NATURAL GAS PRICING IN ALBERTA*

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This paper studies the legislation initiated by both the federal and the Alberta governments in the field of gas pricing in Alberta; explains the workings of the operative sections of such legislation; defines and discusses the factors used in the legislative formulae respecting gas pricing, and provides actual examples of such pricing. The role of the Alberta Petroleum Marketing Commission in the pricing and movement of gas from field to consumer within Alberta, or to the Alberta border for ultimate consumption elsewhere is also discussed. Potential problems respecting the interpretation and application of the Alberta legislation are also studied.

I. INTRODUCTION

Prior to 1971, the discovery of natural gas[1] was considered by most producers in Alberta to be more of a detriment than a benefit. Gas wells were shut in for lack of markets, or for lack of transportation systems to the relatively small existing markets. Where found in conjunction with petroleum, most gas was flared rather than produced[2] for the simple reason that it was not economically feasible to collect and market such gas. During this long, stable period, the greatest group factor in the establishment of the price of Canadian gas was the regulated field prices in the United States.[3]

The Organization of Petroleum Exporting Countries was founded in 1960, and for a decade engaged in relatively ineffective lobbying.[4] This impotence ended with the coming of the early 1970's when this cartel caused the price of crude oil, and consequently that of natural gas, to skyrocket on the world market.

A proposal, made during the first application by TransCanada Pipelines, Limited[5] before the National Energy Board in 1971 to raise the price of gas at the wellhead by 10¢/MmCF, was rejected by the Board as being too great an increase for the eastern Canadian markets to bear. That proposed increase soon became equally unrealistic for the opposite reason. At this point in time, both the federal and the Alberta governments commissioned studies into the field pricing of natural gas.[6] These reports instigated legislation respecting such pricing by both

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[1] Wherever in this paper there appears a term or contraction listed in column I, that term or contraction shall mean the entire definition appearing opposite it in column II.

COLUMN I		COLUMN II
A.P.M.C.	p. 465 #20	Alberta Petroleum Marketing Commission
Gas	p. 455 #1	Raw gas or marketable gas, as those expressions are defined in The Oil and Gas Conservation Act, R.S.A. 1970, c. 267, s. 2 (20)
MmBtu's	p. 458 #10	Million British Thermal Units
Produced	p. 455 #2	Includes produced, extracted, recovered or manufactured.

[2] *Id.*

[3] John Ballem; interview, February 27, 1976.

[4] Faud Rouhani, *A History of O.P.E.C.* (New York: Praeger Publishers, 1971), pp. 177-249.

[5] John Ballem; interview, February 27, 1976.

[6] *Report on Field Pricing of Gas in Alberta*, Alberta Energy Resources Conservation Board, August 1972; *Review of Field Pricing of Gas in Alberta*, Alberta Energy Resources Conservation Board, July 1973; National Energy Board Report to the Governor in Council, *In the Matter of the Pricing of Natural Gas Being Exported under Existing Licences*, 1974.

levels of government, with the end result that government has displaced private industry in the pricing of natural gas in Alberta.

As stated in section 49 of the Petroleum Administration Act, S.C. 1974-75, c. 47, the federal government entered the area of gas pricing for the purpose of both representing and controlling two essentially conflicting groups, having opposing interests. On the one hand, lies the western Canadian producer, and the federal government's desire, to obtain fair market value for the gas, for the benefit of those producers, and for the benefit of the federal government, through increased tax returns. On the other hand, the federal government prompted by the central provinces, has determined the need to shelter those provinces form the full impact of world prices for gas. A further purpose in entering the gas pricing field was the promotion of future explorations and development of oil and gas production in the producing provinces.[7]

While the federal government's declared objectives in passing the pricing legislation are laudable, there is an additional reason behind their entry into the field. If uncontrolled, the rapid escalation of gas prices to world market levels would result in windfall profits to the oil and gas corporations. Consequently, and, it is submitted, quite rightly, both the federal and provincial levels of government have entered what is indeed a lucrative tax field.

The rationale for the entry of the Alberta government into the field of gas pricing only partially coincides with that of the federal government. It too desires the benefits of increased taxation, and feels it is in the best interests of the province for the producer to obtain the highest possible price, in the circumstances, for its natural gas, and thus be encouraged to engage in further exploration and development. Further, while the Alberta government feels little responsibility to the eastern consumer and will not lessen pressure for extensive price increases in federal-provincial negotiations, out of sympathy for the eastern consumer's plight, it does realize that world prices for natural gas will be attained only by dragging Ontario and Quebec, kicking and screaming the entire way, into the world marketplace.

It has been suggested that the provincial government viewed the federal intervention into the pricing of natural gas as nothing more than further federal encroachment upon the provincial domain of minerals and natural resources, and that the provincial government leapt into the arena in hopes of forestalling, or at least limiting, federal entry into the field. However, to the extent that the federal government now occupies the field, it does so primarily in accordance with bilateral agreements with the producing provinces, including Alberta. Thus, by agreement respecting control of pricing, and the division of the taxation spoils to be gained therefrom, the pricing of natural gas is at present another of the many areas wherein both the federal and provincial governments have taken a measure of control away from private industry, presumably never to relinquish that control.

The purpose of this paper is to study the legislation initiated by both the federal and the Alberta governments in the field of gas pricing in Alberta; to explain the workings of the operative sections of such legislation; to define and discuss the factors used in the legislative formulae respecting gas pricing, and to provide actual examples of pricing:

[7] The Petroleum Administration Act, S.C. 1974-75, c. 47 at s. 49(d).

(a) from the field to consumer within Alberta,
(b) from the field to the Toronto City Reference Point,
(c) from the field to the International Border, en route to the United States.

Due to the complexity of these factors, the analysis of which would unreasonably lengthen this paper, the treatment of each will be descriptive only, of necessity superficial, and discussed only with respect to the overall formulae in which they appear, rather than with respect to the rationale underlying each factor. Further, I will discuss the role of the Alberta Petroleum Marketing Commission in the pricing and movement of gas from field to consumer within Alberta, or to the Alberta border for ultimate consumption elsewhere. Finally, I will raise and discuss some of the problems which several gas producers in Alberta foresee respecting the interpretation and application of the Alberta legislation, specifically the Natural Gas Pricing Agreement Act, S.A. 1975, c. 38, as amended by S.A. 1975, c. 70.

II. FACTORS USED IN PRICE CALCULATIONS

This section includes a brief discussion respecting the definition, deprivation and application of each factor.

1. INTERNATIONAL BORDER PRICE is that price at which natural gas is sold at any point on a Canadian international border. This price does not apply to gas transmitted into the United States for the sole purpose of re-transmission into Canada, or used for the purpose of re-transmission of such gas, for consumption within Canada.[8] The international border price is established by the Governor in Council, upon the recommendation of the National Energy Board. Pursuant to section 82 of the National Energy Board Act,[9] the National Energy Board is empowered to issue export licences to all exporters of natural gas. Section 81 of that Act prohibits the export of any gas except under the authority of and in accordance with a licence issued under that Part of the National Energy Board Act. Pursuant to section 82, the Board must satisfy itself that the price charged by an applicant (for an export licence) for gas exported is just and reasonable in relation to the public interest. Regulation 11A (SOR/70-434), under Part VI of the National Energy Board Act, provides that any price charged by applicants for licences for gas which is exported is subject to review by the National Energy Board, and further, upon such review, where the Board is of the opinion that there has been a significant increase in prices for competing gas supplies or for alternative energy sources, the Board is to report those findings and its recommendations to the Governor in Council. Taking into account those findings and recommendations, the Governor in Council may, under Regulation 11A(2), by order establish a new minimum export price for that licence. An example of such an order is that variation of the Trans Canada Pipelines, Limited, licence GL-37, by order of the National Energy Board Number AO-4-GL-37, approved by Order in Council, P.C. 1975—1137, whereby the price to be received by Trans Canada Pipelines, Limited after the 1st day of November, 1975 was set at not greater than and not less than

[8] Natural Gas Pricing Agreement Act, S.C. 1975, c. 38 as amended.
[9] National Energy Board Act, R.S.C. 1970, c. N-6 (1st Supp.) at s. 28.

$1.60/MmBtu's.[10] This price is at present that price at which all Alberta gas is exported.

2. TORONTO REFERENCE PRICE is the price, set by federal-provincial agreement, at which all gas produced for consumption within Canada but outside its province of production is sold. It employs the input "gate" at Toronto, Ontario as the delivery point, for gas destined for eastern Canadian markets. At present, the Toronto reference price is $1.25/MmBtu's; that price being fixed by federal-provincial agreement, and subsequent complementary orders: Alberta O.C. 1499/75, under the Natural Gas Pricing Agreement Act, S.A. 1975, c. 38, as amended by S.A. 1975, c. 70; Canada P.C. 1975-2439, under section 51 of the Petroleum Administration Act, S.C. 1974-75, c. 47, by the Alberta and federal governments, respectively.

3. CANADIAN COST OF SERVICE includes all costs associated with transportation, metering and related costs from the Alberta-Saskatchewan border to its destination (if the gas is to be consumed in Canada, but outside its province of production); or those same costs involved in moving the gas from the Alberta border to that point on the international border at which the gas is exported. This factor of the various pricing formulae is determined by the National Energy Board, pursuant to sections 50 to 54 inclusive, of the National Energy Board Act. Upon application to the Board, a rate hearing is held, and orders are issued by the Board which set, amend, or reject the amendment of the Canadian cost of service for that carrier.

4. ALBERTA BORDER PRICE is defined in the federal-provincial letter agreement published as Alberta Regulation 318/75, paragraph 2, as being that amount equal to the Toronto Reference Price less the Canadian cost of service from the Alberta border to the Toronto reference point. For the month of November, 1975, the Alberta border price was set at 81.223 cents/MmBtu's[11] on a dry basis, or the equivalent of 82.661 cents/MmBtu's on a wet basis, at 14.65 pounds per square inch absolute at 60° Fahrenheit. For the month of December 1975, the imputed Alberta border price was raised to 81.703 cents/MmBtu's on a dry basis, or the equivalent of 83.149 cents/MmBtu's on a wet basis.[12] The Alberta border price has remained constant since that time, and in the absence of rate hearings before the National Energy Board, or a further federal-provincial gas pricing agreement, is likely to remain so for some months. The Alberta border price is thus a combination of two sub-factors: one, the Toronto reference price, established by federal-provincial agreement, and the other, the Canadian cost of service, set unilaterally by a federal agency.

The Alberta border price, the international border price and the Toronto reference price are subject to alteration at the termination of the present federal-Alberta pricing agreement on June 30, 1976.

5. ALBERTA COST OF SERVICE is used in the context of this paper as it is defined in section 1(b) of the Natural Gas Pricing Agreement Act. It may vary, depending upon the location of the gas field, the type of gas produced and other factors, but can be determined

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10. Million British Thermal Units.
11. General Orders under the Petroleum Administration Act, S.O.R./76-58, S.O.R./76-59, S.O.R./76-60.
12. Edmonton Journal, January 24, 1976.

with respect to any given field by application to the Alberta Petroleum Marketing Commission. For the purposes of this paper, the Alberta cost of service figure will be assumed to be 7.6¢/MmBtu's,[13] wherever necessary in a pricing formula.

III. THE FEDERAL LEGISLATION RESPECTING GAS PRICING

The National Energy Board was established under section 3 of the Act, while the original field pricing study commissioned by the federal government was authorized, pursuant to section 22(2). Section 50 of the Act sets out the powers of the National Energy Board respecting its ability to make orders "with respect to all matters relating to traffic, tolls or tariffs." Sections 51 to 54 inclusive provide specific description respecting this power, and provide that all tolls charged shall be specified in a tariff filed with the Board; that all such tolls shall be just and reasonable; and that the Board may disallow any tariff or part thereof that it considers to be contrary to any provisions of this Act or to any order of the Board.

Under section 61, the essentials of the Canadian cost of service are established. The differential between the amount for which the gas is sold by the transmission company, and the cost to the company of the gas where it enters the pipeline, is, for the purposes of this Act, deemed to be a toll charged by the company to the purchaser, for the transmission of the gas. This formula represents the former concept respecting all gas pricing in Canada, whereby the transmission and service charges were levied against the consumer. However, the present legislation reverses the traditional concept so that the producer, rather than the consumer, bears all transmission and service costs. This concept reversal will be further discussed within the problems section, below.

As discussed in the consideration of the international border price concept, it is pursuant to this statute that the federal government controls the export of natural gas, with respect both to the pricing, and of the quantities of gas exported.

(a) *The Petroleum Administration Act, 1974-75, c. 47.*

As stated in the introduction, section 49 of this Act outlines the purposes for the enactment of this legislation. Part III of the statute deals with domestic gas restraint.

Section 50 provides the legislative authority for the Minister to enter into bilateral agreements with the producing provinces for the purpose of establishing mutually acceptable prices for the various types of gas produced in each province during the period of any such agreement. The National Energy Board is given the power to administer this part of the Act on behalf of the Minister under section 65 of the Act.

Where there is an agreement with a producer province entered pursuant to section 50, section 51(1) allows the Governor in Council to set prices for the various kinds of gas which are produced for ultimate consumption outside of the province of production. This power was employed in conjunction with the Province of Alberta in establishing the Toronto price, under the present federal-provincial agreement.

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[13] Alberta Petroleum Marketing Commission, *Summary of Commission's Actions*, undated, paragraph 4.

Section 51(2) sets out the factors to be considered in setting the price for the various kinds of gas, and grants the power to review such prices from time to time to achieve the stated purposes of this part of the act.

Section 52 contains the federal government's reserve power, to be employed in the event that no agreement pursuant to section 50 can be reached, or where such an agreement is reached, but later terminated, or should prove ineffective. This section allows the Governor in Council to unilaterally set gas prices for that gas sold or for delivery domestically, outside the province of production or at any international border point. The powers granted under this section roughly correspond to those granted under the sections concerned with federal-provincial agreements.

Section 53 contains the prohibition against the movement, sale or purchase of gas outside its province of production, unless the price paid to acquire that gas is the prescribed price, that is, approved by special or general orders of the National Energy Board. To date, all such special or general pricing orders have been made pursuant to the existing federal-provincial gas pricing agreement.

The federal government's constitutional justification against encroachment upon provincial areas of control lies in the restriction upon the operation of the Petroleum Administration Act in section 53(2). That section excludes from the effect of this section, and thereby effectively from the entire statute, a sale of gas in the province of production for consumption within that province.

Section 64 establishes the machinery which deals with part of the controversial flowback scheme, concerning gas sold outside Canada or domestically, outside its province of production. The amount which is returned to the producer under this section is defined as the excess of the total revenues received by the purchaser, for gas sold in a month, less the purchaser's cost of service in that month, to the producers of that gas. It also authorizes regulations to be made by the Governor in Council respecting the workings of this machinery. To date, this scheme has been applied only with respect to gas sold in foreign markets. The expression is derived from the return, along the pipeline route (flowing "back") to the producer of the gas, of any excess described above. The rationale for the inclusion of flowback provisions in the federal and Alberta legislation is the stimulation of further exploration and devalopment within each province of production. The success of this policy is, at present, difficult to determine, and it has been questioned whether any such stimulation whatsoever has occurred since and due to the inception of this program.

IV. THE FEDERAL-PROVINCIAL AGREEMENT

The key connection between the federal Petroleum Administration and National Energy Board Acts and the Alberta Natural Gas Pricing Agreement Act is the federal-provincial agreement which contained the above-mentioned flowback scheme. The scheme was proposed in a letter from the Honourable D.R. Getty, Alberta Minister of Energy and Natural Resources to the Honourable A. Gillespie, Minister of Energy, Mines and Resources (Canada), dated October 17, 1975. A letter in response contained the federal government's acceptance of that proposal, and both the Alberta and the federal governments formalized the agreement by issuing complementary Orders in Council:

Alberta O.C. 1499/75, Canada P.C. 1975-2439. The Alberta Order in

Council, incorporated into Alberta Regulation 318/75, deemed this federal-provincial agreement to be an agreement made pursuant to section 4(1) of the Natural Gas Pricing Agreement Act. That statute was passed in part for the purpose of giving legislative authority to the above agreement. However, the agreement, which pre-dates the legislation, is ineffective without the later legislation. To overcome this inconsistency, the agreement, the Natural Gas Pricing Agreement Act, and other provincial and federal orders concerning the pricing of gas have been deemed effective as of November 1, 1975.

V. ALBERTA LEGISLATION RESPECTING GAS PRICING

The provincial authorization granting the Minister the power to enter into a federal-provincial agreement on behalf of the province, for the purposes of establishing the prices for various kinds of gas during the period of such agreement, rests in section 4(1) of this Act. Subsection 3 of that section further authorizes the Lieutenant-Governor in Council to declare that the above-mentioned letter, and the reply thereto, be deemed to constitute such an agreement. This has been done by virtue of Alberta Regulation 318/75.

While section 6 provides for the making of regulations by the Lieutenant-Governor in Council, as at the date of writing, only interim regulations, Alberta Regulation 32/76, have been published. These regulations are not considered particularly useful with respect to applications to the Alberta Petroleum Marketing Commission under the Act, and most persons interviewed did not wish to speculate as to the nature and scope of forthcoming regulations. However, the Alberta Petroleum Marketing Commission has issued interim instructions respecting such applications. These instructions will be discussed below.

The major operative section of the Act respecting the determination of the field price for gas is section 10. This section, in keeping with the overall tenor of the statute, is structured to apply where there is a subsisting federal-provincial agreement. The section distinguishes gas intended for removal and consumption elsewhere from gas produced for consumption within the province. Section 10(1) states that the price of gas delivered under a gas sales contract and intended to be removed from Alberta shall, for all purposes, be deemed to be an amount equal to:

(a) the Alberta border price for the month,
plus (b) the price adjustment for the month,
less (c) the Alberta cost of service with respect to the gas.

Subsection (2) of section 10 defines the price of gas delivered under a gas sales contract in any month, for consumption within Alberta as:

(a) an amount equal to
(i) the Alberta border price *plus* the price adjustment
less (ii) an amount estimated by the officer designated by the Minister for that purpose, as the Alberta cost of service, if that gas had to be moved to the Alberta-Saskatchewan border;

or

(b) an amount equal to the contract field price *plus* the price adjustment for the month;
whichever is the lesser amount.

Subsection (3) allows for the exempting of specific gas sales contracts by the Regulations.

By virtue of section 11, the regulated field price, defined as being the price to be paid by application of section 10, determined with respect to any gas sales contract applies notwithstanding:

(a) anything in the gas sales contract,
(b) any award under the Arbitration Act, R.S.A. 1970, c. 21, or any agreement which redetermines the price under a gas sales contract, or
(c) any order of the Public Utilities Board under the Gas Utilities Act, R.S.A. 1970, c. 158.

The effect of this section, including possible internal conflict with section 1(4), and conflict with the Gas Utilities Act will be discussed below.

Part 2 of the Natural Gas Pricing Agreement Act deals with the acquisition and resale of gas by the Alberta Petroleum Marketing Commission, as agent for the Crown in right of Alberta. Within the operative section, section 14, subsection (1) provides that the Minister may, by order, direct any owner of gas in Alberta to deliver that gas to the Minister at the point within the province prescribed in that order. Although the legislation is relatively recent, approximately twenty individual orders have been issued by the Commission, to virtually every major gas producer in Alberta,[14] pursuant to this section.

Section 14(3) details the formulae for determining the price of the gas, to be paid by the Minister to the producer where gas is delivered under an order pursuant to subsection (1). The applicable formula is dependent upon the ultimate destination of the gas in each instance:

(a) In the case of gas intended to be removed from Alberta, such compensation is to equal the Alberta border price *less* the Alberta cost of service to the point on the Alberta border at which the gas is to be removed.
(b) In the case of gas intended for consumption within Alberta, compensation is to equal the lesser amount of:
  (i) the Alberta border price *less* the "estimated Alberta cost of service" if gas were to be moved to the nearest Alberta border and a transmission pipeline were available.
or (ii) the contract field price *plus* the Alberta cost of service prescribed in the Minister's order under subsection (1).

Whatever the destination of the gas, the payment to the producer invariably includes the price adjustment for the month in which the gas is sold.

Section 14(4) provides for the resale of the gas so acquired, less any constituents removed pursuant to section 15, to the person from whom the Minister purchased the gas (that person to whom the order under subsection (1) was directed) and provides for resale at the Minister's discretion where that person elects not to buy back the gas. Subsection (5) details the prices at which the Minister shall sell the gas:

(a) in the case of gas sold for consumption within Canada, but outside Alberta, or gas used in transmission of Canadian gas back to Canada from the United States:
  at the amount paid as compensation under subsection (3):
(b) in the case of gas sold for consumption outside Canada, except gas for retransmission into Canada:

the international border price *less* the sum of:
  (i) the Alberta cost of service, and

[14] Alberta Petroleum Marketing Commission, *Summary of Commission's Actions*, list of Ministerial Orders, p. 3.

(ii) the Canadian cost of service from the Alberta border to that point at which the gas crosses the international border.

Subsection (7) provides that the statute shall be deemed to have retroactive effect, for the purposes of legitimizing an order made pursuant to this section, as of November 1, 1975.

Under section 15, the Alberta government has given itself the power to remove any constituent from that gas other than methane, while it owns and is in possession of gas pursuant to an order under section 14(1). Section 15(1) further grants the government the power to contract for the removal of any such constituent, and to sell within Alberta, and to any person, any constituent so removed. Subsection (2) limits the application of this power to that situation in which the Lieutenant-Governor in Council declares it to be in the public interest that the constituent be removed from the gas, is satisfied that the constituent would not otherwise be removed from the gas within Alberta, and approves the removal of the constituent from the gas by the Minister.

The purpose for the inclusion of this power is to ensure feedstocks for the petrochemical industry which the Alberta government hopes to attract to the province in the near future, as part of the secondary industry promotion policy advocated by the Lougheed Administration. Several fears and criticisms of this reservation have been expressed by major gas producers in Alberta. These will be discussed below.

Section 16 establishes the Natural Gas Pricing Agreement Act Fund, to be held and administered by the Minister. Subsection (3) provides that the proceeds from the sale of gas received by the Minister pursuant to section 14 shall be paid into the Fund. Subsection (4) authorizes the Minister to pay out of the Fund:

(a) compensation payable by the Minister pursuant to section 14 with respect to gas delivered to him under that section;

(b) any cost of service incurred by the Minister with respect to gas delivered to the Minister under section 14, at any cost involved in the movement of the gas from the point of delivery to the Minister, to the point of delivery to the purchaser of the gas from the Minister.

(c) moneys paid to producers and original puyers pursuant to the regulations under subsection (5).

Subsection (5) authorizes the making of regulations respecting the flowback scheme discussed above. By virtue of this subsection, the Natural Gas Pricing Agreement Act Fund becomes the vehicle by which the flowback scheme is administered. Under section 16(6)(b), the Petroleum Marketing Commission has been appointed to administer the Fund. Regulations passed pursuant to this subsection may allow producers and eligible original consumers to receive payments of the price adjustment, the latter on the condition that they pass on that price adjustment to the producers from whom they purchased. The price adjustment is the final factor used in pricing formulae, arising with respect to the administration of the Fund, and the flowback scheme in general. The mechanics of the flowback scheme are as follows:

The International border price	160¢
less the Alberta border price, which includes the Alberta cost of service and the payment to the producer delivering to the commission	83¢
less the Canadian cost of service	approx. 50¢
EQUALS a balance of	27¢

This balance, shown here to equal 27¢/MmBtu's, is that amount by which the receipts from the exporter exceed the costs to the Alberta Petroleum Marketing Commission in acquiring and transporting that gas. This balance remains in the Natural Gas Pricing Agreement Act Fund and, is available for distribution (as the Price adjustment) at the end of each month. For the month of November 1975, this Fund totaled approximately $44.5 Million.[15] For the same month, the price adjustment was 22.5¢/MmBtu's.[16] To obtain the price adjustment, the Alberta Petroleum Marketing Commission divides the total number of Btu's (times 1,000,000) produced in Alberta during that month, into the total amount remaining in the Fund after those payments authorized under section 16(4) have been made.[17] For the month of December 1975, the price adjustment equaled 24.0¢/MmBtu's.[18]

The Natural Gas Pricing Administration Act (Bill 88, 1975), as yet unproclaimed, is the Alberta equivalent of section 52(1) of the federal Petroleum Administration Act. Under section 9 it provides for the unilateral establishment of the price of any gas at the point of production, at the contract delivery point, or at any other point in Alberta. Section 13 provides for the acquisition and resale by the Crown, akin to those powers granted under the Natural Gas Pricing Agreement Act, however, section 14 provides legislative authority for the determination, by the Minister, of an "Alberta border price" solely on the basis of regulated field prices, rather than by reference to external orders of the National Energy Board. As with section 52(1) of the Petroleum Administration Act, this Bill is intended to be employed in the absence of a federal-provincial agreement, and will not be proclaimed unless there is a breakdown in the present agreement, or a new one cannot be negotiated before the termination present federal-provincial agreement on 30 June 1976. As the Bill is intended as a contingency measure, it mirrors the adoption of a much stronger position respecting provincial ownership and control of natural gas than does the present Natural Gas Pricing Agreement Act.

Apart from this position respecting the unilateral controlling of gas prices, the mechanics of the Natural Gas Price Administration Act, and the Natural Gas Pricing Agreement Act are similar with minor discrepancies only.

Other Alberta legislation is important with respect to the area of the pricing of natural gas only in consideration of the potential conflicts created by the inclusion of section 11 in the Natural Gas Pricing Agreement Act.

The provincial government is using the legislation in the area of gas pricing for two purposes. First, to promote its policy respecting conservation of non-replenishable resources and promotion of growth of secondary industry in the province, and secondly, to protect the provincial prerogatives arising from ownership of those natural resources. These purposes, it is hoped, can be achieved by placing into the hands of a provincial agency, the Alberta Petroleum Marketing Commission, powers concerning the deployment and pricing of all gas

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15. Elma Spady; interview, January 19, 1976.
16. Alta. Reg. 11/76 (1976).
17. Elma Spady; interview, January 19, 1976.
18. "Alberta Petroleum Marketing Commission, Notice", Edmonton Journal, January 24, 1976.

produced within the province. The constitutional justification for both pieces of Alberta legislation rests with the ownership *in situ* of the Crown gas, and in the stipulation in the legislation that all sales transactions take place within the province of Alberta. It is merely the excercise of a right of ownership, while owned by the Crown in right of Alberta, and in its possession, that allows the removal of any constituent other than methane, pursuant to section 15 of the Natural Gas Pricing Agreement Act.

It is, as a result of policy decisions by both the Alberta and the Federal governments, that the price of natural gas is related to the price of petroleum. At present, the present of gas is said to be approximately 85% of the price of the equivalent heating amount of Canadian petroleum. Because of this bond, as the price of Canadian petroleum increases and approaches world market values, so will the price of natural gas. Further, while the general approach adopted by the price-determining agencies involves the Commodity value concept, at present, the Toronto reference price of $1.25/MmBtu's and the international border price of $1.60/MmBtu's are arbitrary values, related not only to commodity value, but to a number of other economic and political factors as well.[19] It has been suggested that if true commodity value were adopted, using southern California markets as the point at which that value were to be determined, the field price of natural gas in Alberta would be approximately $2.10/MmBtu's

VI. THE ROLE OF THE ALBERTA PETROLEUM MARKETING COMMISSION

The A.P.M.C.[20] was established to administer the Alberta petroleum legislation under the Petroleum Marketing Act, S.A.1973,c.96. Pursuant to section 3 of the Natural Gas Pricing Agreement Act allowing the Minister to delegate those powers granted to him under the Act, the A.P.M.C. has been appointed as the agency to administer that statute on behalf of the Minister.

The marketing scheme established under the Natural GAs Pricing Agreement Act represents a new concept in gas pricing. Previously, a value was established at the wellhead and transportation and service costs were added to that base price and charged to the ultimate concumer. This was in accordance with most other marketing legislation, as well as uncontrolled enterprise. Under the new legislation, the situation is reversed. By federal-Alberta agreement, the international border, Alberta border and Toronto reference prices are fixed. From those prices are deducted all transportation and service costs, with the remainder being that amount the producer receives for its gas. As such, while the producers previously showed little interest in the transportation rate hearings before the National Energy Board, since the enactment of the Natural Gas Pricing Agreement Act their interest has been sparked. As a result, a number of briefs have been presented to the National Energy Board by the gas producers in applications respecting rate increases.

As mentioned above, the A.P.M.C. is the agency through which the

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[19] National Energy Board Report to the Governor in Council, *supra*, n. 6 at 5-13 - 5-18.

[20] *Supra*, n. 1.

Alberta government issues orders respecting delivery of gas, and buys and sells all natural gas produced in the province, pursuant to the Natural Gas Pricing Agreement Act.

While the Regulations under the Natural Gas Pricing Agreement Act do not specifically deal with the procedures of the A.P.M.C. with respect to gas pricing, the A.P.M.C. itself has issued a number of interim instructions[21] which outline those procedures to be followed in making an application to the A.P.M.C. These interim instructions include forms to be filled, instructions respecting form completion, and examples of completed forms. They deal with application, for price adjustment from the Pricing Agreement Fund for solution and injected gas, as well as statements made by applicants in support of the included forms.

Upon application, the Alberta Petroleum Marketing Commission will establish an Alberta cost of service for any gas field, pursuant to interim Regulation 2 (Alberta Regulation 32/76) under the Natural Gas Pricing Agreement Act. Under Regulation 3, the A.P.M.C. is empowered to issue orders prescribing a new delivery point for any gas, if the A.P.M.C. is of the opinion that the contract is substantially removed from the point at which the gas sold first becomes marketable. This point is normally the outlet "gate" of the processing plant at which the gas is readied for transmission. This power, which includes the right to specify any point in Alberta as the new delivery point, is limited in application to those gas sales contracts relating to gas sold or delivered for consumption within Alberta.

The Alberta Petroleum Marketing Commission is also the administrator of the Alberta Natural Gas Pricing Agreement Act Fund, as well as the appointed administrator of the potential Natural Gas Constituent Proceed Fund. The administration of the first Fund involves all those functions discussed above relating to sections 14 and 16 of the Natural Gas Pricing Agreement Act. It includes the collection from each producer, to whom an order was issued under section 14(1), of monthly statements reporting the number of Btu's (times 1,000,000) produced during the month in question; determining the price adjustment for the month; and the actual disbursement of price adjustment cheques to producers and original consumers from the Calgary office of the A.P.M.C. on the 25th day of each month.[22] In the event that the Lieutenant-Governor in Council makes a declaration and approval order under section 15(2) of that Act, the A.P.M.C. will also administer the extraction of constituents from the gas, and the Fund (No. 1) in the manner described in section 15. The administration of the Natural Gas Constituent Fund (No. 1) would be similar in nature and procedure to that of the Natural Gas Pricing Agreement Act Fund, described above.

The policies of the Alberta government as implemented by the Alberta Petroleum Marketing Commission deal as much with constitutional postures and the potential implementation of policies as with the present implementation of existing policies. Merely by being involved in the buying and selling arrangement under the Natural Gas Pricing Agreement Act, the A.P.M.C. continually represents the

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21 Alberta Petroleum Marketing Commission, *Interim Instructions*, undated.

22 Elma Spady; interview, January 19, 1976.

provincial position respecting ownership and control of natural resources within Alberta. However, a different situation is presented when one considers the power, under section 15 of the Natural Gas Pricing Agreement Act, to remove any constituent other than methane from the gas. In the Provincial government's drive to attract secondary industry to Alberta, in this instance, the petrochemical industry, it has ensured that should such industry be attracted, it will not suffer for want of feedstocks. By threatening to remove the ethane from the natural gas in this manner, the Alberta government hopes to persuade producers to voluntarily supply that ethane to the petrochemical industry. The implications of this policy will be further discussed below.

In view of the relative youth of the relevent legislation, the Alberta Petroleum Marketing Commission is to be congratulated for developing what appear to be workable practices and procedures, in the absence of extensive directions through the passing of regulations under the Natural Gas Pricing Agreement Act by the Alberta government. Those practices and procedures which have been developed relate primarily to the individual orders given to the major producers and original consumers, and to the administration of the Natural Gas Pricing Agreement Act Fund. Further, more detailed practices and procedures related to the functions of the A.P.M.C. are certain to be developed in the near future, both through the publication of a more complete set of regulations under the Act, and through the increased experience of the A.P.M.C. and those dealing with it.

VII. EXAMPLES: FOR GAS DELIVERED AND SOLD TO THE MINISTER

All prices used in this section are:
i) expressed in cents per Million British Thermal Units,
ii) for gas on a saturated basis, or the equivalent thereto,
iii) effective as of 1 December, 1975.

1. Consumption Within Alberta

a) Alberta border price .... 83¢/MmBtu's
plus price adjustment for December, 1975 .... 24.0¢
less estimated Alberta cost of service .... 07.6¢
EQUALS .... 99.4¢/MmBtu's

or

b) Contract field price .... (example) 15¢/MmBtu's
plus Price adjustment for December .... 24¢
EQUALS .... 39¢/MmBtu's

The second calculation is considerably lower, and thus, is the applicable price in this instance.

In many instances involving gas for consumption within Alberta, the producers are tied to long term, low priced contracts, such that the compensation that they now receive is often only half that received by "exporters". This discrepancy is the cause of the application for increased contract field price in the recent case before the Public Utilities Board.

2. Consumption Within Canada, Outside the Province of Production

To the Alberta border:
Alberta border price .... 83¢

plus Price adjustment for December	24¢
less the Alberta cost of service	07.6¢
PRICE paid to the Producer	99.4¢/MmBtu's
To the Toronto Reference Point:	
Toronto reference price	125¢
less Alberta border price	83¢
EQUALS Canadian cost of service from Alberta border to the Toronto Gate	42¢/MmBtu's

3. Export Gas sold by the A.P.M.C.

a) International border price	160¢
less Canadian cost of service (approx.)	50¢
less Alberta cost of service	07.6¢
EQUALS Amount received by A.P.M.C. from sale to exporter	102.4¢/MmBtu's
b) International border price	160¢
less Alberta border price	83¢
less Canadian cost of service	50¢
EQUALS Differential	27¢/MmBtu's

It is this differential, here represented as 27 cents/MmBtu's which remains in the Natural Gas Pricing Agreement Fund after disbursements pursuant to section 16(4). This amount is thus available for distribution to producers and eligible first consumers, as the price adjustment, once the total gas produced in any month is divided into the Fund for that month, pursuant to the price adjustment formula.

VIII. PROBLEMS ARISING FROM AND ASSOCIATED WITH THE INTERPRETATION AND ADMINISTRATION OF THE NATURAL GAS PRICING AGREEMENT ACT

While the mechanical requirements and formulae delineated in the Natural Gas Pricing Agreement Act are complex, in general, they are straight forward and reasonably clear. Further, the language of the statute is clear and concise; and interpretation of the Act is generally not difficult. However, some problems have arisen.

A major problem with respect both to the interpretation and application of the Act arises with respect to section 11. The intention expressed therein is that the regulated field price determined with respect to a gas sales contract for any month is to apply notwithstanding anything in that gas sales contract; or any award under the Arbitration Act (Alberta); or any agreement that redetermined the price under a gas sales contract; or any order of the Public Utilities Board under the Gas Utilities Act (Alberta). It has been suggested that if a literal interpretation of this section is made, this provision conflicts with section 1(4) of the Act, whereby an order of the Public Utilities Board under the Gas Utilities Act is deemed to be a gas sales contract. Further, this conflict possibly interferes with the jurisdiction of the Public Utilities Board to make an order under the Gas Utilities Act respecting the raising of price paid under an existing gas sales contract. This internal conflict would arise, it is argued, in any instance in which the regulated field price equals the contract field price. This situation can, but will not necessarily, arise where gas is produced for consumption within Alberta. The argument against this submission is that there is no jurisdictional question respecting the issuance of an order by the Public

Utilities Board in this situation, but that section 11 simply limits that amount by which the Public Utilities Board may increase the price to be paid under a gas sales contract such that the increased price must not exceed the formula price derived under section 10(2)(a).

In connection with section 1(4) of the Act, it has been argued that upon the proper interpretation of the section, it applies only where there is no existing gas sales contract and where delivery is made pursuant to an order of the Public Utilities Board, under the Gas Utilities Act. Thus, except in that one limited situation, the Public Utilities Board would continue to possess jurisdiction respecting the alteration of prices to be paid under a gas sales contract. It is submitted, however, that a reading of section 1(4) within the context of the entire statute, of necessity, results in an interpretation wherein the effect of the section is considerably broader in scope than as described above.

The opposing viewpoint argues that the Act completely revokes any powers of the Public Utilities Board to issue orders varying the price to be paid for gas under a gas sales contract.

That neither of these positions is unanimously accepted by the natural gas industry in Alberta is evidenced by the recent application[23] to the Public Utilities Board for such a price increase. This application has been disputed on the above-mentioned ground respecting revocation of jurisdiction. Mr. J. C. Sacks, Acting Chairman of the Public Utilities Board, has accepted both oral and written arguments on this issue. The hearing of that application was adjourned on March 17, 1976.

Upon re-convening, the Public Utilities Board assumed the jurisdiction to hear the matter, and heard testimony for several days. However, before a decision could be rendered, Bill 57 was introduced into the Alberta Legislature, effectively curtailing this, and any other similar hearings by the Public Utilities Board.

Bill 57, section 2(1) amends the Gas Utilities Act by adding section 5, whereby a prerequisite to the hearing of specified matters including the increase of price paid to a producer under a gas sales contract, by the Public Utilities Board, is authorization to do so by an order of the Lieutenant-Governor in Council.

Sections 2(2) states that subsection (1) is to apply to any proceeding commenced, but not concluded under specified sections of the Gas Utilities Act. This can be directed only toward Mr. Saks' hearing upon the application to increase contract field prices of the applicants. Bill 57 has not as yet been proclaimed.

In this manner, the Alberta government has effectively eliminated the problem regarding the power of the Public Utilities Board to increase contract field prices to equal, but to exceed the formula price for gas for consumption within Alberta. It remains to be seen whether this amendment will effectively freeze the amount paid to those producing for the Alberta market at the relatively low values most contracts now stand. While this ensures lower gas prices for Albertans, it would not be entirely consistent with the stated aim of encouraging future exploration and production within Alberta.

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23 IN THE MATTER OF the Public Utilities Act, being chapter 301 of the Revised Statutes of Alberta, 1970; and IN THE MATTER OF the Gas Utilities Act, being chapter 158 of the Revised Statutes of Alberta, 1970, and; IN THE MATTER OF AN APPLICATION under section 16 of the said Act for a change in the rate or charge for the supply of gas under a contract.

Another question concerning the interpretation and application of the statute arises with respect to gas sales contracts containing "take or pay" provisions. The essence of such a provision is that the contracting purchaser covenants to pay for the gas under the terms of the contract, whether he actually takes delivery of the gas at the time specified in the contract or not. If the purchaser does not desire to take delivery of the gas at that time, for whatever reason, under such a provision he gives notice to that effect to the contract vendor, thereby establishing a credit for that amount of gas. The credited gas can be taken at a later date, but within a time period specified in the contract, by the giving of further notice to the vendor.[24]

Most contracts containing such a take or pay provision also include a provision respecting payment of the differential. This is defined as being the difference in value between the market value of the gas when actually delivered and the price paid for the gas, under the contract, at the time the take or pay provision was invoked. However, some parties to long term gas sales contracts, not foreseeing the recent immense increases in gas prices, incorporated take or pay clauses, which did not include differential provisions into their contracts.

The Natural Gas Pricing Agreement Act speaks in terms of the price of gas "delivered". While the intent and purpose of the Act is to govern all gas sales contracts, a question arises with respect to gas for which payment has been made, but delivery withheld, pursuant to a take or pay clause which does not include a differential payment provision. In this situation, will the provincial government request royalty payments for such gas based upon the original, lower price, or will it demand that royalty payments be based upon the price at which the gas is delivered, pursuant to the Act? At present, the answer to this question is unknown.

Further, dissension among some of the oil and gas corporations in Alberta has been occasioned by this question as some vendors under such contracts are attempting to recover sums in addition to the original contract price, sufficient to satisfy royalty claims based on the price of the gas as delivered to the Alberta Petroleum Marketing Commission, merely upon the speculation that such will be the position adopted by the Alberta government in this matter. As could be expected, those purchasers against whom this pressure is being directed have adopted a passive attitude, resisting such pressure until the problem is resolved.

A further problem respecting the application of the Natural Gas Pricing Agreement Act to contracts involving take or pay provisions concerns the flowback provisions described above. A purchaser under a gas sales contract can only claim the flowback amount, or price adjustment, if it can equate itself with a producer. In order to establish that position, it must prove an interest in the reservoir itself. If a contract, such as the one in question, is involved, that consumer may well prove an interest in the reservoir, as it has an absolute right to that gas for which it has paid, pursuant to the contract, subject only to a time limitation upon the right to take that gas. The consumer in such a situation might thus be able to keep beneficially the flowback payments, rather than distributing that money among its producers on a *pro rata* basis. This result is contrary to the intention of the Natural Gas Pricing Agreement Act, expressed in section 16(5)(c) of that Act. That intention is that the flowback monies be received by

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[24] Donald MacFarlane; interview, February 5, 1976.

the producers of the gas, to promote further exploration and production of gas, with a resultant increase in royalty revenues to the provincial government. Both of these aims would be thwarted, should the purchaser described above be allowed to take beneficially the price adjustment payments under the federal-provincial flowback scheme.

Several practical problems, from the viewpoint of the Alberta producer, have arisen, or have been foreseen from the application of the Natural Gas Pricing Agreement Act. The first problem, expressed by all representatives of the producers interviewed, regards the basic concept of the legislation. As stated above, all previous gas pricing proceeded from the establishment of a field price, to which all transportation and service costs were added, the total being the price paid by the consumer. Under the Natural Gas Pricing Agreement Act, border and final market prices are established, with all transportation and service charges subtracted therefrom; the remainder being the price paid to the producer. As a result of this concept reversal, all transportation and service charges are borne by the producer, and, as a class, those producers are understandably upset.

A related problem, apart from the direct lessening (from the producer's viewpoint) of revenues, involves the necessity to 'police' all future rate hearings resulting from applications by carriers, to ensure that all rates and tolls charged by those carriers for the transportation of Alberta gas to market are justified. The complaint of the producers in this respect is the necessary expenditure of time and money to attend and make submissions at these rate hearings.

Another practical problem, from the viewpoint of the producer, concerns the compulsory sale within Alberta of all natural gas sold pursuant to section 14(1) of the Act. While this problem primarily concerns the pricing and use of petroleum, by virtue of this provision, it arises respecting natural gas as well. Prior to the enactment of this stature, the major, integrated producers were able to defer the taking of profit with respect to their gas to that point along the chain of corporations they felt was most beneficial. The usual preferred point at which profit was taken was the gasoline pump, or the natural gas burner tip. By virtue of the provision within the Natural Gas Pricing Agreement Act necessitating sale within Alberta, this ability has been taken from the integrated companies.

However, this provision ensures that Alberta, as the province in which the sale of the gas occurs, receives the tax revenue arising from such sales.[25] Further justification for the provision can be found in the constitutional credibility that this provision lends to the other sections of the statute. As such, it is submitted that this compulsory sale provision is justified on a purely economic basis; that is, the increased provincial tax revenues, even if the constitutional justification should prove inadequate.

The producers interviewed foresee a major problem arising in connection with the power the Alberta government has given itself under section 15 of the Natural Gas Pricing Agreement Act, respecting the potential extraction of any constituent of natural gas, other than methane. In subsection (2) of that section, the provincial government has stated that this provision is to be employed only where a constituent would not otherwise be removed within Alberta. The rationale cited for the inclusion of this provision, is ensured supplies of ethane feedstocks to petrochemical companies which, at

[25] Vincent Reed, McLaws & Co., Calgary; interview, February 6, 1976.

present, are interested in establishing facilities in Alberta, but are unwilling to do so without such ensured supplies. Interviewees list several complaints respecting both the form and application of the provision. At present, the major producers have long term contracts for the removal and sale of some of the ethane in question to other private concerns. Government intervention would interfere with these contracts, with detrimental effects respecting producers and their present purchasers.

Further, representatives of the producers have stated that the provincial government represented to them that the petrochemical companies it hopes to attract to Alberta require such legislation, ensuring feedstocks, as a prerequisite to the establishment of processing facilities in Alberta. Representatives of some large Alberta producers interviewed, maintain that they were never approached by the petrochemical concerns in attempts to contract for the supply of such ethane as would be required. Instead, the petrochemical companies approached the provincial government directly, side-stepping the traditional private enterprise routes. Those interviewed take exception to this approach. Further criticism in this respect was directed at the Alberta government for not ensuring that the petrochemical companies had attempted private negotiations, which proved unsuccessful, or had at least inquired into the possibility of ensuring the necessary feedstocks by contract, before demanding direct governmental intervention into a field traditionally occupied, almost exclusively by private enterprise. This complaint relates primarily to the aversion by advocates of free enterprise to any intrusion, by any level of government into areas traditionally controlled by private industry, on the grounds that the private enterprise approach results in more efficient economic functioning of a system, if not always more equitable solutions, than does government control.

An answer to this complaint lies in section 15(2) of the Natural Gas Pricing Agreement Act. While the government did not ensure that all reasonable attempts had been made to contract with the Alberta producers for the supply of petrochemical feedstocks, this section ensures that the legislation, with respect to removal of such constituents, will be invoked only where private industry fails to remove those constituents within Alberta. Thus, the producers at present, have been given the opportunity to contract for the supply of ethane to the petrochemical companies that was denied them prior to the passing of the Act.

In the event that the Alberta government does exercise its power to remove constituents from natural gas, a further problem will arise. That problem concerns the amount of consideration to be paid to the producer for such constituent. Representations have been made to the government, but rejected[26] respecting the possible amendment of the Natural Gas Pricing Agreement Act such that the government would be required to pay to the producer the commodity value of any constituent removed pursuant to section 15. These representations were grounded in the fear that the Alberta government would reimburse the producers for the heating value only of the constituent, whereas the commodity value of ethane, that constituent intended to be so removed, as a feedstock for the petrochemical industry, is represented by the producers as being at least twice and possibly as much as four times the heating value of that ethane.

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26. Canadian Pacific-Canadian National Teletype, November 25, 1975, CAA411 252359, FPG361.

The producers fear that the provincial government will pay them the heating value of the ethane removed, and then sell that ethane to the petrochemical companies at the same price, which is substantially below market value for such a feedstock, as further inducement for the establishment of petrochemical processing facilities in Alberta. The natural gas producers in Alberta are not pleased with the prospect of thus subsidizing the establishment of a petrochemical industry in Alberta, at least where such would be the only source of subsidization.

IX. CONCLUSIONS

At present, gas pricing in Alberta is almost exclusively a result of recent federal-provincial negotiation and agreement. These negotiations, and, hopefully, continued agreements, are certain to continue so long as factors other than pure commodity value must be considered when determining the price of natural gas, such that the prices paid for Alberta natural gas are less than world prices. All federal and Alberta legislation concerning gas pricing which is currently in use, reflects the existence and effect of the present federal-provincial gas pricing agreement. While most of that legislation is reasonably straightforward, some problems have developed respecting its interpretation and application which have not as yet been solved.

It is hoped that the present federal-provincial co-operation will continue, and that a further agreement can be reached before the termination of the present one on June 30, 1976. However, both the Alberta and federal governments have reserved unto themselves powers concerning the pricing of gas in the absence of such an agreement. Should a future situation necessitate the deployment of those powers, the Alberta and federal governments may find themselves in confrontation before the courts, attempting to justify the extent of their excursions into the field of the pricing of Alberta natural gas.