Cited as "1 FE Para. 70,235"

Indeck-Yerkes Energy Service, Inc. (FE Docket No. 89-21-NG), August 24, 1989.

DOE/FE Opinion and Order No. 326

Order Granting Conditional Authorization to Import Natural Gas from Canada

I. Background

On March 28, 1989, Indeck-Yerkes Energy Services, Inc. (Indeck-Yerkes), 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 No. 0204-127, for authorization to import from Indeck Gas Supply Corporation (Supply) up to 4.5 Bcf of Canadian natural gas per year over a 15-year period beginning November 1, 1990. Indeck-Yerkes is an Illinois corporation and wholly-owned subsidiary of Indeck Energy Services, Inc. (Services), also an Illinois corporation. Services and its subsidiaries are engaged in the development, ownership, operation and maintenance of cogeneration projects.

The imported natural gas would be the primary source of fuel for a 53-MW gas-fired cogeneration facility to be constructed by Indeck-Yerkes adjacent to the existing DuPont-Yerkes plant in Tonawanda, New York. It is anticipated that the cogeneration facility will be completed and in commercial operation by March 1, 1990. It will be operated as a "qualifying facility" under section 201 of the Public Utility Regulatory Policies Act of 1978. In addition, Indeck-Yerkes has filed a certification of compliance with the coal capability requirements for proposed new electric powerplants under the Powerplant and Industrial Fuel Use Act of 1978, as amended.1/ It is expected that the facility will consume an average of 12,000 Mcf per day of natural gas under normal operating conditions. It will provide up to 75,000 lbs/hr. of steam at 550 psig to DuPont-Yerkes and will generate 53 MW of electricity to be sold to Niagara Mohawk Power Corporation of New York.

Indeck-Yerkes will buy the Canadian natural gas from Supply in accordance with their gas purchase agreement dated December 27, 1988. Supply has agreed to sell and deliver up to a maximum of 14 MMcf of natural gas per day and up to an annual contract quantity of 4.5 Bcf. The price will equal Supply's weighted average cost of the natural gas delivered to Indeck-Yerkes, including a management fee as described below and all costs related to transportation in Canada by NOVA Corporation of Alberta and TransCanada PipeLines Limited (TCPL) to the point at the international border where Indeck-Yerkes receives the volumes. The term of the agreement between

Indeck-Yerkes and Supply extends through January 1, 2006, with provision for extension for subsequent periods of one year, until terminated by a 12-month notice in writing by either party. Indeck-Yerkes estimates that the delivered price it will pay Supply during the first year of the proposed import arrangement would be $2.52 per Mcf. Indeck-Yerkes bases this estimate on its calculation of Supply's weighted average cost of natural gas per Mcf purchased from producers under four contracts submitted as part of its application.

The volumes of gas that Supply has available for resale to Indeck-Yerkes will be provided by Northstar Energy Corporation (Northstar), Chesapeake Resources Ltd., et al. (Chesapeake, et al.), and Bow Valley Industries, Ltd. (Bow Valley). Together, those Canadian producers contractually agreed to sell to Supply, on a firm basis, a total of up to 25.8 MMcf per day and up to 9.34 Bcf of natural gas per year as well as up to .33 Bcf of natural gas per year on an interruptible basis. According to the application, after TCPL's transportation shrinkage allowance, estimated to be approximately 7 percent, these volumes net Supply a total of 9.0 Bcf per year or up to 24.0 MMcf per day for export at the international border. Of the total volumes purchased by Supply from the producers, 4.5 Bcf per year or 12.0 MMcf per day will be sold to Indeck-Yerkes. The remaining 4.5 Bcf purchased annually will be sold by Supply to Indeck-Yerkes' affiliate, Indeck Energy Services of Oswego, Inc. (Indeck-Oswego), to fuel a cogeneration facility it is planning to build near Oswego, New York. Indeck-Oswego has an application for authority to import that gas from Supply pending before the DOE in FE Docket No. 89-22-NG.

Indeck-Yerkes states that the four contracts encompassing the entire quantity of gas purchased by Supply will be administered by a single producer, Bow Valley. Bow Valley will also act as Supply's liaison with TCPL for the transportation of Supply's gas through TCPL's system. For this service, Bow Valley will receive a fee from Supply of approximately $0.02 (U.S.) per Mcf of purchased gas which will be included in the price of gas paid by Indeck-Yerkes.

Indeck-Yerkes described Supply's gas purchase agreements with the Canadian producers as follows:

A. Northstar Agreement

Under the Northstar gas purchase agreement, Supply will purchase with a lump sum payment in the amount of $13.65 million (U.S.) to be paid on November 1, 1989, a total volume of 26 million MMBtu (approximately 26 Bcf) of natural gas to be delivered over a maximum term of 18 years. Additionally, Supply will reimburse Northstar for its actual production taxes, and gathering and processing costs based on an initial rate of $.315 (U.S.) per MMBtu. This initial rate is to be increased annually by an amount equal to the greater of five percent or the U.S. GNP deflator commencing on January 1, 1989. Supply will reimburse Northstar for all related royalty payments and all transportation costs to the point of delivery near Empress, Alberta. Supply also agreed to a minimum take of at least 6,000 MMBtu of gas per day and contends that it is highly unlikely that Supply will be unable to take at least that amount at any time during the term because the average combined daily requirements of the two cogeneration facilities consuming this gas is estimated to total 24,000 Mcf per day.

B. Chesapeake, et al., Agreement

The Chesapeake group of producers has agreed to sell Supply a total of up to 7,078 Mcf per day of natural gas over an initial term of 15 years. Additional non-firm volumes may be purchased if needed in any year. Under the Chesapeake agreement, Supply will take title to the gas delivered to the Alberta border at an initial price of $1.67 (U.S.) per Mcf. Commencing January 1, 1991, and each year thereafter, the contract price will escalate by three percent of the preceding contract year price. Supply also agreed to pay an annual bonus set by a formula essentially fixing the price of the gas, subject to ceiling amounts, to the price received by Indeck-Yerkes' affiliate, Indeck-Oswego, for electric power sold to Niagara Mohawk from its Oswego, New York, cogeneration facility. The bonus payments would start in 1992, when the maximum bonus payment would be $.12 per Mcf and could gradually rise to a maximum of $3.75 per Mcf in 2004 as the price paid for the electric power exceeds the specified floor rate which increases beginning in 1998.

The Chesapeake contract volumes will be produced from dedicated reserves that are to be verified annually by an independent engineering firm. Further, in the event the firm sales volumes are not delivered, Supply's agreement provides that the Chesapeake producers must reimburse Supply for the reasonable cost of securing substitute production from other sources.

C. Bow Valley Agreements

Supply has two contracts with Bow Valley dated February 13, and March 13, 1989, under which Bow Valley will sell Supply, on a firm basis, a combined total of up to 12,500 Mcf of Canadian natural gas per day for an initial term of 15 years. Supply has agreed to take or pay for a total of 4.56 Bcf of gas per year, but is given the right to receive any prepaid volumes at any time up to two years after the end of the term of the agreements. Supply will take title to the gas at a point of interconnection between Bow Valley's and TCPL's transmission facilities located in Saskatchewan. The pricing provisions of Bow Valley's February agreement are identical to those of the Chesapeake agreement. The initial price will be $1.67 (U.S.) per Mcf and escalates each year by three percent, plus a bonus to be determined under the same formula contained in the Chesapeake contract. The March agreement provides for the same $1.67 price and bonus formula, but provides for a four percent annual escalation to the initial price. Bow Valley has agreed to pay for the transportation to its interconnection with TCPL and any Canadian taxes, royalties and duties assessed on the delivered gas. Bow Valley will guarantee delivery of at least 12,500 Mcf per day from its own reserves and has agreed to secure substitute production from other sources in the event it incurs a production problem or for some other reason cannot deliver the contract volume as agreed.

The point of delivery for the gas imported by Indeck-Yerkes to enter the U.S. will be at an interconnection between TCPL and a new border facility near and parallel to the existing facilities of Tennessee Gas Pipeline Company (Tennessee) in the vicinity of Niagara Falls, New York. Indeck-Yerkes states that National Fuel Gas Supply (National) will transport up to 12,000 Mcf per day of its imported natural gas on a firm basis from Niagara Falls through the new Niagara Spur Loop Line that would be constructed and jointly owned by Tennessee, National, and PennEast Gas Service Company, to a point of interconnection with National's existing facilities at East Aurora, New York. From this point, the import will be delivered to National Fuel Gas Distribution Corporation's pipeline facilities for subsequent delivery to Indeck-Yerkes' Tonawanda cogeneration facility.2/

In support of its application, Indeck-Yerkes states that the imported gas is needed as a long-term fuel supply for its new cogeneration facility and that the natural gas would be purchased under competitive pricing terms. Indeck-Yerkes further asserts that Supply's purchase agreements are with proven reliable Canadian sources from the Provinces of Alberta and Saskatchewan. Indeck-Yerkes also asserts that it sought to negotiate with numerous domestic producers gas supply terms comparable to those contained in its present contracts, but the majority declined to support the long-term firm arrangement at an acceptable predetermined price.

A notice of this application was issued on May 10, 1989, inviting protests, motions to intervene, notices of intervention, and comments to be filed by June 9, 1989.3/ No interventions or comments were received.

II. Decision

The application filed by Indeck-Yerkes 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 is to be authorized unless there is a finding that it "will not be consistent with the public interest." 4/ This determination is guided by the DOE's natural gas import policy guidelines.5/ Under these guidelines, the competitiveness of an import in the markets served is the primary consideration for meeting the public interest test. Other considerations, particularly in long-term arrangements such as this, include, but are not limited to, need for the gas and security of the imported supply.

A. Competitiveness of the Import

The DOE guidelines assume that commercial parties, in the absence of extensive regulation, will negotiate competitive arrangements. The guidelines direct FE to assess the competitiveness of an import proposal to determine whether the arrangement is and will remain market responsive. Indeck-Yerkes' uncontested import proposal, as set forth in the application, is consistent with the DOE's policy guidelines.

The applicant end user has freely negotiated this supply of natural gas which it proposes to import directly to meet the needs of the proposed cogeneration facility under the terms and conditions it considers necessary for the successful operation of its facility over the life of the arrangement. Indeck-Yerkes contends that the proposed import should be found competitive, emphasizing that only the parties to the arrangement would suffer any losses if the gas supply contracted for were to become uneconomic, and that they therefore have a "strong incentive" to arrange for a supply that ensures the competitiveness over the term of the contract.6/ Competitiveness from the perspective of Indeck-Yerkes depends more on price certainty than on more flexible, price adjustment provisions. The applicant also believes that the nature of the overall arrangement, because it involves four supply contracts to serve the needs of two cogeneration facilities, adds "operational flexibility" not always present in more conventional firm supply arrangements.7/ Indeck-Yerkes' arguments are persuasive and, on the basis of the record before it at this time, FE finds the proposed import competitive.

B. Need

Under the policy guidelines, need is presumed to be a function of competitiveness. The presumption, applicable here, is uncontested in this proceeding. Indeck-Yerkes offers additional evidence of need by asserting that it was unable to interest domestic producers in a long-term firm agreement at an acceptable predetermined price. FE therefore makes a preliminary finding that there is need for the proposed import.

C. Security of Supply

The guidelines say that security of the natural gas supply can be demonstrated by reference to the historical reliability of the suppliers. The Provinces of Alberta and Saskatchewan have historically been reliable sources of natural gas to the United States and the reliability of the specific sellers is uncontested. Reliability of the Canadian supplies is supported further in this proceeding by the contractual warranty obligations, under which the suppliers must deliver the daily firm contract quantities or suffer the penalty of having to reimburse Supply for any additional costs incurred in obtaining alternate supplies of natural gas to replace the delivery shortfall.

Therefore, FE also makes a preliminary finding that the import will not lead to any undue dependence on an unreliable source of supply nor otherwise compromise energy security over the contract period.

D. Environmental Determination

The National Environmental Policy Act of 1969 (NEPA) 8/ requires Federal agencies to give appropriate consideration to the environmental effect of their proposed actions. For Indeck-Yerkes' proposed project, the issuance of several major permits and authorizations are required before the project can proceed, including FE's import authorization under section 3 of the NGA and FERC's authorization under section 7 of the NGA for Tennessee and National to construct and operate facilities to transport the natural gas proposed to fuel the cogeneration facility. The FERC has the lead in preparing the environmental analysis required to assess the impacts of the new facilities related to this import project.

When the appropriate environmental documentation is completed by the FERC, the DOE will independently review the analysis and take the appropriate action to complete the DOE's NEPA responsibilities. The FE will then reconsider this conditional order and issue an appropriate final opinion and order. The approval of this import of natural gas is therefore conditioned on completion of an environmental review and DOE's responsibilities under NEPA.

This conditional order makes preliminary findings and indicates to the parties FE's determination at this time on all but the environmental issues 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's NEPA analysis. The results of that reexamination will be reflected in the final opinion and order.

E. Conclusion

After taking into consideration all of the information in the record of this proceeding, I find that granting Indeck-Yerkes conditional authority to import up to 4.5 Bcf of Canadian natural gas per year over a 15-year period beginning on November 1, 1990, is not inconsistent with the public interest.

ORDER

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

A. Indeck-Yerkes Energy Services, Inc. (Indeck-Yerkes), is authorized to import up to 4.5 Bcf per year of Canadian natural gas from Indeck Gas Supply Corporation over a 15-year period beginning on November 1, 1990, in accordance with the provisions described in its application.

B. The authorization in Ordering Paragraph A is conditioned upon entry of a final opinion and order by the Office of Fossil Energy (FE) after review by the Department of Energy (DOE) of the final environmental analyses being prepared by the Federal Energy Regulatory Commission, and the completion by the DOE of its responsibilities on this project under the National Environmental Policy Act. Resolution of this condition may result in further conditions being imposed in subsequent proceedings in this case. Indeck-Yerkes shall be bound by any opinion and order issued in such subsequent proceedings.

C. Indeck-Yerkes shall notify the FE in writing of the date of first delivery of natural gas imported under Ordering Paragraph A above within two weeks after deliveries begin.

D. With respect to the imports authorized by this order, Indeck-Yerkes shall file with the FE within 30 days following each calendar quarter, quarterly reports showing by month, the quantities of natural gas in MMcf imported under this authorization, and the average price per MMBtu paid for those volumes at the international border. The price information shall include a demand/commodity charge breakdown on a monthly and per unit (MMBtu) basis.

Issued in Washington, D.C., on August 24, 1989.

--Footnotes--

1/ 54 FR 3111, January 23, 1989.

2/ The FERC is presently considering the applications of Tennessee (FERC Docket No. CP88-171-000) and National (FERC Docket Nos. CP88-94-000 and CP88-194-000) to construct the required facilities and provide transportation of the Canadian gas for Indeck-Yerkes and Indeck-Oswego.

3/ 54 FR 20185, May 10, 1989.

4/ 15 U.S.C. Section 717b.

5/ 49 FR 6684, February 22, 1984.

6/ Application, at 17.

7/ Application, at 18. Indeck-Yerkes also states that, because contracted natural gas supplies are to be available to fuel both the Tonawanda and Oswego projects, it is unlikely that Supply would be unable to take the entire contracted amount by the time the contract terminates (Id., at 11).

8/ 42 U.S.C. 4321, et seq.