JT Letter
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UNITED STATES OF AMERICA
BEFORE THE
DEPARTMENT OF ENERGY

ECONOMIC REGULATORY ADMINISTRATION

PUBLIC CONFERENCE ON CANADIAN AND
MEXICAN NATURAL GAS IMPORTS

January 18, 1983

The undersigned members of the United States House of Representatives hereby submit the following written comments to be considered as part of the record in the above captioned Conference. As Representatives of consumers who are now or potentially may be served, at least in part, by Canadian or Mexican natural gas, we commend the Economic Regulatory Administration for convening this conference and welcome the opportunity to submit our views on what the ERA should do about the pricing of Canadian and Mexican natural gas, especially since the price of imported natural gas is a key factor in the accelerating natural gas costs our constituents are facing.*

I. Introduction

The average wellhead price for domestic natural gas was $2.49 per mcf. in August 1982, yet the average residential user of natural gas paid $5.56 per mcf. for natural gas in that same month. Why the disparity? Some of this difference, of course, is attributable to transmission and distribution costs, but a significant part is due to the increasing amounts of high cost, supplemental supplies, like $5.00 per mcf. imported natural gas.

According to the Department of Energy's Monthly Energy Review for December 1982, natural gas consumption for the first ten months of 1982 was down 6.4 percent over the comparable period in 1981. Domestic production of natural gas was down 7.6 percent over the same period. Meanwhile, imports of natural gas were up 7.0 percent, even though ample supplies of domestic gas at prices well below $5.00 per mcf. are available for purchase. In short, $5.00 Canadian and Mexican gas is supplanting $2.60 domestic gas.

Although absolute volumes of imported gas remain relatively small (about five percent of total U.S. supply), as was pointed out in the notice establishing this conference, imports have had a substantial impact on the price of gas in the Midwest, the Northwest and California. When transportation and distribution charges are added to the border price, consumers are paying more than $7.00 per mcf. for Canadian and Mexican gas.

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* Although the subjects of this conference are Canadian and Mexican natural gas, we are also deeply concerned about the import of even higher cost liquified natural gas from Algeria. Many of the points discussed in this statement should also be considered as addressing the problems posed by Algerian LNG.

II. The Cause of the Problem

Before turning to the specific questions posed in the Notice of this Conference, it is appropriate to note that the many current and pending projects to import natural gas despite economically unjustifiable price and volumetric terms reflect the distortion in the United States natural gas market caused by the Natural Gas Policy Act. Until recently, the part-regulated/part-deregulated natural gas market, in conjunction with the uneven distribution of price-controlled gas among the various pipelines, allowed foreign gas exporting countries (as well as producers of the few categories of deregulated gas) to command prices far in excess of the market price. The purchasing pipelines would simply "roll in" this high-priced gas and mix it with the cheaper domestic price controlled gas, producing an ever-rising average price to consumers. This means that when pipelines buy high-priced Canadian and Mexican natural gas, the benefits of domestic price controlled gas go not to consumers, as the drafters of the NGPA intended, but to foreign producers.

Since early in 1982, the price of domestic deregulated supplies has gone down sharply for two primary reasons: (1) the current surplus of natural gas; and (2) the "rolling in" process is no longer effective in camouflaging high-priced gas, even average pipeline gas prices have risen to the point where some industrial users of natural gas are switching to number six fuel oil. Yet, the price of Canadian and Mexican natural gas remains artificially high, insulated from the market forces operating in this country by the unilateral ability of the Canadian and Mexican governments to set the price of gas destined for this country. High take-or-pay clauses in imported gas contracts further muffle market signals by preventing pipelines from cutting back on Canadian supplies as much as the high price of those supplies warrants.

While only remedial legislation can alleviate the gas market distortions caused by the NGPA, the ERA must do what it can to bring about a more realistic and flexible pricing scheme for Canadian gas. Accordingly, we support the Petition of the Process Gas Consumers Group and the American Iron and Steel Institute, filed December 21, 1982, to institute Rulemaking Proceedings to "Investigate and Establish Rules with Respect to the Importation of Natural Gas."

III. Questions to be Addressed at This Conference

A. What types of alternative pricing systems, as opposed to a uniform border price, would permit imported natural gas to enter the domestic system at competitive prices? How would such a system assure flexibility to serve individual market over time?

Competitive prices are those within the price range of competitive fuels in the relevant market. Because competition to Canadian natural gas is quite different in different regions (or markets) of the United States, a unified border price is inherently noncompetitive and must, therefore, be changed. Moreover, the current formula by which Canada sets its gas export price is based on an index of imported oil prices in Montreal. This formula which was adopted in March 1980 by the previous administration bears no relationship to

the realities of the current natural gas markets in the United States and should also be changed.

The best pricing system may well be one that would let the parties (i.e., the buyer and seller of natural gas) settle upon a contract which would then be submitted to Canadian and United States authorities for approval. Removing governments from negotiating the price of gas would allow those who best know the market to determine what the appropriate price should be and what provisions should be included to ensure that the price remains competitive. Retaining a requirement of government approval would ensure that the imports are not inconsistent with the public interest.

This system would result in a variety of multiple border prices, but this is essential if the price of imported natural gas is to be competitive in United States' markets.

It may be possible to devise a formula to govern the price of Mexican and Canadian imported natural gas, based on the mix of alternative fuels used in various regions of the United States. While this would be an improvement over the current formula, it is less desirable than direct, uninhibited buyer-seller negotiations. Formula prices tend to become obsolete and constrain the parties' ability to reach an agreement that best suits current market conditions.

B. How can a market-oriented, flexible pricing system for imports be implemented? How would state energy regulatory authorities view such a system?

We leave the second part of this question for State regulatory authorities to discuss. As for how the pricing scheme we suggest could be implemented, no further imports of foreign gas should be authorized until the exporting governments agree to the party-to-party negotiation process which we propose. All future and pending applications for authorization to import foreign gas should be made subject to the party-to-party negotiation procedure without the constraints of a unified border price. Sponsors of existing import projects should be encouraged to renegotiate the price at which gas is now being imported.

At least some Canadian producers seem ready and willing to negotiate with American buyers. They cannot sell as much gas as they would like until the Canadian price is brought more in line with competitive fuels. If, in fact, such renegotiation does not occur, the ERA may want to consider a more draconian prod, e.g., the revocation of import authorization for all contracts not renegotiated by a certain date. This would be no more harsh than the burden American natural gas consumers were forced to bear after Canada unilaterally doubled the price of its natural gas for export by five price increases between May 1, 1979 and April 1, 1981, and after Mexico jumped the price of its natural gas from $3.62 per mmbtu to $4.47 mmbtu on September 16, 1980. (The current price is close to $5.00 per mcf.)

C. With more flexible prices, would take-or-pay or minimum bill requirements cease to be a serious concern? If so, why? If not, how could these problems be resolved?

If the parties are able to negotiate the price at which imported gas will be purchased, we believe that the high take-or-pay and minimum bill provisions now found in import contracts will be changed in a manner more conducive to market responsiveness. For example, a Canadian gas seller who is interested in maintaining high sales volumes ought to be able to negotiate for that, not by insisting on a high take or pay provision, but by cutting the price, something he cannot do now. Conversely, a Canadian gas seller less interested in high or stable volume may be able to charge a higher price for the gas he does sell since he is essentially putting himself in the position of serving peak demand needs for the American purchaser. This is the marketing dynamic that operates in any other business. There is no reason why that cannot happen here once the stumbling block of the unified border price is removed.

If, contrary to our expectation, the buyers and sellers of Canadian natural gas persist in employing rigid and high take-or-pay clauses, the government when it reviews those contracts could refuse to approve take-or-pay clauses in excess of fifty percent or some other reasonable number.

D. Has the cost of Canadian and Mexican gas made it more difficult to sell gas in United States markets? If so, how?

Although the high cost of Canadian and Mexican gas <u>should</u> be making it more difficult to sell gas in United States markets, it <u>is not</u> clear whether it is yet as difficult as it should be. Imports from Mexico were at an all time high in 1981, even though the border price was a record high $4.88 per mcf. Imports from Canada, conversely, have declined since 1979, but according to <u>The National Energy Program, Update 1982</u>, Canadian revenues have risen by 44 percent over the same period (p. 62). The recent commencement of new Canadian import projects will push volumes back up for 1982. Indeed, some pipelines that are now experiencing difficulty in marketing their existing, domestic supplies, such as the Michigan Wisconsin Pipeline and Transcontinental Gas Pipe Line Corporation, have nonetheless applied for authorization to import substantial quantities of Canadian gas.

Nevertheless, the Canadian government has authorized the export of substantially more gas than is currently being exported. This suggests that Canadian authorities too should be receptive to a change in pricing policy that would allow exports to approach more closely the authorized volumes.

E. Is a premium price appropriate for imported gas? If so, under what conditions?

A premium price for imported gas is <u>not</u> appropriate. Any seller of natural gas which offers a feature that is valuable to any gas purchaser (e.g., long term contract, adjustable volumes, close proximity, etc.) should be able to get a higher price than sellers which do not offer such features. That is no reason, however, why imported natural gas <u>per se</u> should command a premium price.

We can see no justification for paying American producers less than foreign producers for the same package of goods and services. If anything, a discount price may be appropriate for imported natural gas, depending upon whether substantial transmission and distribution costs are necessary to get

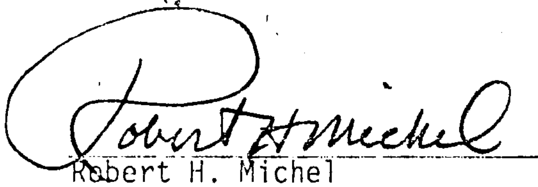
the imported gas to the market it is to serve. In any case, such decisions are best left to the market with continuing oversight by the government in the event that the NGPA has so distorted the natural gas market that even the parties are unable or unwilling to act in a way that reflects the market reality and consumers' interests.

CONCLUSION

We recognize that Canadian and Mexican supplies of natural gas will play an important role in the Nation's efforts to diversify our energy sources and reduce our dependence on foreign oil supplies. It is, however, neither fair nor sensible to demand that American natural gas consumers continue to pay above-market prices for imported natural gas while domestic supplies are available at a lower cost. The consequence of such a policy is exactly the opposite of our long term objective: industrial consumers will switch to fuel oil derived from imported oil. And residential consumers will be forced to bear an ever-greater share of the fixed costs of natural gas transmission systems.

This would be disastrous for residential natural gas consumers in this country and for Canadian producers who have made substantial investments in exploring for and producing Canadian natural gas. The ERA can prevent this from happening by adopting the proposals we suggest above. We urge you to act promptly.

Respectfully submitted,



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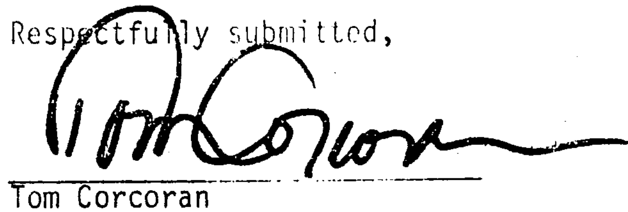

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