

TRADE IN NATURAL GAS: THE CHANGING REGULATORY FRAMEWORK

ROBERT C. PLATT*

SYNOPSIS

Natural gas trade between the United States and Canada is growing at a time when both countries are shifting from direct regulation of utilities to an increased reliance on market forces. Recent decisions by United States courts, the Federal Energy Regulatory Commission (FERC or the "Commission"), and the Economic Regulatory Administration (ERA) have attempted to create a level playing field between domestic and imported natural gas. In addition, the United States-Canada Free-Trade Agreement will affect future natural gas trade between the two nations.

1. INTRODUCTION

The natural gas industry is one of the most highly regulated industries in both the United States and Canada. Each nation has taken its own approach to regulating both the commodity itself and the utilities that handle it. However, both nations are moving toward substituting competitive forces for direct regulation. Also, the natural gas trade between the United States and Canada has become enmeshed in the broader bilateral negotiations and implementation of the United States-Canada Free Trade Agreement.¹ These changes in the natural gas industry have resulted in a number of unfair trade claims. Hence, the natural gas industry may be the setting for an important first test of the viability of the Free Trade Agreement.

The United States has grown increasingly dependent on Canadian

* Associate, Ginsburg, Feldman & Bress, Washington, D.C.; J.D. 1976, B.A. 1973, Cornell University. Robert C. Platt has served as Assistant Advisory Counsel to the Federal Energy Regulatory Commission (FERC). He represents the interests of domestic natural gas producers before FERC, the Economic Regulatory Administration (ERA) and the courts.

¹ The Free-Trade Agreement is not officially published as a treaty. The official text was printed as an appendix to H.R. Doc. No. 216, 100th Cong., 2d Sess. (1988) (containing the United States-Canada Free-Trade Agreement, the Proposed U.S.-Canada Free-Trade Agreement Implementation Act of 1988, and a Statement of Administrative Action). The Agreement has been unofficially reprinted as The United States-Canada Free-Trade Agreement, *done* Dec. 22, 1987-Jan. 2, 1988, 27 I.L.M. 281 [hereinafter FTA].

gas imports. In 1968, for example, the United States imported only 652 Bcf. This volume grew to 1,283 Bcf in 1988.

Unlike unregulated commodities that sell at a stated price, natural gas is frequently sold under contracts that specify two separate rates. A commodity charge represents the price per unit of natural gas sold during a period of time. In addition, a demand charge is assessed each month for the right to purchase a specified maximum quantity of gas. As a result of this pricing structure in such a heavily regulated industry, it is possible for imported natural gas to be competitive, through regulatory benefits, even if the commodity is more expensive on a unit price basis than available domestic supplies. In view of this regulatory context, trade concepts such as "dumping" must be reexamined.

2. STATUTORY FRAMEWORK: TYPES OF AUTHORIZATIONS

2.1. Section 3 of the Natural Gas Act

Section 3 of the Natural Gas Act² is the primary statutory authority for regulation of both the movement of gas across the United States border and the sale of gas over the border. Section 3 requires prior government approval for all imports or exports of natural gas.³ The natural gas industry thus enjoys legislation that would be the envy of the most protectionist advocate of any other industry.

2.1.1. Public Interest Test

Section 3 prescribes a "public interest" standard.⁴ That standard has recently been transformed. Traditionally, the public interest test was viewed as substantially equivalent to the "public convenience and necessity" standard prescribed by Section 7 of the Natural Gas Act.⁵ The test traditionally required an examination of the border price, the need for gas, the security of supply, the effect on the U.S. balance of payments, the effect on domestic supplies, and other factors.⁶ Antitrust policy was also a consideration in applying the public interest test.⁷

More recently, the public interest test has been redefined to focus

² 15 U.S.C. § 717 (1988) (originally enacted as Act of June 21, 1938, ch. 556, § 3, 52 Stat. 822).

³ 15 U.S.C. § 717b (1988).

⁴ *Id.*

⁵ 15 U.S.C. § 717f (1988). See *Distrigas Corp. v. FPC*, 495 F.2d 1057, 1065 (D.C. Cir. 1974), *cert. denied*, 419 U.S. 834 (1974) (judicial legitimation of the traditional view).

⁶ *West Virginia Pub. Serv. Comm'n v. Dep't of Energy*, 681 F.2d 847, 851 (D.C. Cir. 1982).

⁷ *California Gas Producers Ass'n v. FPC*, 421 F.2d 422, 428 (9th Cir. 1970).

on the existence of "competition" without consideration of specific prices, contract terms, balance of payments, or effect on domestic supplies.⁸

2.1.2. *Entities Holding Authorizations*

Section 3 is drafted to require that a specific "person" hold authorization and, traditionally, this was the person taking title to the imported gas at the border.⁹ More recently, the Economic Regulatory Administration has permitted agents of undisclosed principals to hold the Section 3 authorizations without the agents ever taking title to the imported gas.¹⁰

2.1.3. *Agency Action*

The ERA may either grant, deny, or impose conditions on any application for authorization. In addition, Section 3 confers on the ERA the right to impose additional conditions at any time "after opportunity for hearing."¹¹ However, recent cases hold that a trial-type hearing "is required only when it would tend to enhance the accuracy of the decision making; that is, only for determinations of adjudicative facts."¹²

2.2. *Executive Order No. 8202*¹³

Executive Order No. 8202, as amended,¹⁴ requires a presidential permit to construct and operate natural gas border facilities. The Federal Energy Regulatory Commission is authorized to issue permits after consultation with the Secretary of State and the Secretary of Defense.¹⁵

2.3. *Sections 4, 5, and 7 of the Natural Gas Act*

Sections 4, 5, and 7 of the Natural Gas Act provide for the regulation of all gas movement from the border and into the United States, as

⁸ See *infra* Part 3.

⁹ See 18 C.F.R. §§ 153.1, 153.6(a) (1989).

¹⁰ ANR Pipeline Co., 1 E.R.A. ¶ 70,748, at 72,818 (1988).

¹¹ 15 U.S.C. § 717b (1988).

¹² New England Fuel Inst. v. ERA, 875 F.2d 882, 886 (D.C. Cir. 1989); Independent Petroleum Ass'n of Am. v. ERA, 870 F.2d 168, 173 (5th Cir. 1989); Panhandle Producers & Royalty Owners v. ERA, 847 F.2d 1168, 1178 (5th Cir. 1988).

¹³ Exec. Order No. 8202, 3 C.F.R. 560 (1938-1943), *superseded by* Exec. Order No. 12038, 3 C.F.R. 136 (1979), Exec. Order No. 10485, 3 C.F.R. 66 (1974).

¹⁴ *Id.*

¹⁵ See 18 C.F.R. §§ 153.10-.12 (1989) (application procedures). See also Exec. Orders Nos. 12038, 10485, *supra* note 13.

well as of sales for resale in interstate commerce.¹⁶ The Natural Gas Act defines interstate commerce to exclude foreign commerce.¹⁷ Hence, subsequent movement of gas from the international border is not within the jurisdiction of the Natural Gas Act if the imported stream is not commingled with an interstate stream and does not travel outside the state of importation.¹⁸

These provisions allow FERC to exercise plenary power of regulation over interstate pipelines, including the right to review the prudence of management decisions after the fact.¹⁹ The goal of the Natural Gas Act, including its regulation of imports as well as of downstream sales and transportation is "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges."²⁰

3. DIVISION OF AUTHORITY BETWEEN FERC AND ERA

3.1. DOE Organization Act

Prior to October 1977, all authority under the Natural Gas Act was vested in the Federal Power Commission (FPC). The Department of Energy Organization Act²¹ (DOE Act) transferred responsibility for gas imports and exports from the FPC to the Secretary of Energy. The statute vested authority over Section 4, 5, and 7 matters in FERC.²² However, this assignment was qualified: "No function described in this section which regulates the exports or imports of natural gas or electricity shall be within the jurisdiction of the Commission unless the Secretary assigns such a function to the Commission."²³ There is no clear line which separates regulation of imported gas versus regulation of its downstream disposition. Proponents of ERA jurisdiction argue that regulation of imports should extend to the burnertip consumption of the imported gas. Proponents of FERC jurisdiction would draw the line at the international border crossing.

Although the DOE Act assigned import and export matters to the Secretary, he or she is allowed to delegate to other DOE units and has

¹⁶ 15 U.S.C. §§ 717c, 717d, 717f (1988).

¹⁷ 15 U.S.C. § 717a(7) (1988).

¹⁸ *Border Pipe Line Co. v. FPC*, 171 F.2d 149 (D.C. Cir. 1948).

¹⁹ *E.g.*, *Office of Consumers Counsel v. FERC*, 783 F.2d 206 (D.C. Cir. 1986).

But see TransCanada PipeLines Ltd. v. FERC, 878 F.2d 401 (D.C. Cir. 1989).

²⁰ *Atlantic Refining Co. v. Public Serv. Comm'n of New York*, 360 U.S. 378, 388 (1959).

²¹ Pub. L. No. 95-91, 91 Stat. 567 (1977) (codified at 42 U.S.C. §§ 7101-7352 (1982 & Supp. V 1987)) [hereinafter DOE Act].

²² DOE Act §§ 402(a)(1)(C)-(D), 42 U.S.C. §§ 7172(a)(1)(C)-(D) (1982 & Supp. V 1987).

²³ DOE Act § 402(f), 42 U.S.C. § 7172(f) (1982 & Supp. V 1987).

delegated various import matters to FERC²⁴ and the ERA.²⁵ The Secretary's "delegation orders" have finessed the Section 402(f) controversy²⁶ by delegating Sections 4, 5, and 7 to FERC on the assumption that there might be some powers excluded from the congressional delegation to FERC by Section 401(f).²⁷

Even if the Secretary had not cured this ambiguity by delegation, Congress also provided for the statutory supremacy of FERC in any dispute over responsibilities. Section 404(a) of the DOE Act provides:

[W]henever the Secretary proposes to prescribe rules, regulations, and statements of policy to general applicability in the exercise of any function which is transferred to the Secretary under sections 301 or 306 of this Act, he shall notify the Commission of the proposed action. If the Commission, in its discretion, determines within in such period as the Secretary may prescribe, that the proposed action may significantly affect any function within the jurisdiction of the Commission . . . the Secretary shall immediately refer the matter to the Commission, which shall provide an opportunity for public comment²⁸

3.2. Prior to 1984

From 1977 to 1984, FERC regulated imports related to the Alaska Natural Gas Transportation System,²⁹ designated cases which were pending at the FPC,³⁰ handled siting of import facilities and had "residual authority" on issues not addressed by the ERA.³¹ In most cases, an importer had to apply for Section 3 authorizations from both the ERA and FERC. In addition, the project participants would file under Sections 4 and 7 for approval of the downstream disposition of the imported gas.³²

²⁴ DOE Act § 402(e), 42 U.S.C. § 7172(e) (1982 & Supp. V 1987).

²⁵ DOE Act § 642, 42 U.S.C. § 7252 (1982 & Supp. V 1987).

²⁶ See *supra* note 22 and accompanying text.

²⁷ Deleg. Order No. 0204-112, § (b), 49 Fed. Reg. 6,684 (Dep't Energy 1984).

²⁸ 42 U.S.C. § 7174(a) (1982 & Supp. V 1987).

²⁹ Deleg. Order No. 0204-8, 42 Fed. Reg. 61,491 (Dep't Energy 1977). The Alaskan Natural Gas Transportation System is regulated under the Alaskan Natural Gas Transportation Act, 15 U.S.C. § 718 (1988).

³⁰ 10 C.F.R. § 1000.1 (1988); Deleg. Order No. 0204-1, § 11, 42 Fed. Reg. 55,637 (Dep't Energy 1977).

³¹ Deleg. Order No. 0204-55, 44 Fed. Reg. 56,735 (Dep't Energy 1979).

³² See Huard, *Regulation of the Importation and Exportation of Natural Gas: A Survey and Analysis of Section 3 of the Natural Gas Act*, 15 J. INT'L L. & ECON. 533 (1981).

3.3. February 1984 Delegation

In an attempt to provide applicants with a one-forum authorization, the Secretary in February 1984 assigned all Section 3 cases to ERA.³³ The only exception was that FERC retained jurisdiction over the siting of border facilities.³⁴ FERC continued to administer Sections 4, 5, and 7 with the condition that "FERC shall not issue any order, authorization, or certificate unless such order, authorization, or certificate adopts such terms and conditions as are attached by the Administrator [of the ERA]."³⁵

As discussed below, the division of authority between ERA and FERC continues to be controversial. The controversy in part reflects a perception that the ERA has sought to facilitate the importation of Canadian gas, while FERC is generally perceived to be concerned with maintaining equal competitive opportunities between domestic and Canadian natural gas.

Dissatisfaction with the ERA-FERC division has resulted in the introduction of legislation to amend the DOE Act to reassign Section 3 exclusively to FERC.³⁶ On February 7, 1989, the Secretary of Energy removed the responsibility for natural gas imports and exports from the ERA and transferred them to the Assistant Secretary for Fossil Fuels.³⁷ This transfer does not resolve the ambiguity in the division of regulatory responsibility.

3.4. Purchasing Practices

The key issue in the division of responsibility between the ERA and FERC is which agency reviews the prudence of the importing pipeline's gas purchasing practices. Prior to wellhead price decontrols under the Natural Gas Policy Act (NGPA),³⁸ virtually all gas supplies purchased by interstate pipelines were subject to direct regulation. Hence, customer challenges to purchasing practices were limited to selecting high-priced supplies³⁹ or failing to contract for sufficient supplies.⁴⁰ After the enactment of the NGPA and the significant increase

³³ Deleg. Order No. 0204-111, 49 Fed. Reg. 6,684 (Dep't Energy 1984).

³⁴ Deleg. Order No. 0204-112, § (a), 49 Fed. Reg. 6,684 (Dep't Energy 1984).

³⁵ *Id.* § (c).

³⁶ S. 1973, 100th Cong., 1st Sess., 133 CONG. REC. S18,420-21 (1987).

³⁷ Deleg. Order No. 0204-127, 54 Fed. Reg. 11,436 (Dep't Energy 1989), Energy Management (CCH) ¶ 70,051 (Feb. 7, 1989).

³⁸ Pub. L. 95-621, 92 Stat. 3352 (1978) (codified at 15 U.S.C. §§ 3301-3432 (1988)) [hereinafter NGPA].

³⁹ *Metzenbaum v. Columbia Gas Transmission Corp.*, 4 F.E.R.C. ¶ 61,277, *reh'g denied*, 5 F.E.R.C. ¶ 61,095 (1978).

⁴⁰ *Virginia v. Tenneco, Inc.*, 538 F.2d 1026 (4th Cir. 1976); *Monsanto Co. v.*

in gas prices from 1979 to 1982, customers actively challenged pipeline gas purchasing practices, even in the face of a statutory guarantee of pass-through of wellhead gas costs.⁴¹

Domestic gas producers claim that imported gas receives several regulatory advantages that encourage pipelines to purchase imports when less expensive domestic supplies are available. First, unlike domestic wellhead purchases, the purchase of Canadian gas is not subject to scrutiny by either FERC or the ERA. Exporter and pipeline can agree to a division of markets in a border contract. For example, in *Northwest Pipeline Co.* the pipeline entered into a contract that guaranteed forty-five percent of Northwest's sales market to a particular Canadian supplier, regardless of the availability of lower-priced domestic gas. When Northwest's customers challenged the contract, FERC held that ERA approval of the import precluded FERC from examining the prudence of Northwest's purchasing practices regarding the Canadian supplies.⁴² FERC assumed that ERA would provide a forum for challenging the prudence of such transactions. However, ERA has construed the Section 3 public interest standard so narrowly as to prevent such inquiries:

The public interest inquiry into the competitiveness of an import, and the resulting presumption of need if an import is found to be competitive, focuses on whether the negotiated arrangement, taken as a whole, provides the importer with the ability to compete in the marketplace, and with the flexibility to respond to market changes and thereby enhance competitive pressure on market participants. It does not focus on the competitive effect of an arrangement upon domestic producers, or on whether the gas can be supplied more economically by domestic or other suppliers in a particular instance.⁴³

In addition, because the ERA had previously approved the Northwest contract when it covered prices as high as \$4.94 per MMBtu, ERA took the position that no further authorization is required to impose a

FPC, 463 F.2d 799 (D.C. Cir. 1972); *Texasgulf, Inc. v. United Gas Pipe Line Co.*, 610 F. Supp. 1329 (D.D.C. 1985).

⁴¹ NGPA § 601(c), 15 U.S.C. § 3431(c) (1988). See also *Office of Consumers Counsel v. FERC*, 783 F.2d 206 (D.C. Cir. 1986).

⁴² *Northwest Pipeline Co.*, 39 F.E.R.C. ¶ 61,215, *reh'g denied*, 41 F.E.R.C. ¶ 61,022 (1987), *aff'd sub nom. TransCanada PipeLines Ltd. v. FERC*, 878 F.2d 401 (D.C. Cir. 1989).

⁴³ *Texas Eastern Transmission Corp.*, 1 E.R.A. ¶ 70,744, at 72,801 (1987), *aff'd sub nom. Independent Petroleum Ass'n of Am. v. ERA*, 870 F.2d 168 (5th Cir. 1989).

forty-five percent market share guarantee as long as the price of the gas under the amendment does not exceed \$4.94.⁴⁴ Thus, absent a clarification from the agencies or a court decision, parties are without a forum to challenge the prudence of gas purchasing practices under the current interpretation of each agency's jurisdiction.

Recent cases hold that the prudence of an import transaction can be challenged, if at all, only at the ERA. In *TransCanada PipeLines Ltd. v. FERC*, the court considered a challenge by a customer of an importing pipeline to the prudence of the pipeline's purchasing practices.⁴⁵ In essence, the customer claimed that the pipeline's mix of gas supplies included excessive amounts of expensive imports. The court held, "For FERC to take a second look at the arrangement between pipeline and exporter and decide whether the pipeline did in fact arrange reasonably prudent terms would be to say that the Commission may reevaluate either ERA's factual determinations or its policy. This however, is what FERC is specifically prohibited from doing."⁴⁶ Although FERC has made an important distinction between a prudence review of a pipeline's gas supply mix and the regulation of the terms of specific purchases, *TransCanada* did not acknowledge this distinction.

Another recent case also held that FERC, when approving a Section 7 certificate to authorize transportation of imported gas, may "independently examine any effects claimed to be due to the specific transportation proposal, as opposed to effects inherent in the importation and sale of gas in the United States as a whole."⁴⁷ However, this opportunity may have little practical effect, as imported natural gas can be transported under self-implementing authorizations without case-specific review.⁴⁸

3.5. Downstream Section 4 Rate Treatment

The second dispute between the authority of FERC and the ERA centers upon whether the ERA can bind FERC when FERC sets pipeline rates for the resale of the imported gas downstream from the border. For example, in *Northwest Pipeline Corp.*,⁴⁹ the exporter and Northwest, the importing pipeline, agreed in a border contract to "as billed" rate treatment in downstream rates. Northwest sought declara-

⁴⁴ *Northwest Pipeline Co.*, 1 E.R.A. ¶ 70,604, at 72,428 (1985).

⁴⁵ 878 F.2d 401 (D.C. Cir. 1989).

⁴⁶ 878 F.2d at 407.

⁴⁷ *ANR Pipeline Co. v. FERC*, 876 F.2d 124, 132, *reh'g denied*, 885 F.2d 937 (D.C. Cir. 1989).

⁴⁸ See 18 C.F.R. pt. 284 (1989).

⁴⁹ 1 E.R.A. ¶ 70,604, *reh'g denied*, 1 E.R.A. ¶ 70,609 (1985).

tory orders from both FERC and the ERA approving the two-part rate instituted by the newly amended contract. The parties asked the ERA to approve the border contract and to declare its determination binding upon FERC in subsequent Section 4 proceedings.

The ERA approved the border contract and expressly found:

[O]nly the ERA Administrator may review international contracts and authorize imports. Once the Administrator has approved an import arrangement, the FERC, while exercising its Section 4 and 5 authorities, cannot act in a manner inconsistent with the actions taken by the Administrator. Thus, it could not significantly alter or overturn the arrangements upon which the Administrator's actions are based.⁵⁰

Further, the ERA found that "the as-billed flow-through provision" of the contract is "an integral part of the arrangement."⁵¹ Later, the ERA qualified its position by noting that the division of costs between demand and commodity charges is "within the FERC's jurisdiction in an exercise of its authority under Sections 4 and 5 of the NGA to approve these specific 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 FERC would not normally permit to be treated as fixed costs, the Canadian import should be treated no differently."⁵² FERC followed this suggestion and rejected "as billed" flow-through costs in *Natural Gas Pipeline Co. of America* (Opinion No. 256),⁵³ where it required the importing pipeline to recover certain amounts paid in Canadian demand charges in its own commodity rates. The ERA has acquiesced in this requirement, although the ERA has declined to impose the same requirement on two-part rates charged to distributors or end-users whose imports are not subject to a downstream FERC rate proceeding.⁵⁴

⁵⁰ 1 E.R.A. ¶ 70,604, at 72,430.

⁵¹ 1 E.R.A. ¶ 70,609, at 72,445.

⁵² *Natural Gas Pipeline Co. of Am.* 1 E.R.A. ¶ 70,645, at 72,533 (1986).

⁵³ 37 F.E.R.C. ¶ 61,215 (1986), *reh'g denied*, 39 F.E.R.C. ¶ 61,218, *aff'd sub nom.* *TransCanada PipeLines Ltd. v. FERC*, 878 F.2d 401 (D.C. Cir. 1989) [hereinafter Opinion No. 256].

⁵⁴ *Minnegasco, Inc.*, 1 E.R.A. ¶ 70,721, at 72,731, *reh'g denied*, 1 E.R.A. ¶ 70,738 (1987), *aff'd sub nom.* *Independent Petroleum Ass'n of Am. v. ERA*, 886 F.2d 1338 (D.C. Cir. 1989).

4. CURRENT DEVELOPMENTS

4.1. February 1984 Policy Guidelines

In February 1984 the Secretary of Energy issued policy guidelines for ERA consideration of Section 3 applications.⁵⁵ Under the guidelines, an applicant must demonstrate that its proposed importation will be competitively priced. If competitive pricing is shown, the guidelines create a rebuttable presumption that the gas is needed. The guidelines contemplated that the ERA would continue its case-by-case review of Section 3 applications and strongly recommended that the parties to existing long-term arrangements renegotiate to add market-responsive pricing terms.⁵⁶

The guidelines appear to place the burden of proof in demonstrating that an import transaction is competitive on the applicant: "The importer will be required to demonstrate that the provisions in the proposed import arrangement, collectively, ensure that the gas will be competitive."⁵⁷ However, in practice, the ERA has placed the burden of proof on the intervenors challenging an import.⁵⁸

Domestic producers have argued that the guidelines were not properly promulgated because the Secretary did not refer the guidelines to the Commission pursuant to DOE Act Section 404.⁵⁹ The Fifth Circuit, however, in *Panhandle Producers and Royalty Owners Association v. ERA*, held that private parties do not have standing to challenge DOE actions on the failure to comply with Section 404.⁶⁰ Thus, the guidelines will remain in effect until the Secretary issues superseding provisions.

Although the court in *Panhandle Producers* denied standing to those challenging the guidelines, the decision limited the substantive effect of the guidelines in individual proceedings. The court held that the conclusions resulting from application of the guidelines are to be "subject to complete attack" before they are applied in particular cases.⁶¹

⁵⁵ New Policy Guidelines and Delegation Orders from the Secretary of Energy to Economic Regulatory Administration and Federal Energy Regulatory Commission Relating to the Regulation of Imported Natural Gas, 49 Fed. Reg. 6,684 (1984).

⁵⁶ 49 Fed. Reg. at 6,687.

⁵⁷ 49 Fed. Reg. at 6,688. *Accord* Texas Eastern Transmission Corp., 1 E.R.A. ¶ 70,634, at 72,502 (1986).

⁵⁸ *See, e.g.*, Northridge Petroleum Marketing U.S., Inc., 1 E.R.A. ¶ 70,610, at 72,447, *aff'd sub nom.* Panhandle Producers & Royalty Owners Ass'n v. ERA, 822 F.2d 1105 (D.C. Cir. 1987).

⁵⁹ 42 U.S.C. § 7174(a) (1982).

⁶⁰ 847 F.2d 1168, 1173-74 (5th Cir. 1988).

⁶¹ 847 F.2d at 1175. *See also* Panhandle Producers & Royalty Owners Ass'n v. ERA, 822 F.2d 1105, 1111 (D.C. Cir. 1978).

4.2. *Blanket Import Authorizations*

Traditionally, an import authorization would specify a seller/exporter and a purchaser/importer. Since 1985, however, the ERA has authorized imports on a "blanket" basis, without prior knowledge of the specific transactions proposed. The ERA has granted over 109 blanket authorizations covering the importation of over 17 Tcf of Canadian gas.⁶² Applicants receive a "hunting license" for any U.S. market, even without disclosing specific prices or markets. Because the details of specific transactions are not at issue in a proceeding to grant a blanket certificate, the ERA generally approves such applications as a matter of policy, on the assumption that competition from domestic supplies will prevent gas which is priced above the market rate from being imported.⁶³

Producers have sought to limit the blanket import authorizations only to those markets served by open access pipelines. The ERA rejected this restriction in *Tennessee Gas Pipeline Co.*⁶⁴ The only condition that the ERA imposes on blanket authorizations is to limit them to two years from the date of first deliveries. The ERA approves all requested volumes, even though the total volumes far exceed existing pipeline capacity. Extensions beyond the initial two-year term are granted routinely.⁶⁵

4.3. *Regulation after the Border*

4.3.1. *The "As Billed" Controversy*

In response to the 1984 guidelines, Canadians restructured border contracts, substituting two-part rates for take-and-pay clauses. These rates have the effect of shifting costs from the commodity charge collected at the border to the demand charge. The Canadians hoped that by offering a lower commodity charge, Canadian gas would gain better access to U.S. markets, even though the total unit price for gas was higher than competing supplies. This situation would work particularly well in the competitive California market because the Canadian Public Utilities Commission (CPUC) sequences supplies in southern Califor-

⁶² See Brief for Appellant, Independent Petroleum Ass'n of Am. v. ERA, 870 F.2d 168 (5th Cir. 1989) (No. 88-4047).

⁶³ Panhandle Producers & Royalty Owners Ass'n v. ERA, 822 F.2d at 1113.

⁶⁴ 1 E.R.A. ¶ 70,764 (1986), *reh'g denied*, 1 E.R.A. ¶ 70,684 (1987), *aff'd sub nom.* Panhandle Producers & Royalty Owners Ass'n v. ERA, 847 F.2d 1168 (5th Cir. 1988).

⁶⁵ See, e.g., *Salmon Resources, Ltd.*, 1 E.R.A. ¶ 70,749 (1988); *Poco Petroleum, Inc.*, 1 E.R.A. ¶ 70,752 (1988).

nia were based on commodity charges alone.

The market advantage of two-part rates depends upon the ability of downstream pipelines to separate costs in their rates "as they were billed" by the suppliers. In its Opinion No. 256,⁶⁶ the Commission rejected an "as billed" approach and instead required the costs to be reassigned to the commodity rate based upon FERC-approved rate-making principles.

In response to that ruling, the Canadians have attempted to establish two-part rates on the so-called NOVA system⁶⁷ and to reclassify plants from gathering to transmission. In addition, a group of Northeast distributors, who had previously aggregated supplies in the United States with subsequent jurisdictional resales, restructured their operation. By aggregating supplies north of the border, each distributor would hold its own import authorization and purchase the gas under ERA-approved rates without being required to apply FERC Opinion No. 256.

4.3.2. *First Sale Treatment of Marketer Sales*

NGPA Section 601(a)(1)⁶⁸ removes certain first sales from the scope of the Natural Gas Act. Because sales of domestic gas by marketers are first sales, these marketers are not subject to the Natural Gas Act.⁶⁹ Domestic producers, however, contend that when a marketer resells Canadian gas in the United States, that sale is not entitled to "first sale" treatment. The FERC has resolved this issue by asserting Natural Gas Act jurisdiction over the sales and granting blanket certificates prospectively. FERC has not addressed the status of sales for resale by marketers of Canadian gas made prior to the certificates.⁷⁰

FERC has the authority to declare any sale for resale of natural gas to be a first sale if regulation of the sale is necessary to prevent circumvention of ceiling prices under Title I of the NGPA.⁷¹ Certain Canadian importers have sought first sale treatment of imported natural gas as necessary to avoid circumvention of ceiling prices. However, the Natural Gas Wellhead Decontrol Act of 1989 provides for the

⁶⁶ 37 F.E.R.C. ¶ 61,215 (1986), *reh'g denied*, 39 F.E.R.C. ¶ 61,218, *aff'd sub nom.* TransCanada Pipelines Ltd. v. F.E.R.C., 878 F.2d 401 (D.C. Cir. 1989).

⁶⁷ See 39 F.E.R.C. ¶ 61,218, at 61,769 (1987).

⁶⁸ 15 U.S.C. § 3431(a)(1) (1982).

⁶⁹ Inquiry into Alleged Anticompetitive Practices Relating to Marketing Affiliates of Interstate Pipelines (Order No. 497), 53 Fed. Reg. 22,139 (1988); FERC Stat. & Regs. ¶ 30,820 (to be codified at 18 C.F.R. §§ 161, 250, 284).

⁷⁰ Salmon Resources, Ltd., 50 F.E.R.C. ¶ 61,101 (1990).

⁷¹ 15 U.S.C. § 3431(a)(1) (1982).

phasing out of remaining Title I regulation by 1993.⁷² This new statute and the large portion of first sales which are currently decontrolled cast doubt on the viability of the circumvention rationale.

4.3.3. *Agency Imports*

A "person" must hold a Section 3 authorization; this statutory requirement applies to both case-specific and blanket import authorizations. A recent trend is to "sublease" the blanket import authorizations so that the holder of the authorization is merely the agent for the person who takes title to the gas. This creates a regulatory gap.⁷³ Some parties have argued that this practice creates a loophole in FERC's prohibition against brokering interstate pipeline capacity.⁷⁴ FERC proposals on capacity brokering, however, could affect this policy.⁷⁵

4.3.4. *Marketing Affiliates*

The Commission has prescribed certain standards of conduct for the unregulated marketing affiliates of interstate pipelines.⁷⁶ Unregulated marketing affiliates of Canadian pipelines raise the same potential for abuse as do those of domestic pipelines. The marketing affiliates of Canadian pipelines, however, do not appear to be covered by FERC's rulings for marketing affiliates unless they are also affiliates of United States pipelines.⁷⁷

4.4. *The United States-Canada Free-Trade Agreement*

The Free-Trade Agreement resulted from a long process. On September 26, 1985, Prime Minister Mulroney formally requested that Canada and the United States examine the potential for negotiating a Free-Trade Agreement. On December 10, 1985, President Reagan notified the Congress of his intent to enter into bilateral negotiations with Canada using the "fast track" procedures under the Trade Act of 1974.⁷⁸ The negotiations took place between June 17, 1986 and De-

⁷² Pub. L. 101-60, 103 Stat. 157, 157-58 (1989) (to be codified at 15 U.S.C. § 3301).

⁷³ The ERA has not attempted to assert jurisdiction over either the principal or the agency relationship.

⁷⁴ See ANR Pipeline Co., 43 F.E.R.C. ¶ 61,014 (1988).

⁷⁵ See Brokering of Interstate Natural Gas Pipeline Capacity, 53 Fed. Reg. 15,061 (1988) (to be codified at 18 C.F.R. §§ 284.281-.283) (proposed Apr. 24, 1988).

⁷⁶ See sources cited *supra* note 69.

⁷⁷ See Standards of Conduct for Interstate Pipelines with Marketing Affiliates, 18 C.F.R. § 161.1 (1988).

ember 9, 1987. The final text of the FTA was signed on January 2, 1988.⁷⁹ On July 25, 1988, President Reagan transmitted this agreement to Congress for approval, together with the proposed implementing legislation and a Statement of Administrative Actions.⁸⁰

Several provisions of the FTA affect the natural gas industry. Chapter 9, on energy, applies to "measures related to energy goods originating in the territories of either party."⁸¹ A "measure" includes "any law, regulation, procedure, requirement or practice."⁸² The definition of "energy goods" includes natural gas.⁸³

Thus, the natural gas regulation consists of a series of energy measures which are subject to the FTA. Article 902(2) prohibits quantitative restrictions on imports and exports, minimum export-price requirements and minimum import-price requirements.⁸⁴ Under this provision, past Canadian regulations which abrogated border contracts and set the minimum export prices during the gas shortages of the mid-1970s would not be permitted.⁸⁵ In future shortages, any curtailment of exports would have to be on a pro rata basis with domestic allocations.⁸⁶ In general, the FTA attempts to treat imports on the same basis as a national dealing with domestic supplies is treated.⁸⁷ The FTA's "national treatment" obligation also extends to state regulation.⁸⁸

Domestic producers have felt that the agreement may perpetuate the existing trade distortions between the two countries. Congressional debate regarding the impact of the FTA on natural gas centered around these concerns.⁸⁹

4.4.1. *Effect on Existing Statutes and Regulations*

The FTA does not take precedence over existing legislation. The legislation implementing the FTA provides: "No provision of the Agreement, nor the application of any such provision to any person or

⁷⁹ See FTA, *supra* note 1.

⁸⁰ S. REP. NO. 509, 110th Cong., 2d Sess. 4 (1988), *reprinted in* 1988 U.S. CODE CONG. & ADMIN. NEWS 2395, 2398.

⁸¹ See FTA, *supra* note 1, art. 901.

⁸² *Id.* art. 201.

⁸³ *Id.*, Statement of Administrative Action at 48.

⁸⁴ *Id.* art. 902(2).

⁸⁵ See also *id.* art. 904(b), which prevents a minimum price from being used to set an export price higher than the price charged for such energy good when consumed domestically.

⁸⁶ *Id.* art. 904(a).

⁸⁷ *Id.* arts. 105, 902(a), Statement of Administrative Action at 48.

⁸⁸ *Id.* art. 103, Statement of Administrative Action at 56. In theory, whenever a state awards an exclusive franchise to a gas distributor, such action is subject to consultation under FTA art. 2010(2).

circumstance, which is in conflict with any law of the United States shall have effect.”⁹⁰ Thus, the provisions of the Natural Gas Act prohibiting discrimination continue to apply equally to domestic and imported gas. At the very most, the FTA holds the promise for imported gas to receive the same treatment as gas produced or sold by a national. Further, the Statement of Administrative Actions purports to be an exhaustive list of the regulatory changes necessary to implement the FTA.⁹¹ The Statement does not include any regulatory actions regarding natural gas.

4.4.2. Grandfathering the “As Billed” Decision

Shortly after the FTA was signed, the Canadian government suggested that FERC Opinion No. 256⁹² was an example of the type of energy action that would be subject to second-guessing by the binational dispute resolution mechanism.⁹³ However, the Canadian Ambassador and the Administration took the position that Opinion No. 256 was not affected by the FTA.⁹⁴

4.4.3. Binational Dispute Resolution Mechanism

It does not appear that other “energy actions,” such as FERC rate decisions, will be second-guessed by the three binational mechanisms established under the FTA. First, Article 905 of the FTA establishes an informal consultative mechanism between the United States Department of Energy and the Canadian Department of Energy, Mines and Resources regarding “energy regulatory actions.”⁹⁵ FERC and the National Energy Board (NEB) of Canada are not necessarily part of this mechanism. Nor are FERC’s *ex parte* rules⁹⁶ waived in such consultations, in the event that FERC elects to participate.⁹⁷ Furthermore, any

⁹⁰ United States-Canada Free-Trade Agreement Implementation Act of 1988, Pub. L. No. 100-449, § 102(a), 102 Stat. 1851 (1989). See also FTA, *supra* note 1, Statement of Administrative Action at 55.

⁹¹ H.R. DOC. NO. 216, *supra* note 1, Statement of Administrative Action at 1.

⁹² Natural Gas Pipelines Co. of Am., 37 F.E.R.C. ¶ 61,215 (1986), *reh’g denied*, 39 F.E.R.C. ¶ 61,218, *aff’d sub nom.* TransCanada Pipelines Ltd. v. F.E.R.C., 878 F.2d 401 (D.C. Cir. 1989).

⁹³ See DEPARTMENT OF EXTERNAL AFFAIRS OF CANADA, THE CANADA-U.S. FREE-TRADE AGREEMENT 142 (1988); Testimony of C. Geoffrey Edge, former Chairman, National Energy Board of Canada (FERC 1989) (No. RP87-62).

⁹⁴ See S. REP. NO. 509, 100th Cong., 2d Sess. 1, 62-63 (1988), *reprinted in* 1988 U.S. CODE CONG. & ADMIN. NEWS 2395, 2457-58. See also H.R. DOC. NO. 216, *supra* note 1, Statement of Administrative Action at 56.

⁹⁵ FTA, *supra* note 1, art. 905.

⁹⁶ See *Energy Law & Regulation*, 2014

⁹⁷ See H.R. DOC. NO. 216, *supra* note 1, Statement of Administrative Action at

results of a consultation would not be binding on FERC.⁹⁸ Second, the binational dispute resolution mechanism of FTA Chapter 19 does not replace the judicial review provisions of Section 19 of the Natural Gas Act.⁹⁹ Hence, complaints regarding a regulatory action would not be subject to direct review under the FTA. Third, FTA Chapter 18 provides for consultation and ultimately arbitration of trade disputes before the new Canada-United States Trade Commission (CUSTC).¹⁰⁰ Again, the CUSTC does not have the power to review or set aside FERC actions directly. The CUSTC, however, can award compensation to the complaining nation.¹⁰¹ Finally, either party can request the CUSTC to provide an opinion regarding an interpretation of the FTA for use in a regulatory agency proceeding.¹⁰² Thus, the FTA, as approved, will not have as direct an effect on regulation of natural gas as some parties advocated prior to its consideration by the Congress.

In general, the FTA addresses discrimination by the exporting nation where the discrimination harms the importer. It does not remedy discriminatory practices against a domestic industry within the importing country. Thus, the primary forum for assuring that the Canadian gas industry will compete on a fair basis with the domestic gas industry continues to be FERC and the Department of Energy. However, trade concepts remain in place under the FTA which conceivably could provide relief to the domestic gas industry. For example, to the extent that commodity rates are the prime contract provision determining success in the gas markets, a border contract incorporating a below-cost commodity rate could form the basis for an anti-dumping action.¹⁰³

4.5. *New Pipelines from Canada*

Despite the regulatory incentives for importing Canadian gas, a primary obstacle to the volume of short-term imports is the availability of pipeline capacity connecting Canadian producing regions with U.S. markets. FERC has proposed that significant new capacity be added to bring Canadian gas to the Northeast¹⁰⁴ and California markets.

57.

⁹⁸ DOE Act § 401(d), 42 U.S.C. § 7171(d) (1982) (FERC is not responsible to the DOE).

⁹⁹ 15 U.S.C. § 717r (1982).

¹⁰⁰ FTA, *supra* note 1, arts. 1804-1806.

¹⁰¹ See H.R. Doc. No. 216, *supra* note 1, Statement of Administrative Action at 93.

¹⁰² See FTA, *supra* note 1, art. 1808.

¹⁰³ See Tariff Act of 1930, 19 U.S.C. §§ 1673-1673i (1988).

¹⁰⁴ Northeast U.S. Pipeline Projects, Order Ruling on Discreteness of Additional Northeast Projects and Establishing Procedures, 46 F.E.R.C. ¶ 61,012, *reh'g denied*, 47 F.E.R.C. ¶ 61,172 (1989) [*in the matter Northeast Order*].

With respect to the Northeast, the importers have arranged for local distribution companies and end-users¹⁰⁵ to take title to the gas at the border. Because there will be no sale for resale within the Commission's Section 4 jurisdiction, the applicants expect to avoid the application of Opinion No. 256 to the two-part border price structure. In response, domestic producers and a competing domestic pipeline have argued before FERC that the transportation on the new pipelines should be conditioned upon a rate structure consistent with Opinion No. 256.¹⁰⁶ Further, the Commission has relied upon the FTA to avoid addressing allegations regarding excessive dependence on Canadian gas.¹⁰⁷

Parties opposing the construction of new facilities also face a difficult burden in Section 3 proceedings. In *Michigan Consolidated Gas Co. v. ERA*,¹⁰⁸ an industrial end-user sought to bypass its gas distribution company by constructing a pipeline under the Detroit River to connect to Canadian supplies. The distributor opposed the Section 3 application of the end-user, arguing that the bypass would shift costs onto the other customers of the distributor.¹⁰⁹ The court held that the distributor was not injured by the authorization of the bypass and lacked standing to challenge ERA's order.¹¹⁰

Several parties have proposed construction of extensive new pipeline facilities from Alberta and British Columbia to California.¹¹¹ If FERC approves a reasonable portion of the Northeast and California proposals and the pipelines are constructed, pipeline capacity between the United States and Canada could easily double by 1993. Once border capacity is no longer constrained, the California and Northeast markets would compete for Canadian supplies based upon the wellhead price each market can offer. Given this competitive environment, the financing and transportation rate structures of the proposed pipeline facilities may be the first in the history of the natural gas industry to be shaped by a combination of the new trade relationship between the United States and Canada and competitive concerns. With billions of dollars of proposed investments at stake, it is vital that these permanent investment decisions not be distorted by short-term regulatory

¹⁰⁵ *E.g.*, *Ocean State Power*, 1 E.R.A. ¶ 70,810 (1988); *Brooklyn Union Gas Co.*, 1 F.E. No. 86-44-NG (Dep't Energy Jan. 11, 1990).

¹⁰⁶ *See Northeast Order*, 46 F.E.R.C. at 61,070-71.

¹⁰⁷ *Id.*

¹⁰⁸ 889 F.2d 1110 (D.C. Cir. 1989).

¹⁰⁹ *Id.* at 1111.

¹¹⁰ *Id.*

advantages.

5. CONCLUSION

With the reassignment of Section 3 responsibilities from the ERA and the implementation of the FTA, trade in natural gas between Canada and the United States is evolving into a new era. Ultimately, the public will be best served if the Canadian gas industry and the domestic gas industry are allowed to compete based upon price, without regulatory distortions. Whether that goal can be realized remains to be seen.