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UNITED STATES-CANADIAN TRADE IN NATURAL GAS: 1992 IS A PIVOTAL YEAR*

Robert C. Platt†

I. INTRODUCTION

The natural gas industry is undergoing a fundamental restructuring both in the United States and Canada. Although government authorities in both countries profess that their regulatory changes are designed to further competition, the differences between the regulatory structures in the two countries significantly distort competition and prevent the creation of an integrated North American natural gas market. While the on-going restructuring includes a sequence of incremental pro-competitive improvements, the overall timing of the measures adopted in the United States and Canada has long-term consequences which could distort the trade relationship between the two countries beyond the current transition.

The importance of the natural gas industry in serving the nation's energy needs is growing. Concurrently, natural gas trade between the United States and Canada is growing in importance to both nations. In 1986, Canadian imports constituted only 4.62% of domestic consumption.¹ Canadian imports now amount to 8.66% of domestic consumption and about forty-three percent of total Canadian production.² However, this growth in Canadian imports understates the impact of Canadian gas on the on-going restructuring of the United States natural gas industry.

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1. ENERGY INFO. ADMIN., NAT. GAS MONTHLY 4, tbl. 2 (December 1991).

2. *Id.*

A. *The Traditional Natural Gas Act Regulation*

At the historic starting point of that transition, natural gas was produced as a byproduct of oil production, and prevailing wellhead prices for gas were not sufficient to justify its development as a separate energy resource. However, by the energy shortages of the 1970s, gas had reached an economic value which justified the development of gas laden reserves independent of oil production. Throughout this period, gas was typically sold under long-term contracts which transferred title at the wellhead from the producer to an interstate pipeline purchaser. The interstate pipeline served as a merchant holding title to most of the gas which flowed through its system and reselling this gas under long-term contracts with local distribution companies in the market areas. Under such a structure, the large up-front capital expenditure by the gas producer for the exploration and development of the gas reserve was protected by the revenue guarantees in the long-term wellhead sales contract. Similarly, the capital investment by the interstate pipeline in connecting wells and constructing mainline pipeline capacity was protected by minimum bill and minimum take obligations in long-term service agreements with the local distribution companies. Further, interstate pipelines were prevented from making unnecessary investments by federal regulation which required a demonstration of adequate gas supplies and markets before any construction would be certificated.³

B. *The Competitive Goal of the Transition*

At the current end-point of the transition of the industry, wellhead sale of natural gas in the United States⁴ has become a fungible commodity, which is sold mostly on a spot market month-by-month basis. Natural gas futures contracts have been traded since April 3, 1990,⁵ with options on those futures contracts to begin trading later this year.⁶ Generally, producers have perceived that long-term wellhead contracts are no longer available, which has resulted in a drop in drilling activity to the

3. Kansas Pipeline & Gas Co., 2 F.P.C. 29 (1939).

4. The Canadian natural gas industry has undergone a comparable transition. See Dennis C. Stickley, *Toward the Integration of Canadian and United States Natural Gas Import Policies, Part 2*, 25 LAND & WATER L. REV. 335 (1990).

5. *CFTC Stamp of Approval Clears Way for Gas Futures Trading in April*, INSIDE FERC, Mar. 5, 1990, at 3.

6. GAS DAILY, Mar. 5, 1992, at 1. Editor's note: Futures contracts will begin trading October 1992.

lowest point since World War II.⁷ Interstate pipelines have also shifted from their role as merchants of natural gas to predominantly transporters of natural gas for third parties without holding title to the gas. By 1990, seventy-nine percent of total interstate pipeline deliveries was third party transportation, with only twenty-one percent being sales gas.⁸ Although the investment of interstate pipelines in transmission capacity remains protected by long-term service agreements, interstate pipelines no longer bear the risks of matching gas supply volumes and prices with the demands of their markets. The primary impetus for long-term gas purchase contracts stems from the financing of new natural gas-fired industrial users. Facilities such as cogeneration plants typically require long-term pipeline transportation contracts as well as long-term gas supply agreements as a precondition for their financing. Hence, the transition of the industry has moved from a supply constrained industry which required long-term wellhead contracts as a prerequisite for new drilling investment to a demand constrained industry which requires long-term contracts as a prerequisite for major expansion in new demand. The transition also has involved a greater reliance upon market forces and competition as a substitute for classic utility regulation.⁹

Evolution of the international gas trade must be viewed in context of the transition in the domestic gas industry described above, as well as a complete change in the regulation of the U.S. gas industry. Many of these changes were initiated by the Federal Energy Regulatory Commission (FERC), an independent agency with some ties to the Department of Energy.¹⁰ Under the Natural Gas Policy Act of 1978 (NGPA),¹¹ case-by-case regulation was replaced with blanket certificates that authorized routine transactions on a generic basis.¹² The FERC has also provided

7. *Collapse in Prices for Natural Gas Shakes Producers*, N.Y. TIMES, Mar. 2, 1992, at A1. The Baker-Hughes Tool Co. rotary drilling rig count fell to 596 in the week of June 12th, 1992.

8. INTERSTATE NATURAL GAS ASS'N OF AM., CARRIAGE THROUGH THE FIRST HALF OF 1991, Rep. No. 91-5, tbl. A-1 (Nov. 1991). Pipeline sales dropped to 17% of consumption during the first half of 1991.

9. See generally Philip M. Marston, *Pipeline Restructuring: The Future of Open Access Transportation*, 12 ENERGY L.J. 53 (1991).

10. Department of Energy Act of 1977, Pub. L. No. 95-91, §§ 401, 406, 91 Stat. 565, 582, 586-87 (1977) (codified at 42 U.S.C. §§ 7171, 7176 (1988)) (DOE Act); see Edward J. Grenier, Jr. & Robert W. Clark III, *The Relationship Between DOE and FERC: Innovative Government or Inevitable Headache?*, 1 ENERGY L.J. 325 (1980).

11. Pub. L. No. 95-621, 92 Stat. 3352 (1978) (codified at 15 U.S.C. §§ 3301-3432 (1988)) (NGPA).

12. Order No. 27, *Certification of Pipeline Transportation for Certain High Priority Users*, [1977-1981 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,049, 44 Fed. Reg. 24,825 (1979) (codified at 18 C.F.R. pt. 157, subpt. E (1987)) (expedition of transportation for high priority and agricultural end-users); Order No. 46, *Sales and Transportation of Natural Gas*, [1977-1981 Regs. Preambles]

for "open access" to markets by mandating non-discriminatory transportation.¹³ In addition, the NGPA created a national market for gas by

F.E.R.C. Stat. & Regs. ¶ 30,081, 44 Fed. Reg. 52,179 (1987) (codified at 18 C.F.R. pt. 284 (1987)) (adopting final regulations implementing §§ 311(a) and 312 of the NGPA); Order No. 60, *Interstate Pipeline Transportation on Behalf of Other Interstate Pipelines*, [1977-1981 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,107, 44 Fed. Reg. 68,819 (1979) (codified at 18 C.F.R. pt. 284) (adopting blanket certificate authorizing interstate pipelines to transport gas on behalf of other interstate pipelines); Order No. 63, *Certain Transportation, Sales and Assignments by Pipeline Companies Not Subject to Commission Jurisdiction Under Section 1(c) of the Natural Gas Act*, [1977-1981 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,118, 45 Fed. Reg. 1872 (1981) (codified at 18 C.F.R. pt. 284) (permitting Hinshaw pipelines to sell and transport gas in interstate commerce on the same self-implementing basis as intrastate pipelines under NGPA §§ 311 and 312); Order No. 234-B, *Interstate Pipeline Blanket Certificates for Routine Transactions and Sales and Transportation by Interstate Pipelines and Distributors*, [1982-1985 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,476, 48 Fed. Reg. 34,872 (1983); Order No. 319, [1982-1985 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,477, 48 Fed. Reg. 34,875 (1983) (codified at 18 C.F.R. pts. 157, 284), *reh'g granted in part and denied in part*, Order No. 319-A, [1982-1985 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,512, 48 Fed. Reg. 51,436 (1983) (codified at 18 C.F.R. pt. 157) (authorizing blanket certification of interstate pipeline transportation for various high priority end-users); *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (vacating Order Nos. 234-B, 319 and 319-A to the extent that such orders permitted fuel-switchable end-users to have access to spot market supplies without requiring pipelines to provide the same service to local distribution companies and captive customers).

13. Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, [1982-1985 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,665, 50 Fed. Reg. 42,408 (1985) (codified at 18 C.F.R. pts. 2, 157, 250, 284, 375, 381), *modified*, Order No. 436-A, [1982-1985 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,675, 50 Fed. Reg. 52,217 (1985) (codified at 18 C.F.R. pts. 2, 157, 284, 375), *modified further*, Order No. 436-B, [1986-1990 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,688, 51 Fed. Reg. 6398 (1986) (codified at 18 C.F.R. pt. 284), *reh'g denied*, Order No. 436-C, 34 F.E.R.C. ¶ 61,404, *reh'g denied*, Order No. 436-D, 34 F.E.R.C. ¶ 61,405, *reconsideration denied*, Order No. 436-E, 34 F.E.R.C. ¶ 61,403 (1986), *aff'd in part and rev'd in part sub nom.* *Associated Gas Distribs. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *on remand*, Order No. 500, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, [1986-1990 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,761, 52 Fed. Reg. 30,334 (1987) (codified at 18 C.F.R. pts. 2, 284) (interim rule), *extension granted*, Order No. 500-A, [1986-1990 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,770, 52 Fed. Reg. 39,507 (1987), *modified*, Order No. 500-B, [1986-1990 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,772, 52 Fed. Reg. 39,630 (1987), *modified further*, Order No. 500-C, [1986-1990 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,786, 52 Fed. Reg. 48,986 (1987) (codified at 18 C.F.R. pt. 284), *modified further*, Order No. 500-D, [1986-1990 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,800, 53 Fed. Reg. 8439 (1989) (codified at 18 C.F.R. pt. 284), *reh'g denied*, Order No. 500-E, 43 F.E.R.C. ¶ 61,234, *modified further*, Order No. 500-F, [1986-1990 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,841, 53 Fed. Reg. 50,924 (1988) (codified at 18 C.F.R. pt. 2), *reh'g denied*, Order No. 500-G, 46 F.E.R.C. ¶ 61,148, *remanded*, *Associated Gas Distribs. v. FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied sub nom.* *Berkshire Gas Co. v. Associated Gas Distribs.*, 111 S. Ct. 277 (1990), *on remand*, Order No. 500-H, 49 F.E.R.C. ¶ 61,325 (1989), *modified*, Order No. 500-I, 50 F.E.R.C. ¶ 61,172, *aff'd*, *American Gas Ass'n v. FERC*, 912 F.2d 1496 (D.C. Cir. 1990), *cert. denied*, *City of Wilcox v. FERC*, 111 S. Ct. 957 (1991).

providing for the integration of previously segregated intrastate and interstate markets¹⁴ and for the deregulation¹⁵ of all “first sales” of domestic natural gas.¹⁶

In addition to FERC’s shift from case-by-case toward generic regulation, FERC also adopted policies which tended to abrogate the long-term contractual relationships underlying the traditional domestic market structure. For example, FERC sought to condition a producer’s use of open access transportation upon the reduction of take-or-pay obligations under any other contracts held by that producer with a transporting pipeline.¹⁷ At the city gate, FERC Order No. 380 abrogated the commodity minimum bill portions of contracts between pipelines and local distribution companies to the extent that such contracts had guaranteed recovery of variable costs.¹⁸ In subsequent cases, FERC abrogated all minimum bill and minimum take requirements from pipeline-distributor service agreements.¹⁹ However, in Order No. 380-A,²⁰ FERC exempted from its rules the minimum bills guaranteeing the investment in the Alaska Natural Gas Transportation System,²¹ which is used to transport gas imported from Canada. Similarly, minimum bill obligations in import contracts were not covered by Order No. 380. The result of these regulatory policies is that domestic gas now flows predominantly in the spot market while significant volumes of Canadian gas remain under long-term contracts with minimum take provisions.²²

14. NGPA, §§ 311, 312, 314, 601(a), 15 U.S.C. §§ 3371, 3372, 3374, 3431(a) (1988).

15. The NGPA as amended by the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157, 157-58 (1989), provides for the phased decontrol of all first sales of natural gas by January 1, 1993. Canada has also decontrolled its wellhead prices. THE WESTERN ACCORD, AN AGREEMENT BETWEEN THE GOVERNMENTS OF CANADA, ALBERTA, SASKATCHEWAN AND BRITISH COLUMBIA ON OIL AND GAS PRICING AND TAXATION (Mar. 25, 1985).

16. “First sales” are defined in § 2(21) of the NGPA, 15 U.S.C. § 3301(21), to generally include wellhead sales and subsequent sales until gas is sold to a pipeline, distributor, or end-user. See *infra* part III.D.

17. 18 C.F.R. §§ 284.8(f), 284.9(f). These provisions terminated on December 31, 1990. Order No. 500-K, III F.E.R.C. Stat. & Regs. ¶ 30,917, 56 Fed. Reg. 14,848 (1991).

18. 18 C.F.R. § 154.111 (1991).

19. *E.g.*, Northwest Pipeline Corp., 49 F.E.R.C. ¶ 61,072 (1989); Trunkline Gas Co., 42 F.E.R.C. ¶ 61,201 (Op. 297), *reh’g denied*, 43 F.E.R.C. ¶ 61,180 (1988); Transwestern Pipeline Co., 32 F.E.R.C. ¶ 61,009 (1985) (Op. 238), *reh’g denied*, 36 F.E.R.C. ¶ 61,175 (1986) (Op. 238-A).

20. *Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, Order Denying Rehearing and Granting in Part Applications for Stay*, [1982-1985 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 30,584, at 31,061, 49 Fed. Reg. 31,259 (1984), *aff’d*, Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, Trunkline Gas Co. v. FERC, 476 U.S. 1114 (1986).

21. The Alaska Natural Gas Transportation System is regulated under the Alaska Natural Gas Transportation Act, 15 U.S.C. § 719 (1988).

22. In 1990, 1,111 Bcf of gas was imported under long term contracts compared with 421 Bcf

C. *The Problematic Division of Jurisdiction Between FERC and OFE*

Throughout this fundamental transition, the same basic statutory framework of the Natural Gas Act of 1938²³ governed the domestic gas industry. The goal of the Natural Gas Act, including the regulation of imports, is "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges."²⁴ Regarding imports, section 3 of the Natural Gas Act²⁵ is the primary statutory authority for regulation of both the movement of gas across the United States border and the sale of gas at the border. Section 3 requires prior government approval of any import or export of natural gas. The National Energy Board of Canada (NEB) exercises a corresponding authority for Canada.²⁶ Thus, to move gas across the border requires both an NEB export authorization and a section 3 import authorization. Section 3 is currently delegated to the Office of Fossil Energy (OFE)²⁷ in the U.S. Department of Energy (DOE).²⁸

Section 3 prescribes a "public interest" standard for proposed imports. Although the public interest test was traditionally viewed as substantially equivalent to the "public convenience and necessity" standard prescribed by section 7 of the Natural Gas Act,²⁹ OFE has adopted a far more liberal interpretation of the showing necessary to justify an import. Instead of requiring an examination of the border price, the need for gas, the security of supply, the effect on domestic supplies, and other factors,³⁰ OFE now focuses on the existence of "competition" without consideration of the specific details of any particular transaction.

The transition has been made difficult due to a division in responsibility for implementing the Natural Gas 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 Act (DOE

of imports under spot market contracts. ENERGY INFO. ADMIN., NAT. GAS MONTHLY 14, tbl. 6 (December 1991).

23. 15 U.S.C. §§ 717-717w (1988) (originally enacted as Act of June 21, 1938, ch. 556, 52 Stat. 821 (1938)).

24. *Atlantic Ref. Co. v. Public Serv. Comm'n of N.Y.*, 360 U.S. 378, 388 (1959).

25. 15 U.S.C. § 717b (1988).

26. National Energy Board Act, R.S.C., ch. 46, § 22 (1959) (Can.).

27. Prior to 1989, OFE's responsibilities were performed by the Economic Regulatory Administration (ERA), another component of the DOE. This article will use OFE to refer to its predecessor, the ERA, for actions taken prior to February 1989.

28. Delegation Order No. 0204-127, 54 Fed. Reg. 11,436 (Dep't Energy Feb. 7, 1989).

29. 15 U.S.C. § 717f (1988).

30. *West Virginia Pub. Servs. Comm'n v. Department of Energy*, 681 F.2d 847, 851 (D.C. Cir. 1982).

Act)³¹ transferred responsibility for gas imports and exports from the FPC to the Secretary of Energy. All other Natural Gas Act responsibilities were transferred to FERC as the successor to the FPC. Under sections 4, 5, and 7 of the Natural Gas Act, FERC continues to regulate sales for resale and transportation of natural gas in interstate commerce *after* it crosses the border.³² 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.³³ However, the DOE Act qualified the assignment to FERC of these duties: "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 function to the Commission."³⁴ There is no clear statutory line which separates regulation of the *importation* of gas as opposed to regulation of its downstream disposition. Proponents of OFE jurisdiction argue that its regulation of imports should extend to the burnertip consumption of the imported gas, and have sought proposed legislation which would preempt FERC or state regulation of downstream transactions.³⁵ In contrast, 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, these responsibilities can be delegated to other DOE units,³⁶ including the quasi-independent FERC.³⁷ The resulting "delegation orders" have attempted to define the respective jurisdiction of FERC and OFE as well as the criteria to be used by OFE in deciding import cases.³⁸

Part of the current confusion over the division of responsibilities between OFE and FERC stems from the fact that from 1977 until 1984, the

31. Pub. L. No. 95-91, 91 Stat. 567 (1977) (codified at 42 U.S.C. §§ 7101-7352 (1988)) (DOE Act).

32. 15 U.S.C. §§ 717c, 717d, 717f (1988).

33. *E.g.*, Office of Consumers' Counsel v. FERC, 783 F.2d 206 (D.C. Cir. 1986). *But see* Trans-Canada PipeLines Ltd. v. FERC, 878 F.2d 401 (D.C. Cir. 1989).

34. 42 U.S.C. § 7172(f) (1988).

35. H.R. 776, § 201, 102d Cong., 2d Sess. (1992); HOUSE COMM. ON ENERGY AND COMMERCE, COMPREHENSIVE NATIONAL ENERGY POLICY ACT, H.R. Rep. No. 102-474, 102d Cong., 2d Sess. (1992) (reported Mar. 11, 1992).

36. DOE Act, § 642, 42 U.S.C. § 7252 (1988).

37. *Id.* § 402(e), 42 U.S.C. § 7172(e) (1988).

38. Delegation Order No. 0204-112, I F.E.R.C. Stat. & Regs. ¶ 9913, 49 Fed. Reg. 6684, 6690 (Dep't Energy Feb. 22, 1984).

Secretary of Energy had delegated significant responsibilities under section 3 to FERC.³⁹ Although subsequent delegation orders shifted more responsibilities to OFE,⁴⁰ most import transactions, particularly those involving new facilities, still require authorizations from both agencies.⁴¹ This overlap results in the possibility that the two agencies will take inconsistent actions on the same import transaction. In order to foreclose action by FERC inconsistent with an OFE import license, the Secretary has formally delegated to FERC the responsibilities which Congress had already assigned to FERC under sections 4, 5, and 7 of the Natural Gas Act. However, the Secretary conditioned this duplicative delegation to require 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 [OFE]."⁴² Advocates of FERC regulation of imported gas claim that the delegation is superfluous and that the condition is not binding. In contrast, advocates of imported gas transactions have used this delegation order as a basis for seeking exceptions to FERC's generic policies governing the U.S. gas industry.

As discussed below, the division of authority between FERC and OFE continues to be controversial. The controversy in part reflects the perception that OFE 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. Advocates for both views have sought new legislation to alter the current division. To date, legislation reuniting section 3 with the other provisions of the Natural Gas Act under FERC has not been adopted. However, the current National Energy Security Act pending before Congress would effectively deregulate imports and moot the dispute.⁴³

II. CRITERIA USED TO EVALUATE IMPORTS

In February 1984, the Secretary of Energy issued policy guidelines

39. Delegation Order No. 0204-8, I F.E.R.C. Stat. & Regs. ¶ 9902, 42 Fed. Reg. 61,491 (Dep't Energy Dec. 5, 1977).

40. Delegation Order No. 0204-111, I F.E.R.C. Stat. & Regs. ¶ 9913, 49 Fed. Reg. 6684, 6690 (Dep't Energy Feb. 22, 1984).

41. *Id.* No. 0204-112, § (a). Since the division of Natural Gas Act responsibilities under the DOE Act, an importer needs authorizations from both OFE and FERC in most cases. See David L. 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).

42. Delegation Order No. 0204-112, § (c).

43. SENATE COMM. ON ENERGY AND NATURAL RESOURCES, NATIONAL ENERGY SECURITY ACT OF 1991, S. Rep. No. 102-72, 102d Cong., 1st Sess. (1991); S. 1220, § 11104(e)(1), 102d Cong., 1st Sess. (1991). See *infra* parts III.B.3 and III.H.

for ERA consideration of section 3 import applications.⁴⁴ These guidelines still govern import authorizations after the transfer from the ERA to OFE. The guidelines have limited substantive effect in individual proceedings, because as a statement of general policy, the conclusions resulting from the application of the guidelines are to be subject to complete attack before they are applied in a particular case.⁴⁵

The 1984 Guidelines found “ample evidence that most imported gas is not competitive in the markets served, placing a heavy financial burden on U.S. gas consumers.”⁴⁶ Contrarily, by 1988 ERA had concluded that the “policy presumes that buyers and sellers, if free from unnecessary governmental interference, will negotiate competitive arrangements.”⁴⁷ The 1984 Guidelines appear to place the burden of proof on the applicant to demonstrate that an import transaction is competitive.⁴⁸ However, in practice, ERA and OFE have placed the burden of proof on the intervenors challenging an import.⁴⁹

Under the 1984 Guidelines, applicants may seek either long-term import authorizations, or two-year blanket authorizations for a series of short-term transactions. However, the long-term authorizations which predate the 1984 Guidelines still remain, and amendments to those authorizations are routinely approved if the applicants can demonstrate some incremental improvement in the competitiveness of their terms. The fact that the parties agree to the terms is sufficient, even if the contracts are not competitive under an objective standard. OFE has declined to state what factors must be demonstrated to rebut the

44. New Policy Guidelines and Delegation Orders from Secretary of Energy to Economic Regulatory Administration and Federal Energy Regulatory Commission Relating to the Regulation of Imported Natural Gas, [1977-1989 ERA Opinions & Orders] 1 ERA ¶ 70,011, 49 Fed. Reg. 6684 (1984). Domestic producers have challenged the guidelines as not properly promulgated because the Secretary of Energy did not refer the guidelines to FERC pursuant to 42 U.S.C. § 7174(a). However, the Fifth Circuit in *Panhandle Producers & Royalty Owners Ass'n v. ERA*, 847 F.2d 1168, 1173-74 (5th Cir. 1988), held that private parties do not have standing to challenge DOE actions for failure to comply with this requirement.

45. *Panhandle Producers*, 847 F.2d at 1175; see also *Panhandle Producers & Royalty Owners Ass'n v. ERA*, 822 F.2d 1105, 1111 (D.C. Cir. 1987).

46. 49 Fed. Reg. 6684 (1984).

47. *National Steel Corp.*, 1 ERA ¶ 70,811, at 72,973 (1988) (Op. 251-A), *aff'd sub nom. Michigan Consolidated Gas Co. v. ERA*, 889 F.2d 1110 (D.C. Cir. 1989).

48. “The importer will be required to demonstrate that the provisions in the proposed import arrangement, collectively, ensure that the gas will be competitive.” [1977-1989 ERA Opinions & Orders] 1 ERA ¶ 70,011, at 70,018, 49 Fed. Reg. 6684 (1984); accord, *Texas E. Transmission Corp.*, 1 ERA ¶ 70,634, at 72,502 (1986).

49. See, e.g., *Northridge Petroleum Mktg. U.S., Inc.*, 1 ERA ¶ 70,610, at 72,447 (1985), *aff'd sub nom. Panhandle Producers*, 822 F.2d 1105. The courts have interpreted § 3 as placing the burden of proof on the issue of ultimate public interest on the protesters. *New England Fuel Inst. v. ERA*, 875 F.2d 882, 888-89 (D.C. Cir. 1989); *Panhandle Producers*, 822 F.2d at 1111.

presumption of competitiveness.⁵⁰

In addition to the substantive criteria announced in the 1984 Guidelines, OFE also has mechanical application requirements.⁵¹ However, this regulation is not strictly enforced as the applicant is required to supply the specified information "to the extent applicable."⁵² By approving applications that frequently contain little more than recitations of portions of the 1984 Guidelines, "it would appear that DOE's procedure for reviewing applications to import Canadian natural gas has become somewhat of a rubber stamp."⁵³

A. *Importers Showing For Long-term Authorizations*

For a long-term transaction, the applicant must show an arms-length transaction which is sufficiently flexible throughout its contract term. Enforcement of this requirement is lax; the mere allegation is sufficient. In addition, OFE "has not articulated precisely how flexible the terms must be to support the inference that the gas will be competitive."⁵⁴ For a long-term transaction, any price redetermination clause appears to be a sufficient basis to claim the requisite flexibility. The border contract itself need not provide flexibility. For example, in the Alberta Northeast Gas (ANE)/Iroquois imports, OFE approved border contracts which required each importing distribution company to pay all charges incurred by ANE without any renegotiation or arbitration rights. However, the ANE contract with its Canadian suppliers contained a renegotiation clause which allowed ANE to modify the commodity charge, but not the demand charge, through renegotiation or arbitration.⁵⁵

A DOE study illustrates that flexibility can work against the importer.⁵⁶ All fifty-eight current long-term contracts had some price escalator or price adjustment provision.⁵⁷ Forty-five of these contracts,

50. *National Steel*, 1 ERA ¶ 70,811, at 72,924.

51. 10 C.F.R. § 590.202 (1992).

52. *Id.*; *Panhandle Producers*, 847 F.2d at 1175.

53. *Competition to Serve Northeast Natural Gas Markets: Hearings Before the Senate Comm. on Energy and Natural Resources*, 101st Cong., 2d Sess. 28 (1990) (testimony of Mark C. Schroeder, Deputy General Counsel, Dep't Energy).

54. *Panhandle Producers*, 822 F.2d at 1113 n.4.

55. *Brooklyn Union Gas Co.*, 1 FE ¶ 70,285, at 71,200 (1990) (Op. 368).

56. Joan Heinkel & William Trapmann, *Analysis of Long-term Contracts for Imports of Canadian Natural Gas*, ENERGY INFO. ADMIN., NAT. GAS MONTHLY 1, 9 (May 1991).

57. *Id.*

covering ninety-six percent of the volumes, provide for periodic renegotiation of commodity charges.⁵⁸ The frequency of the renegotiation is usually one year, but is as infrequent as every ten years.⁵⁹ Seventy-one percent of total long-term volumes are sold under contracts which tie commodity charges to some other fuel.⁶⁰ This can result in rapid price increases during unstable periods, such as the recent Gulf War, where oil prices will rise more than gas prices.

Although the 1984 Guidelines condemn prior import arrangements for containing take-or-pay clauses,⁶¹ such requirements were not prohibited. Various forms of take-or-pay⁶² and minimum take requirements⁶³ have been permitted and are present in contracts covering eighty percent of long-term volumes.⁶⁴ Provisions which reduce future contractual volumes if the importer fails to take a specified minimum level have also been approved.⁶⁵ These requirements can be stated in terms of an absolute volume or as a percentage share of the importer's total sales market.

The 1984 Guidelines declare, "The federal government's primary responsibility in authorizing imports should be to evaluate the need for the gas"⁶⁶ Once the contract is claimed to be "competitive," the 1984 Guidelines create a rebuttable presumption that the gas is needed.⁶⁷ However, OFE has never found any proffer of evidence sufficient to rebut this presumption. Although the 1984 Guidelines state, "To the extent that there is a specific objection on the grounds of need for the import, the focus should be on the overall energy requirements in the market that can be competitively met by domestic natural gas and other fuels."⁶⁸ However, OFE has declined to consider evidence regarding the impact of proposed imports on the domestic natural gas production⁶⁹ or on other

58. *Id.*

59. *Id.*

60. *Id.* ("(including coal and electricity), an index or market basket of alternate fuel prices, or a combination of petroleum, natural gas, and other fuel or energy prices").

61. [1977-1989 ERA Opinions & Orders] 1 ERA ¶ 70,011, at 70,012, 70,016, 49 Fed. Reg. at 6687, 6688.

62. *E.g.*, Northern Natural Gas Co., 1 FE ¶ 70,460 (1991) (Op. 514); Texas E. Transmission Corp., 1 ERA ¶ 70,634 (1986) (Op. 112).

63. Pacific Gas Transmission Co., 1 ERA ¶ 70,528 (1981) (Op. 29).

64. Heinkel & Trapmann, *supra* note 56, at 9.

65. *E.g.*, Boston Gas Co., 1 FE ¶ 70,503 (1991) (Op. 552); New England Power Co., 1 FE ¶ 70,502 (1991) (Op. 551); Brooklyn Union Gas Co., 1 FE ¶ 70,285 (1990) (Op. 368), *amended by* Order No. 386-D (Nov. 11, 1991).

66. 49 Fed. Reg. 6685.

67. 49 Fed. Reg. 6688.

68. *Id.*

69. Texas E. Transmission Corp., 1 ERA ¶ 70,744, at 72,801 (1987) (Op. 202-A), *aff'd sub nom.* Independent Petroleum Ass'n of Am. v. ERA, 870 F.2d 168 (5th Cir. 1989) ("The public

fuels.⁷⁰

The final criterion specified by the 1984 Guidelines is security of supply. OFE assumes that any Canadian supply is secure and does not inquire as to the extent to which long-term reserves are committed by Canadian producers to a particular transaction. Nor does OFE determine whether the net back price available to Canadian producers in a particular transaction would be sufficient to retain the gas supplies.⁷¹

B. *Importers Showing For Two-Year Blanket Authorizations*

As the domestic gas industry moved toward increasing reliance upon the spot market, the NEB and OFE adopted separate criteria for licensing short-term arrangements. Each granted "blanket" authorizations to provide for an unlimited number of transactions to be conducted during a particular two year period. Because the volume and price or the identities of the supplies or markets in the individual transactions are not known at the time of the application, these items are not included in the application. Hence, no showing of supply, markets, or pricing terms is required.

Instead, the applicant merely recites that the short term of the transaction provides the requisite flexibility. Because an unlimited number of extensions of blanket authorization are granted routinely,⁷² there is a possibility that the importer may build a dependence on the imports which would belie the "flexibility" which OFE presumes from the two-year term.

Producers have sought to limit the blanket import authorizations only to those markets served by open access pipelines. The ERA rejected this condition in *Tennessee Gas Pipeline Co.*⁷³ The only condition that OFE imposes on blanket import authorizations is to limit the overall authorization to two years. OFE approves all requested volumes, even

interest inquiry . . . 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.").

70. Granite State Gas Transmission, Inc., 1 ERA ¶ 70,717, at 72,713 (1987) (Op. 187), *aff'd sub nom.* New England Fuel Inst. v. ERA, 875 F.2d 882 (D.C. Cir. 1989).

71. Brooklyn Union Gas Co., 1 FE ¶ 70,285, at 71,215 (1990).

72. See, e.g., ICG Marketing, Inc., 1 ERA ¶ 70,653 (Op. 130), *extended*, 1 FE ¶ 70,209 (1989), *transferred sub nom.* Canadian Hydrocarbons Mktg. (U.S.), Inc., 1 FE ¶ 70,399 (1990) (Op. 468), *extended*, 1 FE ¶ 70,413 (1991) (Op. 479); Salmon Resources, Ltd., 1 ERA ¶ 70,612 (1985) (Op. 94), *extended*, 1 ERA ¶ 70,749 (1988) (Op. 217), *extended*, 1 FE ¶ 70,287 (1990) (Op. 370); Poco Petroleum, Inc., 1 ERA ¶ 70,752 (1988) (Op. 220), *extended*, 1 FE ¶ 70,290 (1990) (Op. 372).

73. 1 ERA ¶ 70,674 (1986), *aff'd sub nom.* Panhandle Producers & Royalty Owners Ass'n v. ERA, 847 F.2d 1168 (5th Cir. 1988).

though the total volumes authorized far exceed existing pipeline capacity at the border. During the third quarter of 1991, sixty-one companies used their blanket section 3 authorizations to import 147.8 Bcf of natural gas at an average price of \$1.28 per MMBtu.⁷⁴ In contrast, during that quarter, 236.6 Bcf of natural gas was imported from Canada under long-term authorization at an average price of \$1.88 per MMBtu.⁷⁵

III. CURRENT CONTROVERSIES

A. Gas Purchasing Practices

Domestic gas producers claim that the clouded boundary between FERC and OFE jurisdiction creates several regulatory advantages which encourage interstate pipelines to purchase Canadian gas when less expensive domestic supplies are available. The most significant collision between OFE and FERC authority occurs in the subsequent review of interstate pipeline decisions to purchase imported gas. Although this FERC/OFE conflict has diminished as interstate pipelines withdraw from their role as gas merchants, the conflict is likely to reappear at the state level when state utility commissions will seek to review the gas purchasing patterns of local distribution companies which import gas. As the gas industry has evolved away from prior approval and direct regulation of individual gas purchases, the after-the-fact prudence reviews in subsequent rate cases has grown in significance.

In response particularly to the increase in gas prices from 1979 to 1982, customers have actively challenged pipeline gas purchasing practices, even in the face of a statutory guarantee of pass-through of domestic wellhead gas costs.⁷⁶ When gas purchasing practices are successful, the interstate pipeline absorbs the imprudent cost.⁷⁷ State utility commissions also review the prudence of the purchasing practices of local distribution companies.⁷⁸ However, unlike domestic wellhead purchases, the purchase of Canadian gas has not been subject to the same degree of

74. OFFICE OF FOSSIL ENERGY, DEP'T ENERGY, NATURAL GAS IMPORTS AND EXPORTS: THIRD QUARTER REPORT (Sept. 1991).

75. *Id.*

76. 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).

77. Columbia Gas Transmission Corp., 42 F.E.R.C. ¶ 61,021 (1988), *aff'd sub nom.* Office of Consumers' Counsel v. FERC, 842 F.2d 1308 (D.C. Cir. 1988); see also Kathleen T. Puckett, *The "Fraud, Abuse, or Similar Grounds" Exception Under Section 601(c)(2) of the NGPA*, 6 ENERGY L.J. 59 (1985).

78. *E.g.*, Re Southern Cal. Gas Co., 126 Pub. Util. Rep. 4th (PUR) 129 (Cal. Pub. Util. Comm'n 1991) (disallowing \$2.2 million for failure to purchase spot gas).

prudence scrutiny in an after-the-fact review of purchasing practices. For example, in *Northwest Pipeline Corp.*,⁷⁹ the pipeline entered into a border contract which 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 prudence of Northwest's purchasing practices which honored the contract, FERC held that OFE approval of the import contract precluded FERC from examining the prudence of decisions regarding Canadian supplies.⁸⁰ FERC assumed that OFE would provide a forum for challenging the prudence of such transactions. However, OFE has construed the section 3 public interest standard so narrowly as to prevent such inquiries.⁸¹

In the case of the Northwest import, the OFE had previously approved the Northwest border contract when it covered prices as high as \$4.94 per MMBtu. Hence, OFE argued that when Northwest negotiated a price reduction in exchange for a forty-five percent market share guarantee, no further section 3 authorization was required, as long as the border price did not exceed \$4.94.⁸² Nonetheless, Northwest did ask OFE to declare that one of its amendments was in the public interest, which OFE did.⁸³ Subsequent amendments of the Northwest import authorization drew further prudence challenges before OFE on February 2, 1987, by customers and domestic producers,⁸⁴ but OFE has taken no action on these pleadings. In *TransCanada PipeLines Ltd. v. FERC*,⁸⁵ the D.C. Circuit held that the prudence challenges to gas imports should be heard before OFE rather than FERC. However, the *TransCanada* decision did not address the broader question of whether FERC or a state commission may disallow imported gas costs in its overall review of the purchasing practices of a pipeline or distributor which includes some imported gas.

More recently, in the face of a direct challenge from the State of Connecticut, OFE has backed away from its absolute position in the *Northwest* decision:

79. 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).

80. *Id.*

81. *See, e.g.,* *Texas E. Transmission Corp.*, 1 ERA ¶ 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); *Entrade Corp.*, 1 ERA ¶ 70,774, at 72,887 (1988).

82. *Northwest*, 1 ERA ¶ 70,604, at 72,428 (1985).

83. *Id.*

84. *TransCanada*, 878 F.2d at 406, 408.

85. 878 F.2d 401 (D.C. Cir. 1989).

A DOE finding that an import is not inconsistent with the public interest subsumes a finding of prudence. However, this finding is not meant to preclude state agencies from setting appropriate rates for entities they regulate. DOE emphasizes that no state regulatory body has claimed in this proceeding that the purchasing practices engaged in here are inconsistent with state regulatory policies.⁸⁶

After the *TransCanada* decision, considerable confusion remains regarding the appropriate forum for challenging purchasing practices involving Canadian imports.⁸⁷ FERC views this issue as precluded while it will permit a similar inquiry regarding purchases of domestic supplies which carry a statutory guarantee of passthrough. FERC does concede that imported gas costs can be challenged in state commission proceedings.⁸⁸ OFE has declined to consider evidence proffered on the prudence question, but leaves the door open to prudence challenges in downstream state commission proceedings if the importer is a state-regulated local distribution company.

With challenges precluded under the section 4 authority of FERC, the possibility of a forum before FERC remains for those imports which involve transportation or pipeline construction requiring an application for a section 7 certificate of public convenience and necessity. In *ANR Pipeline Co. v. FERC*,⁸⁹ two pipelines sought case-specific certificate authority to transport imported gas to a third pipeline, Texas Eastern, which had obtained a long-term section 3 import license from ERA. At the time, both pipelines had refused to offer "open access" transportation for domestic production, and FERC limited the certificates to the earlier of two years or the date that the pipelines accepted "open access" certificates. Domestic producers challenged the certificates on the grounds that FERC had failed to consider whether the transaction, including the border sale, served the public interest. The D.C. Circuit acknowledged FERC's authority to "independently examine any effects claimed to be due to the specific transportation proposed, as opposed to the effects inherent in the importation and sale of gas in the United States as a whole."⁹⁰ However, FERC subsequently disclaimed its authority to examine the public interest consequences of a specific import border price

86. Brooklyn Union Gas Co., 1 FE ¶ 70,285, at 71,215 (1990), amended by Op. 368-D (Nov. 11, 1991).

87. Louisiana Ass'n of Indep. Producers & Royalty Owners v. FERC, 958 F.2d 1101, 1122-23 (D.C. Cir. 1992).

88. Boundary Gas Inc., 40 F.E.R.C. ¶ 61,302 (1987).

89. 876 F.2d 124 (D.C. Cir. 1989).

90. *Id.* at 132.

arrangement in a section 7 certificate proceeding.⁹¹ As a result, there may be no effective federal forum for parties seeking to challenge gas imports.

The D.C. Circuit in *Louisiana Association of Independent Producers and Royalty Owners v. FERC (Iroquois)*,⁹² clarified the scope of FERC's remaining authority over import transactions, and harmonized *Trans-Canada* and *ANR*. The case involved a billion dollar project to transport Alberta gas to the northeast United States. FERC had issued a certificate to authorize the construction of the Iroquois pipeline from Canada to Long Island and the expansion of the Tennessee and Algonquin systems. Domestic producers claimed that the rate tilt at the border should be corrected to avoid an anticompetitive effect.⁹³ The court noted that OFE and FERC deferring to each other to resolve the rate tilt issue "sounds a bit like the Alphonse-Gaston act."⁹⁴ The court drew a distinction "between FERC's direct consideration of the validity of import contracts approved by [OFE] (which *ANR* petitioners apparently sought) and its consideration of other issues (whether or not also considered by [OFE]), when determining matters such as transportation rates within the Commission's jurisdiction."⁹⁵ Thus, an OFE finding that an import is "competitive" does not preclude FERC from making its own findings regarding anticompetitive effects of the import.⁹⁶

A related variation of the prudence issue was raised in *Trunkline LNG Co. v. FERC*,⁹⁷ where both FERC and ERA had authorized the importation of liquefied natural gas to a facility which FERC had certificated under section 7. The transaction was abandoned as uneconomic, and customers challenged the import contract as imprudent in a section 4 rate proceeding before FERC. Initially, FERC disclaimed jurisdiction over the prudence issue, but later sought a remand to rethink the issue. The court remanded the issue to FERC, over the objection of the pipeline, on the grounds that the court was uncertain whether ERA had made a prudence determination.

As a result of these decisions, imported natural gas has escaped the

91. *Iroquois Gas Transmission System, L.P.*, 52 F.E.R.C. 61,091, *reh'g denied in part*, 53 F.E.R.C. ¶ 61,194, at 61,700-01 (1990) (Op. 357), *aff'd sub nom.* *Louisiana Ass'n of Indep. Producers & Royalty Owners v. FERC*, 958 F.2d 1101 (D.C. Cir. 1992).

92. 958 F.2d 1101 (D.C. Cir. 1992).

93. *See infra* part III.B.

94. *Louisiana Ass'n*, 958 F.2d at 1121.

95. *Id.* at 1122.

96. *Id.* at 1123.

97. 921 F.2d 313 (D.C. Cir. 1990).

intense regulatory pressures which have adversely affected the long-term wellhead contracts that have governed domestic wellhead sales of gas. Although the NGPA guaranteed domestic wellhead sales passthrough of costs in downstream rates, imported gas costs, which do not have the benefit of such a statutory guarantee, have largely escaped scrutiny.

B. *Two-Part Border Price Distortions*

Canadian pipeline rates are designed with all fixed costs recovered in the pipeline demand charge (a pure fixed variable rate design). FERC generally applies a "modified fixed variable" (MFV) rate design which requires domestic pipelines to recover certain fixed costs (return on equity and associated taxes) in the pipeline commodity rate.⁹⁸ FERC has also required certain production-related fixed costs, such as gathering, to be recovered in commodity rates.⁹⁹ During the natural gas shortage from 1975 through 1984, the NEB established a minimum commodity export floor price which was tied to the price of energy alternatives in the United States.¹⁰⁰ This one-part floor price was sufficient to recover all demand and commodity charges incurred in transporting the gas to the border. However, as the NEB permitted a return to individually negotiated border prices, Canadian suppliers sought contract amendments authorizing border prices which collected both monthly demand charges as well as commodity charges. Currently, fifty-three of fifty-eight long-term border contracts feature two-part rates.¹⁰¹ The demand charges were negotiated to be at least as high as the demand charges of the Canadian pipelines with a reduced amount of revenues remaining to be collected in the commodity charges. 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 approach would work particularly well in the competitive California market because the California Public Utilities Commission (CPUC) sequenced supplies in Southern California based on a comparison of commodity charges alone.¹⁰² The resulting difference in commodity rates caused by different rate design methods used in the two

98. Natural Gas Pipeline Co. of Am., 25 F.E.R.C. ¶ 61,176 (1983).

99. Natural Gas Pipeline Co. of Am., 37 F.E.R.C. 61,215, at 61,545 (1986).

100. Mary E. Baluss, *Regulatory Developments Affecting Imports of Canadian Natural Gas*, in THE 1989 NATURAL GAS YEARBOOK 153-54 (Executive Enterprises Publications Co. ed., 1989).

101. Heinkel & Trapmann, *supra* note 56, at 8.

102. In retail rates, California distributors recover all costs in a commodity rate, except for electric generation customers which pay a two-part demand/commodity rate. Re Rate Design for Unbundled Gas Utility Services, 123 Pub. Util. Rep. 4th (PUR) 65 (Cal. Pub. Util. Comm'n 1991).

countries is called a "rate tilt." One study has quantified the size of the rate tilt as favoring Canadian gas in Northeast markets by eighteen to forty-two cents per Mcf.¹⁰³

1. The "As Billed" Decision, Opinion No. 256

FERC addressed this competitive disparity in *Natural Gas Pipeline Co. of America*,¹⁰⁴ when a pipeline renegotiated its border contract from a one-part commodity only price to a two-part, demand/commodity formula. The pipeline proposed to recover its Canadian gas costs in its resale demand and commodity resale rates as they were billed at the border. After an evidentiary hearing, FERC found that a more favorable demand charge recovery would result in the pipeline preferring to purchase the more expensive Canadian gas because of its lower marginal cost. As a result, FERC required domestic pipelines that purchased Canadian gas for system supply to recover Canadian gas costs in their domestic pipeline's sales rate using the FERC criteria for dividing costs between demand and commodity charges. Thus, domestic pipelines could not automatically collect all Canadian gas demand charges in the demand charge of the resale rates. This established a "level playing field" of competition between domestic and imported supplies.

FERC then applied its decision to a number of pending rate cases involving Canadian imports,¹⁰⁵ and amended its regulations¹⁰⁶ to reflect the Opinion No. 256 policy. In response, the Canadian interests unsuccessfully protested Opinion No. 256, including an exchange of letters between Canadian Prime Minister Brian Mulrooney and President Ronald Reagan.¹⁰⁷ Following Opinion No. 256, the Canadians implemented two-part rates on the NOVA system, one of the Canadian pipelines which transported the gas,¹⁰⁸ and reclassified facilities from gathering to transmission in order to reduce the size of the Opinion No. 256 adjustment from demand to commodity rate recovery.

103. *Competition To Serve Northeast Natural Gas Markets: Hearings Before the Senate Comm. on Energy & Natural Resources*, 101st Cong., 2d Sess. 216 (1990) (report by Prather Energy Associates).

104. 37 F.E.R.C. ¶ 61,215 (1986) (Op. 256), *aff'd sub nom.* TransCanada PipeLines Ltd. v. FERC, 878 F.2d 401 (D.C. Cir. 1989).

105. *E.g.*, Northwest Pipeline Corp., 37 F.E.R.C. ¶ 61,255 (1986); Northern Natural Gas Co., 37 F.E.R.C. ¶ 61,343 (1986); Great Lakes Gas Transmission Co., 38 F.E.R.C. ¶ 61,005 (1987); Texas E. Transmission Corp., 38 F.E.R.C. ¶ 61,072 (1987).

106. 18 C.F.R. § 154.305(b)(3) (1991).

107. OFFICE OF INTERNATIONAL ENERGY ANALYSIS, DEP'T ENERGY, U.S.-CANADA GAS TRADE REVIEW (Nov. 1987).

108. *See* Natural Gas Pipeline Co. of Am., 39 F.E.R.C. ¶ 61,218, at 61,769 (1987) (Op. 256-A).

2. Subsequent Evasions of the Policy

Several loopholes in FERC's efforts developed. First, certain importers making sales for resale asked to be exempted from Opinion No. 256 on the grounds that they were merely an "accounting conduit."¹⁰⁹ Second, the Natural Gas Act jurisdiction of FERC is limited to sales for resale and transportation. Canadian import transactions were restructured to avoid jurisdictional sales for resale by transferring title to local distribution companies at the border. For example, a number of the participants in the Boundary project reorganized subsequent phases of that project to aggregate purchases on the Canadian side of the border with each distributor holding a separate import license. Even though this structure would circumvent Opinion No. 256, OFE declined to impose a similar rate condition on the sales to the distributors.¹¹⁰ In *Iroquois*, Tennessee proposed to collect all of its costs in a demand charge only rate, and domestic producers sought for Tennessee's rates to be designed on the same basis as it applied to transportation of domestic gas. Domestic producers then sought to modify the demand/commodity split in the subsequent transportation rates to equalize the "rate tilt." The resulting mechanism, called an Annual Equalization Adjustment (AEA), was introduced in a concurrence by FERC Commissioner Charles Trabandt.¹¹¹ In *Iroquois*, domestic producers sought an AEA in the initial rates of both Tennessee and Iroquois. FERC claims that it lacks jurisdiction to adopt such remedies under the United States-Canadian Free Trade Agreement (FTA).¹¹²

Third, Canadian imports, which can not be structured as a direct sale to a distributor, can be structured to place title in a marketing affiliate of the interstate pipeline instead of the interstate pipeline taking title itself. For example, in the Tennessee NIPPS project, Transco Energy Marketing Co. (Temco), an affiliate of an interstate pipeline, took title to the gas and made sales for resale to local distribution companies served by its parent. If the pipeline parent had imported and resold the gas, it

109. FERC exempted two pipelines on this grounds, *Boundary Gas Inc.*, 40 F.E.R.C. ¶ 61,047 (1987) and *Great Lakes Gas Transmission Co.*, 38 F.E.R.C. ¶ 61,005 (1987), *reh'g granted*, 41 F.E.R.C. ¶ 61,294, at 61,782 n.6 (1987), but refused to exempt *Pacific Gas Transmission Co.*, 50 F.E.R.C. ¶ 61,067, at 61,126-29 (1990), *reh'g denied in part and granted in part*, 51 F.E.R.C. ¶ 61,086 (1990).

110. *Brooklyn Union Gas Co.*, 1 FE ¶ 70,285, at 71,212 (1990) *amended by* Op. 368-D (Nov. 11, 1991).

111. *Tennessee Gas Pipeline Co.*, 51 F.E.R.C. ¶ 61,113, at 61,291-92 (1990) (Trabandt concurring.)

112. *Iroquois Gas Transportation System, L.P.*, 53 F.E.R.C. ¶ 61,194, at 61,704 (1990) (Op. 357).

would be subject to Opinion No. 256, but when intervenors requested that the Tennessee NIPPS transaction be conditioned upon compliance with Opinion No. 256, FERC held that no sales for resale were before it.¹¹³ Temco resold the gas in NIPPS under a "blanket certificate" which FERC has generally made available to marketers. Although such certificates are theoretically subject to Opinion No. 256, FERC has yet to investigate or regulate any of the rates charged under a blanket certificate held by a marketing company.¹¹⁴

3. Proposed Legislation

The Wirth-Domenici Amendment¹¹⁵ to the National Energy Security Act¹¹⁶ would require that:

The Commission shall condition any import authorization pursuant to this section to redress any anti-competitive impacts on United States natural gas producers including, but not limited to, competitive disparities resulting from different rate designs applied to the pipeline transportation of domestic natural gas and the pipeline transportation of imported natural gas.¹¹⁷

However, the full senate approved a version of the National Energy Security Act which did not contain any provisions regarding the rate design for imported gas.

Pro-import interests countered with the Lent-Markey amendment to the House version of the bill.¹¹⁸ The House bill would limit FERC or state jurisdiction over imported gas, and would overturn Opinion No. 256, by providing:

In exercising its authority under this section and sections 5 and 7 of this Act with respect to the transportation rates and charges of an interstate pipeline . . . the Commission shall base any determination of whether rates and charges are just and reasonable on costs and other factors relating directly to an interstate pipeline's transportation function, and not on any factors relating to the natural gas being transported by the interstate pipeline or on rates and charges with respect to pipelines not subject to the Commission's jurisdiction.¹¹⁹

113. *Tennessee Gas*, 51 F.E.R.C. ¶ 61,113.

114. *See infra* part III.D.

115. S. 2166, § 11104(e), 102d Cong., 1st Sess. (1991).

116. SENATE COMM. ON ENERGY AND NATURAL RESOURCES, NATIONAL ENERGY SECURITY ACT OF 1991, S. Rep. No. 102-72, 102d Cong., 1st Sess. (1991); S. 1220, § 11104(e)(1), 102d Cong., 1st Sess. (1991). *See infra* parts III.D and III.H.

117. S. 2166, § 11104(e).

118. H.R. 776, 102d Cong., 2d Sess. (1992).

119. H.R. 776, § 201(b), 102d Cong., 2d Sess. (1992) (reported out of the House Comm. on Energy and Commerce on Mar. 11, 1992, and passed by the House on May 27, 1992).

In summary, in the absence of any new legislation, the rate design issue is left within the discretion of FERC.

4. The Rate Design Under the Restructuring Rule

In a 1989 policy statement, FERC requested that parties reconsider the use of the MFV rate design in individual pipeline rate proceedings.¹²⁰ However, the implementation of that policy statement was slow due to the protracted nature of the rate hearing process. In an effort to establish comparability between pipeline sales and transportation service as well as to clarify the scope of the service obligation which pipelines owe to their sales customers, on July 31, 1991, FERC proposed a sweeping restructuring of pipeline services, the so-called "Mega-NOPR."¹²¹ The Mega-NOPR sought to revisit FERC's MFV rate design, noting that "MFV was devised to design bundled city gate sales rates to help pipelines sell gas by shifting costs from the commodity charge to the demand charge."¹²² After extensive public comment, on April 8, 1992, the Commission issued its Restructuring Rule.¹²³ The Restructuring Rule found MFV rates to be unjust and unreasonable under section 5 of the Natural Gas Act¹²⁴ noting:

This situation of differing levels of fixed costs in pipeline usage [commodity] charges can hinder competition between gas sellers at the wellhead because competition is not based on the seller's costs and therefore on their ability to compete directly with each other. Rather, competition for sales customers is influenced by the fixed costs in the pipeline transportation usage charges.¹²⁵

Accordingly, FERC proposed to make a generic section 5 finding that MFV rates are unjust and unreasonable. The Restructuring Rule adopted a straight fixed variable (SFV) rate design to replace MFV, but permitted parties in each of ninety individual pipeline proceedings to agree upon the selection of a new rate design other than SFV. However, "any party (or parties) advocating something other than SFV carries a

120. Interstate Natural Gas Pipeline Rate Design, 47 F.E.R.C. ¶ 61,295 (1989).

121. Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation, IV F.E.R.C. Stat. & Regs. ¶ 32,480, 56 Fed. Reg. 38,372 (1991).

122. *Id.* at 32,556.

123. Order No. 636, III F.E.R.C. Stat. & Regs. ¶ 30,939, 57 Fed. Reg. 13,267 (1992), *reh'g granted in part and denied in part*, Order No. 636-A, 57 Fed. Reg. 36,128 (Aug. 12, 1992).

124. *Id.* ¶ 30,939, at 30,434.

125. *Id.* ¶ 30,939, at 30,433-34.

heavy burden of persuasion.”¹²⁶ The Restructuring Rule set a firm timetable for implementation of the restructuring and rate changes by the 1993-94 winter to avoid the delays that had been encountered in implementing the 1989 rate design policy statement. Although progress in departing from MFV rates on U.S. pipelines has been slow, OFE nonetheless has cited FERC’s “ongoing review of pipeline rate design” as the basis for rejecting requests by intervenors to impose Opinion No. 256-type adjustments to two-part border rates.¹²⁷ Because OFE considered and rejected such a proposed adjustment in the border price under section 3, FERC in turn took the initial view that it lacked jurisdiction to make compensating changes in downstream transportation rates.¹²⁸

Although wide-spread adoption of pure fixed variable rates in the United States would eliminate much of the rate tilt problem, competitive distortions can still occur in the future if FERC either adopts rate designs which recover some fixed costs in commodity rates or adopts other “mitigation measures”¹²⁹ to shield low load factor customers from the effects of a pure fixed variable rate design. Rate tilts could also recur if the Canadians move toward an all-demand charge rate design to further escalate its quest for the lowest marginal cost.

C. *The Restructuring of Long-term Import Authorizations Held by Interstate Pipelines*

In addition to departing from the MFV rate design, the Restructuring Rule also seeks to establish comparability of service by fundamentally changing the nature of pipeline sales service. As proposed, pipelines would restructure their sales contracts with their customers to transfer title at the production area end of the pipeline rather than at the market area delivery points. All customers would become transportation customers of the pipeline and would receive equivalent service regardless of whether they purchased gas from the pipeline in the production area or from a third party. This restructuring, along with providing customers greater assurances against the unilateral abandonment by the pipeline of

126. *Id.* ¶ 30,939, at 30,434.

127. Brooklyn Union Gas Co., 1 FE ¶ 70,285, at 71,216 (1990).

128. Iroquois Gas Transmission System, L.P., 52 F.E.R.C. ¶ 61,091; 53 F.E.R.C. ¶ 61,194, at 61,704 (1990) (Op. 357), *aff'd sub nom.* Louisiana Ass'n of Indep. Producers & Royalty Owners v. FERC, 958 F.2d 1101 (D.C. Cir. 1992).

129. *E.g.*, Panhandle E. Pipe Line Co., 57 F.E.R.C. ¶ 61,264 (1991) (Op. 369) (one of the first litigated cases under the 1989 Rate Design Policy Statement).

transportation service, is expected to increase competition and to decrease reliance upon pipeline sales service to meet peak needs.

At present, the current pattern of gas supplies serving particular markets is largely a matter of history and chance. If the restructuring is successful, the distribution patterns of gas will change, with supplies serving particular markets in the most economically efficient manner. The Restructuring Rule provides methods for disposing of the resulting unneeded pipeline capacity as supply patterns change. Yet, the Restructuring Rule does not address the treatment of the large number of long-term, high volume import contracts which interstate pipelines hold to purchase gas for their sales customers.

For example, in the case of the Northwest-Westcoast contract,¹³⁰ Northwest no longer required these volumes, nor its capacity on the Pacific Gas Transmission pipeline to bring these volumes from Canada. Yet, Northwest continues to be bound by an obligation to take thirty-five percent of its sales volumes from Westcoast. Accordingly, Northwest has negotiated an assignment of the Westcoast import to four of its largest distributor customers. Under the assignment each customer is obligated to take a minimum of forty-two percent of its share of the contract demand volume.¹³¹ Domestic producers have argued that such contracts are not the product of arms-length negotiations, but rather are concessions extracted by Northwest in exchange for agreeing to a restructuring in advance of the Mega-NOPR. Because Northwest will no longer resell the gas to the four distributors, the demand/commodity division of the Westcoast import will no longer be subject to Opinion No. 256.

Similar disputes have arisen on the Pacific Gas Transmission contracts serving California¹³² and are likely to arise as other pipelines seek to reassign their long-term import contracts. This controversy further tests the assumption of OFE that the contracts presented to it for approval are serving competitive markets.

The relative timing of the resolution of the existing long-term authorizations and the reform of domestic pipelines' rates is critical. As Commissioner Trabandt noted in his concurring opinion in the certification of additional import facilities, there is a danger that delay in implementing a level playing field has the potential "of segmenting a portion of the market for imported gas for the foreseeable future and thus taking a giant

130. *See supra* part III.A.

131. Northwest Pipeline Corp., Application to Transfer Existing Import Authorization, Docket No. 92-18-NG (filed Feb. 12, 1992).

132. *See infra* part III.E.

competitive step backward at a time of crisis (if not panic) in our producing states”¹³³

The disposition of existing long-term Canadian import contracts as well as upstream pipeline capacity is a major point of contention under the Restructuring Rule. Some pipelines claim that their physical configurations require a certain portion of their total deliveries to be received from Canadian-supplied receipt points. However, because of the demand charges and minimum bills associated with certain long-term Canadian supplies, pipeline customers are reluctant to agree to a pro-rata assignment of the pipeline's rights in the current Canadian contracts. Unless some voluntary solution is developed, pipelines will propose new tariffs which require each customer to receive a minimum portion of total deliveries at these receipt points. In the meantime, at least one pipeline, Texas Eastern, has triggered the arbitration provisions in its long term contract with its Canadian supplier, ProGas.¹³⁴ Other pipelines are proposing to buyout their Canadian supply contracts with payments estimated to involve hundreds of millions of dollars.

D. *Jurisdiction of “First Sales” for Resale of Canadian Gas Within the United States*

The NGPA found that the wellhead market for natural gas had become competitive and established a gradual transition toward both price and certificate decontrol of producer sales. The NGPA sought to deregulate both producer sales and other production area sales made by gas processors and gatherers. As a result, section 2(21) of the NGPA¹³⁵ defined the term “first sale” to include all sales prior to title being taken by a pipeline, distributor, or end-user. Section 601(a)¹³⁶ removed such “first sales” of new or deregulated natural gas from FERC's section 7(c) certificate jurisdiction under the Natural Gas Act.

With the emergence of the spot market after the NGPA, brokers began to take title to gas at the wellhead. Because the broker typically took title at the wellhead prior to the sale to the end-user, the broker's sale to the end-user was deemed a “first sale” and was exempt depending upon the categories of gas sold. Because imported gas was not within the scope of section 601(a)(1), resales by brokers of such gas was regulated

133. Tennessee Gas Pipeline Co., 55 F.E.R.C. ¶ 61,484, at 62,650 (1991) (Trabandt concurring).

134. Compliance filing, FERC Docket No. RS92-11 (June 8, 1992).

135. 15 U.S.C. § 3301(21) (1988).

136. *Id.* § 3431(a) (1988).

under the Natural Gas Act in the same manner as resales by pipelines or by producers of old gas.

In order to broker all price categories of gas, some marketers sought blanket certificates to authorize their resales on a generic basis. These certificates initially excluded imported gas, and carried a one-year term in light of the experimental nature of the program. Subsequently, FERC granted blanket certificates with perpetual terms to marketers which were not affiliated with interstate pipelines, but these certificates excluded imported gas.¹³⁷ Later, some marketers sought and received one-year blanket certificates which authorized the resale of imported gas.¹³⁸ Those blanket certificates were "subject to the policy regarding pipeline pricing of imported gas supplies set forth in Opinion No. 256."¹³⁹ Finally, certain end-users and local distribution companies which held long-term import authorizations, sought and received blanket certificates to resell surplus imported gas.¹⁴⁰ FERC also amended blanket certificates issued to pipeline marketing affiliates to permit resales of Canadian gas.¹⁴¹ Brokers of imported gas claimed that the FERC's interpretation of section 2(21) as retaining Natural Gas Act jurisdiction "violated" the United States-Canadian Free-Trade Agreement (FTA),¹⁴² but FERC rejected this argument noting the equal treatment afforded under the blanket certificate.¹⁴³ The National Energy Security Act version passed by the House Energy and Commerce Committee¹⁴⁴ contains provisions which would define all "importation" to be within the NGPA definition of "first sales."

137. Texaco Gas Mktg., Inc., 42 F.E.R.C. ¶ 61,394 (1988).

138. Salmon Resources Ltd., 50 F.E.R.C. ¶ 61,101 (1990), *appeal dismissed sub nom. Tenngasco Natural Gas Co. v. FERC*, 952 F.2d 535 (D.C. Cir. 1992).

139. 51 F.E.R.C. ¶ 61,148, at 61,400.

140. JMC Fuel Servs., Inc., 57 F.E.R.C. ¶ 61,098 (1991), *reh'g denied*, 59 F.E.R.C. ¶ 61,317 (1992); Providence Gas Co., 57 F.E.R.C. ¶ 61,102 (1991), *reh'g denied*, 59 F.E.R.C. ¶ 61,317 (1992); New England Power Co., 57 F.E.R.C. ¶ 61,104 (1991), *reh'g denied*, 59 F.E.R.C. ¶ 61,317 (1992); Commonwealth Gas Co., 57 F.E.R.C. ¶ 61,205 (1991), *reh'g denied*, 59 F.E.R.C. ¶ 61,317 (1992). These blanket certificates for local distribution companies were modelled after the marketer certificates rather than incorporating the terms specified for local distribution companies by Order Nos. 63 and 319, 18 C.F.R. pt. 284, subpt. G (1991).

141. LaSER Mktg. Co., 54 F.E.R.C. ¶ 61,362 (1991).

142. The Free Trade Agreement is not a treaty. The official text was printed as an appendix to H.R. Doc. No. 216, 100th Cong., 2d Sess. (1988); 27 I.L.M. 281.

143. Enron Gas Mktg., Inc., 57 F.E.R.C. ¶ 61,257, at 61,804 (1991).

144. H.R. 776, § 201(a).

E. *The Battle for the California Market: Capacity Brokering and "Buy-Sell" Arrangements*

1. United States Policies on Capacity Brokering

FERC policies on the brokering of a shipper's interstate pipeline capacity have been evolving since FERC first adopted "open access" transportation in Order No. 436. Originally, FERC did not permit such capacity brokering and required each shipper to hold title to the gas being transported.¹⁴⁵ More recently, FERC has permitted limited capacity reassignment under highly limited blanket certificates.¹⁴⁶ Some transactions have been restructured to evade capacity brokering regulation. Instead of the end-user purchasing brokered interstate pipeline transportation capacity from a distributor, a distributor (1) buys gas from an end-user at the wellhead or border, (2) uses the distributor's capacity on the interstate pipeline to transport the gas, and then (3) resells the gas back to the end-user at the point of consumption. These "buy-sell" arrangements would be presented to FERC as the distributor using its interstate pipeline capacity for its normal system supply, when the substance of the transaction is that the end-user is transporting a separately priced gas supply. Because such arrangements require the active participation of the distributor, there is a potential that the distributor will discriminate in which customers can participate in a "buy-sell" program. Out of concern for the potential of the California distributors using their control of capacity to discriminate, FERC vacated the capacity brokering certificates held by El Paso and Transwestern¹⁴⁷ and conducted a technical conference to investigate the California "buy-sell" program.¹⁴⁸ In a companion order to the Restructuring Rule, the Commission determined that the California "buy-sell" programs should be allowed to continue pending the implementation of the Restructuring

145. *Texas E. Transmission Corp.*, 37 F.E.R.C. ¶ 61,260, at 61,684 (1986).

146. *Columbia Gas Transmission Corp.*, 49 F.E.R.C. ¶ 61,071 (1989); *Texas E. Transmission*, 48 F.E.R.C. ¶ 61,248, *clarified*, 48 F.E.R.C. ¶ 61,378 (1989), *order on reh'g*, 51 F.E.R.C. ¶ 61,170, *order on reh'g*, 52 F.E.R.C. ¶ 61,273 (1990); *Mojave Pipeline Co.*, 47 F.E.R.C. ¶ 61,200, *modified*, 50 F.E.R.C. ¶ 61,069 (1990); *Kern River Gas Transmission Co.*, 50 F.E.R.C. ¶ 61,069 (1990); *Oklahoma-Arkansas Pipeline Co.*, 53 F.E.R.C. ¶ 61,019 (1990); *Algonquin Gas Transmission Co.*, 53 F.E.R.C. ¶ 61,417 (1990); *High Island Offshore System*, 53 F.E.R.C. ¶ 61,126 (1990), *amended by* 57 F.E.R.C. ¶ 61,420 (1991); *CNG Transmission Corp.*, 55 F.E.R.C. ¶ 61,189 (1991); *Texas Gas Transmission Corp.*, 55 F.E.R.C. ¶ 61,208 (1991); *U-T Offshore System*, 57 F.E.R.C. ¶ 61,418 (1991). These certificates were modified to incorporate the requirements of 18 C.F.R. § 284.243, which was adopted in the Restructuring Rule. *Algonquin Gas Transmission Co.*, 59 F.E.R.C. ¶ 61,032 (1992).

147. *El Paso Natural Gas Co.*, 56 F.E.R.C. ¶ 61,289 (1991); *Transwestern Pipeline Co.*, 56 F.E.R.C. ¶ 61,288 (1991).

148. *El Paso*, 56 F.E.R.C. ¶ 61,289; *Transwestern*, 56 F.E.R.C. ¶ 61,288.

Rule.¹⁴⁹ The Restructuring Rule itself requires each open access pipeline to establish a mechanism for the non-discriminatory release and assignment of pipeline capacity.¹⁵⁰ In subsequent orders, FERC has rescinded all existing certificates authorizing capacity brokering and required these programs to be restructured to comply with the non-discrimination requirements of the Restructuring Rule.¹⁵¹

2. United States Policy on Agency Imports

Section 3 of the Natural Gas Act requires import authorizations to be issued to a “person,” and the FPC and FERC interpreted this to require that an import authorization be issued in the name of the entity taking title to the gas at the border. However, OFE considers any blanket import authorization as including the unlimited reassignment of the authorization.¹⁵² Hence, the person holding the section 3 authorization may enter into an “agency relationship” with the real party in interest who actually takes title at the border. This creates a regulatory gap because OFE has not attempted to assert jurisdiction over either the principal or the agency relationship.¹⁵³ Thus, an export/import authorization did not need to be held in the name of the real party in interest, which contributes to the circumvention of capacity brokering and other policies.¹⁵⁴

The blanket certificates authorizing the resale of imported gas¹⁵⁵ can also be used to implement buy-sell arrangements. For example, an end-user could use such a certificate to sell gas to a distributor (or other holder of pipeline capacity) at the border for resale back to the end-user at its plant.

3. California Open Access Policies

The northern California market is served by Pacific Gas & Electric

149. El Paso Natural Gas Co., 59 F.E.R.C. ¶ 61,031 (April 8, 1992), *appeal pending sub nom.* Windward Energy & Mktg. Co. v. FERC, No. 92-1208 (D.C. Cir. filed May 8, 1992).

150. 18 C.F.R. pt. 284, subpt. H.

151. Algonquin Gas Transmission Co., 59 F.E.R.C. ¶ 61,032 (1992); Northern Natural Gas Co., 59 F.E.R.C. ¶ 61,362 (1992).

152. Neste Trading (USA), Inc., 1 FE ¶ 70,408 (1991).

153. Compare Brokering of Interstate Natural Gas Pipeline Capacity, 53 Fed. Reg. 15,061 (1988), where FERC takes the position that jurisdiction under the Natural Gas Act extends to the resale of the contractual right to receive jurisdictional service under the Natural Gas Act.

154. Prior to granting the blanket certificates in cases cited in *supra* note 140, FERC had not authorized the brokering of imported gas on a generic basis. FERC sought to induce pipelines into accepting full open access under Order Nos. 436 and 500 by refusing generic rights to some shippers on a pipeline without making such services available to all.

155. *See supra* part III.D.

(PG&E), a local distribution company (LDC), which purchases gas from two domestic pipelines, Transwestern and El Paso, as well as from PG&E's affiliate, Pacific Gas Transmission Company (PGT), an interstate pipeline which connects PG&E with Canada. In Canada, another PG&E affiliate, Alberta & Southern (A&S), aggregates Canadian production and holds a long-term export license to sell the gas to PGT. On July 18, 1990, the California Public Utilities Commission (CPUC) instituted a rulemaking to restructure the procurement of gas supplies and end-user access to the pipeline capacity held by the local distributors.¹⁵⁶ Effective August 1, 1991, the CPUC decided to eliminate the non-core gas supply portfolios of the distributors and to limit the ability of electric generation customers of purchasing gas from the core gas supply of the distributors.¹⁵⁷ The rules provided non-core transportation customers with enhanced access to the capacity of interstate pipelines serving California. The CPUC also adopted a buy-sell mechanism which requires California LDCs to use their capacity for transportation to non-core customers while capacity brokering certificates were pending at FERC. The thrust of these initiatives was to create additional competition by providing large industrial gas customers with greater gas supply options. In response, on September 20, 1990, PG&E entered into an "access agreement" settlement providing up to 250,000 Mcf per day of PG&E's capacity on PGT, which would allow other customers to purchase gas directly from producers in the A&S supply pool. However, this capacity would be limited to transporting gas from A&S producers from August 1, 1991, until August 1, 1994, in recognition of PGT's take-or-pay obligations to A&S and to provide additional time to renegotiate the PGT/A&S contracts. The CPUC also permitted core customers to aggregate load and to obtain third party gas holding that the limitations under the PGT Access Agreement were not applicable to core customers.¹⁵⁸ Since the three pipelines serving California were not authorized to broker capacity on August 1, 1991, the non-core transportation program was implemented as a series of "buy-sell" transactions.

On August 19, 1991, an Initial Decision of a CPUC administrative

156. Order Instituting Rulemaking on the Commission's Own Motion to Change the Structure of Gas Utilities' Procurement Practices and to Propose Refinements to the Regulatory Framework for Gas Utilities, Docket No. 90-07-065 (Cal. Pub. Util. Comm'n 1990).

157. Re Rulemaking on the Structure of Gas Utilities' Procurement Practices and Refinements to the Regulatory Framework for Gas Utilities, 118 Pub. Util. Rep. 4th (PUR) 1 (Cal. Pub. Util. Comm'n 1990).

158. Re New Regulatory Framework for Gas Utilities, 120 Pub. Util. Rep. 4th (PUR) 394, 398 (Cal. Pub. Util. Comm'n 1991).

law judge rejected the settlement, held that the customers of PG&E were not under any obligation to honor the A&S contract and found the A&S contract to be uncompetitive.¹⁵⁹ On November 6, 1991, the CPUC adopted the majority of the law judges decision.¹⁶⁰ The CPUC simultaneously ordered PG&E to provide core aggregators with access to Canadian supplies, including supplies outside the A&S pool.¹⁶¹ Canadian interests have protested this measure as inconsistent with the FTA. The CPUC's Division of Ratepayer Advocates also recommended that PG&E refund to customers \$390 million in excess gas costs paid to A&S as a result of the current PGT/A&S structure.¹⁶²

As with Opinion No. 256, the Canadian authorities responded by viewing the CPUC action as an international incident, and a battle of press releases ensued. Government representatives from the NEB, Alberta, the DOE and the CPUC are conducting negotiations of this dispute under the Energy Consultation Mechanism of the FTA.¹⁶³ The Alberta authorities and the NEB are concerned that if short term spot market transactions are transported under the CPUC open access requirements, takes under the long-term and more expensive PGT/A&S contract will be curtailed.¹⁶⁴ In response, on December 19, 1991, the NEB issued Hearing Order GH-R-1-91¹⁶⁵ on a proposal by the Canadian Petroleum Association to prohibit deliveries into the PGT system of any short term gas destined for the California market until restructuring of the existing long-term contracts was completed. Subsequently, on February 4, 1992, the NEB issued Order MOI-1-92¹⁶⁶ which adopted interim limitations on exports at Kingsgate, British Columbia, into the PGT system capping all short term exports to the highest daily volumes transported prior to that date. Any new short term exports are required to demonstrate that they are not displacing long-term arrangements. The NEB also halted the reassignment of capacity on the Alberta Natural

159. Docket No. R.88-08-018 at 31-40 (Cal. Pub. Util. Comm'n 1991).

160. Re Natural Gas Procurement and Reliability Issues, 127 Pub. Util. Rep. 4th (PUR) 417 (Cal. Pub. Util. Comm'n 1991).

161. Resolution No. G-2967 (Cal. Pub. Util. Comm'n 1991).

162. CPUC Press Release, Jan. 30, 1992.

163. Free Trade Agreement, art. 905, *reprinted in* H.R. Doc. No. 216, 100th Cong., 2d Sess. (1988); 27 I.L.M. 281. See *Agreement on Statement of Principles*, Foster Natural Gas Report, No. 1861, at 14 (Jan. 30, 1992) (press releases of CPUC and Government of Alberta).

164. Two Alberta producers, Shell Canada Ltd. and Amoco Canada Petroleum Co. Ltd. have sued PG&E and A&S for breach of contract. Foster Natural Gas Report, No. 1855, at 15-17 (Dec. 12, 1991).

165. Canadian Petroleum Ass'n, Docket No. GH-R-1-91 (NEB Dec. 19, 1991) (Can.).

166. Canadian Petroleum Ass'n, Docket No. MOI-1-92 (NEB Feb. 4, 1992) (Can.).

Gas pipeline which transports gas to PGT.¹⁶⁷ Subsequently, the NEB further tightened the export of natural gas to Northern California at Kingsgate and Huntingdon, British Columbia, that would displace sales by A&S to PGT.¹⁶⁸ The NEB claimed that its action was consistent with the FTA because “[t]he total volume of gas flowing to the U.S. from Canada will not be restricted; prices are not dictated by the Board but are set by the parties through negotiation; and Canadian purchasers will not be favoured by the imposition of the condition.”¹⁶⁹

While the Canadian government seeks to limit capacity brokering from Alberta to California for the purpose of restraining competition, FERC’s investigation of the buy-sell programs on the Transwestern and El Paso pipelines is directed toward the potential for market power being used to limit competition. The legal authority for the buy-sell program of pipelines transporting domestic gas turns on the sales being either exempt as “first sales” or authorized by blanket marketer certificates. In contrast, the legality of the buy-sell program for Canadian gas turns on the rights of an importer to assign an import authority or on the use of blanket import authorizations.¹⁷⁰ The probable outcome will be that PGT will be forced to buy-out its Canadian suppliers in a manner similar to the settlements reached between domestic producers and pipelines. Ideally, open access principles will ultimately expand to permit California end-users to directly contract with both Alberta and domestic producers without any government enforced cartel¹⁷¹ providing an artificial advantage to any particular supply source.

F. *New Pipeline Construction*

Imports are currently limited by the pipelines’ available capacity to transport gas away from the border. Numerous construction proposals

167. Order No. TGI-1-92 (NEB Feb. 4, 1992) (Can.).

168. Canadian Petroleum Ass’n, Ltd., Reasons for Decision, GH-R-1-91 (NEB June 24, 1992) (Can.).

169. *Id.* at 32.

170. *See supra* parts III.C. and III.D.

171. In contrast, U.S. conservation measures imposed by producing states are being attacked in Congress by the so-called Markey-Scheuer Amendment to the National Energy Strategy Act. This proposal would amend the NGPA to authorize lawsuits by affected individuals to enjoin state conservation measures which limit the production of natural gas. 138 CONG. REC. H3653-60 (daily ed. May 20, 1992).

are pending which could double this capacity.¹⁷² The NEB has authorized the expansion of Canadian pipelines to serve U.S. markets.¹⁷³

FERC is presumably the agency which should decide the financial feasibility of proposed new pipeline construction projects from Canada. On September 20, 1991, FERC revised its rules governing pipeline construction.¹⁷⁴ Order No. 555 would affect imports by codifying the "open season" procedures¹⁷⁵ used in developing pipeline projects to transport gas to the Northeast. It would also provide pipeline sponsors with a regulatory option to construct new pipelines at their own financial risk, with very limited opportunities for third party intervention regarding project need. Under Order No. 555, pipeline construction could commence without a long-term NEB export license if the pipeline is willing to accept the financial risk of the license being denied or rescinded.¹⁷⁶ The Commission's current Optional Expedited Certificate procedures¹⁷⁷ also use the same "at risk" approach, and the pending National Security Act legislation would also provide pipelines with an option of constructing unregulated new pipelines on an "at risk" basis. The result could be that distributors and end-users would sign long-term contracts for imported supplies as a part of a larger agreement to expand pipeline capacity. This might lead to a less competitive market place over time. As with the "rate tilt," certificate conditions which place pipeline owners at risk for underutilization would assure that the imported gas transported by such facilities would be base loaded even if the gas were more expensive than domestic alternatives.

When domestic producers sought to raise the rate tilt issue in evaluating proposed pipeline construction, the Commission held that "concerns about whether the rates are anticompetitive should be raised before

172. *E.g.*, Northern Border Pipeline Co., 58 F.E.R.C. ¶ 61,085 (1992) (312,750 Mcf/day); Altamont Gas Transmission Co., 56 F.E.R.C. ¶ 61,199 (1991) (700,000 Mcf/day); Pacific Gas Transmission Co., 54 F.E.R.C. ¶ 61,035 (1991), *reh'g denied*, 56 F.E.R.C. ¶ 61,192 (1991) (710,000 Mcf/day).

173. Alberta Natural Gas Co. Ltd., Reasons for Decision, GHW-2-91 (NEB May 21, 1992) (Can.) (872,000 Mcf/day to California market); TransCanada PipeLines Ltd., Reasons for Decision, GH-4-91 (NEB May 20, 1992) (Can.) (authorized a 116,100 Mcf/day of new firm service with 69% to be exported to the United States). In April 1992, TransCanada filed an application with the NEB for its 1994-95 expansion to add 227,000 Mcf/day of capacity. NEB Press Release, April 13, 1992.

174. Order No. 555, III F.E.R.C. Stat. & Regs. ¶ 30,928, 56 Fed. Reg. 52,330 (1991). The effective date has been postponed indefinitely. 56 Fed. Reg. 58,844 (1991).

175. Order No. 555 will be codified at 18 C.F.R. § 157.102(e) once the provision becomes effective.

176. III F.E.R.C. Stat. & Regs. ¶ 30,928, at 30,226.

177. 18 C.F.R. pt. 157, subpt. E, *repealed by* Order No. 555, III F.E.R.C. Stat. & Regs. ¶ 30,928. The optional certificate program was upheld in *Public Util. Comm'n of Cal. v. FERC*, 900 F.2d 269 (D.C. Cir. 1990).

the DOE/FE in proceedings involving import authorizations.”¹⁷⁸ In addition, FERC invited all interested parties to raise the issue in on-going section 4 general rate cases of domestic interstate pipelines.¹⁷⁹ At the same time, FERC contends the “competitiveness issue is outside our jurisdiction” as a result of the FTA.¹⁸⁰

Parties opposing the construction of new import pipeline facilities also face a difficult burden in section 3 proceedings. In *Michigan Consolidated Gas Co. v. ERA*,¹⁸¹ an industrial end-user sought to bypass its local distribution company by constructing a pipeline under the Detroit River to connect directly with 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.¹⁸² The D.C. Circuit held that the distributor was not injured by the authorization of the bypass and lacked standing to challenge ERA’s order.¹⁸³

G. Free Trade Agreements

1. The United States-Canadian Free-Trade Agreement

The final text of the FTA was signed on January 2, 1988. On July 25, 1988, President Reagan transmitted this agreement to Congress for approval under the “fast track” procedures of the Trade Act of 1974,¹⁸⁴ together with the proposed implementing legislation and a Statement of Administrative Action.¹⁸⁵ The Statement of Administrative Action, which purports to be an exhaustive list of regulatory changes necessary to implement the FTA, did not specify any regulatory actions regarding natural gas. Further, the legislative history reflects that “level playing field” requirements of Opinion No. 256 were expressly excluded from the reach of the FTA.¹⁸⁶

178. *Northern Border Pipeline Co.*, 58 F.E.R.C. ¶ 61,085, at 61,309 (1992); *Iroquois Gas Transmission System, L.P.*, 52 F.E.R.C. ¶ 61,091, at 61,373-74 (1990).

179. *Tennessee Gas Pipeline Co.*, 51 F.E.R.C. ¶ 61,113 (1990).

180. *Northern Border*, 58 F.E.R.C. ¶ 61,085, at 61,309.

181. 889 F.2d 1110 (D.C. Cir. 1989).

182. *Id.* at 1111.

183. *Id.*

184. 19 U.S.C. § 2112 (1988).

185. S. REP. NO. 509, 100th Cong., 2d Sess. 1, 4, reprinted in 1988 U.S.C.C.A.N. 2395, 2398.

186. See *id.* at 62-63, reprinted in 1988 U.S.C.C.A.N. 2395, 2457-58; see also H.R. Doc. No. 216, 100th Cong., 2d Sess. 56 (1988) (Statement of Administrative Action).

Both the Congress¹⁸⁷ and the Canadian Parliament¹⁸⁸ approved implementing legislation.

2. Impact of the Free Trade Agreement in the United States

The impact of the FTA on natural gas trade remains to be defined. However, areas which the FTA does not affect natural gas are becoming increasingly clear. The FTA does not take precedence over existing legislation, such as the Natural Gas Act. The legislation implementing the FTA provides: "No provision of the Agreement, nor the application of any provision to any person or circumstance, which is in conflict with any law of the United States shall have effect."¹⁸⁹ Nor does the FTA create any private causes of action.¹⁹⁰ At the very most, the FTA holds the promise of giving imported gas sold at the border by a pipeline the same treatment as domestic gas sold by an interstate pipeline. However, advocates of imports have taken a more aggressive view. For example, when opponents of the Iroquois project sought an evidentiary hearing on the application, the project sponsors sought to claim that the FTA prevented the process, and their pleas met favorable reception by some.¹⁹¹ The D.C. Circuit in its review of the Iroquois certificate did not address the question of whether FERC is legally obligated to act consistently with the FTA when a conflict arises between the FTA and the Natural Gas Act. The court observed that the Commission "does not maintain that the Free Trade Agreement deprives it of *all* power to respond to the 'rate tilt' problem . . ."¹⁹² Instead, FERC relied upon a claim of administrative burden. Hence, the court concluded that "FERC's explanation, although perhaps somewhat strained, passes the test of reasonableness."¹⁹³

187. United States-Canada Free-Trade Agreement Implementation Act of 1988, Pub. L. No. 100-449, 102 Stat. 1851 (1988) (FTA Act).

188. Canada-United States Free-Trade Agreement Implementation Act, ch. 65, 1988 S.C. 2863 (Can.).

189. FTA Act, § 102(a).

190. *Id.* § 102(c).

191. Iroquois Gas Transmission System, L.P., 52 F.E.R.C. ¶ 61,091, at 61,406 (1990) (Moler dissenting on holding a hearing on market need and rate issues as prohibited by FTA); *accord*, Letter from Rep. Philip Sharp to Martin Allday, Chairman of FERC (August 6, 1990) (stating FTA in substance and spirit appears to have been violated); Letter from Rep. John Dingell to Martin Allday, Chairman of FERC (August 2, 1990) (stating delay of certification pending a hearing is itself a violation of the FTA) (letters on file at FERC Public Reference Room, Washington, D.C.).

192. Louisiana Ass'n of Indep. Producers & Royalty Owners v. FERC, 958 F.2d 1101, 1124 (D.C. Cir. 1992).

193. *Id.*

3. Impact of FTA in Canada

Annex 905.2 to the FTA specifically eliminates the "Least Cost Alternative Test" which the NEB had previously applied to gas exports. Under this test, the NEB would consider whether the price at which gas was offered in its export market was less than the least cost alternative for the purchasing party. However, this test had already fallen into disuse after the collapse of energy prices in 1985. Further, in 1987, the NEB loosened its surplus reserves test in favor of a Market Based Procedure (MBP) which included (1) a complaints procedure, (2) an export impact assessment, and (3) a public interest determination.¹⁹⁴

The implementation of the FTA in Canada would suggest that the NEB would become very reluctant to reject or impede export applications. However, in 1989, the NEB either denied or imposed restrictive conditions upon six export applications.¹⁹⁵ Further, as discussed above, the NEB is conducting proceedings in an effort to protect the economic value of long-term Alberta export contracts to Northern California markets. The underlying justification for these actions is based upon unattractive pricing terms, failure to pass the cost-benefit test, and an inadequate demonstration of gas supplies.

a. Price

The NEB used a pricing rationale in part to deny an export license in the Vector/Altresco case.¹⁹⁶ Because the NEB was not satisfied that the exported gas was receiving its full opportunity value under the proposed contracts, export applications were also denied on the basis of inflexible contract terms in the Western Gas Marketing Ltd./Niagara Mohawk, Shell/Cogeneration Energy Technology Inc., Direct Energy/Consolidated, Indeck Gas Supply Corp./Oswesgo and Yerkes cases.¹⁹⁷

The NEB's most extreme interpretation of its latitude under the FTA to date was adopted in *Canadian Petroleum Association, Ltd.*¹⁹⁸ The Canadian Petroleum Association (CPA) was concerned that short term exports and interruptible pipeline transportation were displacing

194. Review of Natural Gas Surplus Determination Procedures, Docket No. GH-R-1-87 (NEB 1987) (Can.).

195. Direct Energy/Consolidated, Reasons for Decision, Docket No. GH-1-89 (NEB Dec. 1989) (Can.).

196. Canterra Energy Ltd., Reasons for Decision, Docket No. GH-8-88, at 27 (NEB June 1987) (Can.) ("The primary reason for this result is the relatively unattractive pricing terms in the gas sales contract.").

197. Docket No. GH-1-89.

198. Reasons for Decision, Docket No. GH-R-1-91 (NEB June 24, 1992) (Can.).

high-cost, long-term exports from Alberta to the Northern California market. The CPA sought to block such exports if they undercut the long-term gas sales. Although the FTA prohibits "restrictions" on exports including "any limitation, whether made effective through quotas, licenses, permits, minimum prices requirements or any other means,"¹⁹⁹ the NEB took the position that its restriction on the export of inexpensive gas was consistent with the FTA because "the total volume of gas flowing to the U.S. from Canada will not be restricted; prices are not dictated by the [NEB] but are set by the parties through negotiations"²⁰⁰ The NEB's interpretation is difficult to accept in view of the fact that it is prohibiting the export of gas under lower prices which were also "set by the parties through negotiations." In sum, under the NEB's interpretation of the FTA, it is free to block low cost exports so long as a comparable volume of high priced gas is made available to United States markets.

b. Cost-Benefit Test

The NEB has abandoned the cost benefit test in reviewing its export applications.²⁰¹ Under this test, the revenues received from an export must recover all incremental costs incurred from the transaction including the cost of developing new gas reserves to replace those exported. Because the NEB does not apply such a test to sales to Canadian markets, the cost-benefit test was arguably a violation of the national treatment provisions of the FTA. The NEB review was prompted by industry dissatisfaction with the rejection of a proposal by Amoco to export gas to Washington Natural.²⁰² The NEB required the applicants in that case to develop a realistic forecast of actual export volumes and the cost of replacing those reserves. Under such a cost-benefit test, the proposed major expansion of TransCanada to serve northeastern United States markets would be difficult to justify. However, the NEB relented and approved the TransCanada expansion and the Iroquois-related exports.

c. Adequate Gas Supplies

Several 1989 NEB decisions denied export applications based upon

199. Free Trade Agreement, art. 901, *reprinted in* H.R. Doc. No. 216, 100th Cong., 2d Sess. (1988); 27 I.L.M. 281.

200. Docket No. GH-R-1-91, at 33.

201. Reasons for Decisions, Docket No. GHW-4-89 (NEB Mar. 1990) (Can.).

202. Amoco Canada Petroleum Co., Ltd., Docket No. GH-3-89 (NEB May 1989) (Can.).

insufficient gas supplies.²⁰³ Further, in GH-10-88,²⁰⁴ the NEB considered the proposed export of gas from the Mackenzie Delta to the United States commencing in 1996 and terminating as late as 2020. A number of Canadian intervenors opposed these applications and claimed that the Market Based Procedure (MBP) was not sufficient to protect their interests. One intervenor argued that because the FTA required Canada to curtail exports pro rata with Canadian internal consumption, the NEB should restrict total exports to no more than forty percent of production. The NEB accepted the proposed exports, without deciding the FTA issue.²⁰⁵ In 1991, the NEB issued a fifteen year export license to Dartmouth Power Associates instead of the requested twenty year license due to a failure to show sufficient reserves for the full period.²⁰⁶ Under the FTA, Canada has arguably waived its rights to restrict exports based upon a lack of gas reserves and must apply the same criteria used in evaluating the connection of new Canadian loads.²⁰⁷

The next step in the evolution of Canadian policy came on August 14, 1991, when the NEB sought public comment on further liberalization of the MBP. In response, Jake Epp, Canadian Minister of Energy, Mines and Resources opposed any change in the criterion that the price of exported gas must recover its appropriate share of the costs incurred claiming that it was necessary for the NEB to apply this criterion so long as FERC Opinion No. 256 remained in force.²⁰⁸ Among the criteria which remain to be applied are whether "there is producer support for a gas export license application," that the export sales contract recovers transportation charges on the Canadian pipelines and that the length of the export license term is appropriate.²⁰⁹ The NEB no longer intends to assess whether export sales are likely to be durable over their term and will no longer require exporters to demonstrate that the contracted volumes will actually be taken. Procedural changes would provide greater public

203. *Canterra*, Docket No. GH-8-88; *Direct Energy*, Docket No. GH-1-89.

204. *Esso Resources Canada Ltd.*, Reasons for Decision, GH-10-88 (NEB Aug. 1989) (Can.).

205. *Id.*

206. Foster Natural Gas Report, No. 1836, at 27 (Aug. 1, 1991).

207. FTA Act, art. 904, 102 Stat. 1851. Any export restriction must be justifiable under the General Agreement on Tariffs and Trade (GATT), which allows an export restriction "relating to the conservation of exhaustible natural resources . . . if . . . made effective in conjunction with restrictions on domestic production or consumption." General Agreement on Tariffs and Trade (GATT), art. XX(g), Oct. 30, 1947, 61 stat. A3, 55 U.N.T.S. 187.

208. Letter from Jake Epp, Canadian Minister of Energy, Mines and Resources, to Roland Pridle, Chairman, National Energy Board (Aug. 7, 1991) (letter on file with author).

209. Attachment D to NEB August 14, 1991, Notice of Proposed Changes to the Applicant of the Market-Based Procedure, Docket No. GHW-1-91 (NEB Aug. 14, 1991) (Can.).

notice to ensure adequate time and information for Canadian gas customers to evaluate each license and to decide whether to file complaints.

The NEB has rejected projects where need has not been demonstrated. For example, the Empire State Pipeline was a proposed 155 mile intrastate New York pipeline which bypassed Tennessee Gas Pipeline to serve the same markets. Initially, the NEB denied a certificate to construct the Blackhorse Extension to connect to Empire.²¹⁰ Subsequently FERC issued a section 3 site license and a Presidential permit. Commissioner Langdon's dissent questioned whether the NEB action was consistent with the FTA.²¹¹ A year later, the NEB authorized the extension.

In sum, the NEB continues to act in a manner which protects the interests of Canadian gas suppliers and gas consumers. As demonstrated with the ongoing disputes over exports to California, Canadian authorities seek to protect the contractual rights of their producers during a period when increasing United States regulatory pressures have been brought to bear on domestic producer contracts.

4. North American Free Trade Agreement

The FTA may be superseded by a North American Free Trade Agreement which is currently being negotiated between the United States, Canada, and Mexico under the same "fast track" procedure used for the FTA.²¹² Because energy is one of the subjects of negotiation, domestic producers are concerned that Canada could use this negotiation as a vehicle to obtain additional concessions not achieved in the negotiation of the FTA.

H. *Deregulation of Imports*

The Department of Energy conducted a comprehensive two-year review of U.S. energy policy and issued its *National Energy Strategy* in March 1991.²¹³ The report states with respect to gas imports and exports:

Imports and exports were originally regulated on the assumption

210. Foster Natural Gas Report, No. 1832, at 1 (July 3, 1991). The federal court remanded this decision due to ex parte contacts with two NEB commissioners, who were barred from the proceedings. The NEB held hearings on remand in May 1992. Foster Natural Gas Report, No. 1862, at 37 (Feb. 6, 1992).

211. Empire State Pipeline, 56 F.E.R.C. ¶ 61,050, at 61,201 (1991).

212. Editor's note: The North American Free Trade Agreement was signed by the United States, Canada and Mexico in August 1992.

213. DEP'T ENERGY, NATIONAL ENERGY STRATEGY, Rep. No. DOE/S-0082P (Mar. 1991).

that market forces would not ensure that imports and exports of natural gas would be reasonably priced and consistent with reliable service for U.S. consumers. With today's well-developed, competitive wellhead natural gas market, there is no reason to substitute the Federal Government's judgment for that of contracting parties as to what is a competitive price, and what level of supply security is appropriate.

When all regulation of domestic producers ends on January 1, 1993, both the price and the producer's need to obtain a certificate to sell its gas will be completely deregulated. However, there will be no comparable deregulation of transactions involving the import or export of natural gas. There is no reason to treat these two kinds of transactions differently.²¹⁴

Accordingly, the *National Energy Strategy*, which was subsequently approved by President Bush, recommended repealing section 3.

The *National Energy Strategy* recommendation is based on a faulty premise comparing domestic wellhead sales to border sales made in the market area. The congressional determination that wellhead gas markets were competitive was based on the existence of thousands of sellers. In contrast, border sales are influenced by the natural monopoly of pipeline capacity, with fewer sellers. Border sales are therefore more comparable to interstate pipeline sales in the market area to other pipelines or to local distribution companies. In both cases, the seller can exercise real market power and there are a small number of potential sellers. Because the Administration has not proposed to deregulate such sales for resale, it is difficult to understand the rationale for deregulating sales for resale by Canadian pipelines at the border.

Legislation submitted by the Administration to implement the *National Energy Strategy*²¹⁵ proposed two steps which would have the effect of eliminating the conflicting jurisdiction of FERC and OFE over imports. It would abolish FERC as an independent agency,²¹⁶ and would repeal the present section 3. Instead, all importation of gas would be brought within the definition of NGPA "first sales."²¹⁷ The Administration's plan quietly died as soon as it arrived on Capitol Hill. Alternatives which offered broader industry support have gained the approval of the Senate and the House.

214. *Id.* at 95.

215. S. 570, 102d Cong., 1st Sess. (1991) (introduced March 6, 1991).

216. *Id.* § 221.

217. *Id.* § 213.

I. *Other Trade Actions*

Even if Congress deregulates imports, other remedies exist to equalize competition between Canadian and domestic producers. The antidumping and countervailing duty laws²¹⁸ apply to imports of natural gas.²¹⁹ A 1988 Department of Energy study documented and quantified the effects of the overall tax and royalty incentive which Canada granted to its producers in response to the collapse of energy prices in 1986.²²⁰ Although the Windfall Profits Tax has subsequently been repealed,²²¹ gas crossing the border today continues to benefit from the lower costs afforded by the prior disparities in treatment of drilling investment. This difference could form the basis for assessing a countervailing duty to offset the Canadian governmental subsidy.

An antidumping action to remedy the current trade disparity in natural gas poses greater problems as the NEB requires imported gas to be sold at prices at least as great as its price in Canada.²²² However, if the delivery of gas at the border is viewed as two separate products, the natural gas and the delivery service to bring the gas to the border, a comparison based on wellhead prices rather than delivered border prices is appropriate.

Under Article 1904 of the FTA, any final determination of an antidumping or countervailing duty action can be challenged before a binational panel, which is required to apply United States law.²²³

IV. CONCLUSION

Although the rhetoric from governments on both sides of the border calls for a new competitive, market responsive era in natural gas trade, a one-sided trend is emerging. A dramatic restructuring is occurring in the U.S. markets, with the traditional contractual relationship between producers and pipelines and pipelines and distributors being abrogated under regulatory pressures. FERC is actively promoting competition, where it is shown to exist, as a surrogate for regulation. In contrast,

218. Tariff Act of 1930, §§ 701, 731, 19 U.S.C. §§ 1671, 1673 (1988).

219. See John McInerney, *Energy Imports and the Unfair Trade Laws*, Symposium Paper (on file with *Tulsa Law Journal*).

220. OFFICE OF POLICY, PLANNING AND ANALYSIS, DEP'T ENERGY, U.S. AND CANADIAN TAX AND FISCAL TREATMENT OF OIL AND GAS PRODUCTION (revised May 9, 1988).

221. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 1941(a), 102 Stat. 1107, 1322 (1988).

222. AGREEMENT AMONG THE GOVERNMENTS OF CANADA, ALBERTA, BRITISH COLUMBIA AND SASKATCHEWAN ON NATURAL GAS MARKETS AND PRICES (Oct. 31, 1985).

223. 19 U.S.C § 1516a(g) (Supp. 1990).

Canadian authorities are using the FTA and intervening in United States decision-making to maximize Canadian market share and to insulate long-term contracts from the market and regulatory pressures which U.S. authorities have placed on domestic producers.

The promise of an integrated "North American natural gas industry" will never be fulfilled if the proposed legislation deregulating imports is adopted, the NEB continues to regulate the export of gas to the United States so as to prevent competition, and significant regulatory barriers remain to confront the export of U.S. gas to Canada. The NEB, as well as provincial authorities, will continue to exercise pressure to protect long-term contracts without any countervailing efforts from U.S. government authority. The continuing overdeliverability of domestic gas, coupled with the base loading of Canadian imports and the disparity in tax policies between the two nations, will exacerbate the deterioration of the domestic producing industry. The proposed legislation deregulating imports can only worsen this trend.

The restructuring of the U.S. gas industry is going forward under the Restructuring Rule. This process may also be accelerated by new legislation, if adopted. This restructuring, coupled with the completion of wellhead decontrol, makes 1992 a pivotal year for implementing competitive principles in gas markets. Yet, absent a more targeted use of competition in the regulation of imports, new arrangements involving construction and long-term supply contracts may perpetuate the current regulatory distortions to the detriment of the public interest over the long-term. Ultimately, the public will be best served if the Canadian gas industry and the domestic gas industry are allowed to compete based on price on a "level playing field." Whether that goal can be realized remains to be seen.