UNITED STATES OF AMERICA

DEPARTMENT OF ENERGY

OFFICE OF FOSSIL ENERGY

MARATHON OIL COMPANY

DOCKET NO. 88-22-LNG

ORDER DISMISSING COMPLAINT

DOE/FE OPINION AND ORDER NO. 261-E

JULY 18, 1997

I. Summary

On April 3, 1997, Union Oil Company of California (Unocal) filed a complaint with the Department of Energy's (DOE) Office of Fossil Energy regarding Marathon Oil Company's (Marathon) authorization to export liquefied natural gas (LNG) pursuant to DOE/ERA Opinion and Order No. 261 (Order 261).[(1)] The basis of the complaint is a provision, Section 7, in the May 1, 1988, natural gas exchange agreement (Exchange Agreement) between Unocal and Marathon. Section 7 provides for Marathon to reduce deliveries of natural gas to a chemical plant owned and operated by Unocal prior to reducing deliveries to Marathon's LNG facility.

Unocal claims that this provision violates the public interest doctrine of the Natural Gas Act (NGA).[(2)] Unocal asks DOE to (1) modify the Exchange Agreement by striking the offending portion of Section 7, (2) issue a show cause order to Marathon regarding its transportation of gas going to both domestic and foreign users, and (3) attach a condition to Order 261 requiring Marathon to curtail LNG exports in order to protect domestic deliveries of natural gas.

This opinion and order summarizes Unocal's complaint, as well as subsequent filings made in response thereto. As explained in the Decision section below, Unocal has not met the burden of proof necessary to demonstrate Marathon's current export authority is inconsistent with the public interest under Section 3 of the Natural Gas Act and, therefore, Unocal's complaint is dismissed.

II. Background

A. LNG Exports

Marathon, an Ohio corporation with its principal place of business in Houston, Texas, is a wholly-owned subsidiary of USX Corporation, a Delaware corporation. In conjunction with Phillips Petroleum Corporation (Phillips), Marathon built an LNG plant in Nikiski, in the Cook Inlet area of Alaska, in the late 1960's. LNG export authority was granted to Marathon and Phillips by the Federal Power Commission on April 19, 1967, for a period ending May 31, 1984.[(3)] A five-year extension was authorized by DOE in 1982,[(4)] and a 15-year extension and authorization to export additional volumes was granted in this docket in Order 261, which was issued July 28, 1988. Since that date DOE has issued several amendments to the Order 261 export authority.[(5)] The original Order and subsequent amendments will be collectively referred to herein as Order 261.

In addition, on December 31, 1996, Phillips and Marathon filed an application with DOE requesting a five-year extension, from April 1, 2004, through March 31, 2009, of their current authorization. A notice of the application was published in the Federal Register on March 4, 1997 (62 FR 9758), and several interested persons intervened in protest of the extension, including Unocal.

B. Unocal/Marathon Exchange Agreement

From 1960 until 1988, Marathon and Unocal sold and delivered gas to Alaska Pipeline Company (APL), the transportation affiliate of the principal southcentral Alaskan gas distribution company, pursuant to a gas purchase and sale contract. In 1986, APL sued Marathon and Unocal over a pricing dispute under that contract. In 1988, in settlement of the suit, Marathon and APL entered into a new long-term supply arrangement, Unocal and APL agreed to terminate Unocal's obligation to supply gas to APL, and Marathon and Unocal entered into the Exchange Agreement.

Under the Exchange Agreement, Unocal has the right, but not the obligation, to deliver natural gas to Marathon, and Marathon is then obligated to deliver an equal amount of gas to Unocal's chemical plant. The gas is used as a feedstock at the plant to produce ammonia and urea fertilizer products for both domestic and foreign markets.

Section 7 of the Exchange Agreement reads as follows:

(7) In consideration of the above, Marathon and Unocal agree that on those days when the natural gas demand for all of Marathon's commitments to supply natural gas exceeds the physical capability of Marathon's properties to deliver such gas, then the gas deliveries to Unocal's Chemical Plant at Nikiski, Alaska ("Chemical Plant") shall be reduced as follows:

(i) First, Unocal shall reduce deliveries to the Chemical Plant up to 65 MMCFD if so requested by Marathon, but not in an amount which would reduce such deliveries to less than 95 MMCFD;

(ii) Second, after the reduction contemplated by (i) above, Marathon shall be required to reduce its supply of gas to its LNG facility up to the full amount thereof to the extent necessary to meet Marathon's commitments;

(iii) Third, after the reduction contemplated by (i) and (ii) above had been completed, Marathon and Unocal further agree that in those extraordinary, rare and unusual circumstances, including but not limited to acts of God, machinery failure and pipeline failure, that Unocal shall further reduce deliveries to the Chemical Plant to the extent requested by Marathon.

Any such reductions by Unocal shall not exceed a cumulative period of thirty (30) days in any calendar year. After said thirty (30) days any natural gas deliveries by Unocal necessary to satisfy Marathon's requests shall be by contract for sale. This paragraph does not guarantee deliveries beyond Unocal's capacity to produce natural gas. Notice under this provision may be verbal followed by written confirmation within 24 hours. Marathon shall only make such requests in good faith and with as much advanced notice as possible. Unocal shall, in accordance with Marathon's notice, respond in good faith.

Thus, Section 7 provides Marathon with the ability to reduce deliveries to Unocal's chemical plant for a limited period of time prior to reducing supplies of gas to Marathon's LNG facility. This is the crux of the complaint filed in this docket.

In accordance with the record in this complaint proceeding, Marathon has only invoked Section 7 of the Exchange Agreement on one occasion to reduce deliveries to the Chemical Plant. That was during the first week of January 1997 and was occasioned by a failure of a gas compressor which resulted in a deliverability loss to the Cook Inlet region of roughly 120 MMCFD. As a matter of note, although Marathon owns the majority of the gas that was shutin as a result of the compressor failure, the compressor which failed is operated by Unocal.

In a related matter pertaining to the Exchange Agreement, on January 8, 1997, Marathon filed a complaint against Unocal in the Superior Court for the State of Alaska regarding the parties rights and obligations under Section 7. At issue in the complaint is whether Marathon can invoke Section 7 and reduce deliveries to the Chemical Plant in order to meet sales commitments made after the Exchange Agreement was entered into. Marathon argues that it can and Unocal claims that it cannot.

C. Filings

In its complaint, Unocal asserts, under Section 3 of the NGA[(6)] and under the applicable DOE Delegation Orders[(7)], DOE's primary consideration when assessing an export arrangement is the extent of the domestic need for the natural gas. Unocal states further that DOE has authority under Section 3 of the NGA to modify existing export authorizations and in this case DOE should exercise that authority.[(8)] The bases for Unocal's assertion that DOE should modify Marathon's existing export authorization are as follows. First, the Exchange Agreement, which provided for the curtailment of domestic deliveries to Unocal prior to the curtailment of deliveries to the LNG facilities, was relevant to Marathon's export arrangement. Therefore, Marathon should have filed the Exchange Agreement with DOE when it applied for the export authorization granted in Order 261, or when it subsequently applied to amend Order 261. Unocal maintains that had DOE been aware of the Exchange Agreement's curtailment provision its consideration of Marathon's export arrangement would have been different.

Second, Unocal claims the Exchange Agreement violates the NGA's public interest standard because it expressly provides for reductions in domestic deliveries during a period of gas shortfall prior to reducing deliveries of gas slated to be exported as LNG. In addition, Unocal states the Exchange Agreement is inconsistent with curtailment priorities as set forth in Title IV of the Natural Gas Policy Act (NGPA).[(9)] Unocal claims under the NGPA "natural gas used for fertilizer feedstock commands a priority in times of curtailment that is second only to residential and commercial utility needs."[(10)]

Based on its claims that the Exchange Agreement violates both U.S. law and DOE policy, Unocal requests the following relief. First, DOE should modify the Exchange Agreement by striking subsection (i) of Section 7. Second, DOE should issue a show cause order requiring Marathon to show why its transportation operations connected with both domestic and export uses of gas do not put domestic use at risk. Third, Order 261 should be conditioned to require curtailment of exports to the extent necessary to protect domestic deliveries.

On May 9, 1997, Marathon filed an answer and motion to dismiss Unocal's complaint. Marathon asserts Unocal's complaint was filed not to protect the public interest standard of the NGA, but to escape its contractual obligations under the Exchange Agreement. In addition, Marathon states the Exchange Agreement is not inconsistent with the public interest standards of the NGA because "the parties willingly agreed to the interruptibility provisions of the Exchange Arrangement" as part of the 1988 settlement of the APL suit.[(11)] Also, Marathons asserts it was under no obligation to file the Exchange Agreement with DOE in connection with its export arrangement, stating that contracts required to be filed are those "contracts which set forth the terms and conditions of the export itself."[(12)] Further, while Marathon acknowledges DOE authority under Section 3 of the NGA to modify existing export authorizations, it contends under the Trunkline LNG Company decision that there must be "compelling and extraordinary" circumstances to warrant modifying an existing authorization, and parties seeking such modification "bear a heavy burden of proof."[(13)] Marathon claims Unocal has not met that burden. Marathon asserts Unocal has not demonstrated there was an actual shortage of gas supplies to meet the regional needs of the Cook Inlet area, but only a deliverability limitation which Unocal could remedy by adding additional production or storage facilities.

In addition, Marathon takes exception to Unocal's assertion the Exchange Agreement is sufficient reason for DOE to issue a show cause order to investigate Marathon's transportation arrangements. Marathon also questions the jurisdiction of DOE to order a modification of Section 7 of the Exchange Agreement since the agreement does not set forth the terms and conditions of an import or export of natural gas. Finally, Marathon asserts DOE consideration of the complaint would compromise the reliability of the United States and Marathon as trading partners by calling into question whether long-term, firm export commitments can be diverted to domestic use whenever a domestic user claims a need and regardless of contractual rights and obligations.

On May 27, 1997, Unocal filed an answer to Marathon's May 9, 1997, answer and motion to dismiss. In it Unocal reiterates its contention that Marathon should have filed the Exchange Agreement with DOE and complains that Marathon's expanded supply commitments and the position it has taken in the Alaskan State court case regarding the interpretation of Section 7 could lead to more frequent curtailments of gas to Unocal. In addition, Unocal disputes that the distinction Marathon made in its filing between a shortfall of deliverability and a shortfall of supply is relevant to DOE's analysis in applying a domestic need test under Section 3 of the NGA. Further, Unocal states DOE has authority to modify the Exchange Agreement in order to protect the public interest, and that the relief sought by Unocal poses no threat to U.S. trade relations.

On June 11, 1997, Marathon replied to Unocal's May 27 filing, repeating its assertion that Unocal is attempting to use DOE's complaint procedures as a means of avoiding its contractual obligations under the Exchange Agreement. Marathon also claims the complaint is merely a defensive tactic in the Alaska State court proceeding and therefore an abuse of DOE procedures. In addition, Marathon reiterates its position that DOE properly should focus on reserves, not on deliverability, in assessing domestic needs when considering an export proposal. Finally, Marathon reasserts its contentions it was not obligated to file the Exchange Agreement with DOE and DOE has no authority to modify the Exchange Agreement.

In other filings, on May 29, 1997, Enstar Natural Gas Company (Enstar) filed a motion to intervene in this proceeding without substantive comments. On June 13, 1997, Marathon filed an answer opposing Enstar's motion to intervene.

III. Decision

Unocal filed its complaint in this docket under Sections 3 and 16 of the NGA [(14)] and Sections 317, 401 and 407 of DOE Administrative Procedures.[(15)] Section 3 of the NGA provides the Secretary of Energy "may from time to time, after opportunity for hearing, and for good cause shown, make such supplemental order in the premises as it may find necessary or appropriate" in an import or export authorization. Therefore, as asserted by Unocal and acknowledged by Marathon, DOE does have authority to review and modify existing import and export authorizations.[(16)] However, as noted in Trunkline, DOE will only "exercise this authority on the basis of a fundamental change in circumstance since the granting of the original authorization or if there is a violation of the terms and conditions of the authorization".[(17)] DOE went on in Trunkline to state The Government considers "it essential to uphold the integrity of an import authorization and will consider revoking, suspending or rescinding an authorization only on the basis of compelling and extraordinary circumstances."[(18)] Further, DOE determined "in asking the agency to take such action... complainants bear a heavy burden of proof to demonstrate that the ... existing authorization [is] now inconsistent with the public interest."[(19)]

That burden has not been met. Unocal raises a number of issues, but none of them rise to a level which would justify DOE revisiting the decision it made in Order 261, and upon which the parties to the export arrangement relied.

To begin with, Marathon was not required under DOE Administrative Procedures to submit the Exchange Agreement in connection with its Order 261 export arrangement, so it is not in violation of its authorization for failing to have done so. As noted by Marathon, the contracts DOE requires are those that set forth the terms and conditions of the import or export arrangement. Unocal maintains the Exchange Agreement was relevant to DOE's decision because of the provision which allows reductions in deliveries to the chemical plant prior to reductions in deliveries to the LNG facility. DOE does not agree. All of a supplier's purchase and sale, and in this instance exchange, agreements are part of an integrated gas supply portfolio, and in this sense are connected relevant to the whole portfolio. However, this does not mean that every contract in the portfolio must be submitted to DOE for consideration in an import or export proceeding.

Moreover, we do not believe it would have made a difference in the authorization decision if the Exchange Agreement had been submitted in connection with the Order 261 application. Without more, DOE would have accepted the Exchange Agreement for what it is, part of a contractually agreed to settlement by the parties to the APL suit.

In addition, Unocal claims the curtailment provision of Section 7 violates the natural gas curtailment policies of Title IV of the NGPA, but that title applies to regulatorily approved allocation plans of interstate pipelines to be implemented during a supply shortage.[(20)] It does not preclude contractual parties from agreeing to an interruption provision such as the one in the Exchange Agreement.

Having determined Marathon is not in violation of its authorization for not submitting the Exchange Agreement, we will examine whether there has been a fundamental change in circumstances since the original authorization to justify DOE exercising its NGA Section 3 authority. We conclude the answer is no.

First, there is no change to the underlying export arrangement between Marathon and its export customers nor does Unocal allege any. As stated above, the crux of Unocal's complaint is Section 7 of the Exchange Agreement, which it claims is in violation of the public interest standard of the NGA. Unocal could certainly have asserted at the time of Marathon's application in this docket that Section 7 of the Exchange Agreement was not in the public interest. Although, how it could have credibly done so as a party to the agreement is unclear. But not having done so, it must now meet the "compelling and extraordinary circumstances" test delineated in Trunkline before DOE will consider revoking or modifying Marathon's existing authorization.

The only circumstances cited by Unocal are (1) the single, one-week long, instance when Marathon actually interrupted deliveries to Unocal under Section 7 of the Exchange Agreement in the nine years it has been in effect, and (2) the possibility a favorable ruling by the Superior Court for the State of Alaska to Marathon's petition for clarification of the parties rights and obligations under Section 7 may result in more interruptions in the future. Unocal has not demonstrated there has been any fundamental change in the supply of natural gas available to meet domestic and export demands since Order 261 was issued; it has merely shown that a deliverability problem occurred and Marathon exercised its rights under Section 7 of the Exchange Agreement. Clearly, Marathon and Unocal anticipated precisely this type of occurrence when they entered into the Exchange Agreement or Section 7 would not have been necessary. Therefore, it does not constitute a "fundamental change in circumstance since the grant of the original authorization" under Trunkline but, rather, an occurrence of a circumstance foreseen and provided for by the parties to the Exchange Agreement.

As noted above, Unocal implies that Marathon will invoke Section 7 of the Exchange Agreement more frequently in the future because it has expanded its domestic and export commitments. However, the question of the extent of the applicability of Section 7 in light of those expanded commitments is being considered by the Alaskan court and Unocal and Marathon can pursue the merits of their arguments under applicable contract law. If the ruling is favorable to Unocal its fears will be allayed. If it is in Marathon's favor there would be no change in the circumstances existing at the time of the authorization since it would merely be a ruling on how the Exchange Agreement, which existed at the time of the authorization, is properly interpreted.

Finally, although we find that Unocal does not meet the Trunkline burden of proof regarding modifying or revoking an existing authorization, insofar as Unocal's complaint raises relevant underlying issues, such as tighter regional gas supplies in the Cook Inlet area, or the consideration of deliverability versus supply in the domestic need analysis, they can be considered in Phillips's and Marathon's application to amend their joint export authorization in Docket No. 96-99-LNG.

The complaint filed by Unocal in this docket is dismissed.[(21)]

Issued in Washington, D.C., July 18, 1997.

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1/ 1 ERA ¶70,130, July 28, 1988.

2/ 15 U.S.C. §§717-717w.

3/ FPC Order No. 1227 (37 FPC 777).

4/ DOE/ERA Opinion and Order No. 49 (1 ERA ¶70,116, December 14, 1982).

5/ See, DOE/FE Opinion and Order No. 261-A(1 FE ¶70,454, June 18, 1991); DOE/FE Opinion and Order No. 261-B (1 FE ¶70,506, December 19, 1991);DOE/FE Opinion and Order No. 261-C (1 FE ¶70,607, July 15, 1992);and DOE/FE Opinion and Order No. 261-D (1 FE ¶71,087, March 2, 1995).

6/ 15 U.S.C. §717b.

7/ Delegation Order Nos. 0204-211 (49 FR 6690, February 22, 1984), and 0204-127 (54 FR 11436, March 20, 1989).

8/ Citing Trunkline LNG Company, 1 ERA ¶70,117 (February 25, 1983).

9/ 15 U.S.C. §§3391-3394.

10/ Unocal Complaint at 21.

11/ Marathon Answer at 11.

12/ Id. at 12.

13/ Marathon Answer at 14. Trunkline LNG Company, 1 ERA ¶70,117 at 70,722-3.

14/ 15 U.S.C. §§717b and 717o.

15/ 10 CFR §§ 590.317,590.401 and 590.407.

16/ See Trunkline LNG Company, 1 ERA ¶70,117 (February 25, 1983).

17/ Id. at 70,722.

18/ Id. at 70,723.

19/ Id. at 70,722

20/ See, e.g., Process Gas Consumers Group v. U.S. Dept. Of Agriculture, 65 F. 2d 459 (1981)

21/ Since DOE has dismissed the complaint, Enstar's motion to intervene and Marathon's answer in opposition to Enstar's motion are moot and need not be considered.