NORTHERN PIPELINE AGENCY

ANNUAL REPORT
1986-1987

Canada

Northern Pipeline Agency
Canada

Administration du pipe-line du Nord
Canada

ANNUAL REPORT

1986-1987

Cat. No. C88-1/1987

ISBN 0-662-55616-X

Ottawa, Ontario.
December 31, 1987.

Dear Sir,

I present herewith the Annual Report of the Northern Pipeline Agency for the fiscal year ending March 31, 1987, together with the report of the Auditor General on the accounts and financial transactions of the Agency for the same period, for submission by you to Parliament as provided under Section 13 of the *Northern Pipeline Act*.

Yours sincerely,

Mitchell Sharp

Mitchell Sharp

The Hon. John C. Crosbie, P.C., M.P.,
Minister of Transport and
Minister responsible for the Northern Pipeline Agency,
House of Commons,
Ottawa, Ontario.

Table of Contents

Ottawa—Head Office
The Hon. Mitchell Sharp, P.C., Commissioner,

Centennial Towers (Station 210)
200 Kent Street,
Ottawa, Ontario,
K1A 0E6

Overview of the Alaska Highway Gas Pipeline Project

As expected, plans for second-stage construction of the northern segments of the Alaska Highway Gas Pipeline to link the existing system in the South to the substantial U.S. reserves on the North Slope of Alaska remained on hold during fiscal 1986-87 because of the still-depressed state of natural gas markets in the lower 48 states.

During the period, the outlook for the future of energy generally brightened significantly as a result of the recovery in world oil prices from the previous year's low point of around $10 U.S. a barrel to the $18-$20 level. The turn-around on the oil front, however, was not reflected in U.S. gas markets, which continued to face downward pressure.

The U.S. Energy Information Administration estimated that demand for natural gas south of the border dropped from 17.3 trillion cubic feet (tcf) in 1985 to around 16 tcf in 1986 and preliminary figures indicate the decline continued into the early months of 1987. This compares with average annual consumption in the United States during the period from 1975 to 1981 of 19.5 tcf. During the 1986-87 fiscal year, spot prices for short-term sales of gas in the United States, which have come to assume an increasingly important role in the market, continued to decline to the lowest levels experienced since the early 1970s.

The sluggish state of the U.S. gas market appeared to reflect a number of factors. These included the effect of conservation measures and competition from other energy sources in undermining demand for natural gas and the perpetuation of excess supplies of available gas reserves—the so-called gas 'bubble'. In addition, a number of measures adopted by regulatory authorities to increase competition in the marketplace also exerted downward pressure on gas prices. Notwithstanding the currently depressed state of the market, however, sponsors of the Alaska Highway Gas Pipeline Project in both Canada and the United States remained convinced that a gradual tightening of U.S. gas markets would clear the way for commencement by the early 1990s of second-stage construction to tap North Slope reserves.

(In a report issued in July, 1987, the American Gas Association foresaw a strong possibility that the existing gas bubble of some 4 tcf would have been dissipated by 1990 because of two principal factors—rising demand and a drop in available supplies as a result of a sharp decline in exploration for new reserves.)

The confidence of the project sponsor in the outlook for second-stage construction of the project has also been reinforced by the agency established to oversee the undertaking in the United States. "It is anticipated that Phase II construction efforts will be remobilized in the early 1990s as natural gas markets stabilize and financing prospects improve for the entities participating in the project construction," Theodore J. Garrish, Federal Inspector, stated in a report to Congress in February, 1987. "The ANGTS (Alaska Natural Gas Transportation System) continues to offer great promise in making available to Americans abundant supplies of Alaskan natural gas. This project is important to this nation's energy health and security, and we look forward to its full remobilization."

Although plans for second-stage construction of the project remained suspended during 1986-87 because of the economic circumstances outlined above, there were certain significant developments during the year that had an important bearing both on the project as a whole and on the viable operation of the approximately 2990 kilometres (1,860 miles) of the first stage of the pipeline that were 'pre-built' between 1980 and 1982—an undertaking that constitutes a third of the total proposed pipeline system. This first stage of the project, which consists of a Western and Eastern Leg extending from a point north of Calgary to California and the Mid-West United States, was built at the urging of the U.S. government initially for the purpose of transporting surplus Canadian gas to markets south of the border both to meet pressing U.S. requirements at that time for additional gas supplies and to facilitate undertaking of the second-stage link to the North Slope of Alaska.

The nature of these developments is outlined in the sections that follow. Those wishing further information about the nature of the Alaska Highway Gas Pipeline Project, the proposed route of the system, and the role of the Northern Pipeline Agency are referred to annual reports of the Agency for years prior to 1985-86.

Developments Affecting Operations of the Pre-build and Planning for Second-stage Construction of the Pipeline

Settlement of Dispute Threatening Continued Integrity of the Pre-build

The previous Annual Report by the Agency noted that a dispute had arisen between Pan-Alberta Gas Ltd., the supplier of Canadian gas for export through the pre-build, and United Gas Pipe Line Co., one of the principal U.S. buyers of the gas through the Eastern Leg, when the latter declared its intention in February, 1986, of substantially reducing its future purchases.

United, which was one of three U.S. companies that originally agreed to acquire a combined total of up to 800 million cubic feet per day (mmcf/d), undertook initially to take the lion's share—450 mmcf/d. In the face of deteriorating market conditions, United sought in February, 1983, to reduce the volume of its agreed purchases of Canadian gas on grounds of *force majeure*. Following a similar plea by the two other purchasers of gas from Pan-Alberta through the Eastern Leg, an agreement was reached that provided for a substantial reduction in the minimum volumes the U.S. shippers were required to take without further liability.

In August, 1984, United again declared *force majeure* and once again a compromise agreement was reached, this one reducing its minimum take to 150 mmcf/d. In July, 1985, the U.S. shipper once more resorted to *force majeure* and for a time ceased to purchase any Canadian gas before eventually resuming purchase of its contracted volumes. In February, 1986, however, United once more pleaded market circumstances as justification for reducing its daily take to around 23 mmcf/d. During meetings with senior officials of the U.S. government in May and June of 1986, the Hon. Mitchell Sharp, Commissioner of the Northern Pipeline Agency, pointed out that the contracts for the purchase of Canadian gas provided the foundation for repayment of the funds borrowed to finance construction of the Eastern Leg of the pipeline. He emphasized that abrogation of the contract by United not only posed a threat to the financial integrity of the pre-build, but also to the future financing of the second stage of the project.

In September, 1986, following a submission by United to the U.S. Federal Energy Regulatory Commission (FERC) seeking to be relieved of its contractual obligation, Pan-Alberta launched arbitration proceedings with the International Chamber of Commerce's Court of Arbitration. Subsequently, Pan-Alberta arrived at a settlement of the dispute with United covering the period 1985, 1986 and part of 1987. In part, United agreed to accept a minimum annual take of 40 mmcf/d and to make payments to Pan-Alberta that include $50 million cash and up to $30 million over two years by way of a transportation rebate. In January, 1987, the revised agreement was submitted to the FERC for consideration; it was subsequently approved by the Commission in June, 1987.

Level of Canadian Gas Exports Through the Eastern and Western Legs

In contrast to the situation on the Eastern Leg, purchases of Canadian gas for delivery to the Southern California Gas Co. via the Western Leg of the pre-build have for some years been maintained at maximum contracted volumes of 240 mmcf/d. (In May, 1987, Pan-Alberta announced that it planned to seek regulatory approval for a new contract providing for the continued sale of such volumes over a 12-year period to 2012.) On the Eastern Leg, however, throughput has been substantially below volumes originally contracted for because of the deterioration in market conditions outlined above. During the period from November, 1985, to October, 1986, for example, throughput on the Eastern Leg amounted to only 28 per cent of the system's load factor.

(In the summer of 1987, Foothills Pipe Lines (Yukon) Ltd., principal sponsor of the project in Canada, filed an application with the National Energy Board seeking approval of a new tariff schedule that would permit it to offer interruptible gas delivery service over the Eastern and Western Legs. Pan-Alberta also indicated that it was launching a major effort to promote spot sales of gas through the Eastern Leg in an effort to provide increased utilization of its load capacity.)

Status of Stage-Two Preparations and the Continuing Role of the Canadian and U.S. Regulatory Agencies

Pending the beginning of a change in the economic circumstances that would pave the way for remounting the second stage of the Alaska Highway Gas Pipeline, the level of activity both by the sponsors of the project in the two countries and of the regulatory agencies appointed to oversee planning and construction remains at a low ebb.

A major focus of attention of the sponsors of the project is an intensive review of the anticipated costs of pipeline construction that remains to be undertaken as part of the second stage in Canada and the United States and the building of the gas conditioning plant a Prudhoe Bay. Preliminary indications are that estimated costs will be significantly reduced from earlier levels because of a sharp decline in the rate of inflation and of interest charges.

The regulatory agencies created in each country—the Northern Pipeline Agency in Canada and the Office of the Federal Inspector in the United States—essentially have been performing a stand-by role. In part this has involved maintenance of extensive files, records and plans that will be required as and when the second-stage is reactivated. In addition, both agencies have been involved in monitoring—and, where required, intervening—in current developments that have an actual or potential bearing on the pipeline project. A clear example has been provided by the case of the proposed Trans-Alaska Gas System, which is outlined in the following section.

As has been the case since its establishment in 1978 under the terms of the Northern Pipeline Act, the full expenses of the Northern Pipeline Agency are borne by the Canadian sponsor of the project, which has requested that the NPA continue to play a stand-by role during the prevailing circumstances.

The Proposed Trans-Alaska Gas System

Shortly after sponsors of the Alaska Highway Gas Pipeline Project decided in April, 1982, to suspend plans for proceeding with second-stage construction of the northern segments because of a severely adverse shift in economic, energy and financial market conditions, former Alaskan Governor Walter Hickel began to promote development of alternative means for marketing North Slope gas.

In time, he established the Yukon Pacific Corporation to promote the development of a Trans-Alaska Gas System (TAGS), which involved the establishment of a gas conditioning plant at Prudhoe Bay, and the building of an 800-mile pipeline to transport North slope reserves to Valdez on the south coast of Alaska, where the gas would be liquified and shipped by special tankers to Japan.

At the urging of Yukon Pacific and Alaska's congressional representatives, President Reagan proposed to Japanese Prime Minister Nakasone during a meeting in 1983 that they issue a statement on energy cooperation between the two nations that, in part, encouraged the private sector in both countries to join forces in studying the feasibility of the proposed project. Such a study was initiated in April, 1985, by Pacific Yukon and Arco on behalf of the United States and by the Japanese Institute of Energy Economics.

(In a report issued in June, 1987, the study concluded that the project, which would cost an estimated $11 billion in constant 1986 U.S. currency and involve the export of some 14 million tons of liquified natural gas a year, was not economically feasible at prevailing world oil prices and would be only marginally profitable at around $25 per barrel. In addition, the report concluded that a sufficient market for the proposed gas could not be anticipated to exist in Japan following the 11 years it would take to complete the project, with the result that sales would have to be sought elsewhere in the Far East.

(Despite the report's conclusion that further study of the proposed project was not warranted under existing circumstances, the sponsors of TAGS, supported by the Alaskan congressional delegation, pressed strongly for the issuance of a Presidential Finding that would in principle authorize overseas export of North Slope gas. Such a declaration is required under Section 12 of the 1976 U.S. Alaska Natural Gas Transportation Act. This legislation prohibits the export outside of Canada or Mexico of more than 1,000 mcf/d without an express declaration by the President "that such exports will not diminish the total quantity or quality nor increase the total price of energy available to the United States."

(When it became evident that growing support for this proposal could result in the adoption of a favourable recommendation to the President by the Administration's Economic Policy Council at a meeting scheduled for July, the Canadian government took steps on a number of fronts to express its concern about the potentially adverse implications of such a finding for the completion of the Alaska Highway Pipeline Project. These included both ministerial representations to the U.S. government and meetings in Washington by Mr. Sharp, the Commissioner of the Northern Pipeline Agency, with Alaskan Senators and senior Administration officials. The U.S. government responded by agreeing to undertake consultations on the issue with Canadian government representatives in late September, 1987, before reaching any final conclusion on its course of action.

(While U.S. spokesmen expressed their continuing support for the Alaska Highway Pipeline, they also took the view that the market ultimately should determine the economic feasibility of competing proposals. A Presidential Finding clearing the way for overseas export of North Slope gas would only remove an impediment to a market decision, they argued.

(The Canadian government contended that the 26 trillion cubic feet of proved gas reserves on the North Slope of Alaska provided the basic foundation for the financing and building of the Alaska Highway Pipeline as a joint U.S.–Canadian undertaking in accordance with the agreement between the governments of the two countries of September, 1977. Under that agreement, both governments undertook to "take measures necessary to facilitate the expeditious and efficient construction of the Pipeline..." Canadian representatives argued that any Presidential Finding that appeared to jeopardize the availability of the gas supply providing the conerstone of the project could undermine the undertaking and represent a serious breach of the undertakings by the U.S. government and Congress.

In issuing a Finding on January 12, 1988, that removed the impediment to overseas export of North Slope gas, President Reagan said he did "not believe this decision would hinder the completion of the Alaska Natural Gas Transportation System (ANGTS)". The President noted that his Administration had "removed all regulatory barriers to the private sector's expeditious completion of the project.")

Finance, Personnel and Official Languages

Finance and Personnel

Section 12 of the *Northern Pipeline Act* provides for an annual audit of the accounts and financial transactions of the Agency by the Auditor General of Canada and for a report thereon to be made to the Minister. Section 13 of the Act requires the Auditor General's report to be laid before Parliament together with the Minister's annual report on the operations of the Agency. To comply with these requirements, the report of the Auditor General of Canada on the accounts and financial transactions of the Northern Pipeline Agency for the year ended March 31, 1987, is reproduced as an appendix.

Estimates for 1986-87 provided $645,000 and two person-years for the operation of the Agency. Expenditure for the year totalled $441,000 of which $93,000 represents termination costs for staff previously on secondment and released because of the delay in construction of the second stage of the pipeline. At year-end only three employees were on staff, of whom two were on a part-time basis. The National Energy Board provides finance and personnel services, for which the Agency reimburses the Board.

Section 29 of the *Northern Pipeline Act* provides for recovery of the costs of the Agency from the company constructing the pipeline in accordance with regulations made under subsection 46.1(2) of the *National Energy Board Act*. During the year, Agency receipts totalled $271,000, of which $135,000 was recoveries from Foothills in keeping with the provisions of the Northern Pipeline Act. In addition, $106,000 was recovered in respect of seconded staff, and $28,000 in Yukon easement fees were collected. All amounts were credited to the Consolidated Revenue Fund.

Official Languages Plan

Although the Northern Pipeline Agency is a separate employer under Part II of the *Public Service Staff Relations Act* and is not subject to the *Public Service Employment Act*, the language policies and procedures established for other government departments and agencies have generally been applied. In addition, the Agency conforms as fully as possible with the provisions of the *Official Languages Act*.

In order to allow members of the public to comment on the linguistic aspect of services provided, enquiries may be made by telephoning (613) 993-7466 or by writing to the Head Office of the Northern Pipeline Agency, Station 210, Centennial Towers, 200 Kent Street, Ottawa, Ontario, K1A 0E6.

Appendix

AUDITOR GENERAL OF CANADA VÉRIFICATEUR GÉNÉRAL DU CANADA

AUDITOR'S REPORT

To the Minister responsible for the Northern Pipeline Agency

I have examined the statement of expenditure and receipts of the Northern Pipeline Agency for the year ended March 31, 1987. My examination was mede in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, this statement presents fairly the expenditure and receipts of the Agency for the year ended March 31, 1987 in accordance with the accounting policies set out in Note 2 to the statement applied on a basis consistent with that of the preceding year.

D.L. Meyers, F.C.A.
Deputy Auditor General
for the Auditor General of Canada

Ottawa, Canada
August 14, 1987

NORTHERN PIPELINE AGENCY

Statement of Expenditure and Receipts
for the year ended March 31, 1987

	1987	1986
Expenditure (Note 3)		
Salaries and employee benefits	$ 353,877	$ 758,717
Professional and special services	32,575	81,784
Travel and communications	12,580	69,339
Rentals	34,430	47,609
Materiel and supplies	1,806	4,679
Information	3,473	4,386
Other	1,850	53
	440,591	966,567
Receipts		
Recovery of costs from Foothills Pipe Line (Yukon) Ltd. (Note 4)	135,307	1,180,999
Secondment of Agency staff	105,849	152,068
Easement fees	27,594	27,594
Other recoveries	2,153	3,365
	270,903	1,364,026
Excess of expenditures over receipts (Excess of receipts over expenditure)	$ 169,688	$ (397,459)

Approved by:

Mitchell Sharp

Commissioner

G. F. Gilhooly

Senior Financial Officer

NORTHERN PIPELINE AGENCY

Notes to Statement of Expenditure and Receipts
March 31, 1987

1. Authority and objective

The Agency was established in 1978 by the Northern Pipeline Act (S.C. 1977-78, c. 20). The objective of the Agency is to facilitate the effecient and expeditious planning and construction of the Alaska Highway Gas Pipeline in a manner consistent with the best interests of Canada as defined in the Act.

2. Accounting policies

Expenditure

Expenditure includes the cost of work performed, goods received or services rendered prior to April 1, except for the costs of the employees' contingency and termination plans which are charged to expenditure in the year in which the employee leaves the Agency. Capital acquisitions are charged to expenditure in the year of purchase. Expenditure also includes any costs incurred on behalf of the Agency by government departments, except for contributions to employee benefit plans which are based on budgeted salary costs. All expenditures are financed by parliamentary appropriations and government departments which provided services without charge.

Receipts

Receipts are recorded on a cash basis and are credited to the Consolidated Revenue Fund. Recovery of costs from Foothills Pipe Lines (Yukon) Ltd. is based on quarterly billings.

3. Expenditure

Expenditure for the year was provided for as follows:

	1987	1986
Parliamentary appropriations		
Transport		
Vote 70 (Vote 115 in 1986)—Program expenditure	$ 600,000	$ 1,285,000
Statutory—Contributions to employee benefit plans	45,000	157,000
	645,000	1,442,000
Amount not required	204,409	475,433
	$ 440,591	$ 966,567

4. Recovery of costs from Foothills Pipe Lines (Yukon) Ltd.

	1987	1986
Costs recoverable for the year		
Expenditure for the year	$ 440,591	$ 966,567
* Adjustment in respect of employee benefits	(16,592)	(111,000)
Adjustment for nonrecoverable costs	(10,671)	—
Secondment of Agency staff	(105,849)	(152,068)
Other recoveries	(1,141)	(3,365)
	306,338	700,134
Current year's costs recovered in previous year	(18,624)	—
Excess recovery of costs in the current year	—	18,624
Prior year costs recovered in the current year	—	462,241
Prior year's adjustment recognized in current year	27,594	—
Cost to be recovered in the following year	(180,001)	—
	$ 135,307	$ 1,180,999

* The Agency's share of employee benefits paid to the government for the current year has exceeded the actual employer's share. As a result, costs recoverable for the year ended March 31, 1987 have been adjusted accordingly.

5. Employees' contingency and termination plans

Contingency plan

Senior and certain other key employees who remain with the Agency until completion of their responsibilities and whose service exceeds two years are entitled to an allowance of 13% of accumulated salary received. Based on employees on strength who may become entitled to this benefit in the future, unpaid costs as at March 31, 1987 are estimated at $21,500 (1986—$16,000).

Termination plan

On July 15, 1982, Treasury Board approved a termination plan for employees who are separated due to the reduction of activities announced on May 1, 1982. The amount of termination allowance is based on years of service and includes an amount for relocation as necessary. Based on projected terminations, unpaid costs, including relocation costs, as at March 31, 1987 are estimated at $35,000 (1986—$178,000).

6. Reduction of activities

On May 1, 1982, the United States sponsors of the Alaska Highway Gas Pipeline and Foothills Pipe Lines (Yukon) Ltd. announced that the target date for completion had been set back and all parties were to scale down their activities.

The Agency has been able to reduce staff costs through a secondment to another government department.