

Report of the Committee on International Energy Transactions

I. CANADA/UNITED STATES FREE-TRADE AGREEMENT

On January 1, 1989 the Canada/United States Free-Trade Agreement (FTA)¹ became effective, almost exactly one year after it was signed by President Reagan and Prime Minister Mulroney on January 2, 1988. The United States Congress approved enabling legislation on September 28, 1988. After a bitter election struggle, the Canadian enabling legislation was approved by the House of Commons on December 24, 1988. The Canadian Senate approved the enabling legislation on December 30, 1988.

The FTA is a wide-ranging, bilateral trade agreement that will eliminate tariffs as well as many more non-tariff trade barriers. The agreement's provisions on energy trade, in chapter 9, are particularly significant. Canada has a substantial energy trade surplus with the United States (\$11.2 billion of Canadian energy exports to the United States compared to \$1.9 billion of United States energy exports to Canada).² In 1987, the cross-border energy trade had a total value of \$13.1 billion—consisting of Canadian exports to the United States of crude oil (\$4.8 billion), petroleum products (\$1.4 billion), natural gas (\$2.53 billion) and electricity (\$1.25 billion), and United States exports to Canada of coal and coal products (\$803 million) and petroleum products (\$748 million).

At the heart of chapter 9 is its anti-discrimination provisions. Under article 904, the United States and Canada may restrict energy imports or exports to the other only if:

- (a) the proportion of exports relative to the domestic supply of a specific energy good remains the same. The proportion is set by using the most recent 36-month period for which data are available prior to the restriction, or in such other representative period on which the Parties may agree;
- (b) the Party does not impose a higher price for exports of an energy good to the other Party than the price charged for such energy good when consumed domestically, by means of any measure such as licenses, fees, taxation and minimum price requirements. The foregoing provision does not apply to a higher price which may result from a measure taken pursuant to subparagraph (a) that only restricts the volume of exports; and
- (c) the restriction does not require the disruption of normal channels of supply to the other Party or normal proportions among specific energy goods supplied to the other Party such as, for example, between crude oil and refined products and among different categories of crude oil and of refined products.³

Thus, neither country may treat energy exports to the other country any differently from domestic energy, nor may either country suddenly restrict

1. The Canada/United States Free Trade Agreement, Implementation Act of 1988, P.L. 100-449 [hereinafter FTA].

2. All statistics from Battram & Lock, *The Canada/United States Free Trade Agreement and Trade in Energy*, 9 ENERGY L.J. 327 (1988).

3. FTA, *supra* note 1, art. 904.

energy exports proportionately more than it restricts domestic energy consumption. This provision is important, because it makes supplies from either country much more reliable and removes the spectre of politically motivated embargoes or restrictions similar to those that have wreaked havoc on United States crude oil imports from the Mideast from time to time.

In addition, article 502 applies the anti-discrimination standard to states and provinces by requiring them to give Canadian or United States imports, including energy, "treatment no less favorable than the most favorable treatment accorded by such province or state to any like, directly competitive, or substitutable goods."⁴

The FTA also specifically ameliorates three existing restrictions on energy trade between the United States and Canada. First, it requires the United States Department of Energy to exempt Canadian uranium from any restrictions on the enrichment of foreign uranium.⁵ Second, Canada must exempt the United States from its uranium upgrading policy, which favored a Canadian uranium converter over United States competitors. Third, Canada receives an annual average exemption of 50,000 barrels per day from the prohibition on exporting Alaskan crude oil.

Energy trade within both countries, particularly natural gas and electricity, remains regulated, of course. Therefore, it is possible that energy regulators and regulations in either country can cause trade disputes from time to time. Under paragraph 1, of article 905:

If either Party considers that energy regulatory actions by the other Party would directly result in discrimination against its energy goods or its persons inconsistent with the principles of this Agreement, that Party may initiate direct consultations with the other Party. For purposes of this article, an "energy regulatory action" shall include any action, in the case of Canada, by the National Energy Board, or its successor, and in the case of the United States of America, by either the Federal Energy Regulatory Commission or the Economic Regulatory Administration or their successor. Consultations with respect to the actions of these agencies shall include, in the case of Canada, the Department of Energy, Mines, and Resources and, in the case of the United States of America, the Department of Energy. With respect to a regulatory action of another agency, at any level of government, the Parties shall determine which agencies shall participate in the consultation.⁶

Thus, even before conflicts arise over federal regulations that affect energy imports and exports (such as the now famous case of the Federal Energy Regulatory Commission (FERC) Opinion No. 256),⁷ there will be direct consultation between the national energy departments of each country—who will have discretion to include the affected regulatory agency or agencies in the consultative process. This provision is in addition to, not in lieu of, the separate chapter 18 and 19 procedures for resolving FTA disputes. Under chapter 18, disputes about the interpretation or application of the FTA

4. *Id.* at art. 502.

5. See generally Atomic Energy Act, § 161v, 42 U.S.C. § 2201(v) (1982).

6. FTA, *supra* note 1, art. 905, para. 1.

7. Natural Gas Pipeline Co. of America, 37 F.E.R.C. ¶ 61,215 (1986), *reh'g denied in part and granted in part*, 39 F.E.R.C. ¶ 61,218 (1987).

are to be referred to the Canada/United States Trade Commission (Commission).

The dispute resolution process requires a series of separate and very specific steps. If these devices are not successful within thirty days, the Commission may refer the matter to binding arbitration or establish its own panel of experts. This panel is to use detailed quasi-judicial procedures to determine the facts of the case and present a report to the Commission. It is the Commission itself that resolves the dispute, which will normally be based on the panel's recommendation.

Antidumping and countervailing duty cases are covered by chapter 19. Such cases are removed from the domestic courts' jurisdiction (except for constitutional issues) and are to be determined by a binational panel. This procedure will be used for five to seven years, during which time Canada and the United States will try to develop rules on subsidies and unfair pricing.

II. FEDERAL ENERGY REGULATORY COMMISSION

On December 8, 1986, the FERC issued Opinion No. 256⁸ which, for the first time, held that it is unjust and unreasonable under the Natural Gas Act (NGA) for Natural Gas Pipeline Company of America (NGPL) to flow through in its rates the demand and commodity charges "as-billed" by its Canadian suppliers.⁹ The FERC eventually affirmed Opinion No. 256 in Opinion No. 256-A.¹⁰

Since the issuance of Opinion Nos. 256 and 256-A, the FERC has applied this flowthrough policy to four other interstate pipelines: ANR Pipeline Company;¹¹ Northwest Pipeline Corporation;¹² Tennessee Gas Pipeline Company;¹³ and Texas Eastern Transmission Corporation.¹⁴ The FERC's orders implementing this policy are now on review before the District of Columbia Circuit in the consolidated proceeding styled *TransCanada PipeLines Ltd. v. FERC*.¹⁵ All briefs have been filed and oral arguments were held on January 13, 1989.

The briefs and oral arguments in *TransCanada* cover two broad issues denoted by the court as (1) the "as-billed" issues and (2) the prudence issue.

1. "*As-Billed*" Issues. The primary arguments raised by the petitioners and supporting intervenors addressing the "as-billed" issues (collectively the "As-Billed Petitioners") dealt with jurisdictional and procedural errors. First, the As-Billed Petitioners argued that the FERC's orders exceeded its jurisdiction because the Economic Regulatory Administration (ERA) has sole juris-

8. 37 F.E.R.C. ¶ 61,215.

9. See generally *Report of the Committee on International Energy Transactions*, 8 ENERGY L.J. 147, 153 (1987).

10. Natural Gas Pipeline Co. of America, 39 F.E.R.C. ¶ 61,218 (1987).

11. ANR Pipeline Co., 39 F.E.R.C. ¶ 61,094, *reh'g denied*, 39 F.E.R.C. ¶ 61,351 (1987).

12. Northwest Pipeline Corp., 37 F.E.R.C. ¶ 61,255 (1986), *reh'g denied*, 39 F.E.R.C. ¶ 61,377 (1987).

13. Tennessee Gas Pipeline Co., 37 F.E.R.C. ¶ 61,342 (1986), *reh'g denied in part and granted in part*, 39 F.E.R.C. ¶ 61,374 (1987).

14. Texas E. Transm'n Corp., 38 F.E.R.C. ¶ 61,072, *reh'g denied*, 39 F.E.R.C. ¶ 61,376 (1987).

15. *E.g. TransCanada PipeLines Ltd. v. FERC*, D.C. Cir. No. 87-1229.

diction over international (import) arrangements. These petitioners argued that the FERC's denial of as-billed flowthrough, if affirmed, would nullify contracts negotiated in accordance with the policies of both the United States and Canadian governments, and the FERC's actions significantly altered rates reviewed and approved by the ERA. Second, the As-Billed Petitioners argued that the FERC's orders impermissibly attempted to develop a "North American market," which is beyond its jurisdiction granted under Delegation Order No. 0204-112 issued to the FERC by the Secretary of Energy in 1984.¹⁶ Third, the new as-billed policy allegedly violated the FERC's then-existing regulations, which permitted as-billed flowthrough.¹⁷ Fourth, the Commission's orders allegedly were not based on substantial evidence and were arbitrary and capricious because the FERC: (i) disregarded an Administrative Law Judge's well-reasoned initial decision and record evidence which supported as-billed flowthrough and (ii) summarily applied the new policy adopted in Opinion No. 256 to the other domestic pipeline petitioners without regard to unique distinguishing factors and due process.

In response, the FERC and supporting intervenors argued that the FERC has jurisdiction under the 1984 Delegation Order to alter the classification of Canadian gas costs billed to domestic pipelines, and that the ERA itself has interpreted the Delegation Order to authorize such FERC action.¹⁸ The FERC and the supporting intervenors also argued that the FERC reasonably interpreted its regulations, justified its policy, and that the policy enunciated in Opinion No. 256 was necessary to prevent discriminatory rate treatment and distorted pricing signals.

2. *Prudence Issue.* Southwest Gas Corporation (Southwest) filed a petition for review of the FERC's order imposing the Opinion No. 256 flowthrough policy on Northwest Pipeline Corporation (Northwest). Southwest based its petition on its allegation that the FERC, improperly disclaimed jurisdiction over the prudence of imports in the *Northwest Pipeline Co.* orders.¹⁹ In response, the FERC argued that its reference to the prudence of purchases under an import contract between Northwest and its Canadian supplier was *dicta*. The FERC requested that the court dismiss Southwest's prudence claim because Southwest had failed to assert, on rehearing before the FERC, that the FERC had erred in not reviewing the prudence of Northwest's actual purchases under its Canadian supplier contract, as distinguished from the contract itself. Basically, the FERC charged that Southwest had sought rehearing only of the FERC's denial of authority to review the prudence of the Canadian supplier contract, while on review, Southwest was objecting to the prudence of the purchases under the contract. Notwithstanding this procedural dispute, the FERC argued that because the prudence language in the *Northwest* order was *dicta*, the issue of whether it can review Northwest's actual purchases under the import contract should be dismissed. The FERC asserted that the

16. 49 Fed. Reg. 6684 (1984).

17. Since the orders on review were issued, the FERC has adopted regulations in conformance with its flowthrough policy enunciated in Opinion No. 256. See 18 C.F.R. § 154.305(b)(3) (1988).

18. The ERA was not a party to the proceedings before the FERC or the court.

19. See, e.g., *Northwest Pipeline Corp.*, 39 F.E.R.C. ¶ 61,215, at 61,750-51 (1987).

question regarding the prudence of actual purchases under the import contract will not be ripe for review until such question is concretely presented (and addressed) in a subsequent proceeding.

Edward B. Myers, *Chairman*
Robert A. Hill, *Vice Chairman*

Hugh T. Arthur, II
Roger A. Berliner
S. Lorraine Cross
Michael W. Grainey
Michael W. Hall
Emmitt C. House
Frank X. Kelly

Becky McGee
Kevin R. McSpadden
Steven H. Neinast
Allan M. Pinchoff
John L. Sachs
Jane E. Stelck
W. Bland Williamson

