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ENERGY SERIES

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Over the past 10 years, Canada has had a unique opportunity to exploit its hydrocarbon endowment. Hydrocarbon prices from roughly 2000 to 2015 were sufficient to generate massive investment in upstream oilsands production worth well over $250 billion. This led to the advent of various pipeline infrastructure projects to transport the resulting incremental production to markets.[1]

Concurrently, the opportunity to export Canadian natural gas as liquefied natural gas (LNG) to Asian markets emerged with sufficient economic credibility to generate several world-scale projects led by real players in global LNG markets. These projects included major natural gas pipeline infrastructure from northeast British Columbia to its northern tidewater ports.[2]

Solely private capital advanced all these pipeline infrastructure projects on the basic conviction that the Canadian regulatory system would not represent a material risk to the projects ultimately proceeding. I can categorically attest this to be the case for those projects that TransCanada Corp. advanced over this period. I have strong confidence that this was also the case for those advanced by TransCanada's competitors.

Sadly, too many of these projects evolved to acquire iconic status as examples of regulatory approval dysfunction. Keystone XL and Northern Gateway are prime examples.

The Canadian regulatory process was expected to efficiently provide sustainable approvals for projects that were manifestly in money, using conventional technology applied in topographies well within the project proponents' experience and expertise, and providing accommodation terms to directly affected stakeholders well within, or exceeding, accepted norms. Moreover, the scope of the actual regulatory process was expected to be confined to the projects' directly attributable impacts, not expanded into a platform for vetting fundamental policy grievances typically related to climate and aboriginals.

Other than the approvals related to the Canadian sections of the Keystone system, the Canadian regulatory approval process failed to meet those expectations. Even in those cases where the national regulator ultimately recommended approvals, no one could reasonably contend that the process was efficient. Regulatory cycle times of more than five years conform to no one's reasonable standard of "efficient". Worse, in the cases where projects were rejected, such as Northern Gateway and Keystone XL under the Obama administration, the rationale bore no direct nexus to the regulatory recommendations provided to final political decision-makers. Rejections motivated by political considerations were never made explicit or were imposed long after significant dollars had been expended in the expectation of deference to the regulators' technical competence and integrity.

Projects of the scale that emerged in this period in almost all cases required the expenditure of hundreds of millions of dollars to comply with the expected regulatory rigour of a "complete application"; that is, sufficiently detailed and fulsome to ultimately establish the specific necessary operating and construction conditions for the project to proceed. Would private sector

capital have taken on these projects back in 2007 to 2011 if it had known how dysfunctionally the approval process would devolve? Likely not.[3]

So what is the scorecard that has emerged as of 2017?

- Northern Gateway was rejected entirely on the singular determination of Prime Minister Justin Trudeau — notwithstanding close to six years of regulatory scrutiny and compliance efforts by Enbridge — that the project's basic premises were "too risky" environmentally to abide. "The Great Bear Rainforest is no place for a pipeline and the Douglas Channel is no place for oil tanker traffic," Trudeau said; [4]
- Kinder Morgan's Trans Mountain project achieved approval after almost five years of regulatory process, yet concerns persist about the approval's enforcement; [5]
- Energy East, after having been publicly announced in 2012 and with regulatory application filed in 2015, has yet to commence its regulatory hearings in earnest, due to a series of procedural setbacks and project revisions;[6]
- The Obama administration rejected Keystone XL in November 2015, not on the basis of the regulatory record, but on the thesis that Barack Obama's "credibility" for the Paris Climate Conference required his rejecting the pipeline. The project was essentially moribund until Donald Trump's election in November 2016. Since Trump's inauguration, his administration has essentially reversed the Obama decision. The project is now in the process of reviving itself, with some real possibility it could be under construction by the first quarter of 2018. Canadian regulatory approvals achieved back in 2010 remain valid;[7]
- The two most notable projects to move western Canadian gas to Asian markets as LNG, the Petronas and Shell consortium projects, by year end of 2016 achieved requisite regulatory approvals, inclusive of federal environmental reviews. However, final investment decisions for these projects have been deferred until their economic fundamentals can be reaffirmed in the current commodity price environment. Cycle times for regulatory approval have run on the order of four years.[8]

The election of Donald Trump has clearly restored the possibility that the project that always held the greatest value to Canada — Keystone XL — may actually proceed in 2017. Given that the percentage of the project within Canada is less than 15 per cent and is entirely in the hydrocarbon-centric provinces of Alberta and Saskatchewan, even concerns around enforcing project proponents' rights to build should be minimal. The Kinder Morgan project has some prospect of proceeding before year end, thereby providing Canada with direct tidewater access for its oilsands resource, and serving as a legitimate complement to the Keystone XL system. However, it will doubtless face both litigation and civil disobedience over the course of 2017.

At present, in respect to Northern Gateway, Enbridge faces likely unrecoverable losses. As yet, there is no apparent willingness on its part to engage in litigation against the federal government.gb

From 2009 to 2016, the Harper majority government undertook one substantial attempt to provide "regulatory reform" as embodied in its 2012 budget.[9] Those on the Canadian left deeply resented these reforms as a whole, even such relatively constructive elements as trying to impose reasonable cycle times on the entire regulatory process and consolidate substantially duplicative regulatory processes across jurisdictions. Most notably, this reform initiative changed the historical basis of regulatory approval. The final decision would be in the hands of democratically elected politicians, not the regulators. The regulators would provide a recommendation, which the politicians could accept, reject or impose their own decision upon, distinct from the regulator. Political sanction of the regulatory process was reaffirmed or not, but regardless, it came late in the process and was not necessarily bound by what the regulators had recommended. Historically, the political level could only ratify or not ratify the regulatory approval. Post-2012, it could impose its own decision regardless of that regulatory process. Enbridge in particular would be affected by this change in respect to Northern Gateway. These were the unintended consequences arising from the good intentions of a presumptively empathetic conservative regime.

What should have been done? And would it still be relevant now, even if Canada's greatest window of opportunity has slipped by to some extent, given changes in hydrocarbon markets post-2015?[10]

- What would have allowed these projects to face a more reasonable regulatory risk while still confronting the genuine public interest issues that legitimately should be resolved at the political level?
- Instead of deferring political intervention to the very end of the process it should have come early and only in respect to specific public interest issues, if any, related to these projects.
- The basic elements of such a re-invention of the current National Energy Board (NEB) process for major hydrocarbon infrastructure projects are:
    - A first phase that would resolve whether the project was in the public interest or not. The essential elements of the project would be filed, with special emphasis on how the project conformed to basic public interest criteria. For example:
        - national carbon policy
        - accommodation principles for directly affected stakeholders
        - basic economic justification
        - alignment with other elements of national economic or social policy

- The filing for this first phase would be sufficient to deal with these public interest issues, but would not be the "complete" application ultimately required for phase two, if the project were to proceed beyond phase one;
- The NEB would provide a recommendation to the cabinet on whether the project was consistent with the public interest within one year of filing. The cabinet could either accept or reject that recommendation. Once having accepted the recommendation, the political level would have no further role in the regulatory process. Any approval would be binding on current and succeeding governments;
- The second phase would be entirely within the national regulator's control. Its function would be to apply specific operation and construction conditions on the proponents to carry out the project. That would be based on a fulsome application, inclusive of all relevant engineering and environmental impact information. This phase would be resolved within 24 months of filing a "complete application", a standard that sufficient information has been filed to set reasonable conditions, in the regulator's judgment. This phase would consolidate all other elements of federal and provincial environmental assessment in respect to the project;
- Significantly, the second-phase deliberations would be in the context of a project that had already been determined to be in the public interest. That point could no longer be litigated in the actual hearing process;
- Fundamentally political judgments would be confined to the first phase. The second would be fundamentally a technocratic exercise — fixing of conditions for the project consistent with current accepted best practices and risk tolerances for comparable projects globally;
- Various elements would require elaboration such as:
    - Specifics of phase one filing requirements
    - Identification of major policy issues relevant to the application
    - Process for testing filed material
    - Resolution of relevant stakeholders

If this basic process change had been in effect 10 years ago, much of the dysfunction that played out could have been avoided. Some examples:

- In Northern Gateway's case, if the government's view had been that no spill risk was tolerable in the Douglas Channel and related geography, then that should have been clarified within 12 months, not delayed until almost six years of regulatory process had elapsed;
- In the case of any hydrocarbon pipeline projects filed post-Copenhagen, the government would have been required to clarify that the project conformed to

Canadian carbon policy or not within this 12-month period. Compliance with carbon policy would not hang like a shroud over time, to be invoked even after apparent approvals had been given, as a claim to delegitimize approvals after the fact. This process would have forced governments to have resolved this issue early and explicitly, at least with respect to the infrastructure;

- Again, in the case of virtually all major pipelines filed since 2009, the other great uncertainty on any approval remains the inevitable litigation based on whether the applicant provided adequate stakeholder consultation and accommodation, particularly in respect to aboriginals. Government would have signed off that the principles of accommodation proposed by the applicant conformed or not to the government's expectations. Regardless of any future claims, the federal government would have already aligned itself with those accommodation principles or not. Examples of accommodation would include direct financial compensation for access, project changes, social investment, provision of procurement opportunities, etc.;
- In the case of Energy East, if provinces such as Ontario and Quebec are unalterably opposed to the project, that reality would be taken into account within the first 12-month period in respect to determining the basic national interest.

I am firmly of the view that if such a re-invention is not undertaken, then the risks of the existing regulatory process will have become too high to justify private capital even trying to get an approval going forward. If political intervention is to occur, as it has the democratic validation to do, it must come early in the process, not late. At that point, perhaps, only millions of dollars of proponents' capital is seriously at risk, not hundreds of millions.

To fully restore Canada's capacity to execute such projects, at least three other clarifications of existing Canadian law are required:

- All Canadians must defer to determinations of national interest made by federal regulatory entities. Provinces do not have vetoes on those determinations and moreover, where provincial jurisdiction applies in respect to a specific project's elements, it cannot be applied inconsistently with the federal determination. An example of this would be the denial of perfunctory provincial permits;
- All Canadians are subject to Canadian law — specifically, the legal remedies of pipeline proponents to actually affect their projects apply to all. No Canadian is exempt from those remedies;
- Finally, Canada has free trade among its provinces. Provinces disgruntled with distribution of economic rents that arise from resource development cannot be allowed to impose what in effect are transit taxes on the flow of goods among provinces to redress that distribution.

Those who doubt that these clarifications are required can examine the litany of dysfunctional reactions from various provinces, municipalities and interest groups in respect to the aforementioned projects:

- British Columbia insisted that it had conditions which must be met to ensure its support for any of the crude oil pipeline projects accessing B.C. tidewater. These conditions needed to be viewed as showstoppers — a de facto B.C. veto regardless of any federal determination of national interest. Worst of all, various governments and proponents of the projects largely capitulated to such demands. Whether the projects can bear those costs remains to be seen;[11]
- Virtually every NEB decision is subjected to a perfunctory legal claim that there was inadequate consultation with aboriginal groups, thereby risking delegitimizing the entire approval process. Of course, neither Parliament nor the courts has ever resolved what represents adequate consultation, let alone accommodation. The visceral issue is whether the accepted norms of financial compensation and project modification constitute sufficient accommodation or not. Governments have chosen not to confront this issue directly, so what comes after not confirming those norms — a de facto veto for Canadian aboriginals?[12]
- Quebec communities say that the Energy East project has yet to prove adequate net benefits for them. Is such a consideration the actual decision criterion? Or is it that the ultimate regulatory determination that the project's mitigated risks are acceptable is to be ignored even before it is rendered? Or that the federal determination is binding?;[13]
- Potential litigation from ENGOs arguing that any existing project approvals failed to recognize their impacts on Canada meeting its international climate commitments. This ignores, of course, that at present there is no national prohibition on hydrocarbon production or specific caps on emissions from that sector. Any regulatory decision can never be deferred to if it does not conform to these groups' specific political agendas.

Ideally, the recent NEB modernization panel would be the forum by which these specific process recommendations and related legal clarifications would be taken up and perfected.[14] Sadly, it remains to be seen if this panel will actually seize the opportunity or even recognize the real issues. The Trudeau government created the panel in response to various groups' disgruntlement at the reality that when processing applications for major hydrocarbon infrastructure, the NEB consistently recommended approval, albeit with conditions. Most notably, this happened with Northern Gateway. To assuage that disgruntlement, the panel was charged to examine fundamental process changes that would "restore trust and confidence". A cynic might suggest such a mandate could only be construed to make the existing process even more obstruction-friendly. Efficiency and competence are seemingly secondary considerations.

The way the regulatory process unfolded over the past seven years would hardly have led to concerns that interest groups had not been given sufficient opportunity to participate. The terms were fundamentally generous relative to the scope of the hearing itself or the probative value of their contributions.

The reality remains that certain interest groups are unalterably opposed to any hydrocarbon development and its related infrastructure. The regulatory process is a forum to leverage financial and policy concessions that may not be otherwise available to them through the democratic process.

A final admonition for this panel would be not to alter the NEB's composition from one that is predicated on technocratic competence and integrity to some other misplaced criteria of inclusion and political correctness as ends in themselves.

At some point, Canada either finds the capacity to deal rationally with its major economic opportunities, or else faces the consequences of further economic contraction. It may be too late for many of these recent major hydrocarbon infrastructure projects. The window of opportunity may have closed, in part due to the current dysfunctional process. However, it remains in the country's long-term interest to, at the very least, find as much efficiency in its regulatory processes as possible. If value judgments are to be imposed on resource development then that should be as up front as possible, and not waste capital and human resources.

[1] http://www.arcfinancial.com/assets/699/ARC_Financial_Corp._Fiscal_Pulse_Q1_2016.pdf
[2] https://news.gov.bc.ca/factsheets/factsheet-lng-project-proposals-in-british-columbia
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About the Author

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