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A CN TRADE RELATIONS FORUM
NEW US ENERGY/ENVIRONMENTAL POLICY:
A CANADIAN ENERGY COMPANY VIEW
(SUMMARY)

Peter Kruselnicki
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New US Energy and Environmental Policy: A Canadian Energy View
By Peter Kruselnicki, Vice President of Public Sector Relations, Trans Canada
Summary

TransCanada is the biggest natural gas pipeline company in North America and consequently has a large capital intensive footprint: 59,000km of wholly owned pipeline, 4,000km under construction, and 7,800 km of partially owned pipeline. In addition, it is also one of the top three gas storage businesses in North America and one of the largest private sector energy service providers in Canada. Only Crown corporations in other provinces are larger. TransCanada also holds a largely diversified portfolio of energy assets throughout Canada and the United States.

Given the diverse nature of TransCanada's portfolio, close attention must be paid to regulation and legislation in both Canada and the US at the federal level, as well as at provincial and state levels. Over the last year and a half, TransCanada has spent more time and effort in regards to climate change policy and associated regulatory matters than any other policy matter. It is very complicated doing business in the US: very expensive and very time consuming.

First and foremost, regulatory uncertainty is a major issue, especially since today the number one issue in US is health care reform. The environmental/climate change policy agenda has been pushed well down the ladder, but it's still there. Consequently, in absence of policy action and debate, we have a lot of policy uncertainty. We don't know what the rules will be, when they will be implemented, and what the costs will be.

Uncertainty, while ubiquitous in climate change policy, is very difficult. However, despite the current absence of federal policy, the Environmental Protection Agency (EPA) is moving ahead with its own regulation, under the Clean Air Act. So what you have is the legislative process on one side, and the administration on other, but whether one will expedite the other is open to debate. On top of this you have the Western Climate Initiative (WCI) and the Regional Greenhouse Gas Initiative (RGGI) on the East Coast. Those are just two of the climate change initiatives looking at the implementation of a cap-and-trade or emissions charge based environmental legislation. So you get this fragmentation going on, and Canada is no different. We have Alberta doing one thing and BC another. All the while the federal government is hoping we will get some kind of equivalency agreements. This could take years.

Furthermore, this policy web is woven more thickly when one includes other initiatives such as low carbon fuel standards, regional performance standards, and carbon capture and storage (CCS). Currently, nobody knows how these are all going to come together. The Major Project Management Office under NRCAN is a step in the right direction, but it lacks any legislative clout. It is too early to tell whether it will have a large impact.

Understandably, it is virtually impossible for any company to stay on top of all policy changes, but the sooner a solid regulatory framework is implemented the better, as people can start making investment decisions more quickly. Policy changes affect the current portfolio of assets, future operations, and eventually flow through

to customers; climate change legislation is no different. Hence, it is important for governments to fully understand the risks and costs associated with policy choices, but governments have an inherent difficulty quantifying risk because they don't grow broke. The situation for a private sector company is much different. Privately owned companies are judged by asset values and credit ratings, which are adversely affected by too much risk

And who is taking the risk in all this? The companies – and it's not just regulatory. It's commercial and financing risk as well. In the absence of clear policy direction, higher risk means higher costs. It is important that governments understand this.

Implementation of the right fiscal/policy frameworks is becoming harder for the government as well, and unfortunately, without proper government support for climate initiatives and infrastructure, the less likely private companies will be successful in making projects go ahead. Balanced and effective legislation is necessary. However, the EPA will come up with own its regulation if the US government doesn't. While uncertainty exists as to how onerous it will be, it is likely to be very costly, especially on the monitoring and enforcement side.

While energy security, market based energy development and delivery including open trade, and environmental and climate change objectives are being discussed at an increasing frequency in US, it is still difficult for a Canadian company to get their objectives met in D.C. If you think Ottawa's big, try Washington. Furthermore, the process is perpetual because they just don't know Canadian companies that well. You have to be there; you have to be seen to be there; and you can't just go in once and then leave.

Second, the regulatory approval process is lengthy, challenging, expensive, and cumbersome in both Canada and the United States. Presidential Permits from the Department of State are necessary to cross the US border, and then one must obtain state by state federal agency approvals in what is essentially a bureaucratic maze. Regulatory approvals are also becoming increasingly difficult to obtain; even wind turbines are getting much harder to site. Furthermore, there are now more groups involved in the public review process than ever before, requiring more detailed information be disseminated. This increases costs for companies trying to get approvals. First Nations must be consulted and community issues must be examined. What all this means for companies trying to work in the US (as well as Canada) is the process is longer, costs more money, and sometimes you don't get your approvals.

The Mackenzie Valley Pipeline is a good example of this. The regulatory review process for this project has been going on for five years, and TransCanada does not have a permit yet, despite having already spent hundreds of millions of dollars.

The good news is that extensive dialogue concerning infrastructure spending in the US is providing opportunities for Canadian companies, like TransCanada, to become part of that infrastructure. However, state by state approval and landowner agreements bog down the process as thousands of permits are often required for even just one project. Here, work with industry groups helps to assure that governments are getting correct, consistent information.

In the context of the global climate change debate and from an energy and environmental standpoint, TransCanada, along with other companies, is trying to promote the increased use of natural gas. They also see Carbon Capture and Storage

while requiring a large government role, as a means to help to utilize the large coal reserves in Alberta in a more environmentally friendly way; they acknowledge that risk is still prevalent with CCS technology. Commercially viable, large scale utilization hopefully will be feasible within next five years but currently the technology is too expensive. No tension between CCS and a cap-and-trade or charge based emissions regime is seen, despite the commercial viability of the former depending heavily in the latter. Nevertheless, technologies such as CCS, gas fired generation, and natural gas in transportation could provide environmental benefits as well as improve the bottom line of TransCanada and similar companies.

Most importantly for the energy industry is the construction of solid, open, trusting relationships with governments. These can help private companies understand why the government is taking a certain course of action and what it entails. It's a two-way relationship, with cooperation and lines of communication being critical. TransCanada also stresses the importance of community relations, which is an ongoing dialogue due to the nature of the industry.

Questions

Question:

I was interested in your use of the phrase 'commercially viable' in regards to carbon tax and CCS, and pushing enhanced oil recovery (EOR) aside, the only way I can see commercial viability of CCS would be to meet some other government policy of a carbon charge, whatever the case may be. So how do you see the tension there, in the sense of government funding of some technology that will eventually be market viable only under another government policy? To me there is a strong tension there and I was just wondering how you see it.

Answer:

Well, I'll put on the red finance hat and say I don't see a tension at all. It's the government's decision if they want to apply some kind of carbon charge to make that viable; it's their decision. The question is who pays that charge? How is it applied? Is it applied on a rate base? Is it applied by some kind of charge to a commercial company that can pass on those rates to someone else? You know, that's a good question. All of us would like to see something that is pulled together without some form of government taxation, levy, or subsidy, or whatever you want to call it. But in today's environment there is just a lot of risk involved with these technologies at a large scale. So, it's a great discussion point over the next few years as this climate change discussion evolves. But you're right; there are still folks talking about whether we should scrap cap-and-trade and implement a carbon tax, and that debate will go on for a while yet.

Question:

You mentioned the EPA's work regarding a regulatory framework as sort of a counterweight to the legislative work that is being done, and some folks are looking at that as a way for the administration to go to Copenhagen with something to show, recognizing that nothing will happen on the legislative front from now until December and possibly into 2010. Given that, however, what is your opinion on the possible use of the EPA by the administration to move things along in Congress or the Senate, or to provide a counterweight and put some pressure on the legislative branch to get a bill, sometime, that responds to the administration's objectives?

Answer:

Well, that's the loaded question. We think the EPA is just trudging along doing its thing, and they are going to put a regulatory framework on CO₂ emissions in place. Will it help prod the legislators along? I don't know. They are so distracted on the health care debate right now. For those of you who are following the health care debate in the United States, I am, as a policy junkie, amazed at what is going on down there. They are paralyzed by this health care debate. Most of the time they are talking about health care, health care, health care. I don't think I have seen anything in my career to consume everything and to polarize interest groups along quite the

same lines. If somehow they refocused on the climate change debate they could probably move things along faster, but they are being consumed. Our opinion would be that the administration is using all its political capital on health care. So what is going to be left for the climate change discussion? I don't know. But it is a good point, and the EPA has got its marching orders. So we could go ahead with the EPA regulation, but we are unsure yet as to how onerous it is going to be. The monitoring and reporting alone could be very expensive.

Question:

If I were a US regulator it would be quite tempting for me to make the pipeline companies sort of the gatekeepers for the kinds of emissions policies we develop. That would put you in the position, were NAFTA correct, that would substantially change your business. Are you thinking about that?

Answer:

No. I would say that what we are trying to do is come up with something that is quite balanced. We like to see ourselves in a balanced system and we don't want to put ourselves in that kind of position. Secondly, I think we are concerned that the regulatory regime in which we are working, in Canada and the US, is becoming too cumbersome to get anything major done. Our poster child is the Mackenzie. There is no doubt about that, but there are others. So, I want to take you back to risk. All of these things tie back to who is going to take the risk to get certain things done, and there is a cost to all of these things. I don't mean to avoid your question, but it is not something we would like to see happen. I think that people, the general public, consumers, are paying these costs. So this regulation and policy that we are talking about today, all of the costs will flow through eventually, although there may be some lags; the costs will flow through. So the consumers will pay and that is one of the things the government aren't talking about today, who is going to pay. You can put a cap-and-trade on large emitters like TransCanada and others, but eventually there will be a trickle-down effect to the consumer.

Question:

Just a follow up on that. You talk about the costs of a regulatory regime, both direct, in getting it approved and the opportunity costs because of the delay. I think one of the difficulties in getting a government reaction to that is there is no sense as to how big that cost is. Is it one percent of the cost of the Keystone pipeline? Is it ten percent? Thirty percent? Has TransCanada done anything to try to quantify those costs?

Answer:

I think our regulatory costs to get the Keystone permits are somewhere in the order of \$90M-\$100M. Now, it's a five billion dollar project. Is that excessive? Probably not, but keep in mind one permit, one river crossing, can stop everything for a long time. So please don't quote me on those numbers. I can probably get you the absolute numbers. It is expensive. It is more the time opportunity costs that can have a huge impact. If you mobilize and haven't got a permit, you're coming to the creek bed, and you can't do it, you know these aren't small things that you can just

drive around and move along. So in some cases you look at these things and think, can I get a permit? I know the Enbridge guys dealing with the gateway project tried to get the pipeline to the West Coast, and trying to deal with all the First Nations issues, plus the terrain, community issues, tanker traffic issues. It is very difficult. I am not saying it's impossible, but you have to look at those risks, and sometimes you just can't do it.

Question:

Social license issues, you haven't talked about that yet, in terms of where the end goes, the challenge that has come up on Keystone in courts. How much is that keeping you awake?

Answer:

Well, on any given day we have challenges, but any company that is doing this does. So we have a very extensive community relations program. I am responsible for community investment for TransCanada, so we do invest a lot in various communities to go back to our corporate and social responsibility and our reputation. So I would say we have a very strong social conscience, we are aware of, and try to work cooperatively with any kind of group, landowner groups or whoever, to make sure they understand what our objectives are and how we want to work with them. We are there for a long time, so we know that. The original TransCanada pipeline has been in the ground for fifty years. We want to be part of the community, and we want to be a good neighbor, so we try to maintain that dialogue. Again, it's not a one-time thing, it's an ongoing dialogue.

Question: My question is also about costs. Is there something inherent in the pipeline business so that the costs are higher as a proportion of the total outlay relative to say, a coal-fired power plant?

Answer: I'm not too sure they are building many coal fired power plants these days.

Question: Secondly, are the costs increasing in the pipeline business or in the natural gas business because you have to get these permits?

Answer: I don't want to give you the impression that our situation is unique. I don't think it is, whether it's a transmission line or gas. Any linear infrastructure project is more difficult today. Even siting a power plant or wind turbines is very difficult. It is not a given and it is not going to happen right away. If it does, you're lucky. There is a lot of work involved, and as I mentioned we do a lot of community relations work in advance of a project so the community understands what we are trying to do. In the Keystone case, you're always trying to get ahead of potential issues and understand what the needs of the local community are.

Question:

I noticed in your generation list, there is no biomass. Is TransCanada staying away from biomass because you figure it is uncompetitive or too high risk?

Answer:

No. It's because there hasn't been a good opportunity for us. We tend to concentrate on areas we know well, the Northeast US, Alberta and obviously, Ontario. We are starting a new power project in Arizona, so it's sort of an evolving market for us. But no particular reason, just probably no opportunity just yet that made sense for our company or a location that made sense.

Question:

The whole question of bitumen export is involved in this issue. Within the dynamics of your company, do you care where it is upgraded, this whole value added issue? You are a pipeline company, so who cares right, if it is Oklahoma. But it is an issue for Albertans.

Answer:

Yes, we would be happy to move upgraded bitumen or crude, whatever is available to move, but as far as the upgrading policy and practices of the Alberta government, that is a policy they have to get their heads around. I will say of the issues like CCS technology, is these [projects] have to be commercially viable to work. So if the Alberta government was to create the right fiscal framework and policy, and I don't know what these are, I am sure that upgrading would get done. We are a pipeline company. We will move upgraded or bitumen to the markets that want them, and the US wants the product.

Question:

I have seen your CEO give a couple of talks in regards to the regulatory costs in your talk today, and the message I take away from it, and correct me if I am wrong, is that part of the issue with the regulatory costs is the process has gotten longer and more involved, etc., but there has not really been a change in the end result. Your comment today was something close to "sometimes we don't even get the permit" which suggests to me part of the dispute is that the process is getting longer. But you're still going to get the permit at the end of the day in most cases, we are just going to make you jump through more hoops and spend more money to get it. But since the outcome has not changed that is almost lost or wasted money.

Answer:

I'll give you an example. We tried, along with Shell, to promote a liquid natural gas (LNG) plant, offshore, in Long Island Sound, and we got a very strong decision from the Federal Energy Regulatory Commission (FERC), which gave us our approval, and at the time we were dealing with Governor Spitzer. He had his little problems and disappeared. And then, low and behold, a new governor comes in and makes a decision that this project, at the state level, is not in the public interest. So after three or four years of trying to obtain the regulatory approvals and permits for the project, we didn't get it. I don't want to tell you how many of millions that cost.

This is a risk and a reality in our business, in everybody's business. So that happens, not everything is successful. When I talk to you about the risk, that's part of it. You really have to assess the risk; can you actually make this work, on a whole bunch of levels, not just regulatory, but commercially, financially. It's not a slam dunk, it's very complicated. I just deal in the government world; I do understand some of the financial stuff that goes on, but I don't get involved in a lot of the commercial discussion at the front end. Hal and I do a lot of this kind of work together. In the last two and a half years since I have been at TransCanada, it has been an onerous process. I'm seeing it from the other side for the first time in my career and it's difficult to navigate. So, it doesn't work all the time.

Question:

The government of Canada created a Major Projects Office a few years ago to deal with some of these regulatory overlaps and questions. Has that helped? Is there something similar in the US, and would that be useful for some of these cross-border projects?

Answer:

The Major Project Management Office under NRCAN led by Phil Jennings is a good first step. They do not have any legislative clout so they have to rely on service agreements that are signed by the Deputy Ministers in the various departments that are part of the project. It's a good first step, but it's a coordinating group. It is too early to tell whether it is going to have a huge impact. I think Phil Jennings is a very good leader of that group. I think they have some very talented people working in it. The Deputy Ministers I have talked to are very committed to what they sign. But there are some interesting little things that go on in there that you have to pay attention to. For example, if they ask you for more information the clock stops, right. They commit to time frames, and then oops they need more information, so the clock stops, and you don't start it until you get more information, and that could take a month or two. So anyway, there are little things, but I think they are trying to do a pretty good job of trying to coordinate within the context of their responsibilities. One of the major causes for delay, and not one of the causes for our delay, is that all of us have a duty to consult with First Nations, whether it is on traditional lands or wherever. The Crown has that responsibility as well, and each department of the Crown has that responsibility. So trying to coordinate two, or three, or five departments to do their duty and consulting responsibilities, I mean we could have finished ours months ago but sometimes the Crown is not quite as engaged in some of these things. That is one of the things they are trying to work on, to get some coordination and cooperation done in a more effective and efficient way. So we are slowly but surely making progress.

Question:

So is there anything similar in the US?

Answer:

No, not that I am aware of.

Question:

You mentioned moving solar electricity to California. Could you elaborate? Is that economical?

Answer:

Wind, it's all wind. If you have the right fiscal conditions, the right shippers, the right credit ratings for the parties and counterparties, and you can tie in your construction costs. Again, from start to finish, we think if the right conditions can be put in place and it might be viable.

Question:

You talked quite a lot about regulatory uncertainty and the risk involved, and I am wondering whether you can purchase regulatory risk insurance? Is there a market for insuring that kind of risk?

Answer:

I don't know. How do you insure something like that? It would be a tough one. I know the Alberta government insured forest fires one year and forest fire risk, and we did so well we actually collected, but they didn't renew it because they wanted so much more money for a premium. They weren't happy with us. But no, I don't think it would be practical to insure for something like that, but that's just my opinion.

Question:

You spoke of the regulatory barriers and the costs associated with your developments in both Canada and the United States. Over the decades there have been constant themes, in both Canada and the United States governments, focusing on productivity and competitiveness and the need for Canadian industry to be internationally competitive. Otherwise our standard of living and economic prospects are going to be declining relative to the rest of the world. Doesn't the move towards this ever compounding regulatory stream serve to undermine the agenda for productivity and competitiveness?

Answer:

As a former regulator, what you are always trying to achieve is a balance between what is required and yet not inhibit economic growth. What all of the countries, including Canada and the US, need is economic growth which generates revenue, creates jobs and all those good things. So it could be a barrier, but at the same time, as a former regulator, and maybe I'll use the phrase my previous Deputy Minister of Labour had, you need effective labour legislation because there is some protection for workers. Unfortunately there are things out there that require that legislation and regulation. How far you go is the question. From what I see, I think we have lost sight of the fact that more and more labour regulation and legislation is not always good or effective. When I started with TransCanada and my boss pulled me aside and said one of the things I want to talk about is regulatory reform and process, and I said that's a great ten year project, He said "ten years?" and I said "Yeah." People who don't work with governments, particularly on the federal side, don't know it takes five years to get a piece of federal legislation through these days. Five to ten years, it's like a career, and the difficulty is how do you achieve that balance? I think balance is important; effective regulation is important; community involvement is really, really important. These are just really complicated days. The people we deal with in the US and Canada at the senior levels are smart people. They get it and are sometimes as frustrated as we are, but again it is very difficult to change those rules. Hence people like me have jobs to help.