

Report of the Committee on International Energy Transactions

I. CONGRESSIONAL ACTION

A. *United Nations Convention on Contracts for the International Sale of Goods.*

On October 9, 1986, the United States Senate gave its advice and consent to the ratification of the United Nations Convention on Contracts for the International Sale of Goods (the Convention). Effective January 1, 1988 the Convention *automatically* applies to international commercial contracts entered into by persons whose places of business are in different nations adhering to the Convention, in the absence of express contractual provisions to the contrary. Although specific provisions exempt sales of electricity (as an intangible) from its coverage, other energy sales and purchases and transactions involving energy equipment would be affected. Issues arising under the Convention are now being raised in international sales negotiations, and standard form contracts used internationally will require review.

The Convention offers substantive rules to govern the formation of international sales contracts and the rights and obligations of the buyer and seller that are in many respects similar to the concepts of Article Two of the United States' Uniform Commercial Code (U.C.C.). Its purpose is to provide "neutral" rules in an area in which there is no comparable multilateral international agreement. As a result, bilateral sales agreements often are drafting nightmares that lead to disruptive and expensive arbitration or litigation.

1. When the Convention Will Apply

The Convention *automatically* will apply to sales contracts entered into between parties whose places of business are in different nations, regardless of the nationality of the parties, unless their contract explicitly provides otherwise. If either party has more than one place of business, then the relevant place of business for determining whether the Convention applies is the one most closely related to the contract and its performance. In this regard, the place of procurement or production of goods to meet the buyer's requirements is of greater significance than, for example, the place where the contract was signed.

The Convention also applies to contracts between a party in a ratifying nation and a party in a non-ratifying nation when the rules of private international law lead to the application of the law of the ratifying nation. This provision allows the Convention to apply in cases where only one party has a place of business in a ratifying nation, but it does so at the expense of only the ratifying nation's domestic law. Accordingly, the Senate's resolution provides that the United States will not be bound by this element of the Convention.

2. General Provisions

With a few exceptions, the Convention's general provisions are similar to those found in the U.C.C.: it provides guidelines for the interpretation and construction of the parties' agreement, giving due regard to their intent, course of dealing, and trade usage. Contracts of sale need not be in any particular form and, in a variant from the requirement of a writing found in Section 2-201 of the U.C.C., may be proved by any means. In addition, the Convention imposes no formal requirements with respect to the notices, requests, etc. to which it refers.

3. Formation of the Contract

The Convention sets out rules governing the formation of an international sales contract. These articles set out the prerequisites of an offer, and the withdrawal, revocation and termination of an offer. There are corresponding rules on acceptance. These provisions reflect several carefully negotiated compromises between civil law and common law concepts, with several significant concessions to the common law. For example, the Convention rejects the civil law presumption that offers are irrevocable in favor of the common law presumption of revocability, with a firm offer exception similar to that provided by section 2-205 of the U.C.C.

4. The Obligations of the Seller

The seller's obligation to deliver goods or documents closely resembles the rules of Section 2-504 of the U.C.C. The Convention has provisions regarding warranties, and when the seller will be liable for nonconformity. A seller is permitted, subject to specific limitations, to cure a non-conforming tender. A seller warrants title of the goods sold, and that the goods are free from claims based on industrial property rights.

5. Remedies

Remedies for a seller's breach of contract include not only damages, but also specific performance and avoidance of the contract. The buyer may require the seller to perform his obligations or extend the period for performance. The buyer has a right to avoid the contract if there has been a fundamental breach or if the seller does not deliver goods within any additional period of time fixed by the buyer.

Seller's remedies for breach by the buyer parallel the provisions on buyer's remedies. The seller can seek specific performance of the buyer's obligations or permit additional time for buyer to perform. If the buyer commits a fundamental breach or does not perform within the additional amount of time fixed by the seller, then the seller may avoid the contract.

6. Damages

The damage provisions, which are common to both the seller and the buyer, conform to the basic tenets of common law. These articles provide mone-

tary compensation for expectation damages to the non-breaching party. Recovery is limited to foreseeable losses that the non-breaching party could not avoid by taking reasonable steps to mitigate the losses. The damage formulae look to market-contract price and cover-contract price differentials in much the same way as sections 2-712 and 2-713 of the U.C.C. Interest on late payments may be recovered.

7. Additional Factors

The Convention makes it possible for the parties (and the judge or arbitrator) to avoid a thorny conflict of laws inquiry in determining which laws will govern a contractual dispute. A single, readily available, international standard will govern and furnish the guiding principles. In this sense the Convention provides an excellent planning tool for United States companies. It also lessens the sensitive problem of negotiating with trading partners over choice of law questions by providing a readily available compromise. Nonetheless, the Convention is intended to facilitate agreement of the parties and does not dictate terms. If a sales contract deviates from any provision within the Convention, the contract controls so that parties remain free to tailor a contract which will meet their needs. Additionally, important issues of public policy, such as the validity of contractual provisions, are left to domestic law.

B. Taxes and Fees

1. User Fees

Section 8101 of the Omnibus Budget Reconciliation Act of 1986 (Pub. L. 99-509) authorizes the Customs Service to collect user fees for a period of three years on the importation of all formal entries of merchandise. The fees have been implemented on an interim basis, effective December 1, 1986. 51 *Fed. Reg.* 43188 (December 1, 1986). The regulations, which basically track the statutory language, are construed to include oil, coal, and natural gas. However, the Customs Service is considering exemption of "intangibles", defined to include electricity under TSUS General Headnote 5, 19 U.S.C. 1202. The fees are set at 0.22% *ad valorem* (based on the customs value) for merchandise until October 1, 1987 and at 0.17% *ad valorem* thereafter. The 0.17 % rate that takes effect in fiscal year 1988 may be reduced to some lesser amount if the Secretary of the Treasury determines the lesser amount to be sufficient to provide the revenues needed to conduct commercial operations for the upcoming fiscal year. User fee proceeds are to be deposited in a dedicated account of the Treasury and, subject to authorization and appropriation, will offset appropriations for costs of Customs Service commercial operations. Unless reauthorized by Congress, the authority to collect the fees terminates after September 30, 1989. Comments on the interim regulations were due no later than January 30, 1987.

2. Superfund

Title V of the Superfund Amendments and Reauthorization Act of 1986

(SARA) provides substantially increased financing for the Hazardous Substance Response Trust Fund (Superfund). General revenues to be deposited in Superfund are increased from \$44 million per fiscal year to \$250 million per fiscal year through 1991. In addition, SARA provides for increased financing that touches upon international energy transactions in the following respects:

a. Petroleum Tax

Prior law included an excise tax of 0.79 cent per barrel on petroleum received at United States refineries and on petroleum products imported for consumption, use, or warehousing in the United States. This excise tax expired on September 30, 1985. SARA reimposes the petroleum tax at significantly higher rates of 8.2 cents per barrel for domestic crude oil and 11.7 cents per barrel for imported petroleum products, including crude oil. This new petroleum excise tax is to expire on December 31, 1991.

b. Tax on Federal Chemicals

Prior law included an excise tax on the sale of 42 identified feedstock chemicals manufactured in the United States or imported into the country at specified rates not to exceed the lower of 2% of their estimated wholesale prices or a cap equal to (a) \$4.87 per ton for petrochemicals and (b) \$4.45 per ton for inorganic feedstocks. This tax, like the petroleum tax, expired on December 31, 1985. SARA reimposes the tax on feedstock chemicals generally at the same rate permitted under prior law. The expiration date is December 31, 1991.

c. Tax on Imported Chemical Derivatives

SARA imposes an entirely new tax on 47 listed chemical derivatives. Under SARA, the Secretary of the Treasury is to list any other imported substances determined to have more than 50% of their value derived from petroleum or taxable feedstock chemicals used as materials or process fuel. Generally, the amount of this tax is the amount of tax which would have been imposed by the feedstock tax on the taxable chemicals used as materials (and not process fuel) if such taxable chemicals had been sold in the United States for an equivalent use.

II. INTERNATIONAL ENERGY AGENCY

The International Energy Agency (IEA), an organization within the Organization for Economic Cooperation and Development, is charged with the development of energy policies and the promotion of joint energy research in an effort to assure a long-term energy supply for its member countries. As a member of the IEA, the U.S. is currently participating in several collaborative research and development projects involving energy end-use technology, fossil fuel technology, renewable energy technology, and controlled thermonuclear fusion technology. The following are a few of the recent developments that have occurred with respect to projects in which the U.S. is a participant.

A. *Fossil Fuels*

1. Fluidized Bed Combustion of Coal

In February, 1980, the U.S., together with eight other IEA countries, entered into a "task-sharing" agreement whereby the member countries would focus on a collaborative project to construct and operate an atmospheric fluidized bed combustion (FBC) boiler and share information and experience on technical feasibility, reliability, and economics. As part of that agreement, the U.S. recently commenced construction of a circulating FBC boiler rated at 110 megawatts and two bubbling bed FBC boilers for medium to large utilities. Results from smaller FBC boilers currently in operation have demonstrated that a wide variety of fuels can be burned in the same plant; combustion efficiencies are relatively high in comparison to classical coal-fired boilers; and lower combustion temperatures are present resulting in reduced emissions of pollutants. It is hoped that the U.S. projects produce similar results, but on larger economies of scale.

2. Enhanced oil recovery

A number of collaborative projects have recently been undertaken with respect to enhanced oil recovery including the development of improved techniques for mobility control in displacement of heavy oil by steam; the conducting of laboratory experiments to determine optimum combustions of steam and carbon dioxide injection for heavy oil recovery; and joint studies on flow properties in reservoirs undergoing thermal recovery processes.

B. *Controlled Thermonuclear Fusion Large Tokamaks*

Perhaps the most significant development so far in fusion collaboration has been the recent conclusion of an agreement, under IEA auspices, for close cooperation between the three large magnetic confinement or tokamak experiments recently commissioned in the U.S. at Princeton University, the European Community, and Japan. Under the terms of this agreement, the three organizations concerned will be able to create much closer links between their respective experimental programs, thus exploiting the scientific capabilities of these three research facilities to an enhanced degree, and increasing research and development efficiencies in the tokamak fusion concept.

Under the agreement, the cooperation will be directed towards exchanges of experience on operation, exchanges of scientists and equipment, and a certain degree of joint experimental program planning, whereby specific research activities or experiments could be allocated between the three parties. Management issues in implementing the agreement have already been resolved, and a personnel and information exchange program has been agreed for the coming year, covering 20 assignments and 5 workshops.

III. ECONOMIC REGULATORY ADMINISTRATION

A. *ERA Declines to Condition Imports on "Open Access"*

With the implementation of Order No. 436,¹ the natural gas market in 1986 included more than usual uncertainty regarding transportation. This uncertainty also spread into the area of contracts for natural gas imports. Specifically, on May 5, 1986, the Economic Regulatory Administration (ERA) issued an "Order Providing Opportunity for Further Comments and Granting Interventions", in a series of import dockets.²

In applications filed by Tennessee Gas Pipeline Company (85-40-NG), Western Gas Marketing U.S.A. (86-08-NG) and HNG/InterNorth Gas Marketing, Inc. (86-09-NG) domestic producers filed petitions requesting that imported gas be permitted to move only on those pipelines participating in the Order No. 436 program.³ In the May 5 Order, the ERA cited "serious marketing problems being faced by domestic gas producers during this period of transition to a more competitive natural gas market," as grounds for its decision to consider the issue further.

On November 11, 1986, ERA issued Order and Opinion Nos. 151, 152 and 153 granting import authorization to Tennessee Gas Pipeline Company, Western Gas Marketing U.S.A. Ltd. and Enron Gas Marketing, Inc. without condition based on open access transportation.⁴ Further, the ERA determined such a "condition is discriminatory and not in the public interest" (1 E.R.A. at 72,603, 72,615 & 72,626). The ERA stated that such a condition would "disturb the current equal footing of U.S. and Canadian participants in the gas market, and would discriminate by requiring mandatory compliance with the voluntary FERC Order No. 436 program for importers but not for domestic suppliers." *Id.* Further, the ERA stated as to its blanket import program that "[w]e have found these flexible, market responsive arrangements to be in the public interest" and determined that requiring importers to obtain Order No. 436 transportation would impose an undue regulatory burden on commercial parties attempting freely to negotiate import arrangements.

B. *ERA/FERC Jurisdictional Authority*

Policy guidelines issued in 1984 by the Secretary of Energy expressly delegate approval and regulation of imports under Section 3 of the Natural Gas Act to the ERA. 49 Fed. Reg. 6684 (1984). The guidelines, and delegation order attached to these guidelines, also grant FERC authority to exercise its jurisdiction and functions under Sections 4, 5 and 7 of the NGA to natural gas imports, *Id.* at 6690. Although, the policy guidelines state the guidelines and dele-

1. Order No. 436, F.E.R.C. Stats. & Regs. ¶ 30,665 (1985).

2. Tennessee Gas Pipeline Company, ERA Docket No. 85-40-NG, Western Gas Marketing U.S.A., ERA Docket No. 86-08-NG, Enron Gas Marketing, Inc., ERA Docket No. 86-09-NG.

3. Producers originally filed the same petition in an El Paso Natural Gas import request; however, when El Paso became a participant under Order No. 436, the ERA issued an order granting El Paso import authority and rejecting those petitions as moot. El Paso Gas Marketing Company, 1 ERA ¶ 70,638 (1986).

4. Tennessee Gas Pipeline Company, 1 E.R.A. ¶ 70,674 (1986); Western Gas Marketing U.S.A. Ltd., 1 E.R.A. ¶ 70,675 (1986); Enron Gas Marketing, Inc., 1 E.R.A. ¶ 70,676 (1986).

gation orders were issued to "make a clearer distinction between the responsibility of the Administrator (ERA) in exercising the Secretary's authority to approve natural gas imports and the FERC's responsibility to regulate the imported gas within the domestic natural gas system,"⁵ the impact has been quite the contrary.

The policy guidelines and delegations orders have not completely achieved their stated goal of clarifying the distinction between FERC and ERA of jurisdiction over natural gas imports. On May 15, 1986 the ERA issued Opinion and Order No. 124 in *Natural Gas Pipeline Company of America*, ERA Docket No. 85-24-NG.⁶ In that order, ERA asserted its jurisdiction under Section 3 of the NGA to approve the as-billed rate methodology at the border. Further, the ERA drew upon its authority from the Secretary's policy guidelines and approved the passthrough, finding that the as-billed methodology would further enhance the competitiveness of the import.

However, the ERA attempted to further clarify FERC/ERA jurisdictional lines in Opinion and Order No. 124 and confirmed that FERC has parallel authority under Sections 4 and 5 of the NGA in reviewing downstream rates for proposed imports. While the ERA approved the two-part as-billed passthrough, the ERA did not approve "the passthrough of every single cost element exactly as proposed" and left review of these elements to FERC's jurisdiction. *Id.* at 72,533. Further, ERA's order noted "if components of a demand charge, such as production costs that FERC would not normally permit to be treated as fixed costs, the Canadian import should be treated no differently." *Id.*

Nonetheless, in the same order, ERA said that FERC's exercise of authority under Sections 4 and 5 should be "in a manner consistent with the ERA's decisions and the DOE's policies." The order also urged FERC to exhibit some regulatory restraint from unnecessary stringency in reviewing contracts that had been freely negotiated and approved by the ERA and which include cost recovery provisions that achieve reasonable results and are in compliance with applicable laws. *Id.*

IV. FEDERAL ENERGY REGULATORY COMMISSION: FLOW THROUGH OF IMPORTED GAS COSTS ON AN "AS-BILLED" BASIS.

On December 8, 1986, the Commission issued an Opinion addressing for the first time the issue of the reasonableness of as-billed passthrough of imported gas demand and commodity charges. *Natural Gas Pipeline Co.*, Opinion No. 256, 37 FERC ¶ 61,215 (1986).⁷ In Opinion No. 256, the Commission reversed the initial ruling of the Administrative Law Judge (ALJ)⁸ and held it unjust and unreasonable under the Natural Gas Act (NGA) for a domestic pipeline to flow through its rates on an as-billed basis its importers' demand and commodity charges. The Commission's refusal to allow as-billed flow

5. 49 Fed. Reg. 6684, 6689 (1984).

6. 1 E.R.A. ¶ 70,654 (1986).

7. [Hereinafter Opinion No. 256]. "As-billed" flow through refers to a procedure whereby Canadian demand charges are passed through the U.S. purchasers' demand charges and the Canadian commodity costs are passed through the U.S. purchasers' commodity charges.

8. *Natural Gas Pipeline Co. of America*, 35 F.E.R.C. ¶ 63,054 (1986) [hereinafter *Initial Decision*].

through is based largely on its perception that Canadian pipeline cost allocation methods guarantee recovery of costs which are placed at risk in American pipeline rates and on its perception that as-billed flow through places domestic pipelines at a disadvantage relative to Canadian pipelines. Subsequent to issuing Opinion No. 256, the Commission has applied its Opinion No. 256 rationale to other Canadian import cases, ordering domestic pipelines to recompute as-billed demand charges in accordance with its determinations in Opinion No. 256.⁹ The ruling has created a major furor in Canada and has been the subject of Canadian government protest.

A. *Background*

Natural Gas Pipeline Company of America (Natural) purchases Canadian gas from ProGas (a Canadian gas broker) and from Great Lakes Gas Transmission Company (Great Lakes). ProGas ships the gas from Alberta, Canada to the Canada/United States border through two Canadian pipelines — NOVA and Foothills Pipeline Limited (Foothills). Great Lakes' purchases from TransCanada Pipeline are shipped from Alberta to the United States through NOVA and through TransCanada facilities.

ProGas and TransCanada charged Natural a negotiated demand charge of fifty cents per MMBtu. Historically, ProGas and TransCanada billed Natural a straight volumetric rate (a one-part commodity rate) which Natural assigned to the commodity component of its rates. Subsequent to the Canadian government's initiation of its New Natural Gas Export Policy To Allow Negotiated Price,¹⁰ ProGas, TransCanada and Great Lakes renegotiated their contracts with Natural. They replaced their one-part commodity rates with "two-part rate[s] having demand and commodity components."¹¹ Natural paid ProGas' two-part rate directly to ProGas, and paid TransCanada's two-part rate to Great Lakes which in turn paid TransCanada.

In the Initial Decision, the ALJ determined that the Canadian demand charges were composed of three elements: (1) non-transmission fixed costs; (2) TransCanada's transportation costs and the Foothills demand charge; and (3) the NOVA transportation charge.¹² ProGas' non-transmission fixed costs consisted of NOVA's field transport and processing charges. TransCanada's non-transmission fixed costs included average producer fixed costs composed of the costs of compression, processing and transportation from the wellhead to a central point in the field and take-or-pay carrying costs. The primary issue presented in the *Natural* proceeding was whether the Commission's as-billed Purchased Gas Adjustment (PGA) rule¹³ allowing as-billed flow through for domestic pipelines allows the as-billed flow through of Canadian gas costs to

9. See *Great Lakes Transmission Co.*, 38 F.E.R.C. ¶ 61,005 (1987); *Northern Natural Gas Co.*, 37 F.E.R.C. ¶ 61,343 (1986); *Tennessee Gas Pipeline Co.*, 37 F.E.R.C. ¶ 61,342 (1986); *Northwest Pipeline Corp.*, 37 F.E.R.C. ¶ 61,255 (1986).

10. See *Report of The Committee on Natural Gas Imports and Exports*, 6 ENERGY L.J. 149 (1985) [hereinafter *1985 Committee Report*].

11. *Initial Decision*, 35 F.E.R.C. at 65,185.

12. See *id.* at 65,193; see also *Opinion No. 256*, 37 F.E.R.C. at 61,545.

13. 18 C.F.R. § 154.38(d)(4)(1986).

domestic purchasers.

B. *The ALJ's Initial Decision*

Seeing no distinction between Canadian and domestic gas for as-billed purposes, the ALJ allowed passthrough on an as-billed basis. The ALJ relied on the Commission's as-billed PGA rule¹⁴ and on Commission decisions allowing as-billed flow through of Canadian gas costs to American pipelines.¹⁵ The ALJ also stated that there were "many factors in the record which argue for as-billed flow through of the Canadian gas costs and for the justness and reasonableness of Natural's rates resulting from that as-billed flow through."¹⁶ These factors were stated to include (1) evidence that the renegotiated contracts result in lower gas costs to Natural's customers; (2) evidence that cost shifting as a result of as-billed flow through would be minimal among Natural's customers; and (3) evidence that as-billed flow through of the Canadian gas costs promotes the goals of the gas import policies of the Department of Energy.¹⁷ In response to these factors, the ALJ stated: "In the instant case the benefits which accrue to Natural's customers through the renegotiated contracts for Canadian gas and by as-billed flow through of Canadian gas costs outweigh any detriments and accomplish many of the general goals of rate design."¹⁸

C. *The Commission's Authority To Review Canadian Demand Charges*

One of the major issues addressed by the Commission was the allocation of authority over imports between it and the ERA. Authority over natural gas imports is vested primarily in the ERA. Under section 3 of the NGA, the ERA is charged with determining whether a proposed import is in the public interest.¹⁹ Once the ERA authorizes an import, however, the Commission retains jurisdiction under sections 4 and 5 of the NGA to insure just and reasonable rates after gas crosses the border.²⁰ Responding to allegations that the ERA's granting of import authority preempted the Commission from altering the rates charged by Canadian suppliers to their American customers, the Commission concluded that it can exercise its NGA sections 4 and 5 powers over Natural's gas rates so long as the exercise of those powers does not conflict with NGA section 3 determinations made by the ERA or with policy considerations reflected in the relevant import authorization.²¹ The Commission found relevant an ERA order addressing Natural's contract with ProGas. The Commission quoted ERA language stating:

It is within the FERC's jurisdiction in an exercise of its authority under Sections 4 and

14. See *Initial Decision*, 35 F.E.R.C. at 65,189.

15. See *id.* (citing *Midwestern Gas Transmission Co.*, 31 F.E.R.C. ¶ 61,309 (1985); *Inter-City Minnesota Pipelines, Ltd., Inc.*, 31 F.E.R.C. ¶ 61,238 (1985); *Great Lakes Gas Transmission Co.*, 30 F.E.R.C. ¶ 61,342 (1985)).

16. *Initial Decision*, 35 F.E.R.C. at 65,190.

17. See *id.*

18. *Id.* at 65,194.

19. See *id.*

20. See *id.*

21. Opinion No. 256, 37 F.E.R.C. at 61,541-43.

5 of the NGA to approve . . . specific [imported gas rate] elements while acting in a manner consistent with the ERA's decisions and the DOE's policies. Clearly, if there are components of a demand charge, such as production-related costs that the FERC would not normally permit to be treated as fixed costs, the Canadian import should be treated no differently. However, if the international contract, freely negotiated by commercial parties and approved by the ERA, includes cost recovery provisions that achieve reasonable results and are in compliance with applicable laws, the ERA urges regulatory restraint from any unnecessary intrusion into private contract matters.²²

The Commission also found relevant a statement by the Secretary of Energy that "[i]f the Commission has concerns about the allocation of imported gas costs between demand and commodity charges it has sufficient authority to take the appropriate action."²³ In summary of its position regarding review of imported gas rates, the Commission stated, "our prime consideration is, as stated by the Secretary, to ensure that there is 'no regulatory distinction between the treatment of domestic and imported gas supplies.'"²⁴

D. The Commission's Decision Regarding As-Billed Flow Through

The Commission examined Natural's rates and determined that the as-billed principle did not apply to the flow through to Natural's customers of the Canadian demand charges. In so ruling, the Commission was forced to justify treating Canadian gas differently from domestic gas for cost flow through purposes. The Commission justified differential treatment on the basis that the as-billed principle is "premised on [the] Commission's having examined the costs in the upstream supplier's rates."²⁵ As the Commission is unable to examine a Canadian pipeline's costs, the Commission instead chose to examine the demand charge's effects on downstream domestic purchasers and to disallow flow through of those demand charge components which are unjust or unreasonable.

Although in agreement with the ALJ regarding the beneficial impact of renegotiated Canadian gas supply contracts, the Commission refused to accept the ALJ's contention that the benefits warranted flow through in the demand charge of the Canadian pipeline's "non-transmission fixed costs." In accord with the concept that Canadian imports should be treated no differently from domestic supply, the Commission directed that all gathering and take-or-pay carrying costs be removed from the demand component of Natural's rates.²⁶

The Commission objected to Foothills' and TransCanada Pipeline's placement of all fixed costs in their demand charges as inconsistent with the Commission's adoption of the Modified Fixed-Variable cost allocation method. The Commission reasoned that it did not allow domestic pipelines to recover all fixed costs in their demand charges because "there is no economic reason to

22. Opinion No. 256, 37 F.E.R.C. at 61,542 (quoting Natural Gas Pipeline Co., 1 E.R.A. ¶ 70,645, 72,533 (1986)).

23. *Id.* at 61,542-43 (quoting Comments of the United States Department of Energy, F.E.R.C. Docket No. RM85-1-000 (part D), November 18, 1985, at 7, which are quoted by the ERA in Natural Gas Pipeline Co., 1 E.R.A. ¶ 70,645, 72,532 n.10 (1986)).

24. *Id.*

25. *Id.* at 61,544.

26. *Id.* at 61,545.

assure pipeline profits when sales are not made."²⁷ Owing to the fact that it does not allow domestic pipelines to recover through their demand charges all fixed costs, and to the fact that it is charged with treating foreign and domestic pipelines on an equal basis, the Commission gave Natural the option of either excluding the Canadian pipeline's return on equity and related taxes or excluding an amount determined by the use of Natural's Modified Fixed-Variable method.²⁸

Also, the Commission objected to Natural's inclusion in its demand charge of volumetric or "postage stamp" rates that NOVA charges ProGas and TransCanada. As a fixed cost of an upstream pipeline, the Commission ruled that NOVA's volumetric transportation rate properly is a variable cost to downstream pipelines.²⁹ As such, the Commission held it improper to include the volumetric rate in Natural's demand charge. The Commission reasoned that:

In the instant case, it would be patently unreasonable to require American distributors and consumers to pay demand charges to Natural with respect to NOVA. This is so because neither ProGas nor TransCanada is obligated to pay demand-related dollars to NOVA. They pay only for services rendered. Accordingly, we conclude that Natural's demand charge does not achieve a reasonable result by including NOVA's charges.³⁰

E. In The Wake Of Opinion No. 256

The Commission's Order requiring the removal from Natural's demand charge of 1) fixed costs representing production, gathering, and take-or-pay carrying costs; 2) costs representing a return on equity and related taxes; and 3) costs of NOVA's volumetric transportation, reflects the differences between approved Canadian and American rate design methodologies. Nevertheless, Opinion No. 256 sparked immediate protests from gas importers and exporters and from the Canadian government. Motions for rehearing were filed by Natural, its Canadian suppliers, and the Alberta Petroleum Marketing Commission.³¹ The Canadian NEB protested in a letter to the Commission that the Commission's Order "is inconsistent with established mutual regulatory practice and may have harmful consequences for long-term natural gas trade between the two countries."³² In response to the issues raised in the requests for rehearing, the Commission on February 2, 1987, granted rehearing of Opinion No. 256

27. *Id.* (quoting Texas Eastern Transmission Corp., 30 F.E.R.C. ¶ 61,144, 61,283, *order on reh'g*, 32 F.E.R.C. ¶ 61,056 (1985)).

28. *See id.* at 61,546.

29. *Id.* (citing *Elimination of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions*, Order No. 380-E, 35 F.E.R.C. ¶ 61,384, 61,862 (1986) *aff'd sub nom.* Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (D.C. Cir. 1985)).

30. *Id.* It is interesting to note that subsequent to the Commission's rendering Opinion No. 256, NOVA amended its rate schedule to reflect its conversion to a two-part demand/commodity rate. *See, e.g.*, Motion of ProGas Limited to Reopen Record For The Admission Of Supplemental Testimony, FERC No. TA85-4-17-002, at 5 (filed Dec. 19, 1986).

31. *See Foster's Natural Gas Report (Foster Associates) No. 1602 at 16 (Jan. 15, 1987).*

32. *Id.*

“for the limited purpose of further consideration.”³³

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Melvin E. Waxler
O. Julia Weller

33. Order Granting Rehearing Solely For Purpose of Further Consideration, FERC Nos. TA85-1-26-006 through TA85-1-26-013 (Feb. 2, 1987).