National Energy Board

Reasons for Decision

ProGas Limited and Western Gas Marketing Limited

GH-7-88

December 1988

Gas Export

National Energy Board

Reasons for Decision

In the Matter of

ProGas Limited

Application Pursuant to Section 17 of the *National Energy Board Act* for a Change, Alteration or Variation of Natural Gas Export Licence GL-81

and

In the Matter of

Western Gas Marketing Limited

as Agent for TransCanada Pipelines Limited Application Pursuant to Section 17 of the *National Energy Board Act* for a Change, Alteration or Variation of Natural Gas Export Licence GL-90

GH-7-88
December 1988

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Recital and Appearances

IN THE MATTER OF the *National Energy Board Act,* and the Regulations made thereunder; and

IN THE MATTER OF an Application by ProGas Limited for an Order, pursuant to section 17 of the *National Energy Board Act*, authorizing a change, alteration or variation of Licence No. GL-81, as amended, or, in the alternative, for the issuance of a new licence, pursuant to section 82 of the Act, authorizing the export of natural gas from Canada; and

IN THE MATTER OF an Application by Western Gas Marketing Limited, as agent for TransCanada PipeLines Limited, for an Order, pursuant to section 17 of the *National Energy Board Act*, authorizing a change, alteration or variation of Licence No. GL-90, as amended, or, in the alternative, for the issuance of a new licence, pursuant to section 82 of the Act, authorizing the export of natural gas from Canada.

HEARD at Calgary, Alberta on 13 October 1988.

BEFORE:

R.B. Horner, Q.C.	Presiding Member
J.-G. Fredette	Member
A.B. Gilmour	Member

APPEARANCES:

L.E. Smith K.J. MacDonald M. Samuel L. Shank	ProGas Limited & Western Gas Marketing Limited
M. Putnam, Q.C.	Alberta and Southern Gas Co. Ltd.
G. Dann	The Consumers' Gas Company Ltd.
J. Lutes	Foothills Pipe Lines (Yukon) Ltd.
B. Woods D.Bews	Mobil Oil Canada
J. Burke-Robertson	Tennessee Gas Pipeline Company
S. Koskie	TransCanada Pipelines Limited
J.B. Jolley, Q.C.	Union Gas Limited
S.F. McAllister	Alberta Petroleum Marketing Commission
J. Minor	Minister of Energy for Ontario
D. Tremblay-Lamer	National Energy Board

Chapter 1
The Application

By its application dated 11 August 1988, ProGas Limited (ProGas) sought National Energy Board (Board) approval, pursuant to Section 17 of the *National Energy Board Act* (the Act), to amend natural gas export Licence GL-81, or in the alternative, for a new licence pursuant to Part VI of the Act.

The amendment requested by ProGas would provide the following changes to Licence GL-81:

(i) add Iroquois and Niagara Falls, Ontario as export points;

(ii) extend the term of the licence from the current expiry date of 31 October 1999 to 31 October 2011 resulting in a 24-year licence term for GL-81;

(iii) provide daily and annual maximum authorization levels for Iroquois and Niagara Falls, Ontario for the period commencing 1 May 1991 to 31 October 2011 of 708.2 thousand cubic metres (25 MMcf) and 258.5 million cubic metres (9.1 Bcf) respectively; and

(iv) a provision whereby ProGas could recover authorized volumes not taken during any year of the licence over an extended period following the expiration date of the licence. This extended term would be as long as necessary to allow the licence-holder to export the total remaining term quantity.

The application does not include a change in originally authorized term quantity of Licence GL-81 which is 20.2 billion cubic metres (713 Bcf).

In the alternative, ProGas would accept a new licence for export at Iroquois and Niagara Falls, Ontario with the following terms and conditions:

Term	-	1 May 1991 to 31 October 2011 (20 1/2-years)
Maximum Daily Quantity	-	708.2 thousand cubic metres (25 MMcf)
Maximum Annual Quantity	-	258.5 million cubic metres (9.1 Bcf)
Maximum Term Quantity	-	5.2 billion cubic metres (182.5 Bcf)
Make-up Provision	-	to allow full recovery of authorized term volumes over an extended period following the expiration date of the licence.

Issuance of a new licence to ProGas would require adjustments to Licence GL-81 to reduce the term quantity in GL-81 by an amount equal to the term quantity included in the new licence.

The gas proposed for export would be transported within Alberta by NOVA Corporation of Alberta (NOVA) to an interconnection with the facilities of TransCanada PipeLines Limited (TransCanada) for transportation to Niagara Falls or Iroquois, Ontario. From the international border the gas would be transported either through the Iroquois Gas Transmission System (IGTS) or Tennessee Gas Pipeline

Company (Tennessee Gas) to Burrillville, Rhode Island. The gas is to be consumed by Ocean State Power II (OSP II) to fuel a combined cycle generating plant.

By its application dated 11 August 1988, Western Gas Marketing Limited (WGML), as agent for TransCanada, has requested Board approval pursuant to Section 17 of the Act for an amendment to natural gas export Licence GL-90, held by TransCanada, or in the alternative, for a new export licence pursuant to Part VI of the Act.

WGML is a wholly-owned subsidiary of TransCanada and acts as TransCanada's agent in matters of natural gas purchases in Alberta and the resale of these volumes to domestic and export customers. The Alberta gas purchase contracts are between TransCanada and the producers; TransCanada holds the Alberta energy removal permits and it holds all existing Board export licences. WGML, as agent for TransCanada, acts on its behalf and partakes of the contractual and regulatory approvals held by TransCanada.

The amendment requested by the Applicant to Licence GL-90 would provide for the following changes:

(i) add Iroquois, Ontario as an export point;

(ii) extend the term of Licence GL-90 from 31 October 1999 to 31 October 2012 resulting in a 25-year licence term for GL-90;

(iii) include maximum daily and annual authorizations at Iroquois, Ontario for the period commencing 1 May 1991 to 31 October 2012 of 708.2 thousand cubic metres (25 MMcf) and 258.5 million cubic metres (9.1 Bcf) respectively; and

(iv) a provision whereby WGML could recover authorized volumes not taken during any year over an extended period following the expiration date of the licence. This extended term would be as long as necessary to allow full recovery of any remaining authorized term quantity.

WGML did not request an increase in the term quantity of Licence GL-90 which is 5.4 billion cubic metres (192.1 Bcf).

In the alternative, WGML as agent for TransCanada, would accept a new licence for export at Iroquois and Niagara Falls, Ontario with the following terms and conditions:

Term	-	1 May 1991 to 31 October 2012 (21 1/2-years)
Maximum Daily Quantity	-	708.2 thousand cubic metres (25 MMcf)
Maximum Annual Quantity	-	258.5 million cubic metres (9.1 Bcf)
Maximum Term Quantity	-	5.4 billion cubic metres (192.1 Bcf)
Make-up Provision	-	to allow full recovery of authorized term quantity over an extended period following the expiration date of the licence.

WGML noted that it required a licence term of 21 1/2-years in order to allow it to sell the full term quantity currently authorized under Licence GL-90.

The gas proposed for export would be produced in Alberta and transported by NOVA to an interconnection with TransCanada's facilities for delivery to the border point at either Iroquois or Niagara Falls, Ontario. United States transportation would be by either IGTS or Tennessee Gas to Burrillville, Rhode Island for consumption by OSP II.

Issuance of a new licence to WGML as agent for TransCanada, would result in the revocation of TransCanada's Licence GL-90 which the Applicant agreed to under cross examination during the hearing.

Chapter 2
Reasons for Decision

2.1 Market-Based Procedure

In satisfying itself that the gas to be exported was surplus to the reasonably foreseeable Canadian requirements, the Board used its market-based procedure as established in the July 1987 Reasons for Decision In the Matter of Review of Natural Gas Surplus Determination Procedures. Under the process the Board considers the following: complaints, if any, under the complaints procedure; an export impact assessment filed by the applicant; and other factors relating to the public interest including, inter alia, gas reserves, productive capacity, pipeline facilities, markets and net benefits to Canada.

2.1.1 Complaints Procedure

The complaints procedure provides an opportunity for Canadian gas users to object to a proposed export on the grounds that they cannot obtain additional supplies of gas under contract on terms and conditions, including price, similar to those in the proposed export.

No party to the proceeding filed a complaint or an objection to either the ProGas or WGML export proposal.

2.1.2 Export Impact Assessment

The export impact assessment (EIA) helps the Board to determine whether a proposed export is likely to cause Canadians difficulty in meeting their future energy requirements at fair market prices. The Applicant is required to assess the ability of Canadian natural gas producers to meet Canadian and export requirements for gas; the impact of the proposed export on domestic natural gas prices; and the ability of Canadian consumers to adjust, if necessary, their energy consumption patterns without substantial difficulty.

The onus is on the Applicant to demonstrate to the Board that the proposed export will not likely lead to any major difficulty for domestic consumers in meeting their energy requirements at prevailing market prices.

Given that ProGas and WGML propose to serve the same export customer with equal quantities of gas over relatively the same time period, they filed a joint EIA which addressed the required issues.

The Applicants argued that, in the context of North American demand for natural gas, it is not clear that the sale represents an increase in total demand. They argued further that the sale would lead to increased exploration activity which would result in incremental reserves additions of approximately three-quarters the volume of proposed exports. Thus, there would be only a small impact on supply costs. The Applicants concluded in their EIA that the applied-for volumes of about 16.9 PJ per year, compared to current Canadian production of 3 300 PJ, were too small to have a significant impact on market prices.

The Board agrees with the view that these volumes would have little impact on Canadian production, consumption and prices of natural gas.

2.1.3 Public Interest Determination

As part of its market-based procedure, the Board reviews a number of other factors which it determines to be relevant in the determination of the Canadian public interest.

2.1.3.1 Gas Supply

The Board notes that the gas supply for both ProGas and TransCanada, for whom WGML acts as an agent, was reviewed in its 1982 Omnibus Decision in which the Applicants were granted licences (GL-81 and GL-90) allowing the export of specific volumes of gas. The volume of gas requested for the OSP II contract forms part of the volumes previously authorized for export. The Board also notes that no intervenors questioned the Applicants' gas supply in this proceeding. Based on the results of its previous review and the fact that the proposed exports form part of the volumes which it has already authorized for export, the Board is of the view that it is not necessary to reconsider gas supply in this decision.

2.1.3.2 Energy Removal Permit

2.1.3.2.1 ProGas

ProGas holds removal permit GR 86-71 from Alberta. In order to supply OSP II, ProGas requires some minor amendments to its removal permit. The Applicant testified that it had filed an application with the Alberta Energy Resources Conservation Board (AERCB) requesting that its removal permit be amended to correspond to the contracts with its export customers.

2.1.3.2.2 WGML

TransCanada holds several Alberta removal permits with the majority of its reserves included in removal permit TC85-1.

The Applicant testified that TransCanada would apply to the AERCB in the near future for an extension of the term of its removal permit in order to satisfy the OSP II requirements. No change in the volumes in the removal permit are required.

2.1.3.3 Transportation Arrangements

The exports proposed by ProGas and WGML to OSP II would be transported in Alberta by NOVA to the interconnection with TransCanada's facilities at Empress, Alberta. From there the gas would be transported by TransCanada to Niagara Falls, Ontario.

OSP II formed part of the Tennessee/Iroquois offer of settlement which, at the time of the hearing, was under consideration in the Federal Energy Regulatory Commission's (FERC) Open Season proceeding. Since that time the Board has learned that the OSP II transportation requirements have been included as part of the Niagara Import Point Settlement which was filed as a discrete project with FERC on 18 November 1988 under the expedited comments procedure for the Open Season.

Under this settlement proposal the necessary facilities to transport the OSP II volumes would be constructed in whole or in part by Tennessee Gas, Transcontinental Gas Pipe Line Corporation and PennEast Gas Services Company. The facilities contemplated under the settlement would provide transportation for OSP II from Niagara Falls to Burrillville, Rhode Island and are expected to be initiated in 1989 and would for the most part be fully operational in 1990.

2.1.3.4 Ocean State Power II

The Ocean State Power II facility in Burrillville, Rhode Island will be a 250 megawatt combined cycle electric generating plant. It will be adjacent and similar to the OSP I facility, construction of which is to begin shortly.

The Board notes that OSP I was the subject matter of the Board's Reasons for Decision in GH-5-86 which was released in February 1987. In that decision the Board authorized ProGas to export gas to fuel the proposed OSP I combined cycle generating facility, and issued gas export Licence GL-101.

In their applications, both ProGas and WGML indicated that the gas purchase, power dispatching and regulatory aspects of the OSP II facility were similar to those of OSP I. In particular they noted that the exports to OSP II were likely to occur at a high load factor since OSP II had contracted 100 percent of the power output of its proposed plant on a 20-year firm basis to four major New England power companies: Boston Edison Company, New England Power Company, Montaup Electric Company and Newport Electric Corporation. These companies are members of the New England Power Pool (NEPOOL) and, as such, are subject to the dispatching of electrical generation facilities on an increasing incremental cost of generation basis. The Applicants noted that, as is the case with the OSP I facility, OSP II generation would therefore be dispatched on the basis of the commodity cost of the gas purchased by OSP II plus the variable U.S. transportation charges incurred. Based on this dispatching procedure the Applicants expect OSP II to be ranked for dispatching purposes behind only hydro power and nuclear power. The Applicants also indicated that increasing requirements for electrical generating capacity in the entire New England area was further evidence of expected high load factor sales to the proposed OSP II plant.

The Applicants stated that the U.S. regulatory approval process for the OSP II project was expected to proceed on a timely basis because most authorizations which have been obtained for the OSP I unit also apply to the OSP II unit. The FERC has issued a Final Environmental Impact Statement which found both phases of the Ocean State project to be acceptable. The Applicants stated that most major state permits for the OSP II facility have already been received and that the remaining permits were expected within sixty days.

The Economic Regulatory Authority (ERA) granted authorization for imports of the full OSP I and OSP II volumes on 19 August 1988.

2.1.3.5 Gas Sales Contracts

In support of their applications ProGas and WGML each filed executed precedent agreements with attached gas purchase contracts to be finalized upon fulfilment of all conditions precedent.

The terms of the ProGas and WGML pro forma gas purchase contracts with OSP II are identical to the terms and conditions agreed upon between ProGas and OSP I.

Both the ProGas and WGML contracts provide for 708 thousand cubic metres per day (25 MMcf) of gas on a firm basis over a 20 1/2-year term. The export price pursuant to the contracts will be composed of a demand charge, to be paid monthly, and a commodity charge. In order to remain competitive the export price will be indexed monthly to the cost of fossil fuels used by NEPOOL participants. The demand charge component of the export price will cover the fixed costs incurred in Canada to move the gas to the export point. The initial base export price is $U.S. 3.35 per MMBtu ($U.S. 3.12/GJ). The Applicants stated that with oil prices of about $U.S. 13.00 per barrel the indexed price for OSP II gas at the end of September 1988 would have been $U.S. 2.16 per MMBtu ($U.S. 2.01/GJ).

The Applicants stated that the 20 1/2-year firm gas supply is necessary because OSP II is required to demonstrate that its unit would be economically superior to an alternative coal-fired facility on a life-cycle basis. The initial capital costs per megawatt of capacity for a gas-fired combined cycle facility are lower than those for an alternative coal-fired facility. However, since gas costs are higher than coal costs, a 20-year or more lifecycle is required in order to demonstrate that the gas-fired plant results in a lower average cost for power generated.

The Applicants also stated that the 20 1/2-year firm gas sales contracts were required in order to obtain financing for the OSP II facility.

Both Applicants testified that over 50 percent of their producers, representing in excess of 70 percent of their supply, approved of the terms and conditions of the pro forma gas purchase contracts.

Based on the evidence submitted by ProGas and WGML with respect to the demand/commodity pricing utilized in their respective pro forma export contracts as well as the electrical generation dispatching methodology employed by NEPOOL in meeting its electricity requirements and the increasing need for electrical generation capacity in NEPOOL's market area, the Board is satisfied that the proposed exports would occur at a high load factor.

The Board is satisfied with the terms and conditions included in the pro forma gas purchase contracts to be executed with OSP II by both ProGas and WGML. The Board notes that both ProGas and WGML will be required to file final executed copies of their respective gas purchase contracts with OSP II for approval pursuant to subsection 35(2) of the Board's Part VI Regulations.

2.1.3.6 Cost-Benefit Analysis

The ProGas and WGML applications share common elements and, as a result, the Applicants filed a joint cost-benefit analysis of the proposed gas export sale which was intended to evaluate the economic desirability of the export from the perspective of Canada as a whole.

Table 1 shows the results submitted by the Applicants of the cost-benefit analysis performed using a real discount rate of 8 percent. The export contracts specify an initial or base export price of $U.S. 3.35 per MMBtu ($U.S. 3.12/GJ), which is indexed to prices of fossil fuels purchased by NEPOOL. Evidence at the hearing indicated that the indexed export price in September 1988 would have been $U.S. 2.16 per MMBtu ($U.S. 2.01/GJ) based on oil at $U.S. 13.00 per barrel. The Applicants estimated export revenue using projected fossil fuel prices for the New England Power Pool. By-product revenue was estimated on the basis of the Applicants' oil price forecast. User costs of the export were estimated in accordance with the Board's methodology.

While the exported gas will be used to generate electricity in Rhode Island, the Applicants submitted that the project would not result in reduced electricity exports from Canada.

The Applicants analysed the sensitivity of net social benefits to several factors. For example, net benefits to Canada were estimated at $92.1 million and $55.0 million (in 1988 dollars, discounted to 1988) at real discount rates of 6 and 10 percent respectively. An increase in the value of the Canadian dollar from $0.83 U.S. to $0.91 U.S. would reduce net benefits to $20.2 million.

No intervenor disputed the reasonableness of the cost-benefit analysis submitted by the Applicants. Because the price of gas is contractually linked to the value of fossil fuels, there is a risk that the values of coal and oil may be so low as to yield export prices below then existing market values for gas. However, the Board considers it likely that the present value of the sale will be positive Over the first ten years of the arrangement. At that time the export contracts permit renegotiation of the export price.

Table 1
Cost-Benefit Analysis of the
WGML and ProGas Applications
From a Canadian Perspective: 8% Discount Rate
(in millions of 1988 dollars, discounted to 1988).

Benefits	
Export Revenue	528.10
By-Product Revenue	79.00
TOTAL	607.10
Costs	
Production Costs	120.30
Transmission Costs	108.70
User Costs [1]	306.20
TOTAL	535.20
Net Social Benefit	71.90

1 User cost arises because it generally costs more to find and prove up new natural gas reserves than it costs to develop existing reserves. In a quantitative sense, user cost is a measure of the increased future costs of production that arise from increasing production from existing reserves.

Chapter 3
Disposition

The Board has decided to issue new export licences to ProGas and WGML for their proposed export sales to OSP II. Appendices I and II contain the terms and conditions of the proposed licences including a requirement in each that exports under the licences must commence on or before 1 November 1994. Should this condition not be met, the licences will terminate.

Although ProGas did initially seek an amendment to Licence GL-81 under subsection 17(2) of the Act, in the alternative they also requested a new licence. The Board is of the view that a new licence would be more appropriate in these circumstances and will recommend to the Governor in Council that a new licence that will embody the terms and conditions requested by ProGas with respect to term, maximum daily, annual and term quantities be issued. As well, the Board will include an amending order to Licence GL-81 in order to effect the necessary accommodating adjustments.

With respect to ProGas' request for a condition in the licence to provide for automatic make-up of undelivered quantities of gas at the expiry date of the licence, the Board is not convinced that such a condition is necessary in light of the long-term nature of the licence (20 1/2 years) and the fact that the commercial arrangement between ProGas and OSP II does not depend on such a condition. The Board is of the view that if at a future date it becomes obvious that there will be undelivered quantities under the licence, so-called "trapped gas", then ProGas can make application at that time to remedy the situation. Appendix I contains the terms and conditions of the new licence.

With respect to WGML, the Board has also decided to issue a new export licence and with WGML's consent, given during cross-examination at the hearing, the Board will revoke Licence GL-90. The new licence will embody the terms and conditions requested by the Applicant with respect to maximum daily and annual authorizations, term quantity and licence term. However, for the same reasons discussed earlier with respect to the new ProGas licence, the Board has decided not to include provision for make-up of trapped gas at the expiry of the proposed licence.

The Board notes that, to implement the decision, approval of the new licences is required by the Governor in Council.

The Board's decision took account of a number of issues related to the applications and reviewed during the public proceedings. These included the use of the Board's market-based procedure for the assessment of gas export licence applications by which Canadian gas users could avail themselves of a complaints procedure to complain or object to an export proposal. The Board considers it noteworthy that no complaints were received and that there was virtually no opposition to the Applicants' filings.

However, Union Gas Limited did ask that the Board consider making a comparison between domestic gas sales contracts of the type currently being negotiated by eastern distribution companies and the proposed export contracts in order to satisfy itself that the contracts contain similar terms and conditions. In this regard the Board would point out that no domestic sales contracts were filed in evidence and as a result it is unable to make the comparison. However, the Board notes that this type of comparison is the basis upon which a complaint would be lodged pursuant to the Board's complaints procedure if a Canadian consumer believed that the terms and conditions of the export

contract were more favourable than those available to domestic consumers. In these circumstances an intervenor would be required to file the necessary documents to allow the Board to review the complaint and all parties would have the opportunity to compare the agreements.

The Board concurs with the Applicants' export impact assessment which concluded that because of the relatively small size of the export proposals, the possible impact on Canadian production, prices and consumption patterns would be negligible.

The Board notes that the applications did not involve an increase in the volumes already authorized for export under existing licences. The Board relies upon the review of supply it conducted in issuing the previous licences to determine that the proposed exports are surplus to Canadian requirements. The Board also considers that the OSP II project will provide for consistently high load factor sales over the term of the licence.

Finally, the Board is of the view that based on the cost-benefit analysis submitted by the Applicants, and on the Board's own analysis, it is likely that the present value of the sale will be positive over the first ten years of the arrangement.

R.B. Horner
Presiding Member

J.G. Fredette
Member

A.B. Gilmour
Member

Ottawa, Canada
December 1988

Appendix I
Terms and Conditions of the Licence to be Issued to ProGas

1. The term of this Licence shall be for the period commencing on 1 May 1991 and ending on 31 October 1994, at which time, provided that exports have commenced hereunder, the term shall extend to 31 October 2011.

2. The quantity of gas that may be exported under the authority of this Licence shall not exceed:

   (a) 708 196 cubic metres in any one day;

   (b) 258 500 000 cubic metres in any consecutive twelve-month period ending on 31 October; or

   (c) 5 170 000 000 cubic metres during the term of this Licence.

3. As a tolerance, the amount the Licensee may export in any 24-hour period under this Licence may exceed the daily limitation imposed in condition 2 by ten percent.

4. As a tolerance, the amount the Licensee may export in any consecutive twelve-month period under this Licence may exceed the annual limitation imposed in condition 2 by two percent.

5. Gas exported under the authority of this Licence shall be delivered to the points of export near Niagara Falls, Ontario and Iroquois, Ontario.

Appendix II
Terms and Conditions of the Licence to be Issued to WGML

1. The term of this Licence shall be for the period commencing on 1 May 1991 and ending on 31 October 1994, at which time, provided that exports have commenced hereunder, the term shall extend to 31 October 2012.

2. The quantity of gas that may be exported under the authority of this Licence shall not exceed:

   (a) 708 196 cubic metres in any one day;

   (b) 258 500 000 cubic metres in any consecutive twelve-month period ending on 31 October; or

   (c) 5 443 200 000 cubic metres during the term of this Licence.

3. As a tolerance, the amount the Licensee may export in any 24-hour period under this Licence may exceed the daily limitation imposed in condition 2 by ten percent.

4. As a tolerance, the amount the Licensee may export in any consecutive twelve-month period under this Licence may exceed the annual limitation imposed in condition 2 by two percent.

5. Gas exported under the authority of this Licence shall be delivered to the points of export near Niagara Falls, Ontario and Iroquois, Ontario.