

# 2<sup>ND</sup> CROSS-BORDER FORUM ON ENERGY ISSUES

## Moving Toward Dialogue: Challenges in Canada-U.S. Energy Trade

The Canada Institute of the Woodrow Wilson International Center for Scholars  
Enbridge

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### Introduction

The Woodrow Wilson Center's Canada Institute and Enbridge convened a forum with two of the world's leading energy analysts on September 27, 2004 to discuss the Canada-U.S. energy market. Paul Ziff, CEO of the Ziff Energy Group, and Pulitzer Prize-winning author Daniel Yergin, Chairman of Cambridge Energy Research Associates, discussed essays each had written on the bilateral energy market with specific emphasis on energy infrastructure. The essays were published as part of the second issue of the Canada Institute's *One Issue, Two Voices* publication series. Ziff and Yergin presented their papers to an invitation-only, senior-level group of industry and government officials from both the United States and Canada at the forum, which was held at the Wilson Center in Washington, D.C.

The event was convened as a follow-up to the *Woodrow Wilson Forum on Cross-Border Issues*, co-sponsored by the Canada Institute, Enbridge, and EnCana in March 2004 in Calgary. This joint initiative resulted in a successful event on the broad business relationship between Canada and the United States. The Calgary forum, entitled "**Closing the Gap: Creating a Collaborative Cross-Border Business Environment**," underscored the need for continued cross-border cooperation and the promotion of a vision of North America as an integrated business community. The meeting was an opportunity for key government and business leaders to discuss concrete solutions to improve cross-border relationships in the energy sector, specifically those relating to infrastructure, and concluded with a commitment to pursue the solutions through future collaboration.

This event on the challenges in the Canada-U.S. energy trade represents the Canada Institute's commitment, alongside Enbridge and other partners in Canada, to sustain a cross-border dialogue between key stakeholders from the energy sector. The success of this type of high-level forum, bringing together people in business and government, provides a model for future encounters of this sort. The success of the Calgary forum gave rise to this event, which marks the beginning of a full-fledged series, to continue as the *Cross-Border Forum on Energy Issues*. As the follow-up to the Calgary forum where important bilateral energy issues were first broached, this event is presented as the **2<sup>nd</sup> Cross-Border Forum on Energy Issues: "Moving Toward Dialogue: Challenges in the Canada-U.S. Energy Trade."**

## **Background**

Canada is the world's third largest natural gas producer. It is also the world's ninth largest crude oil producer, and as production increases from its oil sands, its ranking is expected to rise. Canada is the leading supplier of oil to the United States, ahead of Saudi Arabia, Mexico, and Venezuela. During the first five months of 2004, Canadian oil exports to the United States averaged almost 17 percent of total U.S. oil imports. And during the past 15 years, Canadian gas exports to the United States have increased by 80 percent.

Estimates show that by 2008, gas prices will be two and a half times higher than those seen in the 1990s. Curiously, though, even with constantly growing demand for gas in the United States, imports of gas from Canada declined last year. The most notable explanation for this trend is that the supply of Canadian gas is no longer able to meet increasing demand.

## **Issues**

Participants in the forum discussed the numerous factors that influence the efficiency of energy trade between Canada and the United States. Upon analysis, the issues were divided into three general categories: compatibility challenges, regulatory challenges, and environment challenges.

### **Challenges to oversight and regulatory compatibility**

Canada and the United States have two distinct and separate approval processes for oil and gas projects. In Canada, projects must be approved by the National Energy Board (NEB); in the United States, projects must be approved by the Federal Energy Regulatory Commission (FERC). While both of these boards have essentially the same purpose, they differ in their methods and procedures for reviewing and approving projects.

The NEB process tends to be more formal and lengthy, with a panel of board members presiding over the public hearings. The FERC process, although less formal, uses Administrative Law Judges (ALJs) to hear presentations from interested parties; there is broad interpretation of who can participate in the process. The ALJ subsequently forwards a recommendation to the FERC commissioners, who make their decisions in monthly public or periodic internal sessions based upon the written record. FERC is also more political than the NEB, since the U.S. president appoints the five commissioners, no more than three of whom may be from the same political party. The NEB is more politically independent, with the government appointing board members as well as a number of staff.

One speaker remarked that when looking at the relative mandates of the NEB and FERC, it is important to note that their functions diverge in a few key areas. While there is an overlap in the area of regulation, the NEB also has a number of technical functions, particularly regarding market supply. The NEB moved to Calgary from Ottawa a decade ago to be closer to its stakeholders; FERC remains in Washington. These differences must be considered when investigating possible areas of collaboration. Additionally, given that cross-border projects must be approved by both regulatory agencies, the duplication of efforts in the approval process remains a hindrance to bringing projects on line.

Differences in the federal systems of each country also inhibit increased collaboration. In Canada, the federal government has a great deal of power in the approvals process and the NEB tends to take a leading role. On the other hand, in the United States more power resides at the state level, and FERC delegates much more to the states and local communities than is seen in Canada. As a result, the approval of cross-border projects can be slow given the different agency requirements for information. The lack of similar and consistent tolling in cross-border pipelines systems presents another challenge.

Environmental assessments of major energy infrastructure projects also present significant challenges. Canada created the Canadian Environmental Assessment Agency (CEAA) about a decade ago to establish a standard federal environmental assessment process. The issue of regulating CO<sub>2</sub> emissions also remains an uncertain proposition, especially since Canada signed the Kyoto Accord and the United States did not. In the United States, FERC tends to make project approvals conditional on obtaining other environmental approvals, while in Canada, environmental issues are dealt with early in the approval process. Bilateral collaboration to address these differences in the approval process would benefit producers and consumers alike.

### **Regulatory challenges**

Discussion at the forum capitalized on the momentum created by the Memorandum of Understanding (MOU) that had been signed by the NEB and the FERC in May 2004. Participants echoed the MOU's call for joint action, highlighting the part of the document that recognized that coordination of efforts "could promote the public interest through increased efficiency, expedited and coordinated action on significant infrastructure projects."

Almost every presenter expressed serious concern with the slow-moving, tedious approval process for new projects. The evaluation process has become much longer in recent years, driven in part by the increasing number of stakeholders and regulatory boards that are now involved in the approval process, from the genesis of a project's concept to the eventual start-up.

Some participants suggested that the increase in the number of interventions and regulatory boards stems from the way in which the federal government of Canada resolved land claims by First Nations. While much applauded for involving First Nations in the decision-making process, the decisions have also resulted in the formation of dozens of new land, water, and environmental regulatory boards. One speaker suggested that some of these new boards might have too much power, since they can veto a project even after the main regulatory bodies have granted approval.

Many of these new boards have inadequate and rotating staff. Such boards have important legislative powers and can create significant challenges for proponents of new projects, such as the Mackenzie Valley pipeline. In a large region with fewer than 100,000 people, the large number of these independent regulatory agencies is proving to be a major obstacle to the Mackenzie Valley project, which will have noteworthy positive benefits for the local populations.

One presenter decried the high cost of the approval process. Companies are reluctant to invest significant financial capital in the planning phase of a project only to have it rejected for non-technical reasons. Another challenge to long-term contracts has been the unbundling of the local distribution company (LDC) markets, especially when the residential and commercial sectors have been split from the traditional LDC supply sector. One speaker suggested that perhaps the split LDC markets could be reintegrated, at least informally, to secure more long-term contracts.

The slow approval process, coupled with powerful interveners and regulatory boards, makes for an over-regulated system. As such, many new and crucial projects are not proceeding as planned, which in turn limits available supply, spurring high and volatile prices.

### **Environmental challenges**

One of the primary challenges for the natural gas industry is that although its product is seen as environmentally friendly and an efficient source of energy (suggesting strong demand for it over other sources of energy), natural gas is most often found in remote or restricted areas. In other words, while the reputation of natural gas as a clean fuel will encourage the promotion of new natural gas projects, market forces risk undermining such projects as less expensive alternatives are explored. Other factors come into play when calculating the pros and cons of such projects; one particularly potent variable is the influence of public opinion. As a rule, the public pays more attention to environmental issues than to energy issues, and has more sympathy for the environment than for energy supply.

In this regard, several participants raised the issue of the use of natural gas in oil sands production. Given the tight supply of natural gas, it could make sense to use alternative sources of fuel (which are often heavier than natural gas, producing more carbon dioxide). With increasing concern over carbon dioxide emissions and heightened awareness of climate change issues, however, the public is unlikely to support replacing natural gas for use in oil sands production with a heavier fuel. At the same time, continued use of natural gas in oil sands production will exacerbate current supply shortages and result in increased price volatility.

Participants discussed the potential of liquid natural gas (LNG) as a way to combat the supply shortage. Several participants raised concerns about siting LNG terminals and their location as potential terrorist threats. Others voiced related concerns about the reliability of electricity systems, and the availability of capital and skilled labor, all of which compound the supply constraints witnessed in the energy sector as a whole.

Finally, several speakers brought up the issue of NIMBY-ism (“not-in-my-backyard”: a concept generally referring to reluctance by local residents and municipalities to allow industrial projects in their vicinity). Consumers are unhappy with the unpredictable prices of gas and the increasing occurrence of blackouts, yet they are unwilling to facilitate projects (particularly LNG projects, which require special terminals) that would serve to increase supply and reduce price volatility. In short, negative impacts tend to be viewed more locally, while potential benefits of a project are dispersed over a much broader level. NIMBY-ism has recently driven opposition to siting key LNG projects in New England and eastern Canada, despite the significant demand for energy in that region.

## **Solutions**

Forum participants suggested possible solutions to the challenges highlighted above.

### **Solutions for oversight and regulatory compatibility**

While there is already a large degree of cooperation between Canada and the United States, more cross-border cooperation on energy issues is clearly needed. There was broad consensus among forum participants to hold joint NEB-FERC hearings on cross-border projects as a possible first step toward greater collaboration on energy infrastructure. Participants felt that the notion of holding joint hearings was worth pursuing, as it would avoid duplication and shorten the hearing process. For an NEB-FERC joint hearing, there might be co-chairs from each country and a balance of technical support staff from each agency. Harmonizing information requests would also streamline the process and make it more efficient.<sup>1</sup> However, the current FERC and NEB hearing processes differ to such an extent that establishing joint hearings may create its own set of challenges.

### **Regulatory solutions**

There was broad consensus among participants for the need to streamline the project approval process. Participants favored increased predictability and transparency in the process, as well as new policies to provide flexibility in the process.

Participants suggested establishing a two-part process, which would first assess the social demand underpinning a project, and then address conduct analysis and review, thus targeting projects with higher social priority for swifter access to streamlined mechanisms. One speaker suggested that if a project was deemed to be in the national interest, the government should mobilize a “super panel” representing both regional and national interests in order to ensure the project would proceed.

Participants suggested specifically that regulators take a national perspective when looking at the pros and cons of a project, and that legislatures empower regulators with the authority to supersede other agencies as a way to remove unnecessary regulatory hurdles. One speaker noted that FERC already has this capability; FERC does make non-environmental economic decisions in what is called a “preliminary determination of non-environmental issues.” In this case, usually within the first six months of the filing of the application, the routing is concluded first and an environmental review follows. Another FERC filing process involves beginning the environmental review work before the application is made with the commission. Project proponents and stakeholders meet before the application is filed in order to identify concurrent decision-making processes in the hope of arriving at a final decision more quickly. Canadian participants pointed out that Canada and the NEB did not currently have the mechanisms to perform this kind of early or concurrent review.

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<sup>1</sup> See Paul Ziff, “Cross-Border Regulatory Collaboration in its Context: Energy Balances and Energy Policy,” *One Issue, Two Voices*, issue two (September 2004), pp. 2-15.

One speaker suggested that in order to streamline the approval process, regulators should revert to the prior method of preparing and submitting a complete application, followed by a set of discussions from the big picture down to the details. The speaker maintained that this method was more cost-effective and saved project proponents from spending large amounts of money on a project prior to the project's approval.

### **Environmental solutions**

One speaker suggested three possible solutions to the price volatility problem:

1. For utilities, the development of effective customer education programs and flexible gas procurement mechanisms;
2. For the power sector, greater fuel flexibility; and,
3. For individual users, developing hedging and process efficiencies, and re-examining capital investment plans.

Forum participants encouraged regulators to resist linking energy trade with other issues, especially when reviewing environmental and NIMBY questions.

Many speakers asked why there was such a high level of public resistance to natural gas projects, despite the clear necessity for their development. Some believed that the energy industry suffered from a "credibility gap": communications by and on behalf of the industry were often not seen as credible. Other participants proposed that the industry embark on a campaign to educate the public about the natural gas industry, with the goal of building public confidence over time. The objective would be to engage and involve consumers early, and thus encourage the public to attend hearings to speak in support of natural gas projects.

### **Conclusions**

Participants expressed their views regarding the critical goals to be achieved in devising a balanced energy policy:

1. ***Economic competitiveness***: energy policy must account for the true value of energy resources while encouraging competitive, market-oriented prices;
2. ***Energy security***: energy policy should focus on safeguarding supply and protecting infrastructure against terrorism and other disruptions; and,
3. ***Sustainability***: energy policy should take into account climate change, enhance research and development, decrease dependency on fossil fuels, and support the development of alternate fuel sources.

One participant viewed a push toward a continental energy market in North America, and the eventual integration of global energy markets, as integral to the solution of bilateral issues. Presenters wanted to see a genuine commitment on behalf of the two national governments and the industry to develop long-term energy resources.

In his concluding remarks, Enbridge CEO Pat Daniel summarized the discussion noting substantial agreement among panelists regarding the challenges of market inefficiencies: high prices, high volatility, slow approval regulatory processes, and significant time lags in adjusting supply to demand. Highlighting key points from each presentation, Daniel referred to the “unvirtuous circle”: high prices and high volatility result in public distrust of the energy industry, thus making it more difficult to proceed with any alterations or systemic improvements. Daniel also recognized that the public often erroneously believes that energy projects should be stalled to protect the environment—and keep the energy industry at bay; he added that the public neglects to note the cost of such delays to the consumer. He predicted that soon the public would wake up to the need for gas, perhaps after a cold winter with high and volatile prices. He also argued that sustainability and climate change are important issues for Canada and the United States to address together. Discussions about energy policy go hand-in-hand with sustainability and climate change, issues that should be incorporated into fair, efficient, and realistic policy. He reinforced the Canadian government’s “Smart Regulation” platform, to enhance the process for project development.

In closing, Daniel said that the answer to these problems all came down to the consumer. In his closing, he said:

*We need to get the consumer engaged, involved, coming to our hearings in support of projects, not opposing projects—because the vast majority of the projects initiatives that we’re talking about are a huge benefit to society in general, and there isn’t an understanding of that. It’s a huge undertaking to get out and provide that public education, to get the people coming forward to support initiatives, but it shouldn’t be the big bad energy industry against the consuming public when the true beneficiaries are the consuming public.*

Paul Ziff concluded the forum discussion by stating that communication on issues and process can go a long way to avoid discontinuities between decisions; communication, he said, also leads to better coordinated timing and agenda-setting of the two regulatory schedules, which in turn facilitates the regulatory process.