick. But certain important factors involving the gas industry are on schedules that are independent of electric industry restructuring. These factors include:

- The effective period of the favourable terms of the lateral policy;
- Competition from electric generation developers in New England who are proposing to serve the growing New England market, which will not wait for New Brunswick policy; and the fact that industrial customers have signed precedents with M&NE that would be lost without timely decisions.

Therefore, the committee has chosen to proceed initially with its review of natural gas market policies, but has started to address the electric restructuring issue in New Brunswick with an initial planning session. The committee expects to address the issues outlined in "Electricity in New Brunswick Beyond 2000," a discussion paper dated February, 1998, and the Hay-Savoie Report over the next several months.

Summary of Other Issues

Environmental Benefits of Natural Gas

Natural gas is the cleanest fossil fuel source available. The ability to substitute natural gas for either coal or fuel oil will result in substantially lower emissions of sulfur dioxide, carbon dioxide, and nitrous oxides into the air. Lower air emissions will provide the entire province with environmental benefits.

Required Changes to Legislation

The following statutes govern natural gas distribution in New Brunswick:

- *Assessment Act*, R.S.N.B. 1973, c. A-14
- *Gas Distribution Act*, S.N.B. 1981, c. G-2.1
- *Gas Public Utilities Act*, S.N.B. 1982, c. G-2.2
- *Municipalities Act*, R.S.N.B. 1973, c. M-22
- *Pipe Line Act*, S.N.B. 1976, c. P-8.1
- *Public Utilities Act*, R.S.N.B. 1973, c. P-27

The committee recommends that there be a comprehensive review of these pieces of legislation. Such a review should be conducted once the government has agreed on the policies it will adopt for the establishment and operation of the natural gas industry in New Brunswick.

The committee further recommends that legislation be introduced which would terminate the natural gas distribution rights of Moncton Utility Gas without compensation.

Centre for Excellence

The committee heard testimony on the need to be fully informed of the new applications, technology adaptations, development, and commercialization of natural gas. In addition, the testimony focused on the need for a natural gas technology centre to train fire fighters and provide safety and certification to accommodate this new industry. The committee recognizes that a Centre for Excellence is needed for gas to provide maximum penetration and benefits in New Brunswick.

The committee recommends that a Centre for Excellence be established to draw upon the resources of the natural gas industry and key stakeholders to address this new form of energy in the province. The committee sees New Brunswick playing the lead role in establishing a centre in the province by working with key parties to plan and fund research and development that has application to New Brunswick and adjacent jurisdictions. The committee calls for setting up an action committee to outline the research and identify sources of funds.

The committee further recommends that the action committee report back to the government with a detailed plan by February 1, 1999. Finally, the committee suggests that the topic of a centre be addressed in the Request for Proposals evaluation in Stage II.

Recommendations for Stage II Process

Some policy and other issues concerning the establishment of a natural gas industry in New Brunswick, which the Select Committee on Energy has considered in its deliberations, would, in our opinion, be more appropriately dealt with in the Stage II Request for Proposals process.

The purpose of this section is to provide the government with some discussion and comment on these issues.

Term of Franchise

The presenters who expressed an opinion on the term favoured the 20- to 30-year range or longer. The arguments in favour of a fairly long term are:

- The substantial investment required by the LDC. The committee heard from some presenters that this is a long-term investment and that they do not expect returns in the early years.
- The longer the term, the lower the annual fixed costs; hence, the lower the gas rate.
- LDCs may form partnerships with others, such as municipalities, other LDCs, and those offering unbundled service.

One disadvantage of longer-term franchises is the risk of poor performance, including slow penetration. The committee suggests the government require bidders to state clearly how quickly they expect to be able to develop their distribution franchises. The evaluation of the proposals would be based in part on the bidders' proposed performance objectives. The committee suggests the PUB be given the task of periodically reviewing the franchise holders progress towards their objectives and that the PUB be given the authority to modify a franchise, if necessary.

As part of the overall PUB review process, the committee recommends that the PUB require any general class franchise holder to submit periodic reports on the development of the distribution franchise. The PUB would review the company's progress report and compare it to the business plan initially approved by the PUB. If the distribution company was making substantial progress on its plan and anticipated being able to continue doing so during the upcoming period, the PUB would issue a finding of substantial compliance. However, if a company failed to make substantial progress or indicated the likelihood of substantial difficulties in making progress in the near future, the PUB would have the right to conduct a public hearing to determine if the franchise should be modified. This hearing would be limited to those situations where the PUB determined that a distribution company was failing to substantially comply with the performance standards it established in its original franchise application.

The purpose of the franchise review proceeding would be to determine whether the public interest was being served by the continuation of the existing franchise. If other parties thought that they would be able to expand the franchise more effectively, they would be given an opportunity to demonstrate their alternative plan. The proceeding would focus on the need for major changes in public policy and the restructuring of the franchise rights.

Number of Distributors

The number of franchises that will be awarded for the province should be determined as a result of the Request for Proposals process. Bidders will be able to bid on the basis of serving the entire province or serving portions of it. They will be obligated to identify the areas that they propose to serve and state whether their proposal to serve specific areas is contingent upon receiving authority to serve other specific areas. They will also be obligated to describe whether and how they would propose to serve the maximum amount of the province. The government expects to award franchises in a manner that maximizes access to natural gas. Furthermore, the government must retain the ability to negotiate final terms and conditions before awarding the franchise(s).

Development Plans

The Stage II Bidders will be required to provide the following information as a part of their responses to the Request for Proposals:

- The areas that the distributor proposes to serve
- The time frame for serving particular geographic areas
- Proposed market approach by market segments
- Proposed pricing policies and revenue projections by customer class
- Proposed use of incentives for conversions and new areas by market segment
- Proposed affiliations with partners and the proposed role of the LDC relating to sales service
- Proposed programs for mitigating municipal impacts and for working with municipalities
- Proposed policies for providing open access transportation and unbundled service
- Proposed policies for providing access to local production
- A preliminary financial plan.

In addition, the bidders should provide documentation of the major assumptions used in their plans. Along with these requirements, the bidders should propose a regulatory review plan that describes their proposed approach for setting and modifying rates and for changing general terms and conditions of their tariff.

The committee further recommends that the Stage II Request for Proposals be drafted to:

- Require a level playing field for all providers of gas sales service, regulated and unregulated
- State a preference for a fully unbundled system
- State a preference for the utility to have an affiliate perform commodity sales
- Require that bidders be subject to standards of conduct in relation to market power issues
- Ensure that adequate time be allowed for the interested parties to prepare and submit bids for areas they intend to serve.

The committee would expect the decision to be made based on the policies stated in this report. In particular, the decision would reflect the desire to maximize availability of natural gas in the province, the timely development of required infrastructure, and an increase in intra-fuel competition. It would not be appropriate to grant a franchise to a party if it would create market power. This may require a more in-depth examination of market power if a party engaged in the oil, coal, electric, or another natural gas area seeks to obtain a franchise.

The committee recognizes that the regulatory policies it has outlined requires the PUB to have specific expertise of a technical and legal nature relating to natural gas and substantially increases the responsibilities of the PUB. It is very likely that the PUB will require full-time commissioners and a larger staff. To cover this increase in expense, the committee recommends that the PUB be funded through franchise fees.

The committee also determined that it would be desirable for all end-users to support the overall provincial regulatory scheme. The committee recommends establishment of an annual fixed fee for single end-user franchises and a percent of revenues fee for general and producer franchises. Enabling legislation will be required for all of these recommendations.

[1] See Glossary for definition of "Contribution in Aid of Construction."

[2] In general, pipeline rates have fixed charges that are paid on a monthly basis and variable charges that apply to each unit transported. The above example uses an annual total fixed charge and no variable charge in order to keep the example simple. In this example, the 100 percent load factor rate would be $1.00/MMBtu and the 50 percent load factor rate would be $2.00/MMBtu. If the cost of transportation included a variable component of $0.05/MMBtu, in addition to the fixed component of $365, the 100 percent load factor rate would be $1.05/MMBtu and the 50 percent load factor rate would be $2.05/MMBtu.

[3] Pipeline System Design and Construction, Pipeline System Design Seminar Series Fall, 1997, University of Calgary, Table 3-1, Relationship Between Pipe Size, Flow Rate and Capital Cost.

[4] Benchmarking is a form of incentive ratemaking where the performance of the regulated company is compared or "benchmarked" against the performance of similar companies in the industry.

[5] Environmental and Economic Impacts of Coleson Cove Conversion to Natural Gas, ADI Limited, 1996.

[6] Canada's Energy Outlook 1996-2020, Natural Resources Canada.

Documents Tabled

Mr. LeBlanc laid upon the table of the House the *Telegraph Journal* dated October 28, 1998 which contained an article which purported to quote from various sections of a draft First Report of the Select Committee on Energy and outlined numerous recommendations contained therein. The article also referred to certain in camera deliberations of the Committee.

Question of Privilege

Pursuant to Standing Rule 9, Mr. LeBlanc rose on a question of privilege quoting from *Beauchesne's Parliamentary Rules and Forms, Sixth Edition,* at paragraph **850.**(1) as follows:

A committee, having the right to exclude strangers at any time, has the right to sit in private and have its proceedings protected by privilege. The publication of its proceedings in that case would be an offence which the House could deal with upon receiving a report from the committee.

Continuing, he stated that the Select Committee on Energy had reported to the House its grave concerns regarding the leak of a draft report and publishing of portions of its contents and certain committee deliberations. He then cited paragraph **877.**(1) of *Beauchesne's* which states:

No act done at any committee should be divulged before it has been reported to the House. Upon this principle the House of Commons of the United Kingdom, on April 21, 1937, resolved "That the evidence taken by any select committee of this House and the documents presented to such committee and which have not been reported to the House, ought not to be published by any member of such committee or by any other person". The publication of proceedings of committees conducted within closed doors or of reports of committees before they are available to Members will, however, constitute a breach of privilege.

Continuing, Mr. LeBlanc noted that it is an accepted principle that a committee of the House has the right to have its confidential deliberations protected by privilege and submitted that the disclosure and publication of the committee's deliberations and draft report constitutes a breach of privilege of the House and its members.

Mr. LeBlanc gave notice, pursuant to Standing Rule 9(2) of his intention to move the following motion, seconded by Mrs. Barry:

THAT the matter of the disclosure of a draft report of the Select Committee on Energy and the publishing of portions of its contents in the *Telegraph Journal* be referred to the Standing Committee on privileges for appropriate investigation and that the committee report back to this House as soon as possible.

After requesting comments from other Members, Mr. Speaker stated he would attempt to bring the matter back before the House sometime during the day.

Notices of Motions

Mr. D. Landry gave Notice of Motion 25 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Johnson:

WHEREAS certain New Brunswickers have many problems with the new Employment Insurance policy;

WHEREAS most residents of the Acadian Peninsula and certain other areas of the province are seasonal workers;

WHEREAS the intensity rule reduces benefits for seasonal workers;

WHEREAS in certain cases the divisor reduces benefits for seasonal workers;

WHEREAS seasonal workers who do not manage to accumulate enough work hours or work weeks end up having to bridge a gap before returning to work;

BE IT RESOLVED THAT the New Brunswick government continue its efforts to call on the federal government to adhere to recommendations made at the Saskatoon conference and to change its Employment Insurance policy so that New Brunswick seasonal workers are not penalized.

Hon. Mr. Valcourt gave Notice of Motion 26 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Lord:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House any and all studies, reports, memos, correspondence, polling concerning public perception of our healthcare system, our hospitals and extra mural program over the past five (5) years.

Hon. Mr. Valcourt gave Notice of Motion 27 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Lord:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House all reports, data, statistics and information gathered, obtained, sought and or compiled by the government of New Brunswick in regard to the impact of the Harmonized Sales Tax on New Brunswick consumers having an earned annual income lower than $30,000 since April 1, 1997.

Mr. Volpé gave Notice of Motion 28 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Sherwood:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House all documents, memos, correspondence, electronic mail, proposals, minutes of meetings, studies, reports, analyses, regarding the ad campaign produced by the Department of Agriculture including all costs to either the Department and fees paid to outside consultants.

Mr. Volpé gave Notice of Motion 29 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Hon. Mr. Valcourt:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House all financial information, including money spent for, land expropriation, land purchased, survey costs, engineering fees, consulting fees, feasibility studies, reports, studies, federal grant money for the proposed road called the "Corridor Route" between Baker Brook and the Trans Canada Highway.

Mr. Volpé gave Notice of Motion 30 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Mockler:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House a copy of all programs and assistance including, but not limited to grants, loans, guarantees, job creation programs under and or related to l'Association Chasse et Pêche de Lac Baker.

Mr. Volpé gave Notice of Motion 31 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Hon. Mr. Valcourt:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House a copy of all memos, letters, correspondence, proposals, electronic mail, minutes of meetings, feasibility studies including markets, reports, analyses, offers, negotiations between the Province of New Brunswick relating to the cranberry industry; and a list of all agreements, contracts, loans, guarantees, grants between the province of New Brunswick and all cranberry growers.

Mr. Mockler gave Notice of Motion 32 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Green:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House a list of all renovations, repairs, replacement costs, upgrades, that have been done to any and all schools in the province by the Department of Supply and Services and all the related costs, contracts and tenders for the past two (2) years.

Mr. Mockler gave Notice of Motion 33 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Sherwood:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House list of all contracts signed by the Minister of Supply and Services since May 14, 1998.

Mr. Green gave Notice of Motion 34 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Robichaud:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House a copy of the Report on the Physical Condition of Schools.

Mr. Mesheau gave Notice of Motion 35 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Robichaud:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House a list of all hospital bed closings by hospital and facility since 1987.

Mr. Mesheau gave Notice of Motion 36 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Robichaud:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House a list of all drugs/medicines de-listed for coverage by Medicare and or the Prescription Drug Program over the past ten years along with the rationale for de-listing them and the amount of savings projected and the amount of savings realized (actual).

Mr. Mesheau gave Notice of Motion 37 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. D. Graham:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House a copy of all memos, documents, correspondence and electronic mail in the last year related to ambulance service.

Mr. Mesheau gave Notice of Motion 38 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Lord:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House any and all studies, reports, and correspondence between the

Department of Health and Community Services and any private companies in regards to the feasibility of establishing a tele-care network in New Brunswick in the past 5 years.

Mr. Mesheau gave Notice of Motion 39 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Mockler:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House all correspondence, including electronic mail correspondence, memos, agreements, and contracts of any and all funding given by Film New Brunswick to the Mobius Entertainment Corporation.

Mr. Mesheau gave Notice of Motion 40 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Sherwood:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House the details of all contracts, and remuneration following the termination of employment, between Film New Brunswick and its former executive director, Sam Grana.

Mr. Robichaud gave Notice of Motion 41 that on Thursday, December 3, 1998 he would move the following resolution, seconded by Mr. Green:

That an address be presented to Her Honour the Lieutenant-Governor praying that she cause to be laid upon the table of the House a list, by grade level, the actual number of classes by student size by district for the last five years.

Example

District 2

1996 Year

NUMBER OF STUDENTS PER CLASS

Grade Level 28 27 26 25 24 23 22 21 20 19 Other

1 37 22 21 12 7 13 11 07 19 21 12

2 29

etc.

Government Motions

On motion of Hon. Mr. Byrne, seconded by Hon. Mr. C. Thériault:

RESOLVED,

THAT the membership of the Standing Committee on Privileges be amended by substituting the names of Hon. Mr. Byrne for Hon. Mr. McKay and Mr. Mockler for Mr. Volpé.

THAT the membership of the Standing Committee on Private Bills be amended by substituting the names of Mr. LeBlanc for Hon. Mr. Devereux, Mr. Blaney for Hon. Mr. O'Donnell, Mr. Volpé for Mr. Mesheau and Mr. Green for Mr. Mockler.

THAT the membership of the Standing Committee on Procedure be amended by substituting the names of Hon. Mr. Byrne for Hon. Mr. Tyler, Hon. Mr. MacDonald for Hon. Mr. H. Doyle, Mr. Robichaud for Mr. Sherwood, Mr. Green for Mr. Mockler and by adding the name of Mrs. Barry.

THAT the membership of the Standing Committee on Law Amendments be amended by substituting the name of Mr. Green for Mr. Volpé.

THAT the membership of the Standing Committee on Public Accounts be amended by substituting the names of Mr. D. Landry for Hon. Mr. DeGrâce, Mr. Kavanaugh for Hon. Mr. MacDonald, Mr. A. Doucet for Hon. Mr. Doyle, Mr. Sherwood for Mr. D. Graham, Mr. Lord for Mr. Mesheau and Hon. Mr. Valcourt for Mr. Robichaud.

THAT the membership of the Standing Committee on Crown Corporations be amended by substituting the names of Mr. S. Graham for Hon. Mr. O'Donnell and Mr. Mesheau for Mr. Sherwood.

THAT the membership of the Legislative Administration Committee be amended by substituting the names of Hon. Mr. Byrne for Hon. Mr. O'Donnell, Mr. Flynn for Hon. Mr. MacDonald, Mr. Lord for Mr. Mockler and by adding the name of Ms. de Ste. Croix.

THAT the membership of the Standing Committee on Ombudsman be amended by substituting the names of Mr. Johnson for Hon. Mr. Devereux, Mr.Wilson for Hon. Mr. DeGrâce and Mr. Robichaud for Hon. Mr. Valcourt.

Address

The Assembly resumed the adjourned debate on the proposed motion of Mr. S. Graham, seconded by Mrs. Barry:

THAT the following Address be presented to Her Honour the Lieutenant-Governor to offer the humble thanks of this House to Her Honour for the gracious speech which she has been pleased to make to the Legislative Assembly, namely:

Fredericton, N.B.

November 24, 1998.

To Her Honour,

The Honourable Marilyn Trenholme Counsell,

Lieutenant-Governor of the Province of New Brunswick.

May It Please Your Honour:

We, Her Majesty's most dutiful and loyal subjects of the Legislative Assembly of the Province of New Brunswick, now in session, beg leave to extend our humble thanks to Your Honour for the gracious speech which Your Honour has addressed to us, and we assure Your Honour that all matters which may be submitted to us during the session will receive our most careful attention and consideration.

And the debate continuing, it was on motion of Hon. Mr. Devereux, adjourned over.

Speaker's Ruling

Mr. Speaker delivered his decision on a Question of Privilege raised by Mr. LeBlanc earlier in the sitting concerning the disclosure of a draft First Report of the Select Committee on Energy and the publishing of portions of it in a newspaper:

The member in his role as chairman of the Select Committee on Energy, as we are all aware, raised concern about the confidentiality of the committee's deliberations, and laid the claim that there was a question of privilege that should be considered by the House. It has become quite clear to all members that the deliberations of all committees are certainly to be respected and to remain confidential until the committee reports.

It is therefore without very much doubt in my mind that there does exist a prima facia case of privilege and I would invite now, since the member did raise the matter at his earliest opportunity, to proceed with his motion.

Question of Privilege

Mr. ;LeBlanc moved, seconded by Mrs. Barry:

THAT the matter of the disclosure of a draft first report of the Select Committee on Energy, and the publishing of portions of its contents in the *Telegraph-Journal*, be referred to the Standing Committee on Privileges for appropriate investigation, and that the committee report back to this House as soon as possible.

Mr. Speaker, having read the motion, put the qestion, and a debate ensued.

And after some time, Mr. Green rose on a Point of Order and stated that a committee of the House does not have power to send for persons or papers unless such power is expressly conferred upon the committee by resolution of the Assembly in accordance with the provisions of the *Legislative Assembly Act*.

Hon. Mr. Valcourt moved the following amendment, seconded by Mr. Mesheau:

AMENDMENT

THAT the motion be amended to include and give the committee the power to issue subpoenas or to subpoena witnesses.

Mr. Speaker put the question and a debate ensued.

And the debate being ended and the question being put, the amendment was carried.

Mr. Speaker then put the question on the motion as amended and it was resolved in the affirmative.

And then, 12.12 o'clock p.m., the House adjourned.