

Report of the Committee on International Energy Transactions

I. *TRANSCANADA PIPELINES LTD. v. FERC*

On June 16, 1989, the D.C. Circuit decided *TransCanada Pipelines Ltd. v. FERC*,¹ the proceedings of which were described in the Report of the Committee on International Energy Transactions in last Spring's Energy Law Journal.² The court sided with FERC on all issues and denied the petitions for review. In so ruling, the court analyzed the petitioners' challenges in three groups: (1) the Prudence Issue, (2) the As-Billed Issue, and (3) the Alaskan Pipeline Issue.

A. *The Prudence Issue*

Southwest Gas Corporation (Southwest) had argued that the Federal Energy Regulatory Commission (FERC or the Commission) should perform a prudence review of three letter agreements between its supplier, Northwest Pipeline Corporation (Northwest), and Northwest's supplier, Westcoast Transmission Company Limited (Westcoast). The FERC chose not to perform the reviews to avoid inconsistency with the Economic Regulatory Administration's (ERA) import authorization. The court summarized the issue as: "whether the FERC has jurisdiction to review gas import contracts for prudence after the ERA has approved the imports."³

In 1981 the ERA had authorized Northwest to import gas from Westcoast within certain price and volume limits.⁴ The three letter agreements from 1984, 1986, and 1987, altered the terms of the importation arrangement between Northwest and Westcoast, but the new prices and volumes did not exceed the limits specified in the 1981 import authorization. Although the ERA had issued only a general authorization, the FERC maintained that to reject a contract amendment would constitute a significant alteration of the authorized import arrangements.⁵ On rehearing, the FERC justified its refusal to perform a prudence review by explaining that the ERA's import authorization included a finding that the import was not inconsistent with the public interest and as such subsumed a finding of prudence.⁶ Southwest did not challenge that the FERC was precluded from exercising its authority inconsistently with the ERA; instead Southwest maintained that the FERC could consider the prudence of the contracts without creating an inconsistency with the ERA's import authorization.

The court dismissed Southwest's first claim that disallowing passthrough of imprudent costs to customers is not inconsistent with the approval of the

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1. *Pipelines Ltd. v. FERC*, 878 F.2d 401 (D.C. Cir. 1989) (hereinafter *Pipelines*).
 2. Report of the Comm. on Int'l Energy Transactions, 10 ENERGY L.J. 161 (1989).
 3. *Pipelines*, 878 F.2d at 406.
 4. See *Pacific Gas Transmission Co.*, 1 E.R.A. ¶70,528 at 72,140-41 (1981).
 5. *Northwest Pipeline Corp.*, 37 F.E.R.C. ¶61,255, at 61,646 (1986).
 6. *Northwest Pipeline Corp.*, 39 F.E.R.C. ¶61,215, at 61,751 (1987).

import agreements of suppliers. The court pointed out that to deny pass-through to certain costs "would require the FERC to review the prudence of the same terms that the ERA has already approved."⁷ In other words, the action Southwest urged the FERC to take could only occur if the FERC reached the conclusion that the contracts were imprudent, yet such a conclusion would plainly contradict the ERA's findings on the same purchases. The court agreed with the FERC that the ERA's determination that the overall import was not inconsistent with the public interest included a finding of prudence for any purchases within the specified limitations. This notion was further supported by an ERA decision which held that an import authorization necessarily subsumes a finding that the import is not imprudent.⁸

Southwest's second claim was that the ERA could not have found prudence in Northwest's purchasing practices because it did not consider whether gas could have been obtained for a lesser price. The court asserted that this was a policy disagreement between Southwest and the ERA. The DOE's 1984 guidelines⁹ provide the policy that allows the ERA to presume "that the terms are prudent if they are freely negotiated and flexible, unless this presumption is rebutted."¹⁰ The court then noted that it had already upheld the ERA's policies in a different context.¹¹ Ultimately, the court pointed out that the content of the ERA's prudence decision was not at issue in the case before it.

Next, Southwest argued that it was denied an opportunity to challenge the prudence finding because its first attempt before the ERA was sent to the FERC which declined to perform the review thereby leaving Southwest in a "regulatory limbo"¹². The court dismissed this challenge as a mischaracterization of the ERA's decision. The ERA had declared that the 1984 letter agreement was in the public interest.¹³ In denying Southwest's rehearing request to challenge the prudence of the letter agreement, the ERA stated that regulating the ratemaking implications of an import contract was under the FERC's authority but that the FERC was constrained to act consistently with the ERA's action in finding the letter agreement to be in the public interest.¹⁴ The court found the ERA's statement consistent with the FERC's decision not to conduct a prudence review and an ERA decision in another case which held that a determination that an import was not inconsistent with the public interest included a finding that such import was not imprudent.¹⁵

The court dismissed Southwest's final prudence challenges on the grounds that they were not properly before the court. Southwest contended

7. *Pipelines*, 878 F.2d at 407.

8. *EnTrade Corp.*, 1 E.R.A. ¶70,774, at 72,887 (1988).

9. New Policy Guidelines and Delegation Orders From Secretary of Energy to Economic Regulatory Admin. and Federal Energy Regulatory Comm'n Relating to the Regulation of Imported Natural Gas and Delegation Orders No. 0204-111 and No. 0204-112, 49 Fed. Reg. 6684 (1984) (1984 Guidelines).

10. *Pipelines*, 878 F.2d at 407-8.

11. *See Panhandle Producers and Royalty Owners Ass'n v. E.R.A.*, 822 F.2d 1105, 1113 (D.C. Cir. 1987).

12. *Pipelines*, 878 F.2d at 408.

13. *Northwest Pipeline Corp.*, 1 E.R.A. ¶70,604 at 72,428 (1985).

14. *Northwest Pipeline Corp.*, 1 E.R.A. ¶70,609 at 72,445 (1985).

15. *EnTrade Corporation*, 1 E.R.A. ¶70,774, at 72,887 (1988).

that the ERA's failure to review its prudency challenge violated the NGA. The court pointed out that Southwest's petition for review was not of the ERA decisions, but only of certain FERC decisions. Acknowledging a currently pending petition before the ERA challenging the prudence of the 1986 letter agreement, the court concluded: "if ERA's action on that petition is insufficient under the NGA, a petition for review of that decision would properly present the issue."¹⁶

B. *As-Billed Issue*

In *Natural Gas Pipeline Co. of America*,¹⁷ the FERC required Natural Gas Pipeline Company of America (Natural) to recover its costs of purchasing Canadian gas through a modified fixed-variable method of cost allocation instead of allowing as-billed passthrough of fixed costs through the demand charge and variable costs through the commodity charge. By imposing the modified fixed-variable method, Natural was required to shift some of the costs billed to it by its Canadian supplier as fixed costs to the commodity charge for the purpose of recovery.

The Commission determined that the reallocation was necessary because some of the costs included in the Canadian gas fixed charges were costs which, in the purchase and sale of domestic gas, would not be considered fixed; instead, these costs would be recoverable only through the commodity charge. If all of the Canadian fixed charges were allowed recovery through a demand charge, the FERC reasoned, the Canadian gas would have an unfair competitive advantage because certain costs would be guaranteed recovery that are not so guaranteed for domestic gas. The FERC subsequently applied this finding to other similarly situated pipelines¹⁸ who together with Natural constituted the aligned petitioners.

The court first considered whether the FERC had jurisdiction to consider the issue. Immediately, the court distinguished the decision of selecting the proper passthrough method for the costs of imported gas from the decision to conduct a prudency review of the same costs by pointing out that determining a method of passthrough does not require a reevaluation of the ERA approved import contracts. The court noted that the 1984 Guidelines allow the FERC to exercise jurisdiction over imported gas once it is in the domestic gas system "as long as [the] FERC acts consistently with [the] ERA."¹⁹

The aligned petitioners' first claim was that the FERC's reclassification of costs was inconsistent with the ERA's finding that the import would be competitive. The court disposed of this contention by noting the differences between the two findings but demonstrating them to be nonetheless compatible. The ERA's competitive finding simply held that there was a market for the Canadian gas. The FERC's finding was that allowing as-billed pass

16. *Pipelines*, 878 F.2d at 408.

17. *Natural Gas Pipeline Co.*, 37 F.E.R.C. ¶61,215 (1986) (Opinion 256), *reh'g denied*, 39 F.E.R.C. ¶61,218 (1987) (Opinion 256A).

18. The other pipelines were: Northwest, ANR Pipeline Co., Tennessee Gas Pipeline Co., and Texas Eastern Transmission Corp.

19. *Pipelines*, 878 F.2d at 409, (citing 1984 Guidelines).

through would give the Canadian gas a competitive advantage. The court concluded that the findings were not inconsistent because, "it is almost inevitable that there would be a market for gas that had a competitive advantage."²⁰

The aligned petitioners second claim was that there was an inconsistency between the ERA's action and the FERC's action because the ERA had approved the as-billed pass through provision in the import contracts. The court admitted that the ERA had originally so approved the as-billed pass-through provision²¹ but was ultimately swayed by the ERA's later clarification that its approval of the provision was subject to the FERC's authority to reclassify the costs and that the authority included the possible reclassification of fixed costs.²² The court further noted that it had upheld the FERC's reclassification of the costs of imported gas as not inconsistent with the ERA's import authorization in an analogous case.

The court had found in *Wisconsin Gas Co. v. FERC*²³ that the FERC's removal from the pipeline's minimum bills of certain pipeline payments to suppliers of imported natural gas was not inconsistent with the ERA's approval of the subject imports. The basis for this holding was that the FERC's action only involved the terms of contracts between pipelines and their customers, not the terms of the contracts between pipelines and their Canadian suppliers. The court concluded that since the reclassification of fixed costs through the modified fixed-variable allocation method only applies to the relationship between pipelines and customers, the rationale of *Wisconsin Gas* applies to the FERC's reallocation of certain fixed costs to the commodity charge.

Aligned petitioners next challenged the FERC for acting contrary to its own regulations. Specifically, at the time the FERC denied as-billed treatment to the Canadian gas, one of its regulations allowed for changes in the cost of gas between the supplier and the pipeline to be recovered on an as-billed basis.²⁴ The dispute between the aligned petitioners and the FERC centered on differing interpretations of this regulation. The FERC maintained that the regulation only applied to domestic gas and the aligned petitioners contended that in the past the FERC had applied it to all gas.

The court first noted that the regulation does not specify on its face whether it applies to either domestic gas, imported gas, or both. In examining the differing interpretations, the court committed itself to giving the FERC's interpretation a particularly high level of deference for two reasons. First, an agency's interpretation of its own regulation is entitled to "controlling weight unless it is plainly erroneous or inconsistent with the regulation."²⁵ Second, "deference is particularly required when the agency construction rests on mat-

20. *Pipelines*, 878 F.2d at 410.

21. See *Northwest* 1 E.R.A. ¶70,609, at 72,445 (1985).

22. *Natural Gas Pipeline Co. of Am.*, 1 E.R.A. ¶70,645 at 72,533 (1986).

23. *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986).

24. 18 C.F.R. § 154.38(d)(4)(ii)(1986).

25. *Pipelines*, 878 F.2d at 411, citing, *Udall v. Tallman*, 380 U.S. 1, 16 (1965).

ters peculiarly within the agency's field of expertise."²⁶

The FERC justified its interpretation by pointing out that any changes in cost of domestic gas were subject to the FERC's approval at the time of the change. Therefore, the purpose of the as-billed treatment of the regulation was merely to allow the FERC to make an upstream rate change without entailing a regulatory action further downstream that could distort and interfere with the initial action. On the other hand, any change in the cost of imported gas was not approved by the FERC. Consequently, there is not the need to allow the changes to passthrough as-billed. In fact, the opposite is true. If the FERC had intended to allow as-billed treatment for imported gas, all ability to regulate that gas would be lost.

Petitioners claimed that before Opinions 256 and 256A, the regulation was applied to all types of gas. The court dismissed this challenge by noting that the cases petitioners cited, though allowing as-billed treatment to changes in the costs of imported gas, were not based on the regulation in question.²⁷ The court pointed out that in other cases which did involve the regulation, the FERC had offered the same reasons behind its interpretation of the regulation for allowing as-billed treatment only to domestic gas.²⁸ The court ultimately deferred to the FERC's interpretation because it was not clearly erroneous nor inconsistent with the text of the regulation.

The next group of challenges attacked the FERC's reasoning in support of the modified fixed-variable method of cost allocation. First, the aligned petitioners stated that the FERC's claim that the reallocation creates a level playing field, is irrational because Canadian gas that is imported by local distribution companies and brokers is outside the FERC's jurisdiction. The court discards this argument by emphatically rejecting petitioners' apparent contention that "whenever an agency's jurisdiction is not plenary, it is powerless to act."²⁹ The court concluded that the FERC's use of whatever power it had, whether limited or not, to reduce regulatory distortion did not constitute an irrational action.

Second, aligned petitioners alleged that the FERC's decision to impose a level playing field is inconsistent with earlier decisions where it could have imposed a level playing field but, did not.³⁰ The court dismissed this challenge because in both cases the aligned petitioners cited, the Commission ultimately applied the modified fixed-variable allocation method to the imported gas in question. The only difference in the cited cases was that the FERC did not apply the cost reclassification to the imported gas at its first opportunity; instead, it performed the reclassification further downstream. The point at which the FERC chose to reclassify the costs did not affect the ultimate result

26. *Id.*, (citing *Stuart-James Co. v. SEC*, 857 F.2d 796, 800 (D.C. Cir. 1988), *cert. denied*, — U.S. —, 109 S. Ct. 2448 (1989)).

27. *See e.g.*, *Midwestern Gas Transmission Co.*, 31 F.E.R.C. ¶61,309 (1985); *Inter-City Minn. Pipelines, Ltd.*, 31 F.E.R.C. ¶61,238 (1985).

28. *Northwest Alaskan Pipeline Co.*, 11 F.E.R.C. ¶61,088 at 61,182 (1980).

29. *Pipelines*, 878 F.2d at 412.

30. *See Boundary Gas, Inc.*, 40 F.E.R.C. ¶61,047, at 61,146, *reh'g denied*, 40 F.E.R.C. ¶61,302 (1987); *Great Lakes Gas Transmission Co.*, 41 F.E.R.C. ¶61,292 (1987).

of the action. Consequently, the court concluded that choosing to reclassify the costs slightly further downstream in some cases than in other cases, did not present an irrational inconsistency on the FERC's part.

Third, aligned petitioners argued that the FERC's reasoning was arbitrary because the allocation of costs of domestic gas is irrelevant to the allocation of costs for imported gas. The court pointed out that although the policy reasons for requiring domestic producers to face risk for the recovery of certain costs are not applicable to the Canadian producers; the purpose of subjecting Canadian gas to the reclassification was to avoid giving Canadian gas a competitive advantage over domestic gas and not to affect the Canadian producers.

Fourth, aligned petitioners argued that the FERC's reasoning was unsupported by evidence and rested only on economic theory. The court first defeated the claim that agency decisions cannot rest solely on economic theory by demonstrating that the case aligned petitioners cited did not hold that economic theory was insufficient support for agency action.³¹ The court stated that the case merely held that the FERC was in error when it based its action on a theory that it had not used.³² The theory on which the FERC relied, "that different cost allocation methods would affect the relative competitive positions of imported and domestic gas"³³ had been used in the aligned petitioners' cases, and it was a theory the court had earlier approved.³⁴

As to the sufficiency of the evidence on the record, the Court pointed out that petitioners did not challenge the assertions on which the FERC's theory relied. The only evidence the petitioners supplied was evidence of Natural's reduced Canadian gas purchases, which the FERC acknowledged but discarded as irrelevant. The court agreed that such evidence did not contradict the theory that as-billed treatment would give the Canadian gas a competitive advantage.

Finally, aligned petitioners claimed that the application of the policy of Opinions 256 and 256A to the other pipelines was arbitrary and capricious. The court, however, noted that the FERC is permitted to apply an analysis used in one case to other cases that do not contain any relevant factual differences.³⁵ In the case of the aligned petitioners, the FERC found no relevant differences, and the pipelines did not suggest there were any differences.

C. *Alaskan Pipeline Issue*

The final challenge to the modified fixed-variable treatment of Canadian gas was mounted by ProGas Limited. It claimed that Alaskan Natural Gas Transportation System (ANGTS) pipelines are specially entitled to as-billed passthrough and denial of as-billed passthrough to the costs Natural pays ProGas constitutes unlawful discrimination. The FERC acknowledged that the costs associated with gas volumes that are essential to the financing of the

31. *Electricity Consumers Resource Council v. FERC*, 747 F.2d 1511 (D.C. Cir. 1984).

32. *Pipelines*, 878 F.2d at 413.

33. *Id.*

34. *See East Tenn. Natural Gas Co. v. FERC*, 863 F.2d 932, 939 (D.C. Cir. 1988).

35. *See Kansas Gas & Electric Co. v. FERC*, 758 F.2d 713, 721-22 (D.C. Cir. 1985).

ANGTS pre-built facilities are entitled to "as-billed" passthrough. The costs which ProGas complained were unfairly denied treatment, however, were found by the FERC not to be directly tied to the ANGTS financing. The court held that the FERC was reasonable in distinguishing the revenue of the ProGas volumes from the revenue associated with volumes on which ANGTS financing relied. Finally, the court held that the FERC was neither arbitrary nor unreasonably discriminatory in applying the ANGTS exception narrowly to only the revenue stream that was essential to the project's financing.

I. FERC DECISION IN *NORTHWEST PIPELINE CORPORATION*

Recently, the FERC revisited the issue of whether, and under what circumstances, rate changes may be ordered for services rendered through facilities approved as part of the ANGTS. The Commission's order, issued in the context of a rate case settlement filed by Northwest Pipeline Corporation, generally reaffirmed the special protections historically recognized for ANGTS-related rate and tariff structures, but stopped short of providing complete immunization for possible future rate modifications.³⁶ In addition, the Commission separately considered the scope of its Natural Gas Act jurisdiction over gas processing facilities, finding (over the dissenting opinion of Commissioner Trabandt) that ample authority existed to require Northwest to submit, for Commission approval, rate schedules governing gas processing services. Requests for rehearing of the order are currently pending.

A. *Description of Settlement*

By order issued October 19, 1989,³⁷ the Commission approved a modified offer of settlement filed by Northwest Pipeline Corporation (Northwest) resolving cost-of-service and other non-rate design issues in Northwest's general Section 4 rate proceeding. The modified settlement, approved over the protests of Pacific Interstate Transmission Corporation (PITCO) and Pan-Alberta Gas Limited (Pan Alberta), reflected, *inter alia*, modified fixed-variable rate design; compromise levels for representative transportation and sale volumes; rates for interruptible open-cross transportation service based on 100% load factor; refunctionalization of \$53 million in gathering facility costs to transmission; elimination of Northwest's Rate Schedule PL-1 minimum commodity bill as of October 1, 1988; and modification of depreciation rates. It also established a discounted "bench-mark" rate of 20.33¢ per MMBtu in order to define the value of transportation rate discounts made by Northwest as non-cash consideration in the context of Order No. 500 take-or-pay settlements. Further, the derivation of rates and refunds was based on a total non-gas cost-of-service of \$192,722,927 for the period July 3, 1988 through September 30, 1988 and \$201,687,853 for the period commencing October 1, 1988.³⁸

36. Northwest Pipeline Corp., 49 F.E.R.C. ¶61,072 (1989).

37. *Id.*

38. Specifically excluded from the filed settlement (and left for future consideration in "Phase II" of the docketed proceeding) was resolution of issues arising by virtue of the Commission's Rate Design Policy

Of particular note, the modified settlement also proposed changes to Rate Schedule T-1, pursuant to which Northwest provides transportation service for PITCO. As proposed, the modified settlement would eliminate the crediting requirement for Rate Schedule T-1 commodity revenues (heretofore applied as an offset to Account No. 191) and provide instead for the derivation of settlement rates that reflect the T-1 commodity revenues. Further, the settlement proposed to treat "best efforts" service under Rate Schedule T-1 as interruptible service, resulting in an increase in the T-1 "best efforts" commodity rate from 50% of Northwest's interruptible T-1 transportation rate to 100% of that rate, subject to discretionary discounting by Northwest. A 13% equity return was proposed for purposes of establishing the incremental, cost-of-service based facility charges under Rate Schedule T-1.

B. Intervenor Positions Regarding Modified Settlement

The proposed modified settlement was supported by all but two active parties. Moreover, the two opposing parties, PITCO and Pan Alberta, filed comments challenging only the proposed change in rate for best efforts transportation under Northwest's Rate Schedule T-1. Comments concerning whether the Commission's jurisdiction extended to processing services rendered by Northwest were divided. Both the FERC Staff and the Northwest Independent Producer Group filed comments asserting that the Commission has jurisdiction and that rate schedules for gas processing services must be filed. In contrast, Northwest, Enron Oil and Gas Company, and Washington Natural Gas Company advanced arguments challenging the FERC's jurisdiction and opposing any rate schedule filing requirement.

C. Resolution of Issues Presented in Modified Settlement

The Commission's order approving the modified settlement, with condition, focused almost exclusively on the Rate Schedule T-1 issue and the gas processing plant issue. The Commission's treatment of these issues is described below.

1. Rate Schedule T-1 Issues

a. Background of T-1 Facilities and Services

The volumes transported by Northwest under Rate Schedule T-1 consist of supplies purchased by Northwest Alaskan Pipeline Company (from Pan Alberta) and resold to PITCO under certificates issued by the FERC in connection with the 1980 "prebuilding" of the ANGTS.³⁹ By way of the so-called

Statement, issued May 30, 1989. See Interstate Natural Gas Pipeline Rate Design, 47 F.E.R.C. ¶61,295 (1989). By the terms of the settlement, any rate changes attributable to the Phase II consideration of Policy Statement issues are to be prospective from the date of any subsequent final Commission order concerning disposition of such issues. Lastly, the issue of whether Northwest should be required to file rate schedules governing processing services was reserved for Commission determination pending consideration of the comments to the settlement. This latter issue was decided by the Commission in the order discussed herein.

39. See Northwest Alaskan Pipeline Co., 10 F.E.R.C. ¶61,032 (1980), amended, 24 F.E.R.C. ¶61,037 (1983), amended, 24 F.E.R.C. ¶61,038 (1983) modified, 45 F.E.R.C. ¶ 61,133 (1988). See also, Northwest

“Western Delivery System” (consisting of, in addition to the Northwest facilities, facilities owned by Pacific Gas Transmission Company, El Paso Natural Gas Company, and PITCO) volumes purchased by PITCO from Northwest Alaskan are transported from a delivery point near Kingsgate, British Columbia to markets in Southern California. The Western Delivery System constitutes the “prebuild” section of the “Western Leg” of ANGTS. Transportation service rendered on behalf of PITCO through the segment of the Western Delivery System involving facilities of Northwest is governed by Rate Schedule T-1.

Historically, Northwest’s T-1 rate has been calculated on an incremental cost basis as opposed to a “rolled-in” methodology. In effect, a separate cost-of-service is calculated based on the incremental facilities used in the rendition of Rate Schedule T-1 service for PITCO.

Pursuant to procedures adopted by the presiding administrative law judge, only issues concerning the level of the interruptible T-1 rate would be considered in Phase I, the Phase covered by the proposed settlement. In accord with a request lodged by intervenor Fina Chemical and Oil Company, the Administrative Law Judge (ALJ) ruled that the broader allocation and rate design issues of Rate Schedule T-1 would be reserved for Phase II.⁴⁰

b. “ANGTS-Related” Arguments Respecting Rate Schedule T-1

In their challenges to the proposed settlement, PITCO and Pan Alberta argued that the Commission was without authority to modify the Rate Schedule T-1 interruptible rate. They argued that the sanctity of the T-1 rate levels and rate design was relied upon by lenders as a condition to financing the ANGTS. To order either rate or rate design modifications in the face of such lender reliance would, PITCO argued, undermine the protections intended by Congress in enacting the Alaska Natural Gas Transportation Act (ANGTA).⁴¹

In defending its proposed T-1 rate change, Northwest challenged the asserted applicability of ANGTA, and noted that the cost of the interruptible portion of the T-1 rate had heretofore not been considered ANGTS-related. Moreover, according to Northwest, the existing interruptible T-1 rate is half the rate paid by other shippers for identical services through the same facilities and, as such, is unduly discriminatory.⁴²

In considering the arguments raised concerning the T-1 rate change, the

Alaskan Pipeline Co., 11 F.E.R.C. ¶61,279, at 61,551-554 (1980), *modified*, 45 F.E.R.C. ¶61,133 (1988), *amended*, 24 F.E.R.C. ¶61,037 (1983); *amended*, 24 F.E.R.C. ¶61,038 (1983).

40. In this regard, the bifurcation of T-1 issues—and, in particular, the deferral of rate design issues—left relatively little to be resolved in Phase I. Undoubtedly, the ANGTS-related arguments will be reasserted in connection with any Phase II consideration of possible modification of the T-1 rate design.

41. 15 U.S.C. §§ 719-719(o) (1988).

42. Comments filed by the Commission Staff and Fina urged rejection of the entire T-1 rate as unduly discriminatory. As noted, only the level of the interruptible T-1 rate was deemed cognizable in Phase I.

Commission first addressed the "threshold question" of whether the rates at issue are governed by the ANGTA. The Commission's affirmative answer, that ". . . clearly . . . the facilities and the rates . . . are governed by the ANGTA",⁴³ was based on prior Commission determinations. It was specifically based on the 1980 finding that the incremental facilities constructed by Northwest, and through which T-1 service is rendered, represented part of the western leg of the international ANGTS project.

The Commission next considered the specific question of whether the so-called ANGTA-rate assurances applied to the entire 300,000 MMBtu of certificated T-1 service, or only to that portion, 240,000 MMBtu, which represented firm service. Again, relying principally on findings and pronouncements in earlier orders, the Commission concluded that ". . . ANGTA and any related assurances that apply to the 240,000 MMBtu per day firm service apply also to the 60,000 MMBtu per day interruptible portion of Rate Schedule T-1."⁴⁴

These ANGTS-related findings served as the analytical predicate for resolving the ultimate issue: to what extent was the Commission empowered to order changes to the rates established under Rate Schedule T-1. As the Commission observed, this issue posed ramifications not only for Northwest's proposed changes to the interruptible T-1 rate, but also for the broader challenges to the entire T-1 Rate Schedule, including challenges to rate design and cost allocation, which were deferred for Phase II.

According to the Commission, its prior ANGTS-related findings required some regulatory deference to the T-1 rate, but did not preclude modifications ". . . as long as [such] modification[s] do[] not impair the guaranteed recovery of ANGTS related financing." In the Commission's view, its prior ANGTS rate assurances extended only so far as to proscribe actions that would impair the revenue stream associated with debt service and coverage of current expenses. Moreover, the Commission claimed that nothing in its prior orders indicated any intention to immunize all aspects of the T-1 Rate Schedule from future modification.

Notwithstanding these findings, the Commission recognized that its ANGTS-related rate-settling authority may be exercised only following careful consideration of "the need to protect the revenue stream and [with due recognition] that ANGTS matters touch a program in which Canada is an equal partner and that the interests of Canadian as well as domestic citizens are involved."⁴⁵ According to the Commission, the "special status" of ANGTS-related rates requires that any changes be made on a record that fully considers the potential financial and commercial impact on both sides of the international border.

43. Northwest Pipeline Corp., 49 F.E.R.C. ¶61,072 at 61,306 (1989).

44. *Id.* at 61,306.

45. *Id.*

Having established the general parameters with in which its ANGTS-related rate review must proceed, the Commission turned to the record developed on the proposed interruptible T-1 rate change. This record, according to the Commission, contained deficiencies on the potential impact of raising the interruptible portion of Rate Schedule T-1. Nonetheless, the Commission noted that its own analysis, albeit undertaken in the context of a "somewhat deficient" record, indicated that the proposed increase in the interruptible portion of Rate Schedule T-1 would not be likely to have an adverse effect on Northwest's ANGTS-related financing.⁴⁶ The Commission found insufficient information, however, to determine whether, and to what extent, an increase in the interruptible T-1 rate might result in adverse financial and commercial consequences. In the Commission's view, this record deficiency precluded approval of that portion of the settlement proposing an increase in the interruptible T-1 rate. Reiterating the need for a more complete factual record, the Commission modified the proposed settlement to defer the issue of the T-1 interruptible rate. The Commission directed the ALJ to sever such issue from all other issues in Phase II and proceed to a decision at the earliest possible date.⁴⁷

2. Issues Relating to Jurisdiction Over Gas Processing Services

Pursuant to the terms of the modified settlement (Article XVIV) and the procedures adopted by the presiding ALJ, comments were filed by active parties on the issue of whether Northwest's gas processing services were subject to regulation by the Commission. At issue was the jurisdictional status of four natural gas treating and products extraction plants owned and operated by Northwest for the purpose of removing impurities and otherwise conditioning and treating the gas. Three of the four plants were never presented to the Commission for possible certificate review under Section 7(c) of the Natural Gas Act. The fourth, the Ignacio plant, was originally constructed pursuant to a Section 7(c) certificate for which Northwest later filed, and received, Section 7(b) abandonment authority relative to the plant, conditioned on future rate review of the Ignacio plant's costs and revenues.

Parties urging the Commission to take jurisdiction over the processing plants, including Commission Staff (Staff), did so with the objective of forcing Northwest to place on file, as part of its FERC tariff, Commission-approved

46. According to the Commission, its own analysis of the facilities charge reflected in Rate Schedule T-1 (*i.e.* the fixed monthly charge which, in form and substance, operates like a demand charge) may be sufficient for purposes of insuring debt service coverage for the incremental facilities Northwest constructed as its portion of the Western Delivery System. Under such analysis, any adjustment to the interruptible portion of Rate Schedule T-1 (pursuant to which PITCO pays a one part commodity rate and no monthly fixed facility charge) would, in the Commission's view, have no likely impact on debt financing, the underlying revenue stream of which is dependent on revenues derived from firm and not interruptible rates.

47. Finally, the Commission rejected Northwest's settlement proposal which would have permitted discounting of the interruptible T-1 rate, after raising it (as proposed) to the same level as other interruptible transportation rates. The Commission noted that since the T-1 rate was established by an individual Section 7(c) certificate, rather than a Part 284 transportation blanket certificate, the discounting proposal must be eliminated.

rate schedules governing the terms and conditions applicable to gas processing services. Asserting the potential for a regulatory gap in the absence of a Commission finding of jurisdiction, the Staff urged that the Commission invoke its authority under Section 4 and 5 of the Natural Gas Act for the purpose of regulating the rates charged by Northwest for the rendition of gas processing services.⁴⁸

Northwest's arguments to avoid the Commission's jurisdiction relied principally on the Commission's failure to require Section 7(c) certificate authorization for the plants and, in particular, the Commission's 1984 order granting abandonment of the Ignacio plant. In addition, Northwest argued that the plain language of Sections 4(c) and 1(b) of the Natural Gas Act places processing activities beyond the jurisdictional reach of the Commission, inasmuch as such sections apply only to the transportation or sale of natural gas in interstate commerce. Northwest's arguments relied upon Commission and court precedent generally supporting the proposition that processing facilities, and services rendered thereby, may escape Natural Gas Act regulation, at least under certain circumstances.⁴⁹ Finally, Northwest argued that any requirement that it post processing rates would give unregulated competitors an unfair competitive advantage.

The Staff offered a different interpretation of the cases cited by Northwest. According to the Staff, the cases relied upon by Northwest, beginning with *FPC v. Detroit*, recognize the Commission's statutory authority to regulate processing plants and services and, contrary to Northwest's contention, do little more than affirm that such statutory authority may be exercised at the Commission's discretion depending on the facts and circumstances of the individual cases. The operative test, in the Staff's view, is simply whether the processing at issue is incident to the transportation of gas in interstate commerce, regardless of whether it enhances or detracts from the marketability or value of the gas.

Ultimately, however, the Commission's assertion of jurisdiction turned not on subtle interpretive distinctions of Commission and court precedent, but rather ". . . on whether a regulatory gap could arise with respect to rates and services that would have the potential for obstructing access to open access transportation."⁵⁰ Finding its rate and certificate jurisdiction not to be coextensive, the Commission referred to its recent decision in *Northern Natural Gas Co.*⁵¹ where jurisdiction under Sections 4 and 5 of the Natural Gas Act was invoked with respect to gathering services without any precedent finding that the facilities and services at issue fell within the Commission's certificate jurisdiction under Section 7. According to the rationale of *Northern Natural*,

48. Historically, Northwest had reflected as part of its overall cost-of-service, the costs associated with the four non-certificated processing plants. Representative levels of liquid revenue credits were projected for purposes of offsetting these plant costs.

49. The cited cases include *Phillips Petroleum Co.*, 24 F.P.C. 537 (1960); *Texas E. Transmission Corp.*, 43 F.E.R.C. ¶61,044 (1988); *Mid-America Pipeline Co. v. FPC*, 330 F.2d 226 (D.C. Cir. 1964); and *FPC v. Detroit*, 230 F.2d 810 (D.C. Cir. 1955), *cert. denied sum nom Panhandle Eastern Pipeline Co. v. Detroit*, 352 U.S. 829 (1956).

50. *Northwest*, 49 F.E.R.C. at 61,310.

51. *Northern Natural Gas Co.*, 43 F.E.R.C. ¶61,473, *reh'g denied*, 44 F.E.R.C. ¶61,384 (1984).

where excessive rates for non-jurisdictional services (be they gathering or processing) operate, or have the potential to operate, as a barrier to open access transportation and to impediment to more direct price competition, the Commission is empowered to invoke its rate setting authority independent from (and irrespective of) any jurisdictional determination under Section 7.

Sounding the regulatory gap theme, the Commission concluded that, with respect to the facts before it: (i) the processing services rendered by Northwest are "incident" to the transportation and sale of gas in interstate commerce; (ii) absent regulation, Northwest would be positioned to unduly discriminate in favor of its own gas, or among producers, through the use of unregulated rates for processing services, thereby creating a barrier to access to its system; (iii) the potential for rate and service discrimination poses a regulatory gap requiring Commission invocation of Natural Gas Act authority under Sections 4 and 5; (iv) for purposes of implementing and enforcing its Section 4 and 5 authority, no prerequisite finding is required under Section 7 of the Natural Gas Act; and (v) Northwest will be required to file rate schedules reflecting the terms and conditions upon which its gas processing services will be rendered.

III. NATIONAL ENERGY BOARD OF CANADA— RECENT EXPORT DEVELOPMENTS

With the implementation of the Free Trade Agreement (FTA) in Canada and the United States one might have expected that the risk of an export application being rejected by the National Energy Board (Board) would be *de minimis*. This conclusion would seem stronger in light of earlier Board decisions following ratification of Canada's Federal/Provincial Deregulation Agreement,⁵² since the FTA arguably changed little of substance in the existing scheme of export regulation. To the contrary, the Board's export decisions over the past year have been of concern because of the extent and nature of the new restrictions they have placed on bilateral gas trade.

In 1989, following implementation of the FTA, the National Energy Board either denied or imposed restrictive conditions upon six export applications. The underlying rationale for these denials or restrictions included three issues: first, failure to pass the benefit/cost tests; second, relatively unattractive pricing terms, and third, inadequate demonstration of gas supply.

A. *Benefit/Cost Tests*

The principal rationale for imposing new restrictions was change in the Board's benefit/cost methodology. Benefit/cost is a test which the Board employs as part of its public interest determination for export licenses. In essence, the test requires that revenues received from an export sale must recover all incremental costs incurred. This equation includes social costs as well as the traditionally recognized private costs (pipeline gathering and processing facilities, for example). The principal element of the social costs analysis is "user cost." User cost is a concept which attempts to quantify the

52. Agreement on Natural Gas Markets and Price (Oct. 31, 1985).

increased cost of developing more expensive gas reserves to meet existing domestic and export demands sooner than would be the case in the absence of the proposed exports. This test is not applied to sales in the Canadian domestic market which do not require new facilities because Canadian sales are not subject to the Board's regulation. The Board's decision in Amoco's export to Washington Natural⁵³ greatly increased the user cost component because it required that applicants must assume that a higher level of exports will take place in the future than has previously been the case. Thus, rather than consider evergreened exports, a forecast of actual exports is required.

B. Pricing Terms

In the Vector/Altresco decision, the Board based its denial, in part, upon "relatively unattractive pricing terms in the gas sales contract."⁵⁴ A minor variation on this theme was seen in the Board's reliance upon the inflexibility of contract terms and conditions, particularly price, in the Western Gas/Niagara Mohawk, Shell/Cogeneration Energy Technology Inc., Direct Energy/Consolidated, Indeck/Oswego and Yerkes export applications (Applicants).⁵⁵ In all of these cases it appears the Board was not satisfied that the gas to be exported was receiving its full opportunity value.

The Board's concept of full opportunity or market value would appear to envisage price escalators which are based on other long-term firm gas supplies in the particular market. This conclusion was reached despite the fact that the price indices in virtually all of these contracts tracked the changing market conditions which applied to the specific buyer.⁵⁶ In the cogeneration market this would obviously include commodities other than gas. In practical terms, therefore, the Board concluded that the pricing terms were unattractive.⁵⁷

C. Gas Supply

The Board modified the gas supply estimates provided by the Applicants. It reduced the Western Gas reserves by 28%, the Direct Energy reserves by 32%, the Shell reserves by 20%, the Indeck (Alberta) reserves by 25% and the ProGas reserves by 10%. Ironically, it found that Amoco's forecast of reserves was 18% less than its own forecast. In the Vector/Altresco case,⁵⁸ the Board based its denial, in part, on inadequate gas supply. This also proved to be the fate of the Direct Energy/Consolidated sale.⁵⁹ Despite its lower estimate of reserves, the Board concluded that in some cases there would be sufficient gas to supply the export while in another it decided to shorten the term of the license applied for rather than issuing an outright denial of the

53. Docket No. GH-3-89.

54. Docket No. GH-8-88 at p. 27.

55. Docket No. GH-1-89.

56. *Id.*

57. *Id.* For Direct Energy, see p. 76; for Shell/CETI, see p. 52; and for Western Gas/Niagara Mohawk, see p. 68.

58. Docket No. GH-8-88.

59. See Docket GH-1-89.

application.⁶⁰

D. Appeals

In view of these developments, it was not surprising that a flurry of appeals were launched in Canada's Federal Court to challenge the denial of these export applications. The first was filed by Midland Cogeneration Joint Venture (MCV) following the GH-8-88 Decision. The appeal relied, *inter alia*, upon an alleged breach of the provisions of the free trade agreement. The FTA had been incorporated into the text of the National Energy Board Act's export licensing provisions by the *Canada-United States Free Trade Implementation Act*,⁶¹ thus creating an error of law or jurisdiction. This innovative approach, if upheld, would create private avenues of address for infringements of the FTA which are not expressly provided for in the agreement itself. Appeals were also filed by Western Gas, Niagara Mohawk, Shell, and Indeck following the export denials issued in the subsequent GH-1-89 proceeding. Arguments have not yet been presented to the courts in these cases.

E. Review of Benefit/Cost

In the interim, the Board has decided to review the continued appropriateness of its benefit/cost methodology in the context of export applications.⁶² This new written hearing was convened in response to the strong criticism of its earlier decisions launched from all sectors of the producing industry. While the producing sector is optimistic that the Board might relax the restrictive assumptions used in the benefit/cost tests for export licensing purposes, it is by no means clear that the Board will relax the same tests which are also applied in connection with the economic feasibility assessment of the proposed TransCanada PipeLine Limited pipeline expansion.⁶³ It may be necessary to convene a separate review of the economic feasibility tests for facilities in the context of the upcoming GH-5-89 proceeding. In Canada, virtually all export pipeline systems are at capacity necessitating major facilities additions in order to transport incremental exports (e.g., TransCanada PipeLine Limited's 1991/92 Facilities Application). This hearing will consider the facilities necessary to transport the exports which are designed to utilize the Iroquois Gas Transmission System for consumption in major new markets in New England, New York, and New Jersey.

F. Conclusion

The first year of export licensing under the Free Trade Agreement has been tumultuous. As the Board continues to struggle with its role as an export regulator under the FTA and deregulation, regulatory policy has become something of a moving target. Clarification of this role over the upcoming

60. Docket No. GH-8-88 POCO Petroleums/Consumers Power and Midland Cogeneration Joint Venture Ltd Partnership (MCV).

61. Canada United States Free Trade Implementation Act, S.C. 1988, c.65 (P.C. 1988-2863).

62. Hearing Order GHW-4-89.

63. See Reasons for Decision, GH-1-89, Vol. 2, Ch. 19.

year will be instructive to current and prospective purchasers of Canadian gas as all industry participants seek to understand the full impact of the new rules.

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