Report of The Committee On Natural Gas Imports and Exports

Section 3 of the Natural Gas Act (NGA), 15 U.S.C. § 717(b) (1982), provides that natural gas may be exported from or imported into the United States upon a finding that the export or import is in the "public interest". Pursuant to the Department of Energy Organization (DOE) Act, 42 U.S.C. § 7151(a) (1982), Section 3 authority is vested in the Secretary of Energy. With a few exceptions, the Secretary has in turn delegated that authority to both the Economic Regulatory Administration (ERA) and the Federal Energy Regulatory Commission (FERC). Prior to February 15, 1984, the ERA determined whether a proposed import or export was not consistent with the public interest by taking into account such factors as price, the security of supply, the effects on the U.S. balance of payments, compatibility with DOE regulations, and the national and regional needs for gas. On February 15, 1984, however, the DOE issued its "New Policy and Delegation Orders from Secretary of Energy to ERA and FERC Relating to the Regulation of Imported Natural Gas", 49 Fed. Reg. 6,684 (1984). The new policy placed primary emphasis on the competitiveness and flexibility of a proposed import arrangement. It presumed that import arrangements which were the result of direct buyer-seller negotiation were competitive and market flexible. The Delegation Orders extended ERA's responsibility to include *all* Section 3 gas imports, rescinding a previous order which had given the FERC Section 3 authority over Alaska Natural Gas Transportation System (ANGTS) "pre-build" gas. The FERC continues to exercise authority pursuant to Sections 4, 5 and 7 of the Natural Gas Act to consider the siting, construction, and operation of facilities, as well as authority to review ratemaking procedures.

In addition to the new DOE policies, the past year has seen some other significant policy changes by the FERC and the National Energy Board of Canada (NEB) regarding Canadian imports. It is hoped that these changes, in conjunction with other developments abroad, will enhance the marketability of Canadian gas in the United States.

I. Canadian and Mexican Border Price Developments

A. *Overview of Policy Changes Affecting Imports From Canada.*

1. *Department of Energy, "New Policy Guidelines and Delegation Orders from Secretary of Energy to ERA and FERC Relating to the Regulation of Imported Natural Gas," 49 Fed. Reg. 6684 (1984).*

The new import policy guidelines served to streamline ERA's import review authority. Delegation Order No. 0204-110 rescinded Delegation Orders 0204-8 and 0204-14 which had permitted limited FERC Section 3 authority over ANGTS "pre-build" gas. Delegation Order No. 0204-111 gave the ERA exclusive authority under Section 3 to regulate all imports and exports of natural gas, including ANGTS gas. Delegation Order No. 0204-112 clarified and affirmed the FERC's remaining responsibilities over construction, operation and siting of facilities, and ratemaking functions under Sections 4, 5, and 7 of the NGA.

The policy guidelines repudiated the existing uniform border pricing strategy in favor of direct negotiations between buyers and sellers and also emphasized the benefits of free market competition as a price-setting mechanism. "The policy cornerstone of the public interest standard is competition." The guidelines establish "certain rebuttable presumptions and contemplate flexible application" rather than hard-and-fast rules. *Id.* The main principles embodied in this policy include: competitiveness, need, and security of supply.

The new policy guidelines also clarified that the competitiveness of an import will not be based solely on the price of the import, but will be judged on an overall basis by examining the flexibility to permit pricing and volume adjustments as required by market conditions and competition with other fuels (including domestic natural gas). *Id.* at 6688. Market participants are presumed to have the best information upon which to judge competitiveness, and the contracts they negotiate will be reviewed for flexibility in the following areas: volume of gas under contract; base price; price review or adjustment mechanisms; take-or-pay obligations; make-up provisions; and length of contract. The capability to permit adjustments due to changed circumstances may be evidenced by renegotiation, arbitration, or "market-out" clauses. *Id.*

The second factor, need for the natural gas, is based upon its anticipated marketability. If found competitive, there is a rebuttable presumption that need exists. That presumption can be overcome by a showing that the energy requirements in the market are competitively met by domestic natural gas and other fuels. *Id.*

The "security of supply" factor defines a source of supply as "secure" if it "does not lead to undue dependence on unreliable sources of supply." *Id.* The need to demonstrate security of supply increases proportionally with the size of volumes and durations of contracts involved. Security can be demonstrated by the "historical reliability" of the supplier as a dependable source, and the availability of committed gas reserves. Other considerations include: international trade policy, foreign policy, and national security interests. *Id.*

These guidelines were aimed at encouraging the negotiation of new contracts and the renegotiation of existing contracts between buyers and sellers of imported gas at competitive market-based prices. The policy guidelines also provide that freely negotiated contracts carry with them a strong presumption of competitiveness.

2. *FERC Order No. 380, Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, 49 Fed. Reg. 22,778 (1984).*

Order No. 380 eliminated variable costs from pipeline minimum bills. The FERC concluded that minimum bills which permit collection of non-incurred "costs" of gas not purchased were *prima facie* unjust and unreasonable. The FERC stated that collecting "costs" not incurred tended to restrain competition by insulating pipelines and producers from market risk and thus inhibited price decreases.

Order No. 380 does not apply directly to import contracts, which as discussed above, are matters within the sole jurisdiction of the ERA under DOE's new import policy. However, Order No. 380 appears to have a significant potential impact on the ability of exporters to finance major new export projects to the U.S., with the notable exception of the ANGTS. Additionally, it appears that Order No. 380 has encouraged exporters to restructure their gas export contracts to provide for a two-part demand-commodity rate structure in the hopes of receiving some assurance of recovering at least the fixed costs associated with the export facilities. Further, since the effect of Order No. 380 is to abrogate the obligation of customers of pipelines to take-or-pay for gas, importers may be in the position of being required to take-or-pay for imported volumes pursuant to ERA authorizations without any corresponding obligation of their customers to purchase the supplies.

On rehearing of Order No. 380, a number of importers and Canadian exporters and the NEB raised significant concerns regarding the potential impact of Order No. 380 on the financing of existing and future major import projects. The NEB and a number of Canadian exporters pointed out that the project sponsors of the Canadian segment of the ANGTS pre-build, Canadian producers, and Canadian investors and lenders relied on assurances of the FERC and the U.S. government of a minimum stream of revenues in committing themselves to the financing and construction of the ANGTS pre-build. Similar arguments were also raised by Trunkline LNG Company (TLC) with respect to the imports of Algerian LNG. Additionally, TLC also noted that, due to the unusual structure of TLC's minimum bill, the operation of Order No. 380 would remove "fixed" costs from TLC's minimum bill.

In response to these concerns, the FERC, in Order No. 380-A, 49 *Fed. Reg.* 31,259 (1984), clarified that Order No. 380 did not apply to the sales tariffs of Northwest Alaskan Pipeline Company (Northwest Alaskan), the importer of the ANGTS pre-build gas. The FERC stated that such relief was appropriate in light of the status of the ANGTS as a unique international project whose ultimate success had always rested on a framework of mutual trust and cooperation. The FERC, however, did not extend such relief to the minimum bill provisions of the U.S. pipelines purchasing the ANGTS pre-build gas from Northwest Alaskan.

The FERC reiterated the reasons for its special treatment of ANGTS as "a unique international project governed by a unique legal framework", in Order No. 380-B, 49 *Fed..Reg.* 43,635 (1984). Order No. 380-C reaffirmed the FERC's application of the rule to minimum physical take (take-and-pay) provisions.

Several companies have filed requests for waiver of Order No. 380. The FERC denied the requests, *Great Lakes Gas Transmission Corp.*, 29 FERC ¶ 61,135 (1984), and applications for rehearing are pending FERC action.

3. *Canadian Government's "New Natural Gas Export Policy to Allow Negotiated Price", Press Release 84/81, July 13, 1984*

The new export pricing policy was implemented on July 13, 1984 as an alternative to the year-old Volume Related Incentive Pricing (VRIP) program. The new policy allows for negotiated gas contracts, subject to approval by regulatory authorities (the NEB). Where the contract is the result of the renegotiation of an existing export contract, the replacement contract, in addition to meeting the six (6) criteria listed below, must also provide an "enhanced economic return to Canada" in comparison to VRIP. Alternatively, VRIP is still available at a $4.40 threshold for "base volumes" and a $3.40 incentive price for volumes over the base volumes. The threshold base level is the lesser of 50% of the annual license quantity, or 1981-82 actual sales.

In addition to the "enhanced economic return" criterion, the new policy imposes six (6) criteria in evaluating the acceptability of negotiated contracts:

(1) the price of exported gas must recover its appropriate share of costs incurred;
(2) the price must not be less than the Toronto city gate wholesale price; this floor price has been set at approximately $3.10/Mcf. For calculation of the Toronto city gate price, *see Agreement Between the Government of Canada and the Government of Alberta on Energy Pricing and Taxation* (Sept. 1, 1981), and subsequent amendments, including *Agreement to Amend* (June 30, 1983) (based on 65% of Toronto Refinery Acquisition Cost of Oil, less transportation cost, ownership charge, and taxes);
(3) the price must result in U.S. market prices at least equal to the price of major competing energy sources;
(4) contracts must contain provisions permitting adjustments to changing market conditions;
(5) reasonable assurances must be provided that volumes contracted will be taken;
(6) producers must endorse terms of export arrangement and subsequent revisions.

4. Spot Market Sales

In addition to allowing direct buyer-seller negotiations to establish the price and other terms of an export arrangement, the new Canadian export policy also allows Canadian exporters to participate in the growing spot sales market in the U.S. Such spot sales must meet the criteria listed above, and must also be: (1) incremental, so as not to displace other Canadian gas sales; and (2) on an interruptible or best efforts basis. Such sales also promote the flexibility sought by the new DOE guidelines.

B. Impact of U.S. and Canadian Policy Changes.

1. Renegotiated Long-Term Contracts.

a. *NEB Orders.*

As of November 1, 1984, the NEB approved renegotiated export contracts covering around 80 percent of existing U.S.-Canadian export contracts. Department of Energy Report, *Increasing Competition in the Natural Gas Industry,* January 1985, at 46. The Canadian government projects that these renegotiations will translate to lower average U.S. border prices ranging between $3.09/MMBtu (Midwest area) and $3.50/MMBtu (Northeast area). *Id.* The following agreements have already been approved (listed by importer/exporter(s)): Pacific Gas Transmission/Alberta & Southern; Northwest Pipeline Co./Westcoast Transmission; ANR Pipeline Co./Transcanada, Pro Gas; Midwestern/Transcanada; Transco/Sulpetro; United Gas Pipe Line/Pan-Alberta; Panhandle

Eastern/Pan-Alberta; Northern Natural/Pan-Alberta; Pacific Interstate Transmission (PIT)/Pan-Alberta. (All of the contracts involving exporter Pan-Alberta go through the Northwest Alaskan Pipeline *Eastern* Leg of ANGTS, with the exception of PIT, which goes through the *Western* Leg of ANGTS.)

b. *FERC Proceedings.*

A number of importers have made various filings with the FERC to reflect the renegotiation of their import contracts. As stated above, a number of these importers agreed to renegotiate their import contracts to provide for a two-part demand-commodity rate, partially in response to Order No. 380. Additionally, in order to provide some assurance that at least the demand component would be recovered, a number of importers have requested authority to pass through the demand component on an "as-billed" basis in the importer's demand charges to its customers. In addition, the ANGTS-related imports discussed, *infra,* the following are the actions taken on these filings.

(i) *Transcontinental Gas Pipe Line Corporation* (Transco), 29 FERC ¶ 61,148 (1984), involving Transco's renegotiated Canadian gas import contract with Sulpetro Limited, which provides for a two-part demand-commodity rate. In its PGA filing, Transco requested permission to pass through the demand portion of its rates on an "as-billed" basis through its PGA. This would allegedly permit Transco to pass through its demand charges paid to Sulpetro as part of Transco's demand charges. A number of intervenors objected to Transco's request, arguing that approval would result in a reallocation of costs among Transco's customers, and that there is no reason to extend the "as-billed" principle to imported gas. As a result of these concerns, the FERC set Transco's PGA filing for hearing, along with other issues.

(ii) *Northwest Pipeline Corporation* (Northwest), 29 FERC ¶ 61,149 (1984), in which Northwest proposed a pass through on an "as-billed" basis its two-part demand-commodity rates paid to its Canadian gas suppliers, Westcoast Transmission Company, under its renegotiated import contract. As with Transco's filing, a number of intervenors also protested Northwest's request, arguing that the proposal would lead to an unreasonable reallocation of costs. The Commission set this matter for hearing along with other issues.

Recent developments in the market for Canadian spot sales find parties testing the firmness of the Toronto city gate floor price requirement. Although that price is approximately $3.10-3.15/MMBtu, the NEB approved a lower $3.00/MMBtu price between Transco and Sulpetro on September 5, 1984 because the spot sale was on a "best efforts, interruptible basis". On September 21, 1984, the NEB rejected Vector Energy System's low $2.61/MMBtu rate, but said they would accept $2.89/MMBtu on a best efforts, interruptible basis. Between July 1984 and Nov. 8, 1984: 12 spot sales had been proposed, with 4 being approved and 1 rejected; prices proposed ranged from $2.60-$3.40/MMBtu, prices approved ranged from $3.00-$3.17/MMBtu, and the $2.61/MMBtu price was rejected. Some pending applications have proposed a two-part price straddling the Toronto city gate price:

(1) Intermountain Gas Co./Dome Petroleum — 19.8 Bcf at $3.00/MMBtu with an additional 11.4 Bcf at $3.40/MMBtu; (2) Northwest Natural Gas Co./Dome Petroleum — similar $3.00-$3.40/MMBtu price spread.

C. *ANGTS Developments.*

As mentioned, ANGTS "pre-build" gas has been removed from FERC jurisdiction in two respects: (1) Under DOE's new delegation orders, FERC's Section 3 approval authority over ANGTS gas has been transferred to the ERA; (2) Under FERC Order No. 380, ANGTS gas is exempted from the rule requiring elimination of variable costs from minimum bills.

Othar recent FERC developments involving ANGTS include:

(1) *Northwest Alaskan Pipeline Co. (Eastern Leg)*, 29 FERC ¶ 61,302 (1984), in which the Commission approved amendments to Northwest Alaskan's sales tariffs governing its sales of Canadian gas to the three shippers on the Northern Border Pipeline Company (Eastern Leg of the ANGTS pre-build). The tariff amendments were made to reflect the renegotiation of Northwest Alaskan's import contract with its Canadian supplier, Pan-Alberta Gas Ltd. (Pan Alberta).

As a result of the tariff revisions, the average purchase price and minimum take obligations of the three shippers were significantly reduced. Although the average per unit cost of gas to the three shippers varied to reflect the difference in each of the shipper's markets, the import price to all three approved by the NEB was below the equivalent Toronto city-gate price. The exception to the Toronto city-gate price was allowed by the NEB in recognition of the unique status of the ANGTS. The revised tariff sheets governing Northwest Alaskan's sales to two pipelines provide for a two-part consisting of a demand and a commodity component. Under both tariffs, the demand component includes all gathering and transportation costs incurred in moving the gas to the U.S.-Canadian border, as well as other costs. The sales to the ??, however, are made under a three-tiered commodity rate.

(2) *Northwest Alaskan Pipeline Company (Western Leg)*, 29 FERC ¶ 61,304 (1984), in which the Commission approved amendments to Northwest Alaskan's sales tariffs to Pacific Interstate Transmission Company (PIT) through the Western Delivery System (WDS), which is otherwise known as the Western Leg of the ANGTS pre-build. Northwest Alaskan's sales to PIT are made under a two-part rate consisting of a demand and a commodity component. The "Tier I" commodity rate was initially established at $2.40 (U.S.) per MMBtu for volumes up to eighty-five percent (85%) of minimum obligations, with a "Tier II" incentive rate not to exceed $2.30 (U.S.) for volumes purchased above eighty-five percent (85%). As with the Eastern Leg imports, the import price established under the revised tariffs is below the Toronto city-gate price.

(3) *Northern Border Pipeline Co.*, 29 FERC ¶ 61,301 (1984). The FERC extended Northern Border's and Northwest Alaskan's certificate of authority to sell Pan-Alberta gas to Northern Border shippers through October 31, 1996.

(4) *Northern Border Pipeline Co.,* 29 FERC ¶ 61,303 (1984). The FERC approved a change in Northern Border's depreciation methodology which "shift[s] the collection of depreciation expense toward the later years of the new transportation extension through 1996" by increasing depreciation charges over time.

D. Developments in Mexican Imports

On November 1, 1984, Mexico suspended all natural gas exports to the United States through Border Gas, Inc. Prevailing market conditions dictated the domestic use of natural gas and export of residual fuel as the most efficient solution at present. See the DOE Report, *Increasing Competition in the Natural Gas Industry,* January 1985, at 47.

E. Algeria.

Since the December, 1983, suspension of Trunkline LNG Company purchases from Sonatrach, its Algerian LNG supplier, no new developments have occurred. Both parties are engaged in arbitration at present. Some Algerian LNG continues to be imported into Boston Harbor by Distrigas. *Id.* The potential effect of Order No. 380 cannot be determined as of this date.

F. Exports to Japan.

No new developments in 1984; annual exports are consistently around 50 Bcf. *See* summary below for recent data.

II. Summary of Recent Import-Export Data:

(Source: Dept. of Energy Report, *Increasing Competition in the Natural Gas Industry,* January, 1985 at chap. 4: "Natural Gas Imports".)

The combined volumes of U.S. natural gas imports for 1983 were 918 Bcf, and are estimated for 1984 at 825 Bcf. In 1983, the sources of U.S. imports were: Canada — 712 Bcf (78%), Algeria — 131 Bcf (14%), and Mexico — 75 Bcf (8%). 1984 estimates are: Canada — 740 Bcf (80%), Algeria — 35 Bcf (4%), and Mexico — 50 Bcf (6%). With the recent curtailments by Mexico and Algeria, and the new competitive Canadian prices, 1985 could see an even greater proportional share of the import market from Canada.

U.S. exports in 1983 totalled 54.7 Bcf, with 52.9 Bcf (or 97% of all exported gas) going to Japan. Total exports increased from 51.7 Bcf in 1982 to 54.7 Bcf in 1983. Exports to Japan increased from 49.9 Bcf in 1982 to 52.9 Bcf in 1983.