



National Energy Board

Reasons for Decision

**Amoco Canada Petroleum
Company Ltd.**

GO-1-85

February 1985

National Energy Board

Reasons for Decision

In the Matter of

**Amoco Canada Petroleum Company
Ltd.**

Application for a Short-Term Gas Export Order
for Sales to The Washington Water Power
Company

GO-1-85

February 1985

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IN THE MATTER OF the *National Energy Board Act* (hereinafter called "the Act") and the Regulations made thereunder;

AND IN THE MATTER OF an application by Amoco Canada Petroleum Company Ltd. (hereinafter called "Amoco Canada") for a short-term gas export order pursuant to subsection 8(2) of the Act.

Considered by the Board in Ottawa, Ontario on 7 February 1985.

Chapter 1

Application

Amoco Canada applied on 4 January 1985, pursuant to subsection 8(2) of the Act, for approval of a short-term gas export Order and for approval of an export selling price as contained in the Gas Purchase Agreement dated 11 September 1984 as amended 3 January 1985 between Amoco Canada and The Washington Water Power Company (WWP).

Amoco Canada had applied on 31 October 1984 for a short-term export Order to WWP. This application was denied by the Board on 24 December 1984 because the export selling price did not meet the minimum export price test as contained in Criterion 2 of the Export Pricing Policy.

Amoco Canada is a major producer and explorer for natural gas in Canada. The gas Amoco Canada proposes to export under this application would be supplied from reserves located in the Pointed Mountain field located in the Northwest Territories.

By its application dated 4 January 1985, Amoco Canada has applied for a gas export Order to include the following conditions:

- | | |
|----------------------------|--|
| Maximum Daily Quantity | - 187.0 thousand cubic metres (6.6 MMcf). |
| Annual Quantity | - 45.3 million cubic metres (1.6 Bcf) of which 21.5 million cubic metres (0.76Bcf) would be sold during the winter period and 23.8 million cubic metres (0.84 Bcf) would be sold during the summer period. |
| Term | - 1 year, from the date of commencement to 31 October 1985. |
| Selling Price ¹ | - \$U.S. 2.75/GJ (\$U.S. 2.95/MMBtu). |
| Export Point | -Huntingdon, British Columbia. |

The gas proposed for export would be transported by Westcoast Transmission Company Limited (Westcoast) from the field gate to the process plant at Fort Nelson, British Columbia and then to the international border point for export. Westcoast would transport the gas under a "Best Efforts Service Contract".

From the export point the gas would be transported through the U.S. by Northwest Pipeline Corporation (Northwest) to an interconnection with the distribution facilities of WWP in the eastern section of Washington State. The gas would be resold to Fairchild Air Force Base of the United States (Fairchild) and Northwest Alloys Inc. (NW Alloys). Fairchild currently uses coal for space and water heating, while NW Alloys currently uses natural gas for Process heating, but it is the stated

¹ Calculated on the basis of the average noon spot exchange rates as published by the Bank of Canada for the week ending 25 January 1985 at \$U.S. 1.00 = \$Cdn. 1.3242.

intention of NW Alloys to convert to coal if the Amoco Canada gas supply is not available. Therefore, coal is, in these circumstances the competing fuel and not natural gas.

Under the terms of the Gas Purchase Agreement dated 11 September 1984, as amended 3 January 1985, WWP agreed to take and pay for 39.6 million cubic metres (1.4 Bcf) on an annual basis subject to availability. The sale and purchase of gas under the contract would be on a "Best Efforts" basis and as such the supply could be interrupted.

Chapter 2

Reasons for Decision

Applicants seeking Board approval for a short-term gas export order under subsection 8(2) of the Act together with approval of a negotiated export selling price are required to demonstrate that their contractual arrangements meet the following criteria as set forth in the Government's Natural Gas Export Pricing Policy statement dated 13 July 1984.

Government Export Pricing Policy Criteria

- (1) "The price of exported natural gas must recover its appropriate share of the costs incurred."

Evidence:

Amoco Canada provided evidence which showed that the proposed export selling price would yield a netback to Amoco Canada of \$U.S. 1.16/GJ after deducting transportation costs, taxes and royalties. Amoco Canada did not deduct field operating costs at the Pointed Mountain field because the export quantities would be incremental to base load volumes being produced for sale to Westcoast Transmission and as such these incremental quantities would act to reduce overall unit production costs.

Amoco Canada also made a similar argument with respect to transportation costs. The company indicated that it is obligated to pay a fixed monthly amount to Westcoast, regardless of actual quantities that flow, for transportation from Pointed Mountain to the international border. Therefore, since the proposed export sale would be incremental the transportation cost allocated to that sale should be an appropriate share of the variable costs of Westcoast's system tariff.

The company's calculations were as follows:

Recovery of Costs

	\$U.S./GJ ¹	\$U.S./MMBtu ¹
Export Selling Price	2.75	2.95
Deductions		
Westcoast Transportation Cost ²	.01	.02
Federal Income tax	.94	1.01
Petroleum and Gas Revenue Tax	.32	.35
Federal Royalty	<u>.32</u>	<u>.34</u>
Subtotal	1.59	1.72
Netback to Amoco Canada	1.16	1.23

Finding:

Since Amoco is satisfied with the netback for its own production the Board is satisfied that the proposed export selling price would recover its appropriate share of the costs incurred.

- (2) "The price of exported gas must not be less than the wholesale price of natural gas at the Toronto city gate and sold under similar terms and conditions."

Evidence:

The Applicant submitted evidence which demonstrated that its proposed export selling price would meet the minimum price requirement of \$U.S. 2.75/GJ (\$U.S. 2.95/MMBtu) consisting of the sum of the Alberta border price plus TransCanada's Eastern zone toll for Authorized Overrun Interruptible (AOI) summer service plus any appropriate taxes.

Amoco Canada's proposed export selling price is \$U.S. 2.75/GJ (\$U.S. 2.95/MMBtu).

Finding:

The Board is satisfied that the Applicant's proposed export selling price meets criterion (2).

- (3) "The price of exported gas must result in prices, in the United States market area, at least equal to the price of major competing energy sources."

¹ \$U.S. 1.00 = \$Cdn. 1.3242

² Variable cost component of Westcoast's cost of service applicable to Pointed Mountain gas.

Evidence:

Amoco Canada submitted that the major competing fuel to natural gas for both of the proposed end-users is western U.S. coal. The Fairchild Air Base currently uses coal for space and water heating whereas Northwest Alloys has been considering a switch to coal. Amoco Canada provided evidence to demonstrate that the burner-tip price of its gas would exceed the burner-tip price of coal including the operating costs associated with coal handling, as here shown:

Laid-In Cost of Amoco Canada's Canadian Gas Compared to the Coal Alternative

	Fairchild Air Base (\$U.S./GJ) (\$U.S./MMBtu)		Northwest Alloys (\$U.S./GJ) (\$U.S./MMBtu)	
Coal				
Mine Price	1.45	1.56	1.03	1.10
Transportation	1.41	1.51	1.41	1.50
Operation Costs	<u>0.15</u>	<u>0.16</u>	<u>0.17</u>	<u>0.20</u>
Total Burner-tip Cost	3.01	3.23	2.61	2.80
Natural Gas				
Border Price	2.76	2.96	2.76	2.96
Transmission & Distribution	<u>0.56</u>	<u>0.60</u>	<u>0.56</u>	<u>0.60</u>
Total Burner-tip Cost	3.32	3.56	3.32	3.56

In an intervention dated 18 January 1985, the British Columbia Petroleum Corporation (BCPC) submitted that Amoco Canada's application should be denied because it did not meet the requirements of the third criterion. The BCPC stated that Canadian gas should not be competing with the lowest cost energy alternative in U.S. markets which in the case of Amoco Canada's proposed sale is coal, rather, the company should also review prices for other major competing alternative fuels.

By its letter dated 31 January 1985, the BCPC also questioned whether Amoco Canada should be required to file evidence that would document the propositions that both of the proposed U.S. buyers had in-place workable coal-burning facilities and that each buyer had an assured coal supply at the prices quoted in the Amoco Canada application.

In its response to the BCPC argument, Amoco Canada pointed out that its proposed sale would be made to specific end users whose alternate fuel was coal and as such coal is the appropriate competing energy source. Amoco Canada did agree that where a sale is to be made into a large market area made up of diverse end-users, i.e. residential, commercial and industrial customers, then other competing fuel prices should be considered, but this was not the case with respect to Amoco Canada's application.

Finding:

The Board agrees with Amoco Canada that coal is the competing energy source for these two customers. The Board however, notes that Amoco Canada has not included depreciation, inventory or capital costs in its estimate of the burner-tip cost of the coal alternative. In the case of Fairchild Air Base it could be argued that depreciation on the coal handling facilities presently in place is a sunk cost, and thus has no influence on the price the customer is willing to pay for gas; the Northwest Alloys plant however, presently does not use coal, consequently fixed costs for coal facilities and the cost associated with financing such facilities should be included in an applicant's evaluation of the burner-tip cost of using coal. (Amoco Canada did provide an estimate of approximately \$U.S. 2 million to convert the Northwest Alloys plant from gas to coal. The Board accepts that estimate and feels that at such a cost the proposed price to Northwest Alloys would still meet the criterion).

With respect to the BCPC intervention the Board concurs with the BCPC position that Canadian export gas prices should be sensitive to all major competing alternative fuels in the market place and as such should not attempt to compete solely with the least-cost energy alternative. This was not the intention of the export pricing policy and the Board will continue to ensure that the policy position is upheld.

However, in the case of Amoco Canada's proposed sale to The Washington Water Power Company it is the Board's opinion that where a sale is to be made to a specific end-user and not a pipeline or distribution company for its general system supply, then it would be appropriate, under these circumstances, to consider the end-users' specific alternate energy source as the competing fuel. In this particular case the alternate fuel is coal, and whereas coal prices would tend to be too low to attempt to displace, the Applicant's proposed selling price for interruptible service is apparently able to do so and still meet the other criteria for approval.

Finally, with respect to the BCPC request that Amoco Canada file additional documentation with respect to the existing coal burning facilities in-place at both U.S. buyers' locations, the Board accepts Amoco Canada's evidence as filed that one buyer is currently burning coal, and that the other buyer is considering a switch to coal. Likewise with respect to the supply of coal at the stated prices, the Board is satisfied that the Amoco Canada evidence is accurate.

The Board therefore is satisfied that criterion (3) has been met.

- (4) "Export contracts must contain provisions which permit adjustments to reflect changing market conditions over the life of the contract."

Evidence:

Amoco Canada's proposed export sale has a term of only one year. If the sale is extended, the price will be renegotiated prior to the second term. The contract contains provisions allowing Amoco Canada to terminate the sale either in the event an end-user decides to withdraw from the agreement or, if in the opinion of Amoco Canada, the delivery of gas becomes uneconomical.

Finding:

The Board is satisfied that criterion (4) has been met.

- (5) "Exporters must demonstrate that export arrangements provide reasonable assurance that volumes contracted will be taken."

Evidence:

Amoco Canada's contract with The Washington Water Power Company contains an annual take and pay agreement. Under this provision WWP is obligated to take and pay for 1.4 Bcf (87.5% of contract volume) during the contract year at the agreed border price provided that Amoco Canada is able to supply these quantities. This amount is non-refundable and there are no provisions for subsequent recovery.

Finding:

The Board is satisfied that the take and pay agreement provides reasonable assurance that volumes contracted, if available from Canada, will be taken.

- (6) "Exporters must demonstrate that producers supplying gas for an export project endorse the terms of the export arrangements and any subsequent revisions thereof."

Evidence:

The gas Amoco Canada proposes to sell would be produced from its own gas fields in the Northwest Territories.

The BCPC in its intervention dated 18 January 1985, stated that the Amoco Canada application did not meet the requirements of criterion (6). The BCPC submitted that Amoco Canada would have an unfair advantage over other British Columbia producers if the sale were approved. The BCPC stated that while other B.C. producers have agreed to a reduced load factor for sales to the BCPC, Amoco Canada is one of three companies which has not agreed to the cut-back. As such, the BCPC argues that Amoco Canada enjoys higher load factor sales on its B.C. gas production while at the same time the company would realize additional revenue gains from its proposed export sale to WWP.

Finding:

In its review of the requirements under criterion (6) the Board must assure itself that producers supplying gas to an export sale are aware of the details of the supporting contractual arrangements and agree to the conditions of the sale. In the case of Amoco Canada's proposed export sale these requirements have been met insofar as Amoco Canada is the producer of the gas to be exported.

With respect to the BCPC argument, the Board does not agree that the proposed export sale of gas produced in the Northwest Territories gives Amoco Canada an unfair advantage over British Columbia producers. Likewise, the Board is of the view that criterion (6) does not require that producers, other than those who are supplying gas to the export sale, endorse the terms and conditions thereof. The contractual dispute between the BCPC and the Applicant with respect to reduced load factor levels for purchases of British Columbia gas is outside the Board's jurisdiction and as a consequence is not considered by the Board in its determination of this application.

- (7) "Exporters must demonstrate that the sales are truly incremental and will not displace other Canadian gas sales, directly or indirectly."

Evidence:

Fairchild Air Base is currently using coal and will continue to do so unless they can obtain gas at prices which can compete with coal. Northwest Alloys currently uses natural gas but is considering conversion to coal in early 1985 for economic reasons. Westcoast Transmission submitted a letter dated 18 December 1984 stating that Northwest Pipeline Corporation had advised that these loads are incremental and cannot be served during the current contract year with natural gas supplied by Northwest under its existing rate schedules.

Finding:

The Board is satisfied that these sales are truly incremental and will not directly or indirectly affect the marketing activities of the historical long-term importer in the area to be served by the subject sale.

- (8) "Exporters must demonstrate, if applicable, that the sales are on an interruptible or best efforts basis to ensure that longer term export sales and capacity to meet Canadian requirements are not pre-empted."

Evidence:

Amoco Canada submitted that its export sales contract was for a 1-year term only and is a best efforts contract with provision for interrupting the gas supply in the event that pipeline or production capability so required.

Finding:

The Board is satisfied that criterion (8) has been met.

Chapter 3

Decision

The Board has examined the Amoco Canada application in order to ascertain whether it meets the guidelines contained in the Ministerial statement dated 13 July 1984 and finds that in each instance the requirements contained in these criteria have been met.

Accordingly, the Board having taken into account all the matters concerning the Amoco Canada application for a short-term gas export by order has concluded that the proposed export is in the public interest and pursuant to subsection 8(2) of the Act hereby approves the Amoco Canada application.

The attached Order No. GO-1-85 is Amoco Canada's authorization to export gas under the conditions contained therein.

As a further condition to the Order the Board requires that Amoco Canada file with the Board finalized transportation agreements with Westcoast Transmission Company for the transportation of the required quantities from the Pointed Mountain field in the Northwest Territories to the point of export at Huntingdon, British Columbia prior to the commencement of the export.

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