



Case Closed

Deconstructing Pipelines: NERA's Role in Canada's Omnibus "Pipeline Abandonment" Proceeding before the National Energy Board

Overview

On May 31, 2013, TransCanada filed an application with Canada's National Energy Board (NEB) for approval of a collection mechanism for recovery of costs related to pipeline abandonment, in accordance with the NEB's Land Matters Consultation Initiative (LMCI). TransCanada proposed a surcharge based entirely on energy billing determinants. Enbridge Gas Distribution Inc. and Union Gas Ltd., the Ontario gas distributors, opposed TransCanada's application. NERA was retained by Enbridge and Union to evaluate TransCanada's proposed methodology. On May 31, 2014, the NEB released a decision rejecting TransCanada's collection mechanism in favour of NERA's recommended methodology.

Background

In 2008, the NEB identified an approach for its LMCI, part of which dealt with financial issues related to pipeline abandonment. All pipeline companies were required to file abandonment cost estimates and a proposal on how to collect these funds.

TransCanada's "Mainline" is the longest pipeline in North America and is the primary supplier of natural gas to Ontario. However, TransCanada is currently experiencing a shift in demand due to a shale gas boom in the Northeastern United States. The company proposed a collection methodology through a surcharge on an equal dollar per gigajoule basis, which would help it deal with this shift in demand by recovering a disproportionately large amount of abandonment costs from an area where demand was greater.

NERA's Role

Enbridge and Union retained NERA Senior Vice President Dr. Jeff D. Makhholm as a witness to represent them on issues of TransCanada's proposed collection mechanism. Vice President Kurt Strunk served as consulting expert.

TransCanada's application proposed a "postage stamp" methodology, a surcharge based on energy billing determinants flowing on the pipeline. Notably, this methodology did not account for the distance that gas was shipped, despite large variances in length of haul and many pipeline costs being distance-based.

NERA, in the testimony of Dr. Makhholm, argued that pipeline abandonment costs were a function of both distance and geography, where a longer pipeline means higher costs. NERA stated that there was no reason to depart from the method used for recovering pipeline construction, and that the ratio of rate base approach would be reasonable and appropriate because it would better reflect the distance-related nature of the cost than TransCanada's proposal, which excluded distance as a factor.

In addition, NERA claimed that cost allocation is not an exact science, but a way to use objective measure to differentiate among pipeline shippers in a reasonable and workable fashion.

The Result

The NEB rejected TransCanada's abandonment surcharge methodology in favour of the ratio of rate base approach recommended by NERA. The NEB stated that:

TransCanada PipeLines' proposal, which would have shippers pay for abandonment costs based on the volume of gas they ship, is flawed. It does not recognize that a shipper with a greater distance of haul, in general, requires a greater portion of the Mainline, and therefore should pay more to abandon it.

In the Board's view, TransCanada PipeLines' proposal would not result in just and reasonable tolls because it ignores that abandonment costs are a function of distance.

The NEB subsequently directed TransCanada to file another application for recovery of abandonment costs using the ratio of rate base methodology.

About NERA

NERA Economic Consulting (www.nera.com) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. We bring academic rigor, objectivity, and real world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

NERA's clients value our ability to apply and communicate state-of-the-art approaches clearly and convincingly, our commitment to deliver unbiased findings, and our reputation for quality and independence. Our clients rely on the integrity and skills of our unparalleled team of economists and other experts backed by the resources and reliability of one of the world's largest economic consultancies. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

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