Cited as "1 ERA Para. 70,124"

Cabot Energy Supply Corporation (ERA Docket No. 84-09-LNG), February 26, 1985.

DOE/ERA Opinion and Order No. 72

Order Granting Authorization to Import Liquefied Natural Gas for Short-Term and Spot Market Sales, and Granting Interventions

I. Background

On August 11, 1984, Cabot Energy Supply Corporation (CESCO) filed an application with the Economic Regulatory Administration (ERA) of the Department of Energy (DOE), pursuant to Section 3 of the Natural Gas Act, for a blanket authorization to import up to five cargoes of liquefied natural gas (LNG) (125,000 m3/ ships or their equivalent) in a 12-month period. The total LNG proposed to be imported in any 12-month period would not exceed 15 trillion Btu, and the agreement executed by CESCO with its supplier(s) under such authorization would not exceed five years in duration. Although the application does not identify specific suppliers or customers, CESCO intends to import the LNG only pursuant to specific supplier and customer agreements. CESCO expects that its customers under the requested authorization would include distribution companies, pipelines, industrial users and other end users. While some agreements could require only one shipload, it expects that most deliveries would supply short-term market needs for one or two heating seasons.

CESCO claims that its application for a blanket authorization is in harmony with the Secretary of Energy's policy guidelines1/ emphasizing competitive pricing and responsiveness to changing market conditions. It proposes to fulfill its obligations as an importer under the guidelines "by ascertaining the reliability of the source and the need for and marketability of the LNG." CESCO asserts that the LNG would be purchased from a reliable source such as Sonatrach, the Algerian national oil company, and sold to customers having short-term requirements. CESCO proposes to enter into specific agreements which will include price, quantity, delivery schedule, and market-responsive provisions as appropriate, and to file a copy of each agreement with the ERA as well as notify the ERA that an import is taking place before the initial ship under each arrangement sails for the U.S. Only existing facilities would be used for the importation and sale of the LNG. CESCO believes that this procedure will eliminate the need for a public notice and regulatory proceeding before each individual import takes place, and that such short-term arrangements will not be inconsistent with the public interest.

In CESCO's opinion, the existence of an agreement with a potential customer will establish the presumption of need and marketability of the import and that, in dealing with reliable sources to meet short-term needs, security of supply will not be an issue. In addition, it believes that the procedures outlined in its application meet both the requirements of the DOE policy guidelines for importing natural gas and Section 3 of the Natural Gas Act.

II. Interventions and Comments

On October 24, 1984, a notice was issued by the ERA inviting protests or motions to intervene by December 3, 1984.2/ The ERA received five timely motions to intervene, one being a joint motion by nine intervenors, and two late filings, one being comments from Sun Exploration and Production Company (Sun) which were filed on December 10, 1984, and the other a motion to intervene filed by Pacific Gas Transmission Company (PGT) on December 12, 1984. CESCO was the only party to file reply comments. Sun did not move to intervene and is therefore not a party to this proceeding. There was no opposition to any of the motions for intervention. None of the intervenors protested the application or asked for further procedures. With regard to the late filing by PGT, no delay in the proceeding or prejudice to any party will result from granting intervention. Therefore, the PGT late filing is accepted and this order grants intervention with respect to all movants.3/

The joint petitioners, nine of the 11 distribution companies which now purchase all of the LNG imported by a CESCO affiliate, Distrigas Corporation (Distrigas), and sold to them by another CESCO affiliate, Distrigas of Massachusetts Corporation (DOMAC), raised the issue of allocating the costs of a DOMAC-owned LNG terminalling facility at Everett, Massachusetts, if LNG for short-term sales is brought in by CESCO at this facility. Both CESCO and DOMAC are wholly-owned subsidiaries of Cabot Corporation and the costs of the Everett facility are presently being paid for by the 11 customers of DOMAC through terminalling service charges regulated by the Federal Energy Regulatory Commission (FERC).

Boston Gas, another of the 11 DOMAC customers, also raised the issue of cost allocation at the Everett facility. Boston Gas expressed concern that approval of CESCO's application may jeopardize Boston Gas' DOMAC supply since there are no details as to how it might affect the availability of volumes to DOMAC. It also noted that no mention is made of how CESCO volumes might be transported from the Everett facility to the ultimate buyer, but recognized that many of these issues would be the subject of FERC proceedings.

Brooklyn Union, also a DOMAC customer, requested that the ERA impose the following condition if it grants the authorization sought by CESCO:

> CESCO import arrangements authorized hereby shall be without

detriment or disadvantage to customers of existing import projects who are dependent upon such existing projects' gas supplies.

All of the DOMAC customers were concerned about the potential adverse impact of the short-term blanket supplies on their long-term LNG arrangements. They were concerned about the need for a proper allocation of costs of the DOMAC facilities that are presently paid for by DOMAC's customers through terminalling services provided by DOMAC under its FERC gas tariff. Furthermore, they expressed concern about the possible impact that this transaction may have upon DOMAC's overall operations and rates to its customers.

CESCO, in its answer, contends that the condition proposed by Brooklyn Union, and, by inference, the concerns raised by DOMAC's other customers, are inappropriate and unnecessary. CESCO contends that DOMAC and Distrigas have permanent certificates of convenience and necessity, and that DOMAC is legally required to serve Brooklyn Union and its other customers, regardless of CESCO's actions.

Brooklyn Union and the other DOMAC customers did not make it clear to the ERA how such an adverse circumstance could occur, or how such a condition would remedy it. However, in the event such a problem were to arise, the FERC, through its certification and ratemaking processes, provides sufficient protection and remedies to DOMAC's customers. Since the allocation of costs of the Everett terminalling facilities between present DOMAC customers and CESCO customers is also regulated by the FERC, any issues in this regard should be brought before the FERC, not the ERA. Hence, the proposed condition is unnecessary.

Brooklyn Union also states that sufficient information has not been provided to enable the ERA or anyone else to determine if all proposed sales are in the public interest and would not be to the detriment of customers with existing gas import projects. Brooklyn Union proposes that, if granted, the authorization should require that the ERA issue a notice and provide a comment period upon receipt of a copy of each letter agreement and gas purchase contract with a U.S. purchaser. After the comment period, Brooklyn Union proposes that the transaction would take place unless the ERA issues an order, before the sailing of the first ship delivering supplies under each arrangement, disapproving or modifying the arrangement. The comments made by PGT would appear to support this proposal because PGT is concerned that the ERA retain for itself the ability to determine that consumers are protected and that the Secretary of Energy's gas import guidelines are satisfied.

CESCO, in its answer, contends that to allow notice and comment could mire CESCO in procedures which might last so long that the intended purchaser would no longer need the LNG by the time the authorization was granted. CESCO notes that it has proposed to notify the ERA before the ship sails, and to file the relevant contracts with the ERA.

The ERA understands the concern that lies behind the request for a review and comment period before individual transactions are executed. Brooklyn Union, and PGT by inference, want to ensure that the ERA has the opportunity to intervene and stop an unacceptable transaction before it occurs rather than have to attempt, after the fact, to mend an adverse situation. However, it appears to the ERA that this approach assumes that the government knows better than the parties involved the best terms, use, and timing of an arrangement. It assumes that the parties involved in the transaction have neither the good economic sense nor the legal tools to operate in their own best interest. The ERA does not accept either of these assumptions. As stated in the policy guidelines, "[t]he market, not government, should determine the price and other contract terms of imported gas." 4/ Moreover, the situation underlying proposed blanket authorizations for short-term sales is one in which the market demands quick responses or the transactions do not occur. Although the lead time for LNG shipments is somewhat longer than for overland deliveries of gas, the buyer-seller dynamics are the same. The transactions which would occur under blanket authorizations would be short-term with market-responsive prices and terms. Furthermore, no party is locked into long-term sales nor any terms to which they themselves have not agreed.

PGT intervened as a major importer of natural gas from Canada into the northern California market. PGT suggests that the ERA consider what impacts short-term imports have on the competitiveness of long-term, firm imports. Specifically, PGT cites as an example the proposal made by Northwest Alaskan Pipeline Company (Northwest Alaskan) in its application for blanket authorization to make spot sales.5/ Northwest Alaskan asserted that sales under the blanket authorization would lot displace other Canadian sales. PGT contends that this type of safeguard should also be imposed on the CESCO authorization.

In its answer, CESCO states that PGT's concern appears to be that CESCO will compete in the marketplace. CESCO states that it intends to do so. CESCO goes on to say, however, that it does not propose to supplant long-term supplies. Rather, AESCO proposes to bridge short-term gaps which may occur in the fluctuating supply and demand for gas. CESCO further states that PGT's concern about the need for more safeguards is answered by the proposed structure of the blanket authorization which will ensure that only market-responsive transactions will occur.

PGT raises the important issue of long-term versus short-term imports, and, by inference, requests the ERA to protect long-term imports. The ERA is not persuaded to take such action. As the Secretary of Energy's policy guidelines recognize, both short-term and long-term projects have roles to play in the marketplace. Each type of project--long-term and short-term--has different components which make up the competitive package; that package will be more or less appealing to a particular customer depending upon that customer's needs. If a customer finds a short-term purchase more attractive than an existing long-term arrangement, that is a signal that the long-term arrangement should be restructured or renegotiated to remain competitive. While the need for assured long-term supplies often overrides the desire for short-term savings, this is not always the case, and participants in the changing natural gas market must be sufficiently flexible to respond to competition in the various forms it takes in order to retain their position in that market. Thus, the ERA is disinclined to impose conditions on this authorization to protect long-term arrangements from competition, even in the short-term.

Sun filed comments protesting the application and requesting that the ERA deny it. Sun alleges that (1) there is no current need for the LNG when significant surplus supplies are available; (2) the cost of the LNG would likely be in the range of $7.00 to $9.00 per MMBtu which is substantially higher than the cost of available domestic and Canadian gas and alternate energy supplies; (3) the balance of trade would be adversely impacted by $250--$300 million; and (4) failure to establish need and consumer benefit is contrary to the policies established in DOE/ERA Opinion and Order No. 50 in the Trunkline LNG Company case.6/ Sun thus concludes that the application is not in the public interest.

Although Sun filed comments opposing the application, Sun did not file a motion to intervene or in any way petition to become a party to this proceeding. The basis for its protest, that the arrangement does not comply with Order No. 50, is, however, erroneous. The findings and criteria used in Order No. 50 apply only to the factual circumstances of that case, not to any other import application. As stated in the Federal Register notice of this application, the Secretary of Energy's policy guidelines on gas imports establish the policy which the ERA intends to follow in its decision on the factual circumstances of this case. Sun did not directly address the issue of competitiveness in the marketplace which is key to our decision on an import application, although it stated that there is no current need for the LNG. Sun has not demonstrated that the import would be uncompetitive, and thus has not overcome the presumption of need based on competitiveness as set forth in the policy guidelines. Sun's concern about whether there is sufficient information for the ERA to determine that the import is not inconsistent with the public interest is addressed below in the discussion of the decision.

CESCO in its reply comments stated that many of the "disputable statements of movants" were not premised upon the new policy guidelines which emphasize competition, pricing and responsiveness to changes in market conditions. CESCO stated that none of the intervenors has demonstrated that the import arrangement is not consistent with the public interest, and emphasized that its application addresses the considerations of competitiveness, need, and security of supply by which an import arrangement would be judged. CESCO therefore reiterated that the ERA should grant the authorization.

III. Decision

The CESCO application has been evaluated in accordance with the Administrator's authority to determine if the proposed import arrangement meets the public interest requirements of Section 3 of the Natural Gas Act. Under Section 3, an import is to be authorized unless there is a finding that it "will not be consistent with the public interest." 7/ The Administrator is guided by the Secretary of Energy's policy guidelines relating to the regulation of natural gas imports. Under these guidelines, the competitiveness of an import arrangement in the markets served is the primary consideration for meeting the public interest test.

This decision recognizes recent institutional changes in the natural gas industry, particularly the development of the spot market. An active spot market, along with more flexible long-term contracts, are among the new market mechanisms that are allowing pipeline and distribution companies, producers, and consumers to adjust more rapidly to changing market conditions.8/ The DOE's policy is to foster full development of a spot market as an integral part of a properly functioning market for natural gas, while assuring that the unexpected, market-disruptive consequences do not occur during this transitional period to a deregulated market. Furthermore, a spot market helps achieve the policy goal for gas imports of having "a supply of natural gas supplemental to domestic production available on a competitive, market-responsive basis . . . ." 9/

In its comments, PGT recommends that in granting an authorization the ERA should reserve for itself the ability to determine that the DOE import policy guidelines will be satisfied by structuring such blanket arrangements to contain adequate safeguards to assure that any adverse impacts are avoided. Several other intervenors, and Sun, expressed concern that there is not sufficient information on individual transactions to ascertain that they are not inconsistent with the public interest. While the ERA does not agree with the specific conditions recommended by PGT and Brooklyn Union, the ERA does agree that some safeguards are warranted.

Spot market sales by their nature are quick, short-term transactions designed to adapt gas sales to changing market conditions. Accordingly, requiring each spot sale to be considered individually with a notice and comment period would defeat this purpose since the opportunity to make the sale could pass before the required administrative procedures are completed.

The time required by the administrative process necessitates that, if quick, short-term, spot transactions are to be approved at all, they must be reviewed as a group or on a blanket basis using information presented about the type of transaction and the circumstances under which such transactions would be undertaken.

Moreover, the nature of spot sales arrangements--that each spot sale is voluntarily negotiated, short-term, and frequently executed on an interruptible, best-efforts basis--provides assurance that such transactions will be consistent with the policy guidelines and in the public interest. Thus, the series of spot sales transactions proposed by CESCO can be evaluated and found to be in the public interest without knowing the precise terms of each sale, inasmuch as each sale is freely negotiated and would not take place if the gas was not marketable, not competitively priced, and not needed. It is not essential to know in advance the terms of each sale as long as the parameters for each sale are known.

However, the ERA does not have the responsibility of ensuring that the parameters surrounding each sale are in the public interest. Therefore, the ERA does believe that some conditions are necessary to provide safeguards against unintended and unanticipated results because the blanket authorization mechanism is a new and untried concept. Such safeguards should include a reporting requirement and a limitation on the term of the authorization. The latter will provide an opportunity for review of the blanket authorization mechanism and its impacts after a reasonable period of time.

Accordingly, the ERA is limiting CESCO's blanket authorization to a two-year period. The two-year period would begin on the date of first delivery. The limitation is imposed in recognition for short-term, spot market sales is new and experimental. Two years or less is the typical length of a spot market sale. Contracts of up to five years, as requested by CESCO, would not be consistent with the purpose of this blanket authorization. A two-year limit on the term will provide the ERA the opportunity to review the impacts of the program before any lengthier authorization is considered. Assuming the spot market and the blanket authorization operate as envisaged, it should not be difficult for CESCO to request and receive an extension of the blanket authorization.

Furthermore, to facilitate the review of spot market sales transacted under this authorization, the ERA has concluded that a quarterly reporting requirement is required. As a result, submission of the individual contracts as proposed by CESCO will not be required, although in accordance with the application, no gas is to be imported without completed buyer-seller contracts. Quarterly reporting is consistent with that required in other recently issued import authorizations. Under this requirement, CESCO must report whether a spot sale has been made, and if so, report the details of each spot sale transaction during the preceding quarter, including the purchase and sales price, volume, contract, ultimate suppliers and purchasers, and markets served. The ERA reserves the right to amend or further condition the import authorization based upon periodic review of the spot market sales effected. The ERA believes that these conditions will provide the information needed to evaluate the impact of spot market sales under the CESCO proposal on a timely basis. This will allow the ERA to adequately protect the public interest.

No intervenor has claimed that CESCO's proposed arrangement does not conform to the DOE policy guidelines. At most, intervenors have raised concerns that there was not sufficient information in the record to enable the ERA to ascertain compliance with the guidelines. However, the ERA has concluded that the information CESCO has presented demonstrates that the spot sales arrangements entered into under CESCO's proposal would be freely negotiated, and would not take place if they were not competitive arrangements.

As set forth in the gas import policy guidelines, the need for an import is recognized to be a function of its competitiveness. Under the competitive arrangement proposed by CESCO, it will purchase LNG only to the extent it needs the gas to serve specifically defined short-term customers. No intervenor challenged the need for the gas. Only Sun claimed there is no need, but failed to make an adequate demonstration consistent with the Secretary of Energy's policy guidelines.

In short-term, spot arrangements, the ERA has taken the position that security of supply is not an issue of significance. This is such a short-term supply situation, where CESCO expects to supply market needs on a short-term, spot basis for only one or two heating seasons.

After taking into consideration all information in the record of this proceeding, I find that the authorization requested by CESCO, limited as discussed above, is not inconsistent with the public interest and should be granted.10/

Order

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

A. Cabot Energy Supply Corporation (CESCO) is authorized to import up to the equivalent of five cargoes of LNG (125,000 m3/ ships or their equivalent) each year during the two-year period beginning on the date of first delivery to an LNG facility in the U.S., with the total LNG imported in each year not to exceed 15 trillion Btu, all to be imported under specific short-term, spot sale supply and customer agreements in accordance with the provisions stipulated in CESCO's application filed with the ERA on August 31, 1984, as modified by this Order.

B. CESCO shall notify the ERA in writing of the date of first delivery of LNG imported under Ordering Paragraph A above within two weeks after the date of the first delivery.

C. With respect to the LNG authorized to be imported by this Order, CESCO shall file with the ERA in the month following each calendar quarter, quarterly reports showing, by month, whether spot sales have been made, and if so, the details of each spot sale. The details reported shall include the purchase and sales price, volume, contract adjustment and take provisions, duration of the agreement, ultimate sellers and purchasers, and markets served.

D. The motions for leave to intervene, as set forth in this Opinion and Order, are hereby granted subject to the administrative procedures in 10 CFR Part 590, provided that participation of the intervenors shall be limited to matters affecting asserted rights and interests specifically set forth in their motions for leave 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.

Issued in Washington, D.C., February 26, 1985.

--Footnotes--

1/ 49 FR 6684, February 22, 1984.

2/ 49 FR 44011, November 1, 1984.

3/ Intervenors are:

Bay State Gas Company*

Berkshire Gas Company*

Boston Gas Company

Brooklyn Union Gas Company

Colonial Gas Company

Connecticut Light & Power Company*

Essex County Gas Company*

Fall River Gas Company*

New Jersey Natural Gas Company*

Pacific Gas Transmission Company

Providence Gas Company*

South Jersey Gas Company*

Tennessee Gas Pipeline Company

Valley Gas Company*

The joint petitioners are shown by an asterisk (*).

4/ 49 FR 6685, February 22, 1985.

5/ Filed October 16, 1984, in ERA Docket No. 84-16-NG.

6/ 1 ERA Para. 70,117, Federal Energy Guidelines.

7/ 15 U.S.C. Sec. 717b.

8/ In Increasing Competition in the Natural Gas Market; Second Report Required by Section 123 of the Natural Gas Policy Act of 1978, submitted in January 1985, the DOE observed that an active spot market will allow the natural gas market to allocate risks efficiently and will help minimize price and supply fluctuations as the market moves from a tightly regulated environment towards fully competitive market conditions. See Summary, pp. S-1 and S-5, and Chapter 6, p. 75.

9/ 49 FR 6687, February 22, 1984.

10/ Because the proposed importation of LNG will use existing facilities, DOE has determined that granting this application is not a Federal action significantly affecting the quality of the human environment within the meaning of the National Environmental Policy Act (42 U.S.C. 4321, et seq.) and therefore an environmental impact statement or environmental assessment is not required.