Cited as "1 FE Para. 70,447"

Rochester Gas and Electric Corporation (FE Docket No. 90-05-NG), May 16, 1991.

DOE/FE Opinion and Order No. 503

Conditional Order Granting Long-Term Authorization to Import Natural Gas from Canada and Granting Interventions

I. Background

On January 22, 1990, Rochester Gas and Electric Corporation (RG&E) filed an application with the Office of Fossil Energy (FE) of the Department of Energy (DOE), under section 3 of the Natural Gas Act (NGA) and DOE Delegation Order Nos. 0204-111 and 0204-127, for authorization to import up to 16,000 Mcf per day of natural gas from Canada over a 15-year term for use as part of RG&E's system supply. The gas would be purchased from Unigas Corporation, Calgary, Canada (Unigas), imported via a new import point near Grand Island, New York, and transported from the border to the facilities of RG&E through the proposed facilities of Empire State Pipeline Company, Inc. (Empire State). When construction is completed, the facilities of Empire State would include 155 miles of 14-inch pipeline extending from the U.S. border to a point near Syracuse, New York. The term of the authorization requested would begin on the date that the proposed Empire State pipeline system is placed in service.

RG&E is a natural gas and electric public utility serving approximately 260,000 natural gas customers in and around Rochester, New York. In support of its application, RG&E states that the proposed import arrangement will help RG&E to diversify its natural gas supply, storage and transportation arrangements; enhance its ability to obtain gas that is competitive with other fuels and natural gas; and further the goal of providing additional gas to the U.S. Northeast. RG&E is now dependent on CNG Transmission Corporation (CNG) for most of its gas supplies and for all transportation.

The applicant states that the gas would be purchased from Unigas under a gas sales contract executed on November 29, 1989. Under the RG&E-Unigas gas sales contract, RG&E may purchase up to a maximum daily contract quantity of 16,000 Mcf of natural gas over a term of ten years that may be extended to fifteen years. If RG&E fails to purchase at least 85 percent of the daily contract quantity, then RG&E is required to reimburse Unigas for the resulting unabsorbed demand charges for transportation of the gas in Canada on Nova Corporation of Alberta's (NOVA) and TransGas Limited's (TransGas) pipeline systems, i.e., charges for pipeline capacity contracted for on those pipeline systems to transport gas to RG&E that must be paid whether or not it is used. Unigas is obligated to mitigate such unabsorbed charges to the extent possible. The gas supply arrangement also provides that Union Enterprises Ltd., parent company of Unigas, would guarantee Unigas' obligations to supply gas to RG&E up to a maximum payment of $7,500,000.

According to RG&E's application and other filings in this proceeding, Unigas is currently making firm sales of gas to Northern Natural Gas Company and would obtain the gas sold to RG&E via an affiliate, Mark Resources, Inc. (Mark), from gas producing areas in the Saskatchewan and Alberta provinces.

RG&E states that the pricing mechanism in the RG&E-Unigas contract for determining the commodity charge paid by RG&E for gas is essentially a netback formula that subtracts out the transportation charges, plus a monthly performance incentive based on volumes purchased, from a monthly Rochester inlet price that incorporates a monthly base price index. The monthly base price index would give equal weight to three separate price factors in determining the commodity charge that RG&E would have to pay: (1) the average market price established for Canadian gas in the province of Alberta by Alberta's Department of Energy; (2) the monthly price for Mid-Continent gas as listed in such publications as Inside FERC, Natural Gas Intelligence, and Natural Gas Week; and (3) the firm service delivered price paid by RG&E for gas under long-term contracts having a term of six or more years. Specifically, the RG&E-Unigas contract provides that the monthly contract price for natural gas shall equal the Rochester inlet price computed by multiplying $2.915 per MMBtu by the monthly base price index minus the Empire State and TransCanada PipeLines Limited (TransCanada) demand charges and minus a monthly performance incentive of up to $.03 per MMBtu depending on the volumes purchased above 85 percent of the daily contract quantity.

In addition, the RG&E-Unigas gas sales contract contains a monthly contract maximum price that is keyed to the commodity charge paid for gas by RG&E to CNG, RG&E's principal supplier of gas. Specifically, the contract provides that the commodity charge paid by RG&E to Unigas may not exceed 107 percent of the CNG commodity price and will be adjusted down to the CNG commodity price for specified periods if the commodity charge paid to Unigas remains at 107 percent of the CNG price for six consecutive months or for eight months of a 12-month period. Further, in the event that alternatively-sourced gas to that which Unigas intends to purchase in western Canada appears to be mutually attractive, the RG&E-Unigas contract provides for substitution of such gas for delivery to RG&E. If the combined demand charges of TransCanada and Empire State rise above $1.08 per Mcf on the date of first delivery of the gas or on January 1, 1992, whichever is later, then the Rochester inlet price may be renegotiated at the request of either RG&E or Unigas. If such demand charges rise above $1.35 per Mcf, then the Rochester inlet price may be renegotiated at the request of RG&E.

RG&E asserts that the price of the imported gas will be competitive over the term of the proposed export because it is indexed to the selling price of gas in western Canada and large segments of the U.S. RG&E also asserts that the maximum price mechanisms in the RG&E-Unigas contract assure that the price of the imported gas will seldom be higher than that paid by RG&E to CNG for natural gas.

A notice of the application was issued on February 27, 1990, inviting protests, motions to intervene, notices of intervention, and comments to be filed by April 4, 1990.1/ Great Lakes Gas Transmission Company filed a motion to intervene without comment. CNG filed a motion in opposition to RG&E's import proposal and requested that the application be dismissed, or if not dismissed, that a trial-type hearing be granted. National Fuel Corporation (National Fuel), also filed a motion to intervene in opposition to RG&E's application and requested additional procedures if it is determined that the Federal Energy Regulatory Commission (FERC) does not have jurisdiction to review issues relating to the construction and operation of the proposed Empire State pipeline. On November 16, 1990, National Fuel withdrew its opposition to the RG&E application and its request for additional procedures and stated that it intended to become a customer of the proposed Empire State pipeline. This order grants intervention to all movants.

In its opposition motion, CNG contends that RG&E's gas supply contract with Unigas is anti-competitive and that RG&E has not shown that the proposed import is needed nor based on a secure source of supply. CNG asserts that the proposed import is anti-competitive because the commodity price which RG&E would pay is based on CNG's commodity charge, a charge containing some demand charges, and therefore is virtually guaranteed to be below CNG's rate. CNG also asserts that Unigas may sell the gas below cost and may engage in predatory pricing with which CNG cannot compete. In addition, CNG expresses a belief that the RG&E-Unigas contract is not a contract negotiated at arms length because all of the gas would be obtained from Mark, an affiliate of Unigas, and because RG&E and St. Clair Pipelines Ltd., an affiliate of Mark, have equity interests in the proposed Empire State pipeline.

Further, CNG contends that the gas is not needed because all of RG&E's gas requirements can be met by CNG and other suppliers. With respect to security of supply, CNG contends that the sources of gas supply for the proposed import have not been shown to be secure because Unigas and Mark are untested suppliers of gas to the U.S., because Unigas has no substantial reserves or gas production of its own and because firm transportation arrangements are not in place to move the gas to RG&E. CNG also argues that security of gas supply sources must be questioned because RG&E is a part owner of the proposed Empire State Pipeline project and that the proposed import is driven by RG&E's desire to support that pipeline project.

In its answer filed to CNG's opposition motion, RG&E contends that its gas supply contract with Unigas contemplates the sale of gas that is competitive with that sold by CNG to RG&E and that there is no basis for CNG's claim that Unigas may sell gas to RG&E below cost since the pricing mechanism in the RG&E-Unigas contract ties the price of gas to gas prices in three major market areas so that that price will always be close to the market price in RG&E's market area. RG&E argues that Unigas, albeit a relatively new supplier of gas to U.S. markets, nevertheless is currently supplying up to 130 MMcf per day to U.S. purchasers. RG&E also submitted a copy of the gas supply contract between Mark and Unigas dated January 18, 1990, which identifies specific gas reserves dedicated by Mark to its contract with Unigas.

With respect to the issue of need, RG&E asserts that the proposed import arrangement is competitive, that need is a function of competitiveness and that gas that is competitive is presumed to be needed, a presumption which is not rebutted by CNG's assertions that other gas is available to RG&E.

II. Decision

The application of RG&E has been evaluated to determine if the proposed import arrangement meets the public interest requirements of section 3 of the NGA. Under section 3, an import must be authorized unless there is a finding that it "will not be consistent with the public interest." 2/ In making its section 3 determination DOE is guided by its natural gas import policy guidelines,3/ under which the competitiveness of the import in the markets served is the primary consideration for meeting the public interest test. The DOE also considers, particularly in long-term arrangements, need for and the security of the imported natural gas supply. In addition, DOE considers the environmental effects of the proposed natural gas import arrangement.

A. General Policy Considerations

The guidelines contemplate that contract arrangements should be sufficiently flexible to permit pricing and volume adjustments in response to changing market conditions. RG&E's import proposal, as set forth in its application, is consistent with the policy guidelines. The pricing mechanism in the RG&E-Unigas gas supply contract for determining the price of the imported gas takes into account changes in the price of gas in three major market areas. Further, since the RG&E-Unigas contract provides that the commodity charge can never be more than seven percent above CNG's commodity charge and may be adjusted to an amount equal to CNG's commodity charge under certain circumstances, the price of the imported gas will reflect changes in the price charged by CNG, a principal supplier of gas to RG&E's market area. In addition, RG&E and Unigas may substitute other gas in lieu of gas from Mark if it would be mutually beneficial. Although RG&E must reimburse Unigas for demand charges on the Nova and Transgas pipeline systems for pipeline capacity covering 85 percent of the daily contract quantity whether the pipeline capacity is used or not, Unigas is obligated to mitigate charges for unused capacity to the extent possible. If the combined demand charges of TransCanada and Empire State for transportation of the imported gas rise above certain levels, then the RG&E-Unigas contract provides for renegotiation of the price of the imported gas. All of these provisions, taken together, demonstrate that the proposed import should be competitive and sufficiently flexible to remain competitive over the terms of the import authorization requested.

Need for natural gas is viewed under the DOE guidelines as a function of marketability and natural gas is presumed to be needed if it is competitive. While the long-term competitiveness and marketability of RG&E's proposed import is determinative as to the need for the Canadian gas, DOE also believes that the record indicates that there is a need for long-term, secure and competitively-priced gas in RG&E's market area to provide a diversity of supply sources to an area now heavily dependent on CNG for its natural gas requirements.

With respect to security of supply, DOE notes that Canada has historically been a secure source of supply for natural gas and that the record indicates that Unigas has never defaulted on any of its gas supply obligations. Further, Unigas' supply contract with Mark identifies gas reserves which Mark has dedicated to supplying Unigas.

With respect to its request for dismissal of RG&E's application, or if not dismissed, that a trial-type hearing be conducted with respect to the issues of competitiveness, need for the imported gas and security of supply, CNG contends: (1) the proposed import is anti-competitive because the commodity price is based on CNG's commodity charges that contain demand charges so that the Unigas rate will always be lower than CNG's, that Unigas may sell gas below cost and may engage in predatory pricing and that the RG&E-Unigas contract was not negotiated at arms length in view of an affiliate relationship between suppliers of the gas and owners of equity interests in Empire State, including RG&E; (2) that the imported gas is not needed because CNG and other suppliers can meet RG&E's gas requirements; and (3) that security of supply has not been shown because Unigas and Mark are relatively new suppliers of gas to U.S. markets, that Unigas has no significant gas supplies of its own, that firm transportation arrangements are not in place for the gas and that RG&E's principal reason for the import proposal was to support the Empire State pipeline project.

DOE finds little merit in CNG's contentions. Even if, as CNG contends, under the pricing formula in the RG&E-Unigas contract, Unigas' commodity rate would always be lower than CNG's, Unigas' demand charges would be higher. The result is a competitive price. The record indicates that RG&E was fully aware of the U.S./Canadian rate designs at the time that RG&E negotiated the gas supply contract with Unigas and that it was one of the many factors considered in fashioning a mutually acceptable gas supply arrangement. We have found previously that the two-part rate design utilized in Canadian import arrangements is largely analogous to the two-part rates found in domestic gas supply arrangements. 4/ Further, there is no information in the record showing that Unigas contemplates selling gas below cost or which suggests that Unigas has or could achieve the market dominance necessary to benefit from predatory pricing or to successfully engage in such a practice. In addition, the bare assertion that there is an affiliate relationship between the supplier of the imported gas and equity owners in the proposed Empire State pipeline does not demonstrate that the proposed import is not competitive. DOE believes that the overall import arrangement proposed indicates that it was conceived to provide alternative sources of competitively-priced gas to RG&E's market area and not to provide a supply of gas to be transported on the proposed Empire State pipeline.

With respect to need, the fact that RG&E's gas requirements can be met by CNG and other suppliers, as CNG contends, is not evidence that the imported gas is not needed. Long-term competitiveness is the key factor in determining need. In addition, as previously stated in this Opinion and Order, the record indicates that there is a need for additional competitively-priced gas in RG&E's market area now dominated by one supplier.

On the issue of security of supply, the fact that, as CNG contends, Unigas and Mark are relatively new suppliers of gas for U.S. markets and that Unigas does not have significant gas supplies of its own does not provide a basis for questioning security of supply. Mark's contract with Unigas indicates that Mark has significant gas reserves which have been dedicated to meeting its supply obligations to Unigas. Further, whether or not firm transportation arrangements have been made to transport the imported gas is not relevant to the issue of security of supply. Finally, even if it were true, as CNG contends, that RG&E's principal motivation for the proposed import was to support the proposed Empire State pipeline, this would not be an indication that gas supply sources were not secure since RG&E could hardly achieve such an objective by making gas supply arrangements that were unreliable.

Accordingly, based on the record before it at this time, DOE preliminarily finds that the proposed import is competitive and sufficiently flexible to remain so over the term of the import authorization requested. DOE also preliminarily finds that the imported gas is needed, that security of supply has been established and that the proposed import will not lead to any undue dependence on an unreliable source of supply nor otherwise compromise the energy security of the nation over the term of the proposed import.

With respect to CNG's request for a trial-type hearing, section 590.313 of DOE's administrative procedures require the party filing a motion for a trial-type hearing to demonstrate that there are factual issues genuinely in dispute that are relevant and material to a decision and that a trial-type hearing is necessary for a full and true disclosure of the facts. DOE has examined the matters raised by CNG in requesting a trial-type hearing and concludes that CNG's concerns do not reflect a factual dispute but rather a different policy perspective that departs substantially from DOE's established policy to promote competition in the public interest. The record does not reveal a genuine factual dispute as to what the terms of the proposed import are or what the facts are relating to need for the gas or security of supply but rather it reveals a difference in view as to what import arrangements are in the public interest. Accordingly, CNG's request for a trial-type hearing is denied.

B. Environmental Determination

The National Environmental Policy Act of 1969 (NEPA) 5/ requires Federal agencies to give appropriate consideration to the environmental effects of their proposed actions. RG&E's import proposal requires the issuance of several permits and authorizations before the project can proceed, including DOE's import authorization under section 3 of the NGA and FERC's authorizations related to the Empire State Pipeline project. FERC (Docket Nos. CP90-316-000 and CP90-317-000) has the lead in preparing the environmental analysis required to assess the impacts of the new pipeline facilities related to this import project. 6/ DOE is a cooperating agency in the environmental review process.

The approval of this export/import arrangement is therefore being conditioned on completion of the environmental review of the proposed Empire State pipeline facilities and DOE's responsibilities under NEPA. When this process is completed, DOE will then reconsider this conditional order and issue an appropriate final opinion and order.

This conditional order makes preliminary findings and indicates to the parties DOE's determination at this time on all but the environmental issue in this proceeding. All parties are advised that the issues addressed herein regarding the import of natural gas will be reexamined at the time of the DOE's review of the FERC environmental analysis. The results of that reexamination will be reflected in the final opinion and order.

C. Conclusion

After taking into consideration all of the information in the record of this proceeding, I find that granting RG&E conditional authority to import from Canada up to 16,000 Mcf per day of natural gas, is not inconsistent with the public interest and should be approved. However, we are not authorizing this import for the term proposed by RG&E, but will limit it to a term of ten years.

DOE's policy in issuing long-term import authorizations is that they do not exceed the initial expiration date of a particular contract. The gas sales contract between RG&E and Unigas is for a term of ten years, but may be extended for successive periods of five years by mutual agreement of the parties under provisions to be determined through negotiation. Because RG&E has not shown that circumstances exist here which would warrant departing from established policy, its request that DOE authorize the proposed imports for 15 years is denied. This in no way, however, forecloses RG&E's ability to file for an extension of import authority at a later time.

ORDER

For the reasons set forth above, pursuant to section 3 of the Natural Gas Act, it is ordered that:

A. Subject to the condition in Ordering Paragraph B, Rochester Gas and Electric Corporation (RG&E) is authorized to import up to 16,000 Mcf per day of natural gas from Canada in accordance with the provisions of its November

29, 1989, gas sales contract with Unigas Corporation, as described in the application and discussed in this Opinion and Order.

B. The authorization in Ordering Paragraph A is conditioned upon entry of a final opinion and order after review by the Department of Energy (DOE) of the environmental documentation being prepared by the Federal Energy Regulatory Commission and the completion by the DOE of its National Environmental Policy Act (NEPA) responsibilities.

C. The term of this authorization is for ten years commencing on the date the proposed pipeline facilities of Empire State Pipeline Company, Inc. are placed in service.

D. RG&E shall notify the Office of Fuels Programs (OFP), Fossil Energy, FE-5O, Forrestal Building, 1000 Independence Avenue, S.W., Washington, D.C. 20585, in writing of the date of initial imports of natural gas made under Ordering Paragraph A above within two weeks after deliveries begin.

E. RG&E shall file with the Office of Fuels Programs, within 30 days following each calendar quarter, quarterly reports showing by month, the total volume of natural gas imports in Mcf.

F. The motions to intervene, as set forth in this Opinion and Order, are hereby granted, provided that participation of the intervenors shall be limited to matters specifically set forth in their motions to intervene and not herein specifically denied, and that the admission of such intervenors shall not be construed as recognition that they might be aggrieved because of any order issued in these proceedings.

G. The motion of CNG Transmission Corporation (CNG) requesting summary dismissal of RG&E's application is hereby denied. In addition, CNG's request for a trial-type hearing is denied.

H. The authorizations granted in Ordering Paragraph A are subject to the condition stated in Ordering Paragraph B, the resolution of which may result in further conditions being imposed in subsequent proceedings in this case. RG&E and the intervenors in this proceeding shall be bound by any Opinion and Order issued in subsequent proceedings.

Issued in Washington, D.C., May 16, 1991.

--Footnotes--

1/ 55 FR 7772, March 5, 1990.

2/ 15 U.S.C. 717b.

3/ 49 FR 6684, February 22, 1984.

4/ Natural Gas Pipeline Company of America, 1 ERA Para. 70,645 (May 15, 1986), at 72,533.

5/ 42 U.S.C. 4321, et seq.

6/ On December 14, 1990, the FERC published a Notice of Intent to Prepare an Environmental Assessment for the Proposed Empire State Project and Request for Comments on its Scope. (55 F.R. 5149, December 14, 1990).