

# February 2006: Why Canada Needs a National Energy Plan

## U.S. is now determined to control Canada's electric power

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Canadians who care about the effects of U.S. imperialism tend to associate it with the adamant positions the U.S. takes on trade deals and its aggressive measures related to security. The drama of these events--particularly the war in Iraq, the softwood lumber and beef disputes, border issues, and U.S. surveillance of Canadians--overshadows the less visible but equally insidious acts of U.S. imperialism.

I refer here to the regulatory changes that the U.S. makes, by fiat, on matters like energy that affect Canadian economic security. These involve actions that are leading to a deep and permanent integration with the United States--to a form of continentalism with the U.S. firmly in control.

Canadians did not pay much attention to the U.S. Energy Policy Act that was passed last summer--aside, that is, from the warnings of environmentalists that the Act would likely intensify North American environmental destruction. I suspect the decision to ignore it by Canadian media and politicians is because the U.S. point of view already firmly dominates the oil and gas sectors in Canada. And the federal government is anxious not to say or do anything that might give the impression it was contemplating another National Energy Policy. By adopting a head-in-the-sand approach to energy, however, Canada imperils its energy security for the future, particularly for one area of energy that is still mostly in public hands in Canada: electricity. But both the generation and sale of electricity in Canada are increasingly and rapidly coming under U.S. control.

Official U.S. policy is designed to create an integrated, competitive, privatized "North American" electricity market run by American rules and American players. The prevailing Canadian system is based on public utilities which engage in long-term planning to ensure sufficient supply of electricity and adequate transmission and distribution. The Americans plan to transform it into a competitive market-based model that will rely on the vagaries of the market to determine how much is produced and who gets it.

In Canada, the response of governments to U.S. dictates has been surprisingly limp: rather than challenging U.S. regulatory imperialism--as, ironically, many U.S. states and state public utilities are doing--Canadian governments at both the national and provincial levels are readily acquiescing to U.S. demands. All of this is occurring with virtually no public debate, government analysis, or media scrutiny.

The U.S. plans for electricity restructuring assume that competition will bring about abundant supplies and lower prices. In the face of the rather monumental restructuring failures that have actually occurred in the U.S., this approach seems more faith-based than reason would allow. The weird reluctance to face up to the problems of restructuring--inadequate supplies, transmission congestion, price escalation, and more government subsidies of private electricity development just to get more generation built--can only be accounted for by a government that is firmly in the control of the private energy companies, or one that follows a blind adherence to the myth that the market is always efficient--even when it clearly isn't. (Of course, there is always the possibility that both these factors are in play.)

One of the major problems for Canada is that our own energy regulatory body, the National Energy Board (NEB), is extremely weak, at least relative to the enormous powers of its U.S. counterpart, the Federal Energy Regulatory Commission (FERC). And it is through FERC that the U.S. is implementing its plans. The new U.S. Energy Policy Act ratcheted up FERC's powers considerably. According to FERC's chairman, Joseph Kelliher, these new powers constitute "the most important change in federal electricity and gas laws since the 1930s."

FERC has become decidedly imperialistic since George W. Bush came to power. The main drive is to pave the way for a "seamless" continent-wide marketplace for electricity through what it called a Standard Market Design (SMD). This standardization would require breaking up integrated utilities to allow competition in the electricity market. This is a dramatic change in policy that amounts to a profound and thorough redesign of the entire U.S. electricity market and, of course, the Canadian market as well. It affects Canada because the U.S. insists that any Canadian provinces that export electricity to the U.S. must adopt an identical system to that in the U.S. This demand, by the way, flies in the face of NAFTA, and, if Canadian governments wanted to protect public systems of providing electricity, NAFTA would be the vehicle to do it. More on this later.

One key feature of a private market is the separation of transmission systems (the large power lines that transport power from the generators to the distributors) from the control of public utilities. FERC is extremely aggressive in pursuit of this objective because, without access to transmission systems, private generators of electricity would have no markets. Since utilities usually own the transmission systems, removing utility control over transmission is crucial to privatization initiatives. The U.S. FERC envisions very large transmission areas, or Regional Transmission Organizations (RTOs), that would control the transmission activity in specific areas of the continent.

The creation of any RTO requires that all utilities give up the operation and control of their transmission systems to the new entity. Each RTO will be set up as a private company, and no utility will have a voice in its governance structures or its operations. The major change this makes for Canadian public utilities is that it will give a private U.S. company control over the entire electricity system. Any RTO will have authority to set prices, enact all interchange schedules, maintain system reliability and security, and plan for future expansion of the system. While the utilities may still own the assets—i.e., the transmission lines and control centres—the private RTO will be able to determine the extent of new investment, its nature and, thereby, who gets the electricity.

Many state governments, utilities, and consumer groups in the U.S., most notably in the West and the South, have reacted very negatively to FERC's invasion of their regulatory territory. Surprisingly, there was no resistance from any governments or consumer groups in Canada. This was such a sore point in the U.S. that, in an effort to have the Energy Bill passed, Congress forced FERC to hold off ruling on "standard market design" until the end of 2006. Nevertheless, according to FERC's chairman, the way that "voluntary" RTOs are proceeding means in effect that standard market design is already happening, so specific rulings aren't needed.

In sharp contrast to FERC, Canada's regulatory body, the National Energy Board, has minimal powers, and even those it does have are seldom exercised. The NEB's location in Calgary ensures that it completely supports private energy--of any description. So it is not surprising that it has had no role in resisting U.S. attempts to redesign the North American system in U.S. interests.

The NEB's mandate on electricity is restricted to the regulation of exports and the construction of facilities related to international trade. Unlike FERC, the NEB does not regulate energy within provincial boundaries, inter-provincial electricity trade, or energy emissions. But in recent years, even the NEB's close monitoring of exports, which in the past included public hearings on each application for an export permit, has been replaced by blanket export permits that last for up to 10 years. These permits appear to be given very easily, and certainly without public scrutiny. The result is that frequently export permits are given to companies that do not produce any electricity at all. For example, Duke Energy, headquartered in Charlotte, North Carolina, was given a ten-year blanket export permit to export electricity from B.C. even though it has no generating facilities. Big companies see their future in trading electricity--much in the way that Enron did--not in actually generating it.

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All major electricity-exporting provinces in Canada have complied in some measure with FERC orders for breaking up the integrated nature of the utilities. While the provincial governments in Canada seem to realize the U.S. is encroaching on their regulatory areas, they are cooperating with FERC to a much greater extent than are many of their U.S. state counterparts.

One of the major implications for Canada in the new design for the transmission market is that it will encourage the system to expand in order to increase the export and import of power, and to encourage private electricity generation. When increased access to U.S. markets occur, as is the intention of the RTOs, all new private energy generation in both countries will have the option of selling within the province or selling in the U.S. This will result in domestic consumers competing with American consumers for power produced within Canada, very much as they already do for oil and gas. And, since the prices in the U.S. are higher, they will rise much higher in Canada too.

New investments in cross-border transmission lines could well turn out to be very expensive for provinces in Canada--particularly in view of the proposed large expansion of private generation and the relatively small proportion of electricity that can now be exported through existing transmission lines. Since for the most part the wires will still remain in the public sector in Canada, it will very likely be the public that will be paying for the expansion of the system--primarily to meet the requirements of the private sector and the export markets.

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Developing a private electricity system within an integrated North America market creates huge problems. One is related to the relentless increase in the sheer size of the electricity markets and the distances over which electricity is transported. The electricity

grids between Canada and the U.S. serve two main purposes: one is to ensure the reliability of the system, and the other is to permit trading of electricity. But the main issue in the creation of continent-wide markets is the extent that the objectives of trade itself will override other significant domestic objectives of delivering electricity: the social objectives of equity, low costs, regional development, Aboriginal rights, reliability, and conservation. As trading areas extend thousands of miles across the continent, efficiencies are lost, reliability of the system is compromised, and meeting local needs can be superseded by the lure of large incomes from exports.

A second problem created by the restructuring of the electricity sector is the startling increase in electricity trading by corporations that do not produce electricity, but buy and sell it to take advantage of different prices in different areas of the continent. While Enron's trading needs brought about the North American system redesign and the new rules to facilitate traders, its initiatives have taken a life of their own long after its activities have been discredited.

A third problem related to restructuring comes from the attempts to deregulate some parts of the electricity business (generation), while retaining the monopoly aspects of other aspects (transmission and distribution). The technology of transmission has not changed its characteristic as a natural monopoly, mainly because the construction of a transmission system is complex, expensive, and does not efficiently allow for competing transmission lines. The result is a hybrid system with a competitive market in electricity generation that encourages increased supply, coupled with a limited and monopolistic transmission system. The bottlenecks that are created then tend to limit the expansion of the generation market and thus increase the unreliability of the system itself. It is this problem that is most crucial in overcoming the barriers that now exist to a continent-wide electricity market.

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The crucial decision facing Canadians is whether electricity systems should remain independent and controlled by Canadian governments, or whether they should be subsumed within the U.S. system. Integrating the U.S., Canadian, and Mexican electricity markets--which is the goal of FERC--will result in prices that are established by the U.S. markets, and regulations that advance the energy objectives of the U.S. and private companies.

This does not need to happen. The North American Free Trade Agreement (NAFTA) permits both trading and investment without instituting standard market designs. There is no requirement in international law that any entity in Canada has to completely change its system in order to export into the U.S. This is a fundamental protection that has been retained under NAFTA: according to the NAFTA Commission for Environmental Cooperation in its assessment of the cross-border electricity trade, provincial decisions to acquiesce to FERC demands are voluntary--at least under NAFTA's legal requirements--and the U.S. has no right to insist on identical systems in order to trade. Under NAFTA, no province in Canada is required to have exactly the same kind of organization of its market or industry as exists in the U.S. (Admittedly, Canada must grant "national treatment" to foreign firms. But, as long as a government treats private domestic and foreign firms in the same way, it is not contravening NAFTA.)

In order to use the protections of NAFTA, Canada would need to have a national government that is pro-active in protecting Canada's electricity interests. The absence of a strong Canadian presence becomes glaringly evident in the negotiations with the U.S. over market design and transmission organizations. Each province is basically on its own in determining its relationship with the U.S. This is unfortunate because the impression FERC projects in its drive to control the entire North American electricity industry is that Canadian electricity systems will have to mirror developments in the U.S. in order to have access to the U.S. market.

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Canada has a strong legal position to maintain public provision of electricity. Among some important actions that would need to take place would be the following:

1. Electricity, currently a provincial issue, needs to be treated as a national one. The increased internationalization of U.S. regulatory design requires a strong national voice in negotiations with the U.S. Electricity is no longer confined by provincial boundaries and, in the face of U.S. regulatory imperialism, Canada can justify taking action in the design of future markets.
2. The federal government should firmly resist the development of a "seamless North American electricity market," which requires the complete integration of provincial electricity systems with the U.S. system.

3. Canada should use the protections in NAFTA to allow public utilities and provincial governments to maintain integrated utilities in the public sector.

4. The federal government should encourage greater integration of the Canadian electricity sector. Currently, each province has closer ties with the U.S. than it does with other provinces. This is partly a result of the regulatory vacuum at the national level. With the need for market reliability and for new investments in electricity generation, increased inter-provincial planning would make a lot of sense. The U.S. has a regulator that deals with national and international issues. It is time that we in Canada had one, too.

5. Canadian public entities should maintain control of transmissions systems and not surrender any part of these systems to foreign-controlled organizations (like the Regional Transmission Organizations).

6. All transmission systems should be owned and operated by public entities.

7. Canada should prohibit private exports of electricity and private power trading.

8. The federal government should have a strong regulatory role in electricity-related environmental issues. Related to this, it should do the following:

- institute a nation-wide electricity conservation program;
- require provincial governments to conduct system-wide assessments of all private power projects for their cumulative effects (currently they are assessed individually); and
- establish an institute for environmentally responsible energy development and invest heavily in green energy development in the public sector.

It is time for Canada to recognize that it needs a clearly defined energy policy. So far, there is no sense that energy security, which is much on the minds of the U.S. and other countries, figures at all in Canadian government policy. Canada gave up control over its oil and gas, and appears not to be rethinking this policy even with regard to the treatment of new reserves and new exploration. In this neglect of its national energy security, Canada is distinct from most other countries, where the largest oil companies and the largest reserves are owned by nation states.

If Canada begins to treat electricity as it has oil and gas, we can expect very similar results, and the loss of control of another vital resource. Canada is free to make its own decisions and need not adopt the U.S. strategy for a deep integration of electricity markets. NAFTA allows both trading and investment across borders without having to establish identical market structures. But in order to pursue this route, the Canadian government, at the very least, would need to have a plan and become pro-active in protecting the country's interests.

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