Negotiated settlements in Canada

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(research with Joseph Doucet)
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Outline

• National Energy Board in Canada
• The change over time
• What are negotiated settlements
• What is their extent
• What difference do they make
• What regulatory policy is conducive
• Conclusions and implications
National Energy Board

• Regulates international and inter-provincial oil & gas pipelines in Canada since 1959
• 3 oil pipelines
• 5 gas pipelines (2 opened 2000)
• Limited overlap/competition between pipelines
• but not zero, and choice of destination
Gas Pipelines
Toll issues

• NEB deals with construction of lines, energy exports, frontier activities

• Our main interest here is pipeline tolls
  • Prices for transmission of oil and gas
  • Associated terms & quality of service parameters

• Tolls account for 3% of NEB applications

• But for 43% of NEB hearing days
  • More go to hearing and hearings take longer

• But picture has changed over time
### NEB toll hearings

<table>
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<th>Avg annual number</th>
<th>Avg dur’n (days)</th>
<th>Avg hearings days/year</th>
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Toll hearing days one quarter of previous level
What caused this change?
Negotiated settlements

- Conventional regulatory process involves litigation of each case
  - Testimony, cross-examination, judgement etc
- There is an alternative process:
  - Negotiation between utility and interested parties/stakeholders
  - Settlements agreed (if successful)
  - Presented to regulator for approval
  - Which may or may not be forthcoming
    - Reduces need for hearings – but is that all?
Effect of settlements?

• Conventional view: settlements reduce cost and time of normal regulation
• But achieve broadly same outcome
• More recent evidence: not so
  • Wang: FERC
  • Littlechild: Florida PSC
• Settlements follow different process and yield different outcomes
• Including outcomes otherwise unattainable
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Figure 3: Settlement activity since 1985

Source: NEB toll decisions

- Tolls set through traditional regulation (litigation)
- Tolls set through negotiated settlement
- Some contribution of settlement to toll determination
- Tolls not yet determined
Impact of settlements

• Settlements have almost completely superceded litigation since 1995 (for tolls)
  • Exception TCPL 2001-4 reflects argument with NEB rather than objection to settlement

• Settlements are typically longer
  • Gas litigations generally annual
  • Now settlements up to 5 years or more

• Multi-year incentive regulation
  • Not otherwise possible for litigation to commit parties not to seek to reopen cases
Nature of settlements

• Scope of settlements has been varied
  • tariffs, opex, ROE, service quality, capex programs (as well as multi-year incentives)
• transition to light-handed regulation
  • allowing individual settlements with utility
  • price discovery regime to facilitate new entry
  • complaint-handling procedures
  • complaint-based regulation only for NEB
• improvements in industry relations
  • productivity, service design, communications
Reasons for success

• The aim was not just cost-saving
  • In fact settlements take time and effort
• Parties could negotiate mutually beneficial outcomes
  • Better and more far-reaching than could expect NEB to deliver
• NEB was always sympathetic
• But change of NEB policy important
Role of NEB

- 1985, 1986 cherry-picking by NEB discouraged settlements
- 1988 Guidelines sought to encourage them
  - But not convincing
- 1994 Revised Guidelines effective
  - Normally accept unopposed settlements
  - Not judge whether each element reasonable, but whether process OK: open, informed, agreement
  - ‘consensus of affected parties a good measure of the public interest’
Generic cost of capital decision

- Everyone fed up with repeated repetitive hearings on cost of capital
- Generic Cost of Capital decision 1994
  - Fix benchmark formula for all companies, observed parameters simply updated annually
- This facilitated settlements
  - removes main item of disagreement (0-sum game)
  - removed pipeline market power
  - focus on areas of potential agreement (+ve sum)
  - left scope to agree premium for better service, innovative products etc
Conclusions

• Negotiated settlements have transformed the approach to oil and gas pipeline regulation in Canada since 1995
• Mutually beneficial outcomes
  • More innovative and better industry relations
• Need research on experience elsewhere
  • Settlements have been problematic in some places
• Scope to apply this concept in UK & EU?
  • Can present utility price control process survive?