

Report of The Committee On Natural Gas Curtailments

During 1981, major developments in the curtailment area occurred in the D.C. Circuit Court, which issued two decisions regarding the rules promulgated by the Federal Energy Regulatory Commission ("FERC") and other agencies to implement the agricultural curtailment priority under the Natural Gas Policy Act ("NGPA"). In addition, several major pipeline curtailment cases pending at the FERC were resolved.

I. RULEMAKING DEVELOPMENTS UNDER TITLE IV OF THE NGPA

A. The Agricultural Priority for Process Steam Uses

On June 30, 1981, the United States Court of Appeals for the District of Columbia issued an opinion in *Process Gas Consumers Group, et al. v. United States Department of Agriculture*, Nos. 80-1558, *et al.*, involving appeals from the U.S. Department of Agriculture's ("USDA") curtailment rule defining the term "process fuel" under Section 401(f)(1)(B) of the NGPA. Section 401(f)(1)(B) limits the agricultural curtailment priority, in the case of fertilizer, agricultural chemicals, animal feed, or food, to their "process fuel or feedstock" uses of natural gas. In an April 1980 rule, the USDA defined "process fuel" to include certain boiler fuel uses of gas which produce "process steam." The definition included "natural gas used to produce steam which in turn is directly applied in processing of products and for compression of products so that processing may take place, in addition to direct flame and precise heating applications of natural gas"

The parties challenging the USDA's definition made two principal arguments: (1) the term "process fuel or feedstock" in Section 401 of the NGPA excludes boiler fuel; and (2) the FERC, not the USDA, has primary authority to define the technical terms of the NGPA.

Addressing the allocation of authority first, the Court agreed that, as expressed in Section 501(b) of the NGPA, "Congress intended the FERC — not The Secretary of Agriculture — to have primary responsibility for defining the many technical terms in the Act." However, since the FERC had not defined process fuel under the NGPA, "the Secretary of Agriculture is left to construe statutory directives on his own." Still, because the Secretary of Agriculture lacks primary responsibility for defining terms and for balancing all of the public interest factors, his rule "is not entitled to the same deference as would be a definition issuing from the FERC under the authority of Section 501(b)."

The Court then turned to the issue, "Can 'boiler fuel' ever be 'process fuel'?" The Court stated:

"While we do not decide the larger question of what 'process fuel' means under the Act, we do conclude that Congress believed that 'process fuel' does not include boiler fuel."

Citing the definitions of "process gas" and "boiler fuel" which were in use at the time the NGPA was enacted by Congress and the NGPA's clear division of agricultural products into two groups, with Section 401(f)(1)(B) products

limited to their "process fuel and feedstock uses", the Court reasoned that it would be difficult to read Section 401(f)(1)(B) "as not being intended to exclude . . . boiler fuel." As to the USDA's argument that any limitation on the agricultural priority would be inconsistent with "Congress' overall purpose" of assuring "full food and fiber production," the Court held that "while Congress was solicitous of 'essential agricultural users', it also gave consideration to the needs of natural gas users in lower priority categories."

On August 27, 1981, the FERC issued an order implementing the decision by the Court of Appeals. (Docket No. RM79-15). Interstate pipelines were required by the Commission to remove from the essential agricultural use category in their updated index of entitlements for 1981 the boiler fuel used by manufacturers of fertilizer, agricultural chemicals, animal feed, or food.

B. Court Decision on High-Priority and Agricultural Curtailment Priority Rules

On July 29, 1981 the D.C. Circuit Court issued its decision in *Process Gas Consumers Group, et al. v. U.S. Department of Agriculture, et al.*, Nos. 79-1336 *et al.*, reviewing the agricultural and high-priority curtailment rules issued by three federal agencies under Section 401 of the NGPA. These included permanent and interim curtailment rules issued by FERC and the USDA in 1979 and the final rule issued by the Economic Regulatory Administration ("ERA").

The Court's decision resolved challenges to both the "high-priority" and "essential agricultural use" curtailment priorities as those have been implemented by the three agencies. In general, the Court's decision upholds the three agencies' curtailment regulations against challenges by all sides in the proceedings. The Court reversed and remanded agency curtailment rules in only two respects. *First*, accepting the argument that "plant protection" gas may be needed in some instances in which a plant is continuing to operate, the Court rejected the ERA's rule that defines plant protection as limited to periods when an industrial facility is shut down. *Second*, the Court rejected the FERC's decision to apply fixed base periods to the high-priority user category, and it remanded the issue to the Commission for further consideration. The Court ruled that high-priority growth should be recognized by the elimination of fixed base periods, potentially requiring reopening of most interstate pipelines' curtailment plans. This portion of the Court's decision prompted a dissent by Judge Wald.

A brief summary of the Court's major substantive holdings follows.

With respect to the ERA's proposed rule concerning high-priority uses:

- The Court of Appeals reversed the ERA's determination that requirements for plant protection may be treated as Priority I only when operations are shut down. The Court recognized that there may be circumstances in which gas may be used to protect life, health or physical property even while an industrial facility continues to operate. It remanded the matter for further consideration and for a more thorough explanation for the agency's rationale.

Prior to the Court's ruling, ERA had proposed to revise its definition of plant protection to adopt the Court's view.¹

- The Court upheld ERA's finding that an alternate fuel test need not be imposed upon large commercial users in the high-priority category. According to the Court, if Congress had intended an alternate fuel test for the high-priority category, it would have said so explicitly.

- The Court rejected a pharmaceutical manufacturer's claim that it is legally entitled to "high-priority" classification because of the social importance of pharmaceutical and medical products.

With respect to the FERC rule, the Court unanimously rejected challenges to it by agricultural users. The Court:

- Rejected contentions that the NGPA's agricultural curtailment priority must be "flowed through" to the burner tip, thereby overriding state curtailment authority. The court ruled that Title IV of the NGPA applies only to interstate pipeline curtailment plans, not state plans.

- Rejected challenges to the FERC's decision to restrict agricultural requirements to volumetric limitations contained in contracts and certificates of service. The Court noted that acceptance of the agricultural users' arguments would enable them to receive more gas during a shortage than during ordinary periods of operation, a "paradoxical result" which the Court found to be unsupported.

- Rejected claims that the NGPA's curtailment priorities must be applied to "capacity curtailments" as well as to supply curtailments. The Court accepted the FERC's argument that capacity curtailments are infrequent, pose more complex issues, and, therefore, should be left for case-by-case consideration.

- Overrode challenges by agricultural users and the State of Louisiana to FERC's partial requirements formula for allocating end users' requirements among multiple pipeline suppliers. As noted below, this portion of the opinion was subsequently vacated by the full court after granting suggestions for rehearing *en banc* filed by the State of Louisiana and United Gas Pipeline Co.

- Rejected arguments by certain distributors that the NGPA requires FERC or DOE to require all pipelines to classify storage injections in any particular curtailment priorities. The Court agreed with FERC that a complete reexamination of the storage gas issue is not required by the NGPA.

- With respect to the FERC's self-help program for agricultural users, Order No. 27, the Court rejected one agricultural petitioner's argument that the Commission should have allowed agricultural users access to off-shore gas. The Court also upheld the FERC's decision to limit self-help transactions to five-year terms in most cases.

The Court was divided in resolving challenges by various parties to USDA's and FERC's proposals to abolish fixed base periods for agricultural users. The Court rejected challenges to USDA's decision to certify agricultural gas requirements based on 100 percent of current requirements. The Court found that USDA had ample statutory authority to certify gas requirements to

¹ERA Docket No. ERA-R-79-10-A, *Proposed Rulemaking Concerning Review and Establishment of Natural Gas Curtailment Priorities for Interstate Pipelines*. Letter of Hazel R. Rollins, Administrator ERA to FERC, setting forth proposed rule, 10 C.F.R. §580.02(b)(11)(iv) (Dec. 19, 1980).

FERC on this basis. However, Judges MacKinnon and Robb split with Judge Wald as to whether FERC had authority to deviate from the USDA certification in implementing curtailments. The majority ruled that FERC had no such discretion and that "FERC reasonably concluded that its function was simply to implement the USDA certification" without giving it a substantive review. Judge Wald disagreed noting that USDA had no authority to dictate curtailment methods to FERC.

In an equally important ruling, all three judges accepted arguments by two distributors that if fixed based periods were to be abolished for the agricultural priority, it would be discriminatory to impose fixed base periods on the "high priority" categories. "It would turn the statutory scheme of priorities upside down to allow growth in a lower priority while discouraging it in the primary (high-priority) sector of the economy." To remedy this defect, the majority ruled that because the USDA certification required FERC to abolish fixed base periods for agricultural uses, FERC must abolish base periods for high-priority users as well.

In her dissent, Judge Wald agreed that different treatment of the two priorities should be avoided. However, she criticized the majority for resolving this problem by requiring FERC to adopt an inflexible rule abolishing fixed base periods. She argued that USDA could not dictate the method of curtailment for both agricultural and high-priority users, but that FERC had full "authority and responsibility" to select the allocation method for both priorities.

Several parties sought rehearing of the D.C. Circuit Court's decision, with respect to the base period issue and the partial requirements issue. By order dated November 13, 1981, the full D.C. Circuit, with Judges MacKinnon and Robb dissenting, granted a rehearing *en banc* with respect to both issues. The court vacated the portions of the July decision dealing with all aspects of the fixed base period issue, including the portions of the decision upholding USDA's certification and FERC's imposition of a contract and certificate cap on agricultural use volumes. The court also vacated the prior decision's treatment of the FERC rule governing partial requirements formulas. Rehearing briefs will be submitted in early 1982 and oral arguments are currently scheduled for April.

C. Section 401(b) Alternative Fuel Test

Section 401(b) of the Natural Gas Policy Act of 1978 provides that if the Commission, in consultation with the Secretary of Agriculture, determines that use of a fuel (other than natural gas) is economically practicable and that the fuel is reasonably available as an alternative for any agricultural use of natural gas, then the provisions of NGPA Section 401(a), relating to curtailment priority for essential agricultural uses, do not apply with respect to curtailment of deliveries for such use. The Commission issued final rules to address the alternative fuel test issue on August 11, 1980 (Order No. 55-B). Ten applications for rehearing were filed, and on October 8, 1980, the Commission granted rehearing solely for purposes of further consideration. No additional action has been taken by the Commission.

An appeal to the D.C. Circuit Court of the interim rule (Order No. 55) issued October 26, 1979 is in abeyance pending FERC rehearing of Order No. 55-B. Order No. 55-B was also appealed to the D.C. Circuit in December of 1980.

D. Definition of "Essential" Industrial Process and Feedstock Uses

Section 402 of the NGPA requires the Secretary of Energy: (a) to determine which industrial process and feedstock uses of natural gas are "essential," and (b) to determine and certify to the Commission the natural gas requirements for such essential industrial process and feedstock uses. On December 19, 1980, DOE transmitted to the Commission a copy of its proposed final rule concerning review and establishment of curtailment priorities, as required by the DOE Organization Act.² This proposed final rule included the Secretary's proposed action under NGPA Section 402. The rule cannot become effective until approved by the Commission (FERC Docket No. RM80-67). No public action has been taken in this matter to date.

II. CURTAILMENT COMPENSATION

Compensation persisted in 1981 as an issue in natural gas curtailment cases before FERC and the courts. Compensation is a device whereby natural gas pipeline customers experiencing less than average curtailment make payments to other customers experiencing higher than average curtailment to compensate them for absorbing the disproportionate burden of curtailment.

A. Appeal of Order No. 92

In January 1981, Consolidated Edison Co. appealed FERC Opinion No. 92 to the Court of Appeals for the District of Columbia. *Consolidated Edison Company of New York, Inc. v. FERC*, Docket No. 81-1082. Opinion No. 92, issued on August 4, 1980, ruled that compensation is incompatible with end-use curtailment. Opinion 92 stated that end-use curtailment was designed to minimize the total cost to society of conversion to alternative fuels by curtailing first those users who could most readily utilize an alternate fuel. It stated that compensation provisions would frustrate the very goals of end-use allocation by attempting to shift the costs of curtailment away from low priority users and to impose them on high priority users. The enactment of end-use curtailment priorities in Title IV of the NGPA was cited as a legislative endorsement of end-use curtailment. Opinion No. 92 cites other Commission certificate, rate, and curtailment policies as reasons for rejecting compensation proposals. FERC denied all applications for rehearing of this order on December 8, 1980.

²See note 1, *supra*.

The appeal by Consolidated Edison Co. objected to the Commission's ruling that compensation is incompatible with end use curtailment and that end use curtailment plans are not discriminatory in the absence of compensation. Oral argument took place in December, 1981. No decision has yet been issued.

B. FERC Compensation Developments

Order No. 92 did not put an end to all FERC proceedings concerning compensation. FERC stated in the order that it would "rarely be in the public interest to approve a compensation arrangement" but did not rule out approval of some compensation arrangements in "unique" circumstances. For example, hearings on the compensation proposals for the Transcontinental Gas Pipe Line Corporation continued in 1981. The Commission had previously issued orders considering whether compensation was required on the Transco system. In an order issued August 4, 1980, the Commission provided for disbursement of currently escrowed compensation funds collected for 1974-1975 but denied compensation for later time periods. In the face of a number of protests, in an order on rehearing, issued December 8, 1980, the Commission withdrew the August 4, 1980 order and set for hearing the question whether compensation should be permitted for any period.

A new compensation settlement proposal, virtually identical to the resolution offered by the Commission on August 4, 1980, was filed with the Presiding Administrative Law Judge on March 18, 1981. The Judge concluded that the settlement could not be approved because, if the decision in *State of North Carolina v. FERC (North Carolina)*, 584 F.2d 1003 (D.C. Cir. 1978) is applicable, it would require development of current data precisely quantifying the financial consequences of Transco's curtailments to avoid any discriminatory impacts. By order issued December 30, 1981, the Commission approved the settlement proposal and stated:

"We have concluded that *North Carolina* is inapplicable to any portion of this settlement which will comprehensively and equitably resolve the compensation question for all Transco periods and thereby terminate ten years of litigation over Transco's curtailments. Accordingly, we approve the comprehensive settlement."

Regarding the period from 1976-1978, the Commission found *North Carolina* inapplicable to this *interim* plan and reaffirmed the Commission position stated in Opinion No. 92 that compensation is generally inappropriate. The Commission found that permitting compensation for the period after 1978 would frustrate the curtailment hierarchy set up by the NGPA.

III. PIPELINE CURTAILMENT DEVELOPMENTS

A. El Paso Natural Gas Company

A settlement of El Paso Natural Gas Company's curtailment case was approved by the Commission on March 26, 1981, Docket No. RP72-6 *et al.*, and resolved over nine years of litigation affecting more than 20 pending

FERC dockets and about a dozen pending court appeals. Terms of the settlement will control virtually all aspects of El Paso's gas curtailment policies for the next 10 years as well as service to new customer requirements, storage services, and refunds of gas volumes that were improperly allocated in the past.

El Paso will continue to allocate gas according to the five end-use priorities historically contained in its curtailment plan, except that the second highest priority will be subdivided to incorporate Title IV of the NGPA. The three subpriorities will be Priority 2A — essential agricultural uses under NGPA §401, Priority 2B — essential industrial process and feedstock requirements under NGPA §402, and Priority 2C — large commercial and other process and feedstock uses. The issue of whether ignition fuel and flame stabilization (IF&FS) facilities constitute "process" gas uses was compromised by placing all IF & FS requirements in Priority 2C, with none permitted in the preferred Priority 2B.

After assigning end-use requirements to priorities, El Paso will allocate gas to its customers in a two-step process that recognizes the different operating characteristics of its California and East of California customers.

B. Texas Gas Transmission Corporation

By Order issued March 31, 1981, the FERC authorized implementation of a settlement agreement in Texas Gas Transmission Corporation, Docket No. TC81-9-000, on an interim basis. No final approval of the settlement has yet been granted.

The settlement will govern curtailments by Texas Gas for the next five years. As in the El Paso settlement, the parties in the Texas Gas case agreed to allow the continued use of Texas Gas' historic curtailment priorities, except that a special relief mechanism was established to protect industrial process and feedstock uses and agricultural uses, which are protected under Title IV of the NGPA. In addition, if in any year Texas Gas projects a specified level of curtailments in the upcoming winter, then a conference will be convened to determine whether further measures are needed to protect process, feedstock and agricultural requirements. If an agreement is not reached, Texas Gas is required to prove either that full implementation of then existing regulations or continued implementation of the settlement plan is in the public interest.

The settlement would also extend a provision in Texas Gas' current plan that authorizes distributors to sell entitlements during periods of curtailments, although the FERC Staff has voiced a technical objection on jurisdictional grounds.

C. Southern Natural Gas Company

There has been continuing litigation in 1981 on the Southern Natural Gas Company system over the manner in which the agricultural priority should be implemented. A "Proposed Order of Presiding Officer Determining Compliance with Order No. 29" was issued on September 23, 1981. (Docket No. SA80-59). In that order, the Presiding Officer determined that Southern

Natural's attempt to implement the agricultural priority complied with both the final rule and the requirements of the NGPA. Action by the Commission on the Presiding Officer's Proposed Order is expected soon.

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