Avenir Diversified Income Trust

Application for Common Carrier Declaration
Taber Field

March 7, 2006

Alberta Energy and Utilities Board

ALBERTA ENERGY AND UTILITIES BOARD
Decision 2006-021: Avenir Diversified Income Trust, Application for Common Carrier Declaration, Taber Field

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ALBERTA ENERGY AND UTILITIES BOARD
Calgary Alberta

AVENIR DIVERSIFIED INCOME TRUST
APPLICATION FOR COMMON CARRIER DECLARATION **Decision 2006-021**
TABER FIELD **Application No. 1378400**

1 DECISION

Prior to hearing final arguments on the application, the Alberta Energy and Utilities Board (EUB/Board) asked counsel for the parties involved in this proceeding if they wanted a further opportunity to attempt to settle matters before the Board ruled on the application. The parties indicated that a negotiated settlement was preferred and that a further opportunity to attempt a settlement would be worthwhile. The Board was concerned, however, that without some direction from the Board, the parties would not be able to progress beyond the negotiating positions that had resulted in the parties failing to resolve any of the substantive issues raised in the application. On December 1, 2005, therefore, the Board advised the parties that in the absence of a negotiated settlement, it considered that there was a need for the common carrier order and would grant it, that the existing tie-in points were appropriate, that a transportation fee included in the order would be set using the JP-05 methodology,[1] and that the effective date for the order would be September 3, 2005. The Board provided the parties a period of about two weeks to resolve the matters in question. The parties filed submissions on December 15, 2005, indicating that they had been unable to resolve the matter and requesting that the Board issue its full decision on the application.

In accordance with the above and the discussion below, the Board approves Application No. 1378400, subject to the approval of the Lieutenant Governor in Council, with the form of the order as shown in Appendix 1.

2 INTRODUCTION

2.1 Application

Avenir Diversified Income Trust (Avenir), formerly Val Vista Energy Ltd. (Val Vista) applied to the EUB

- under Section 48(1) of the *Oil and Gas Conservation Act* (*OGCA*) for an order declaring Dynegy Canada Inc. (Dynegy) as a common carrier of gas produced from a portion of the Taber Second White Specks B Pool (the B Pool), through a pipeline extending from Legal Subdivision 10 of Section 14, Township 9, Range 14, West of the 4th Meridian (LSD 10-14-9-14 W4M), to a location in LSD 6-29-9-14 W4M;

[1] The JP-05 methodology for calculating fees is set out in the report *JP-05: A Recommended Practice for the Negotiation of Processing Fees*, a joint industry task force report prepared by the Canadian Association of Petroleum Producers, Gas Processing Association Canada, the Petroleum Joint Venture Association, and the Small Explorers and Producers Association of Canada.

- under Section 48(4)(a) of the *OGCA* for the EUB to designate the existing tie-in points as the points at which the common carrier shall take delivery of the gas to be transported under the common carrier order;
- under Section 55(1) of the *OGCA* for the EUB to set the transportation fee to be paid for the gas to be taken by the common carrier; and
- under Section 56 of the *OGCA* for the above-noted order to be effective as of January 1, 2005.

2.2 Interventions

Dynegy filed an intervention opposing the application.

Corinthian Energy Corp. (Corinthian), Diamondback Energy Ltd. (Diamondback), and Rider Resources Ltd. (Rider) filed submissions in support of the application and appeared at the hearing. Diamondback's representative participated at the hearing as part of the Avenir witness panel. Iliad Adventures Ltd. (Iliad) also filed a submission in support of the application but did not appear at the hearing.

2.3 Hearing

The Board held a public hearing in Calgary, Alberta, which commenced on November 16 and concluded on November 21, 2005, before Board Member J. D. Dilay, P.Eng. (Presiding Member) and Acting Board Members F. Rahnama, Ph.D., and K. G. Sharp, P.Eng.

The Board considers that the record of the proceedings closed on December 15, 2005, when Avenir and Dynegy each made submissions to the Board indicating that they had been unable to resolve matters respecting the application.

Those who appeared at the hearing are listed in Appendix 2

3 BACKGROUND

The B Pool is a sweet, dry, gas pool currently interpreted by the EUB as a narrow pool about 2 to 3 sections in width, trending in a southeast to northwest direction, and underlying all or portions of 36 sections in Townships 9 and 10, Ranges 13 to 16, W4M. The EUB's pool order boundary for that portion of the pool of interest in this application is shown in the attached figure.

Avenir is the licensee of six gas wells, as noted in the following table, which are tied into the proposed common carrier pipeline, as shown in the attached figure, and which produced gas from the B Pool until September 3, 2005. (Diamondback has a 10 per cent interest and Iliad has a 5 per cent interest in three of the Avenir wells.) In addition, until September 3, 2005, Avenir was flowing gas through the Dynegy pipeline from five other B Pool wells owned by Corinthian and Rider, as shown in the table below and in the figure. The location of the point where gas from each of the wells of interest ties into the Dynegy pipeline is also shown in the figure. Gas from the wells flowed through the Dynegy pipeline to LSD 6-29-9-14 W4M and into Avenir facilities before flowing into a sales gas pipeline.

Well Location: LSD-Township-Range W4M	Well Licensee	Date Production Began
6-18-9-13	Corinthian	May 23, 2003
8-18-9-13	Corinthian	May 23, 2003
8-13-9-14	Avenir	April 13, 2004
10-14-9-14	Avenir	December 13, 2001
16-15-9-14	Avenir	February 14, 2002
16-20-9-14	Rider	December 13, 2001
10-21-9-14	Avenir	December 13, 2001
6-22-9-14	Avenir	December 13, 2001
4-23-9-14	Avenir	April 13, 2004
4-24-9-14	Corinthian	May 23, 2003
5-28-9-14	Rider	December 13, 2001

4 PRELIMINARY MATTERS

Avenir and Dynegy filed an Agreed Statement of Facts at the commencement of the hearing, with the result that a number of matters that may otherwise have been the subject of direct or cross-examination were clarified for the record at the expense of little or no hearing time. The Board commends this approach and expresses its appreciation to the parties and their counsel for taking this step in the proceeding.

In 2001, Val Vista (Avenir's predecessor[2]) and Dynegy entered into the following agreements:

- Construction Management Agreement, November 16, 2001;
- Declaration of Trust, December 14, 2001;
- Pipeline Lease Agreement, December 14, 2001, referred to herein as the Lease Agreement;
- Option Agreement, December 14, 2001; and
- Dynegy Canada Master Physical Agreement and Schedule A Confirmations, December 14, 2001, referred to herein as the Marketing Agreement.

These agreements, excluding the Marketing Agreement, are collectively referred to herein as the Agreements. In summary, the Agreements provided that Val Vista would construct a pipeline (the proposed common carrier pipeline) and then lease it from Dynegy, the owner of the pipeline, for a monthly fee of $21 988.34 plus the Goods and Services Tax for a three-year term ending December 31, 2004. The Agreement provided Val Vista with the option of purchasing the pipeline from Dynegy for $160 000 at the end of the term of the Lease Agreement. In addition, the Lease Agreement included an overholding provision specifying that if Val Vista did not exercise the option to purchase the pipeline and wished to continue to use the pipeline after the lease term expired, it could do so on a month-to-month basis on the same terms as contained in the Lease Agreement for the monthly fee of $21 988.34.

Val Vista subsequently constructed a 6-inch steel pipeline with a capacity of 106.06 thousand cubic metres per day (10^3 m^3/d) (3800 thousand cubic feet per day [mcf/d]) extending from LSD

[2] Avenir purchased Val Vista on March 28, 2005.

10-14 to LSD 6-29-9-14 W4M. It began flowing gas through the pipeline in December 2001 from the wells noted above.

Val Vista did not exercise the option to purchase the pipeline before that option expired on December 31, 2004. However, Val Vista, and then Avenir, continued to operate and flow gas through the pipeline until September 3, 2005, when Avenir shut in all wells flowing gas into the pipeline. In addition, on September 3, 2005, Avenir provided documents to Dynegy purporting to convey, transfer, and assign all Avenir’s rights, title, estate, and interest in the pipeline to Dynegy. Avenir considered the Agreements with Dynegy to be expired or terminated no later than September 3, 2005.

Dynegy stated that after December 31, 2004, the Lease Agreement allowed Avenir to use the pipeline at the agreed fee ($21 988.34) on a month-by-month basis. Dynegy considered that the agreed-upon fee was still in effect, because Avenir did not exercise the option to purchase the pipeline and continued to flow gas through the pipeline. Dynegy argued that the Agreements do not state that they terminate when no gas is flowing through the pipeline or even on the transfer of the title to the pipeline over to Dynegy. It said that there is no automatic termination of the Agreements and that it did not know how the Lease Agreement in particular could be terminated.

The Board believes that as a general rule a common carrier order should not override a contract into which parties have freely entered, and the Board has therefore considered whether the Lease Agreement or any part of it relating to the issues raised in this application is still in effect. The Board notes that the term of the Lease Agreement expired on December 31, 2004. The only provision of the Lease Agreement that addresses the continued use of the pipeline by Avenir after that date is Section 11.8:

> 11.8 **Overholding**. If the Lessee [Avenir] remains in possession of the Pipeline after the expiration of this Lease, the Lessee shall be deemed to so remain in possession as a lessee from month to month subject to the terms of this Lease insofar as the same are applicable on a month to month tenancy, and a renewal of the term originally granted shall not be created by implication of law. This clause shall not be construed as a consent to overholding nor does it preclude the Lessor [Dynegy] from taking any action to recover the Pipeline.

The Board finds that the term “possession of the Pipeline” used by the parties in the overholding provision of the Lease Agreement refers to Avenir continuing to transport gas through the pipeline as it had done before the term of the Lease Agreement expired. This interpretation is the most reasonable interpretation consistent with the other terminology and provisions in the Lease Agreement. Avenir stated that the Lease Agreement had no effect after December 31, 2004, or alternatively that it could have no effect after September 3, 2005. Dynegy stated that Section 11.8 of the Lease Agreement represented the parties’ agreement on a fee for the transportation of Avenir gas through the pipeline even after term of the Lease Agreement expired. Dynegy could not say if or when Section 11.8 would no longer apply, but its position at the time of the hearing was that the overholding provision was still in effect.

The Board finds that Section 11.8 of the Lease Agreement applies to Avenir’s use of the pipeline after December 31, 2004, and therefore the Board is not prepared to make an order on this application that would have effect while Avenir was exercising its entitlement under Section 11.8 of the Lease Agreement.

In the Board’s view, when Avenir ceased flowing gas on September 3, 2005, and provided documents to Dynegy that conveyed all of Avenir’s interest in the pipeline, Section 11.8 of the Lease Agreement could have no further effect. In law, an overholding lessee remains in possession of the leased property as an extension or implied renewal of its entitlement under the lease itself. In this case, the overholding provision of the Lease Agreement stated that there would not be a renewal of the lease term but that Avenir could elect to continue in possession of the pipeline on a month-to-month basis. By ending its use of the pipeline and surrendering all of its interest in the pipeline, Avenir ended its possession of the pipeline, as that term is used in the Lease Agreement. When an overholding lessee surrenders possession of the leased property, its entitlement to the leased property ends and it cannot thereafter come back into possession of the leased property except by another agreement or entitlement. The Board therefore finds that on September 3, 2005, when Avenir surrendered the pipeline to Dynegy, Avenir’s entitlement to overhold under Section 11.8 of the Lease Agreement ended and the Lease Agreement ceased to govern the fee Avenir would pay to transport gas through the pipeline. After that day, Avenir was in the position of any other party that wished to transport gas though the pipeline and did not have an agreement to do so with Dynegy.

5 ISSUES

The Board considers the issues respecting the application to be

- delineation of the pool to be subject to the proposed common carrier order;
- need for the common carrier order and in this regard
    - whether there are producible reserves available for transportation in the proposed common carrier pipeline,
    - whether there is a reasonable expectation of a market for the gas to be transported through the common carrier pipeline,
    - whether the applicant was able to make reasonable arrangements for use of the pipeline, and
    - whether the existing pipeline represents the only economic way or is the most practical way or is a clearly environmentally superior way to transport the gas to be produced; and
- terms of the common carrier order, including
    - the portion of the B Pool to be subject to the order,
    - the tie-in points to be included in the order,
    - the effective date of the order, and
    - the transportation fee to be included in the order.

6 DELINEATION OF THE POOL

The Board notes that no issues were raised by any party with respect to the delineation of the pool to be subject to the proposed common carrier order. The EUB’s current outline of the subject pool in the area of interest is shown in the attached figure.

7 NEED FOR THE COMMON CARRIER ORDER

7.1 Views of Avenir

Avenir submitted that producible reserves are available for transportation through the proposed common carrier pipeline. It calculated remaining reserves in the area of the pool to be subject to the proposed common carrier order of 30.99 million m^3 (1.1 billion cubic feet), assuming transportation fees in the order of $0.22/$10^3$ m^3/kilometre (km) (1 cent/mcf/mile) of pipeline. It estimated the project life to be between 6 and 12 years, depending on economic conditions. It submitted that there was potential for further drilling in the area, which would extend the life of the pool, assuming it could obtain reasonable transportation fees. Avenir also submitted that a transportation fee of $19 000/month, as offered by Dynegy, would reduce the recoverable reserves by half and cut the project life to less than 4 years.

The applicant confirmed that there was a market available for the gas to be transported through the proposed common carrier pipeline.

Avenir submitted that it had not been able to make a reasonable arrangement with Dynegy to use the pipeline. It considered that on January 1, 2005, and in any event by September 3, 2005, it was in the position of any other party that may request transportation on the pipeline. Dynegy rejected an offer made by Val Vista in October 2004 to purchase Dynegy's pipeline for $20 000, as well as an offer made by Avenir in June 2005 to purchase the pipeline for $160 000. In addition, Dynegy rejected the applicant's proposed transportation fees of $0.22/$10^3$ m^3/km (1 cent/mcf/mile), which Avenir considered to be a typical fee in the general area, as well as a proposed fee of $1.10/$10^3$ m^3/km (5 cents/mcf/mile). The applicant submitted that Dynegy's position that the Lease Agreement was still in effect and that Avenir should pay $21 988.34/ month ($96.90/10^3 m^3 [$2.73/mcf] or $14.78/$10^3$ m^3/km [$0.67/mcf/mile]) was incorrect and unacceptable. Avenir also rejected an offer by Dynegy in February 2005 to use the pipeline for $19 000/month. Avenir contended that with the fee structure proposed by Dynegy, wells would be shut in sooner than with Avenir's proposals; in addition, it was unlikely that Avenir would drill additional wells in the area. Avenir concluded that the matter remained unresolved, as the parties' positions were far apart.

The applicant acknowledged that it would be economic to build either a replacement 6-inch steel pipeline or a smaller plastic pipeline. It said that constructing the plastic pipeline would have limited environmental impact on the area, which was agricultural with specialized crops. However, any new construction would have a further impact on landowners, who were not happy with the construction of the Dynegy pipeline and wanted it to be completed as quickly as possible. Avenir did not consider building a new pipeline to be a viable solution, since the Dynegy pipeline was in place and not being used. It considered that building a pipeline in these circumstances would be needless proliferation.

Avenir concluded that as it had been unable to make any reasonable arrangements to use Dynegy's pipeline and since this pipeline was the most practical way to transport its gas, a common carrier order was needed to provide access to the pipeline on reasonable terms.

7.2 Views of Other Parties Supporting the Application

Corinthian, Diamondback, Rider, and Iliad did not specifically comment on the availability of reserves to be transported through the proposed common carrier pipeline or the availability of markets for the gas.

Corinthian reiterated its support for Avenir's application, submitting that the impact of the situation on Corinthian had been significant, as it had resulted in all of its Alberta production being shut in. It stated that as a consequence not only had considerable uncertainty been cast over its ability to develop its assets in the area, but the situation had also affected its ability to mitigate its Crown mineral expiries through further drilling and the establishment of production. Corinthian submitted that in addition, due to the shut-in of all its production in the province, it had been required to place a deposit with the EUB in order to comply with the requirements of the EUB's Licensee Liability Rating program. As a result, uncertainty existed surrounding Corinthian's ability to acquire additional assets in the province without being assessed further deposits. Corinthian stated that the Board's role of ensuring that its regulations enable the orderly and efficient development of resources within the province also involved ensuring that industry players did not lose sight of the bigger picture, namely the economic development of oil and gas reserves and facilities on a level playing field and in a manner that provided a fair return for stakeholders.

Diamondback also confirmed that it supported Avenir's application; it noted that the Dynegy pipeline was the only way it could get its gas to market.

Rider and Iliad indicated in their written submissions that they had an interest in the gas to be transported through the Dynegy pipeline and that they supported the Avenir submissions.

7.3 Views of Dynegy

Dynegy did not dispute that reserves were available for transportation in the proposed common carrier pipeline or that there was a market available for the gas.

Dynegy submitted that there was no need for a common carrier order, as the Lease Agreement was still a binding agreement between Avenir and Dynegy governing the transportation of gas by Avenir through Dynegy's pipeline. Dynegy also indicated that it was willing to negotiate an alternative to the Lease Agreement if there was an advantage to Dynegy, as shown by its offer in February 2005 to lease the pipeline to Avenir for $19 000/month for a 3-year term. Dynegy considered that Val Vista's and Avenir's proposals to purchase the pipeline for $20 000, and to flow gas for $0.22 or $1.10/10^3 m^3/km (1 cent or 5 cents/mcf/mile) did not come close to offering Dynegy a reasonable rate of return on its investment. In addition, Dynegy was not prepared to accept Avenir's offer in June 2005 to purchase the pipeline for $160 000, as Avenir's right to acquire the pipeline on those terms had expired on December 31, 2004. Dynegy agreed that negotiations with Avenir had broken down and that the parties' positions were far apart.

Dynegy acknowledged that there were no other existing pipelines Avenir could use as an alternative to the Dynegy pipeline. It submitted that building a new pipeline to replace the Dynegy pipeline would be economic for Avenir and that there would be almost no environmental issues with building such a pipeline. However, it agreed that building a new pipeline would result in the addition of unnecessary facilities.

Dynegy submitted that there was no need for the common carrier order and that the application should be dismissed.

7.4 Views of the Board

The Board accepts the evidence and statements that producible reserves are available for transportation and that the applicant has a market for the gas.

From the evidence submitted, the Board considers that Avenir has made reasonable attempts to resolve the matter. However, the parties continue to have significantly different viewpoints as to whether the Lease Agreement remains in effect, at least to the extent of dictating the fee that Avenir should pay to transport gas on the Dynegy pipeline. As a consequence, negotiations are at an impasse.

The Board notes that there are no other existing pipelines Avenir could use to transport its gas. Both parties indicated that constructing a new pipeline would be economic and would have limited environmental impacts. However, given that Dynegy's pipeline is in place and is not currently being used to transport any gas, the Board does not consider the building of a new pipeline and the further imposition on the existing landowners to be a reasonable solution in this case.

In view of the foregoing, the Board concludes that there is need for the common carrier order.

8 TERMS OF THE COMMON CARRIER ORDER

8.1 Views of Avenir

Avenir submitted that only the portion of the B Pool shown in the figure should be subject to the proposed common carrier order. This is the portion of the pool where the wells flowing into the Dynegy pipeline are located.

The applicant submitted that the points at which the common carrier would take gas into the pipeline would need to be included in the order only if Dynegy had an issue in this regard. If tie-in points are included in the order, the applicant proposed that the existing tie-in points be designated as the delivery points.

Avenir requested that the common carrier order be made effective as of January 1, 2005, as the Lease Agreement contract expired on December 31, 2004. The applicant suggested that alternative effective dates for the order would be May 20, 2005, when the application was completed; August 17, 2005, the originally scheduled hearing date (the hearing was rescheduled twice); or September 3, 2005, when Avenir stopped flowing gas through the pipeline and provided conveyancing documents to Dynegy.

Avenir requested that the Board set a transportation fee to give effect to the common carrier order, as the parties were far apart on this issue. Avenir advocated the use of the JP-95 methodology[3] as the appropriate guideline for determining the transportation fee in this case. The applicant argued that the JP-95 method was currently accepted and adopted by industry and so represented the industry's commitment to the regulators as to the approach to be used when two parties were unable to arrive at an appropriate fee for use of spare capacity.

Avenir had submitted calculations in accordance with the JP-05 methodology in its original application but acknowledged that the report setting out this methodology had not been endorsed by the JP-05 task force participants at the time of the hearing. It submitted that the JP methodology described a fair and equitable manner of establishing a relevant range of fees that represented fair value for the use of surplus capacity for both the owner and the user of a facility. Avenir asserted that while the JP methodology acknowledged and supported the sanctity of existing contracts, once a contract expired, the JP methodology represented the appropriate method for establishing a basis for the fair and equitable negotiation of fees. Avenir argued that since the Lease Agreement expired on December 31, 2004, or alternatively was terminated at the very latest as of September 3, 2005, when all gas flowing through the pipeline was shut in, using the JP methodology was appropriate since it was intended to apply to such situations. The applicant further argued that the JP methodology addressed Dynegy's concerns regarding its position as the owner of a midstream asset who owns no production in the area, the risk of excess capacity, the coverage of operating costs, and the expectation of a fair return for use of capacity. Avenir said that the Agreements between the parties defined Dynegy as the owner of the pipeline. Therefore, Dynegy should bear the risk of excess capacity on the pipeline, as it had the ability to provide input into the pipeline specifications, had it chosen to do so. Avenir submitted that the lease payments as outlined in the Agreements did not reflect a transportation fee per se, but rather represented the terms of a financing deal between the parties, and so were subsequently not reasonable to use as a transportation fee once the Lease Agreement ended.

On the basis of the JP-95 calculations that it submitted, Avenir stated that the appropriate fee should be between \$3.71 and \$4.82/10^3 m^3 (10.46 cents and 13.60 cents/mcf), depending upon the risk premium applied. Avenir further argued that these calculations gave Dynegy the benefit of the doubt, as the \$800 000 used in the calculations as the basis for capital cost was actually the financing cost, whereas the actual as-spent cost to construct the pipeline was \$575 000. Avenir submitted that the \$800 000 stated in the Agreements represented the deemed value of the pipeline for the purposes of the financing arrangements, but that the JP methodology recommended using actual as-built cost to ensure that in a non-arm's-length transaction fair value was established and that financing costs did not flow through to other users of the facility who were not party to the financing arrangement.

Avenir rejected the use of the cost-of-service approaches proposed by Dynegy. It acknowledged Dynegy's assertion that the calculation of a tariff should be done on the basis that the owner of a pipeline was entitled to an opportunity to recover its capital costs and earn a fair return on its investment. The applicant asserted that these considerations guided the fundamental business decisions underlying the terms of the original Agreements between Dynegy and Val Vista. As a result, they would have been accounted for within the negotiated terms of the Agreements in which risk components were present for both parties. Avenir argued that the Agreements were contingent upon the parties entering into the Marketing Agreement and, therefore, when

[3] The JP-95 methodology for calculating fees is set out in the report *Joint Task Force Report on Processing Fees,* April 15, 1996, a joint report by the Canadian Association of Petroleum Producers, the Petroleum Joint Venture Association, and the Small Explorers Association of Canada.

considered together, the Agreements and the Marketing Agreement resulted in Dynegy receiving a return of its invested capital and a fair return on that investment. Additionally, Avenir noted that Dynegy remained the owner of the pipeline and could therefore continue to generate revenue by collecting transportation fees or selling that asset. The applicant acknowledged that a cost-of-service approach may be appropriate in certain situations, such as where a natural monopoly existed, where a facility was being constructed to serve multiple clients and the service provider was fundamentally the sole service provider. Avenir also contended that the operator of the pipeline would be required to apply to the regulator for a ruling on the terms and conditions of that service, an approach industry generally would not wish to have in place. It further argued that under a cost-of-service approach, the original capital investment was normally recovered over a significantly longer period than the approximately three years in which Dynegy had capital returned. The applicant submitted that use of such an approach in this instance may have implications for the economic and orderly development of resources in the area, as it may then be more economic to build a bypass pipeline or, alternatively, adversely affect conservation by decreasing the volume of economically recoverable reserves.

8.2 Views of Other Parties Supporting the Application

Corinthian, Diamondback, Rider, and Iliad indicated that a fee of $0.22/10^3 m^3/km (1 cent/mcf/mile) was typical in the area and represented a reasonable fee.

Corinthian further stated that a common carrier order, with a fee determined according to the JP methodology, would not result in an outcome where there were winners and losers but rather would benefit all parties and allow them to return to their primary business.

8.3 Views of Dynegy

Dynegy submitted that there was no need for a common carrier order, but if an order were issued, it did not take issue with Avenir’s proposals about the portion of the pool to be subject to the order or with the points at which the common carrier would take delivery of gas.

With respect to the effective date of the order, Dynegy submitted that no Board order should apply while the Lease Agreement was still in effect. It submitted that the Lease Agreement remained in effect pursuant to the overholding provisions of Section 11.8. Alternatively, Dynegy said that if the Board were to issue a common carrier order, the effective date should be no earlier than September 3, 2005, the date that Avenir stopped flowing gas in the pipeline.

Dynegy noted that if a common carrier order were issued, it would contract a third party to operate the pipeline.

With respect to a transportation fee, Dynegy submitted that the applicable transportation rate should be $21 988.34/month, as set out in the Lease Agreement. The intervener expressed the view that the best way to determine fairness and equity was for two arm’s-length parties to freely negotiate and come to commercial terms. Dynegy stated that the Lease Agreement constituted a valid and binding agreement between the parties on transportation fees. It argued that the mutually agreed-upon commercial arrangements in place offered Avenir the alternatives of purchasing the pipeline for $160 000 pursuant to the option agreement, returning the pipeline to Dynegy, or continuing to use the pipeline on a month-to-month basis pursuant to Section 11.8 of the Lease Agreement. Dynegy further argued that by asking the Board to set a transportation rate, Avenir wanted to avoid the commercial arrangements it freely entered into and to use the pipeline without having either exercised the purchase option or being required to pay the amounts specified in the Agreement. Dynegy asserted that Avenir was asking the Board to override the contractual arrangements between the parties and contended that doing so would have implications for industry on the ability to freely negotiate, obtain economic certainty, and have binding business agreements enforced.

However, Dynegy stated that if the Board found that a regulated rate was appropriate, Dynegy's position was that a cost-of-service methodology should apply. Dynegy offered a number of alternative rates, based upon variations in a Rate Based Rate of Return approach, as shown in the following table:

Fully Depreciated Rate of Return Cost of Service - Cost of $800,000									
Depreciation Term (years)	Revenue Requirement/ Month ($)			Conversion to $/mcf[1]			Conversion to $/10^{3}m^3		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
6.5	15,227	14,134	13,002	1.138	1.056	0.972	40.400	37.502	34.500
10	13,008	12,326	11,590	0.972	0.921	0.866	34.514	32.704	30.752
12	12,321	11,766	11,153	0.921	0.879	0.833	32.691	31.219	29.593
Fully Depreciated Rate of Return Cost of Service - Cost of $575,000									
Depreciation Term (years)	Revenue Requirement/ Month ($)			Conversion to $/mcf[1]			Conversion to $/10^{3}m^3		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
6.5	11,399	10,613	9,800	0.852	0.793	0.732	30.245	28.160	26.003
10	9,685	9,181	8,676	0.724	0.686	0.648	25.697	24.360	23.020
12	9,310	8,911	8,471	0.696	0.666	0.633	24.702	23.644	22.476
Semi-Depreciated Rate of Return Cost of Service - Cost of $800,000									
Depreciation Term (years)	Revenue Requirement/ Month ($)			Conversion to $/mcf[1]			Conversion to $/10^{3}m^3		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
6.5	17,185	16,679	16,113	1.284	1.246	1.204	45.597	44.255	42.753
10	14,280	13,980	13,613	1.067	0.045	1.017	37.889	37.093	36.120
12	13,381	13,145	12,839	1.00	0.982	0.959	35.504	34.878	34.066
Jumping Pound 95 - Cost of $800,000									
	Revenue Requirement/ Month ($)			Conversion to $/mcf[2]			Conversion to $/10^{3}m^3		
	13,148	12,635	12,151	0.119	0.114	0.110	4.039	3.882	3.733

1. Conversion from monthly revenue requirement assumes 440 mcf/day (current throughput).
2. Conversion from monthly revenue requirement assumes 3800 mcf/day (current capacity).

Dynegy argued that this case was equivalent to a situation where an owner of a pipeline had erected the service for others and had no intention of ever shipping on the pipeline. It was therefore the rate equivalent to the model employed by ATCO Gas or Nova Corporation of Alberta (Rate Based Rate of Return). Dynegy asserted that it had only entered into the Agreements to finance the building of the pipeline due to the expectation of a return of its capital plus a reasonable rate of return, based upon the negotiated contractual arrangements. It argued that a cost-of-service approach and its associated revenue requirement were therefore necessary for Dynegy to obtain a fair return on its invested capital and to ensure that the party that designed and built the pipeline, namely Val Vista and subsequently Avenir, was ultimately responsible for the associated risks and costs. Dynegy contended that any revenue it received through the Marketing Agreement was irrelevant to the calculation of its return on the Agreements, as the Marketing Agreement offered no assurances at the time it was entered into by the parties that

Dynegy would ever realize any benefit. Dynegy submitted that without the Marketing Agreement revenue and accounting for the fact that it was not paid the purchase price, Dynegy had not earned a return on its investment at the expiry of the initial contract on December 31, 2004, and at best had received only a return of its capital.

Dynegy stated that it was inappropriate to use the JP methodology as a basis for setting the transportation fee in this instance. It argued that this methodology would be unreasonable, as it would require Dynegy to bear the risk and cost of substantial excess capacity in a situation where Avenir was not only the anchor shipper, but was wholly responsible for determining reserves, designing capacity, and building and operating the pipeline. Dynegy referred to a section of the JP-05 report concerning new midstream facilities. The JP-05 report states: “If a facility is built by a third party to handle a producer’s production, the fee structure for the ‘anchor’ producer need not be according to JP-05 for the initial production stream.” Dynegy stated that the initial production stream referred to all the production expected from the wells existing at the time the facility was constructed, however long they may produce. It further claimed that the fact that Avenir had exclusive rights to the capacity of the pipeline and could mitigate its cost by negotiating transportation rates with other producers was consistent with Avenir being the de facto owner/anchor shipper. Dynegy stated that the JP methodology normally assumed that the party building and owning the facility was either a producer building the facility for its own purposes and providing capacity for third parties or a midstreamer building or purchasing the facility, taking into account what the utilization of that facility will be in the determination of the purchase price and rates. Dynegy contended that neither of these scenarios applied in this instance, as Dynegy had no production in the area and had no input into the specifications of the pipeline.

Dynegy submitted that the appropriate value for determining the rate base in this instance was the $800 000 invested by Dynegy and not the $575 000 Avenir spent to build the pipeline. Dynegy argued that the applicable rate going forward must only consider the recovery of the total forecast revenue requirement based upon the invested amount of $800 000. Therefore, the Board should not have consideration for the revenue received by Dynegy or the expenses incurred by Val Vista through the Marketing Agreement.

8.4 Views of the Board

The Board notes that there was no dispute regarding the area of the B Pool that should be subject to the common carrier order and accepts the area requested by the applicant as appropriate. The Board also notes that no issues were raised respecting the points at which the common carrier would take gas into the proposed common carrier pipeline. The Board is prepared to include a provision in the common carrier order to designate the existing delivery points, in order to give full effect to the order.

With respect to the effective date of the order, the Board considers that the order should not be in effect while the Lease Agreement was still in force and governed the fee that Avenir paid to transport its gas through the pipeline. As indicated previously, the Board considers that the Lease Agreement was ended on September 3, 2005. Therefore, the Board considers that September 3, 2005 is an appropriate effective date for the order.

Given that the dispute between the parties relates mainly to transportation fees, the Board considers that a fee should be included in the common carrier order.

The Board notes the alternative methods of rate determination presented by the parties: the contractual fee of $21 988.34/month, a cost-of-service methodology, and the JP methodology. As previously stated, the Board rejects Dynegy's position that the Lease Agreement is still in force and dictates a monthly fee of $21 988.34. The Board also is not prepared to consider that amount as a reasonable transportation fee because the evidence was clear that the monthly fee was based on a financing arrangement and not on considerations recognized as being relevant to fee negotiation.

The Board has also considered Dynegy's alternative position that a cost of service methodology should be adopted. While the Board acknowledges the applicability of a cost-of-service methodology in certain instances, the Board does not accept Dynegy's argument that the present case is analogous to that of a regulated pipeline, where the owner provides capacity for use by others and has no intention of shipping its own product. While that may have been the outcome of the Agreements, in the Board's view the pipeline in this case cannot be equated to a regulated pipeline, as the necessary conditions, such as in a natural monopoly where economies of scale provide that efficiency of distribution is best achieved through a single supplier, are not present. If Dynegy had wanted a cost-of-service methodology to be applied throughout the life of the pipeline or after the Agreements had ended, it could have negotiated for that when the Agreements were being developed. In cases where the conditions described above exist, a cost-of-service methodology ensures that the users of a pipeline fulfill the revenue requirement of the owner of a pipeline and bear the risk of any excess capacity. The Board does not believe that such conditions exist in this instance, and the Board concludes that the risk of any excess capacity should be borne by Dynegy, as owner of the pipeline. The Board finds that a cost-of-service rate structure is not warranted in this case and that such an approach does not meet the standard expressed by industry peers through their support of the JP-05 guidelines.

In considering the appropriate methodology for use in determining the transportation fee, the Board believes the establishment of a transportation fee fair to all parties is paramount. The Board supports the goal of establishing industry-acceptable guidelines to fee negotiation, which should facilitate negotiated rates that are fair and reasonable. The Board is disappointed that in this case an agreement could not be reached, even when the parties were given further direction following the hearing. In the absence of a compelling alternative, the Board believes that a fee based upon JP-05 would be fair and reasonable in this case. The methodology to calculate fees in the JP-05 guideline was developed with the intent of establishing fees that represent fair value to both the users and the owners of a facility. The methodology has been developed by industry and has the support of industry. As previously stated, the Board is not persuaded to adopt either of the alternatives to JP-05 advanced by Dynegy.

In determining the effective transportation fee, the Board was mindful of its mandate to ensure the economic, orderly, and efficient development of resources within the province. The Board is also cognizant of the effect of the applicable transportation fee on both resource development and conservation in the area, noting that the rates proposed under the terms of the Agreements or under a cost-of-service methodology may result in both a loss of economic reserves and a decrease in future resources development activity. While the Board was mindful of these matters, the Board's decision on this application is based primarily on the other considerations set out in this report.

The Board notes the parties' differing views regarding the applicable capital rate base to be used in the calculation of the transportation fee. The Board is of the view that the $800 000 figure represented Dynegy's expenditure for the purposes of the financing arrangements, and the Board finds that the appropriate capital rate base to be used in an arm's-length fee calculation is the as-spent cost to build the pipeline, in this case the amount of $575 000.

For the reasons noted, the Board finds the effective initial transportation fee for use of the subject pipeline to be $\$3.215/10^3\ m^3$ ($0.091/mcf), based on the calculations shown in Appendix 3. The Board finds it appropriate to position the fee at the midpoint of the calculated relevant range after considering the circumstances in this case and the particular elements of risk borne by the respective parties.

Dated in Calgary, Alberta, on March 7, 2006.

ALBERTA ENERGY AND UTILITIES BOARD

<original signed by>

J. D. Dilay, P.Eng.
Presiding Member

<original signed by>

F. Rahnama, Ph.D.
Acting Board Member

<original signed by>

K. G. Sharp, P.Eng.
Acting Board Member

APPENDIX 1 COMMON CARRIER ORDER

EUB Alberta Energy and Utilities Board

Order No. MISC 2006-XXX*

MADE at the City of Calgary, in the Province of Alberta, on	ALBERTA ENERGY AND UTILITIES BOARD

WHEREAS the Lieutenant Governor in Council, by Order in Council Number O.C. # dated #, hereto attached as Appendix A, has authorized the granting of this order.

The Alberta Energy and Utilities Board (EUB) pursuant to the Oil and Gas Conservation Act, chapter O-6 of the Revised Statutes of Alberta, 2000, orders as follows:

1) Dynegy Canada Inc. is a common carrier of gas produced that portion of the **Taber Second White Specks B Pool** comprising Section 7 of Township 9, Range 13, West of the 4th Meridian (Section 7-9-13 W4M), and Sections 13, 14, 15, 20, 21, 22, 23, 24, 28, and 29-9-14 W4M, through the pipeline extending from Legal Subdivision (LSD)10 of Section 14-9-14 W4M to LSD 6-29-9-14 W4M.

2) The points at which the common carrier is to take delivery of the gas to be transported on the pipeline subject to this order shall be the existing tie-in points along the pipeline as of the effective date of this order.

3) The transportation fee to be paid to the common carrier for gas transported pursuant to this order shall be $3.215 per thousand cubic metres of gas.

4) This order is effective as of September 3, 2005.

END OF DOCUMENT

* This is only a draft form of the Order. The Order, when issued, may have minor variations from that set out here.

APPENDIX 2 HEARING PARTICIPANTS

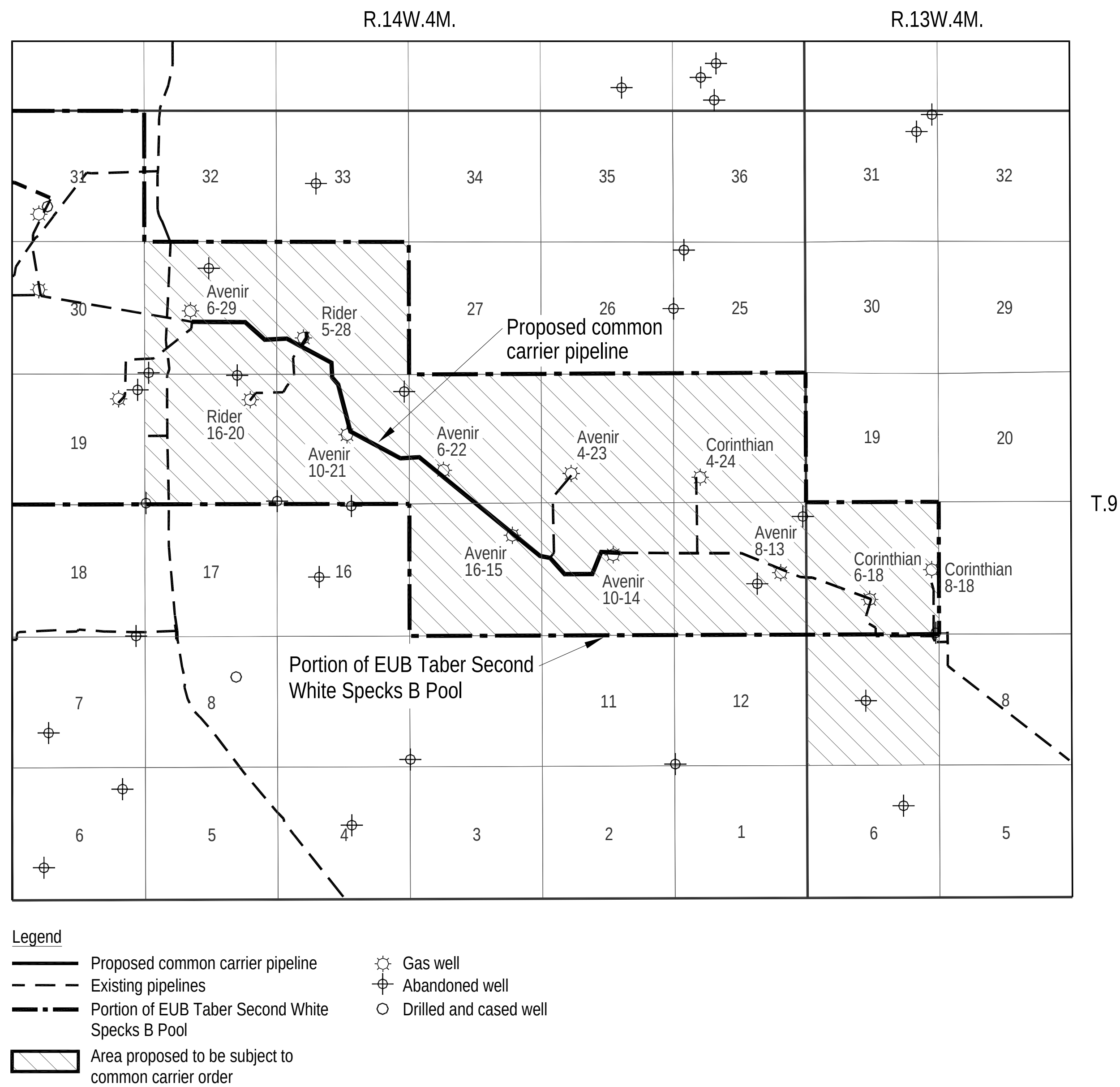
Principals and Representatives (Abbreviations used in report)	Witnesses
Avenir Diversified Income Trust (Avenir) formerly Val Vista Energy Ltd. (Val Vista) C. A. Crang	J. C. Burns, P.Geol. R. J. Evanchuk, P.Eng., of Natural Gas Consultants Ltd. J. D. Kingsbury, P.Eng., of Gas Processing Management Inc. M. W. Mychaluck, formerly of Val Vista, now of Diamondback Energy Ltd. L. Walter, CMA, formerly of Val Vista
Corinthian Energy Corp. (Corinthian) C. Davis, P.Eng.	C. Davis, P.Eng.
Rider Resources Ltd. (Rider) G. T. Kubat, P.Eng.	
Dynegy Canada Inc. (Dynegy) P. J. Forrester	H. L. Parlette H. W. Johnson, of Stephen Johnson Chartered Accountants
Alberta Energy and Utilities Board staff G. D. Perkins, Board Counsel K. Fisher J. Meckelborg	

APPENDIX 3 EUB CALCULATION OF TRANSPORTATION FEE

A	Original Facility Capital Cost ($)	575,000	
B	Undepreciated Capital ($)	419,175	From AC2 Form (used for lost GCA only) (or may be calculated as original capital reduced 10% per year, usually zero after year 10)
C	GCA Depreciation		From AC2 Form (used for lost GCA only) (or may be calculated as 10% of total capital in first 10 years, zero thereafter)
D	Original Facility Startup Year	2001	
E	Major Capital Addition Capital Cost ($)	-	
F	Major Capital Addition Year		
G	Facility Capacity (10^3 m^3/d)	107	Per operating day
H	Owners Throughput (10^3 m^3/d)		Per operating day
I	Third-Party Throughput (10^3 m^3/d)	12.4	Per operating day (cannot be zero)
J	Facility Operating Days/Year	350	Default to 350
K	Capital Cost Inflation Rate (%)	3	Default to 3%
L	Inflated Total Capital ($)	628,318	"**A**" and "**E**" inflated to current year
M	Rate of Return (%)	20	Fixed!
N	Annual Operating Cost ($)	-	Includes overhead; may be rolling average
O	Working Capital Allowance ($)	-	**=M*N**/6 (return on 2 months' operating costs)
P	Year (today)	2004	
Q	Upper Limit Capital Fee	3.36	$/$10^3$ m^3
R	Lower Limit Capital Fee	3.07	$/$10^3$ m^3 (not less than 50% of upper limit)
S	Operating Cost Fee	0.00	$/$10^3$ m^3
T	Lost Gas Cost Allowance Fee	0.00	$/$10^3$ m^3 (decreases to zero after year 10 assuming no new capital)
U	**Upper Limit All-In Fee**	**3.36**	
V	**Lower Limit All-In Fee**	**3.07**	

Notes on Item:

A As-spent capital to build pipeline.
B As-spent capital depreciated 3 years.
C Lost GCA not applicable, as Dynegy has no prodcution in Alberta.
G Pipeline capable of transporting 37 450 10^3 m^3/year, as per Statement of Facts.
I In 2005 total production from all wells put through the pipeline (440 mcf/day), as per Statement of Facts.
N Operating Costs to flow through to users of pipeline.
S Operating Costs to flow through to users of pipeline; Operating Fee not applicable.
T Lost GCA not applicable, as Dynegy has no prodcution in the Alberta.



Overview of area and facilities of interest in Application No. 1378400