

Report of the Committee on Judicial Review

I. JURISDICTION AND PROCEDURE

In 1992, the federal circuit courts issued several opinions involving the scope of the Federal Energy Regulatory Commission's (FERC or Commission) jurisdiction and procedure under the Natural Gas Act (NGA), the Natural Gas Policy Act (NGPA), the Outer Continental Shelf Lands Act (OSCLA), and the Federal Power Act (FPA).

A. *The Natural Gas Act (NGA)*

1. *Tenngasco Exchange Corp. v. FERC*¹

The court dismissed for lack of standing an appeal by an interstate pipeline's marketing affiliate, Tenngasco Exchange Corporation, of two orders in which the FERC asserted jurisdiction under section 7(c) of the NGA over sales for resale in interstate commerce of imported Canadian gas. Salmon Resources, Ltd., an independent gas marketer, sought FERC authority to sell Canadian gas for resale in the United States. Tenngasco, a gas marketing affiliate of Tennessee Gas Pipeline Co., intervened. Tenngasco asserted that section 601 of the NGPA, which generally eliminated the certificate requirement for sales of gas defined as "first sales," deprived the FERC of NGA jurisdiction over all sales of imported gas. The FERC disagreed. Salmon Resources did not appeal, but Tenngasco did. The D.C. Circuit found that whatever the result is for independent marketers like Salmon Resources, the result would not affect Tenngasco because, under section 2(21) of the NGPA, the "first sales" exception for an interstate pipeline's marketing affiliate does not apply to the affiliate's sale of imported gas not produced by either the marketer or its pipeline affiliate. Accordingly, because Tenngasco could not show that any injury it suffered was likely to be redressed by a favorable decision as to Salmon, its appeal was dismissed.

2. *Cascade Natural Gas Corp. v. FERC*²

The court upheld the FERC's authority under the NGA to permit an interstate pipeline to construct a tap and meter facility that would allow it to deliver gas directly to two industrial customers, and thereby bypass a local distribution company's (LDC) distribution system. The court held that such gas deliveries would constitute "the transportation of natural gas in interstate commerce" and not "the local distribution of natural gas" under section 1(b) of the NGA. The court found that "local distribution" requires "the retail sale of natural gas and its local delivery,"³ which did not occur here, where the pipeline was functioning solely as a third-party transporter. The court also found that the state commission did not have concurrent jurisdiction, the

1. 952 F.2d 535 (D.C. Cir. 1992).

2. 955 F.2d 1412 (10th Cir. 1992).

3. *Id.* at 1420-21.

FERC's decision had a rational basis, and no evidentiary hearing was required.

3. *Mississippi River Transportation Corp. v. FERC*⁴

The court upheld a FERC order that issued a certificate of public convenience and necessity under section 7(c) of the NGA for an interstate pipeline's firm direct sales, subject to, among other conditions, the requirement that the transportation component of the pipeline's bundled rate be no less than the applicable maximum rate for firm transportation under the pipeline's open-access tariff. The court held that the NGA did not prevent the FERC from regulating the transportation component of direct sales, and that such rate setting authority did not interfere with the state's ability to regulate the direct sale of gas.

4. *Altamont Gas Transmission Co. v. FERC*⁵

The court upheld the Commission's dismissal of Altamont's section 7(c) application for "authority to build a pipeline to carry gas from the Canadian border to Wyoming, to be transported from there to the south-central Californian market by Kern River Transmission Company."⁶ Altamont had argued that the Commission's decision foreclosed the possibility of a comparative hearing between Altamont's application and that of its rival, Pacific Gas Transmission Company (PGT), as required by the "*Ashbacker*" doctrine.⁷ In May, 1990, the Commission had ruled that PGT's and Altamont's applications were incomplete. Part of the deficiency for Altamont included the absence of an application by Kern River Gas Transmission Company for expansion of its facilities which were necessary to handle the additional load from Altamont. Even though Altamont filed an amended certificate application as ordered, the Kern River application did not appear. As a result, the Commission dismissed Altamont's application.

The court rejected Altamont's argument that the Commission should have been satisfied with Altamont's assurances that Kern River would file its certificate application, as well as Altamont's argument that the Commission improperly dismissed its application. Finally, Altamont argued that the Commission's conduct "was inconsistent with its treatment of applications in later cases,"⁸ pointing to the Commission's action in approving applications filed by El Paso Natural Gas Company and by Northwest based on assurances that essential upstream or downstream facilities were in existence. The court emphasized the differences between the El Paso and Northwest applications and the Altamont application. The court distinguished the El Paso application because the Commission "shoved El Paso into a position where evidence as to related facilities was needed"⁹ when it converted El Paso's application *on*

4. 969 F.2d 1215 (D.C. Cir. 1992).

5. 965 F.2d 1098 (D.C. Cir. 1992).

6. *Id.* at 1099.

7. See *Ashbacker Radio Corp. v. FCC*, 326 U.S. 327 (1945).

8. 965 F.2d at 1101.

9. *Id.* at 1102.

its own from an optional expedited certificate to a section 7(c) application, and then asked for the additional information. In addition, for both El Paso and Northwest, the needed facilities were in existence, whereas for Altamont the essential facilities required new construction. In this regard, the court pointed out that when assessing the cumulative environmental impact of a certificate application, pre-existing facilities need not be assessed for environmental impact. In contrast, for the Altamont application, necessary construction would be considered as part of the environmental assessment on the Altamont project.

5. *Tenneco Gas v. FERC*¹⁰

The court approved, in most respects, the Commission's marketing affiliate rule in Orders 497 and 497-A. Specifically, the court upheld the requirement that pipelines must contemporaneously disclose to affiliates and non-affiliates information on gas transportation. Additionally, it set aside and remanded to the Commission the requirement of contemporaneous disclosure of sales and marketing information. The court also affirmed the standard that operating personnel of a pipeline and its marketing affiliate must function independently to the maximum extent possible, and affirmed the Commission's one-year "sunset" limitation for Order No. 497 reporting requirements. Further, the court found that allegations challenging the Commission's authority to assess civil penalties for violations of Order No. 497 related to transportation under the NGA was not ripe because the Commission had not yet assessed any penalties for NGA transportation. The court noted, however, that the reach of the Commission's civil penalty authority was "a potentially knotty problem . . ."¹¹

Finally, the court considered the issue of whether the Commission properly held that the operations of two joint venture pipelines, Northern Border Pipeline Company and Ozark Gas Transmission System, should be subject to Order No. 497 because they had not rebutted the presumption that they were affiliated with a natural gas marketing entity. The court affirmed the Commission's decision as to Northern Border. As to Ozark, however, the court held that the Commission had not considered evidence that Ozark's management may only act upon a unanimous vote of its partners. Such evidence did rebut the presence of sufficient control and therefore the court ruled that Ozark should not be subject to Order No. 497.

6. *Freeport-McMoRan Oil & Gas Co. v. FERC*¹²

The court focused primarily on the obligation of government attorneys to prevent needless litigation. Three rate orders were under review. After the petitioners filed their brief with the court, but before the FERC's answering brief was due, the Commission issued an order in a different docket that superseded and rendered moot the orders under review. The FERC's brief in *Free-*

10. 969 F.2d 1187 (D.C. Cir. 1992).

11. *Id.* at 1210.

12. 962 F.2d 45 (D.C. Cir. 1992).

port was subsequently filed, and several months later counsel for both parties appeared for oral argument. During oral argument, counsel for the FERC stated that the Commission had no objection to the petitioners' request that the challenged orders be vacated. When a member of the panel suggested that counsel for a public agency has a special obligation to take steps to avoid litigating a moot case, counsel for the Commission disagreed. In its opinion, the court cited various authorities for "[t]he notion that government lawyers have obligations beyond those of private lawyers."¹³ To the contrary, the court stated that government lawyers should "refrain from continuing litigation that is obviously pointless, that could easily be resolved, and that wastes court time and taxpayer money."¹⁴

B. Natural Gas Policy Act (NGPA)

1. *Louisiana Intrastate Gas Corp. v. FERC*¹⁵

The court vacated for further consideration the FERC's determination that it had jurisdiction over an intrastate pipeline's transportation rates under section 311(a)(2) of the NGPA.¹⁶ Louisiana Intrastate argued that the facility at issue was a gathering line. The FERC rejected the pipeline's argument solely because the pipeline had characterized its facility as a "transportation" line. The court held that the FERC's reasoning was not supported by substantial evidence, and noted the Commission's failure to apply the requisite "primary function" test.¹⁷ Further, the court vacated the FERC's determination that the facility's rate design should be based on a fixed percentage of the facility's total physical throughput capacity rather than on a lower actual throughput figure. The court found no rational reason for the FERC's choice of the higher 90% capacity throughput percentage.¹⁸

2. *Tennessee Gas Pipeline Co. v. FERC*¹⁹

The court vacated an interim rule that, among other things, required thirty days notice to the FERC before commencing pipeline construction pursuant to NGPA section 311. Despite the FERC's argument that environmental damage could result from projects completed in haste in order to avoid the burdens of a final rule, the court held that the FERC failed to support its claim that the interim rule fell within the "good cause" exception to the Administrative Procedures Act (APA) notice and comment procedures.²⁰ The court found that the omission of notice and comment procedures is warranted only in extraordinary circumstances, which were not present in this case.²¹ Noting that the FERC's experience with the interim rule demon-

13. *Id.* at 47.

14. *Id.*

15. 962 F.2d 37 (D.C. Cir. 1992).

16. 15 U.S.C. §§ 3301-3432 (1988).

17. 962 F.2d at 42.

18. *Id.* at 44.

19. 969 F.2d 1141 (D.C. Cir. 1992).

20. *Id.* at 1142.

21. *Id.* at 1146.

strated the value of public participation in rule making, the court stated that the “clarifications the Commission has had to issue in order to make the rule workable illustrate the wisdom of the APA’s requirement that an agency have the benefit of informed comment before it issues regulations that have the force of law.”²²

C. *Outer Continental Shelf Lands Act (OSCLA)*

1. *Tennessee Gas Pipeline Co. v. FERC*²³

The court upheld the FERC’s decision not to apply Order No. 509 and related orders, which govern open access transportation on the Outer Continental Shelf (OCS), to gathering facilities on the OCS. Tennessee Gas argued that, unless prohibited, a pipeline owner that also produced gas would give preference to the transportation of its own gas over that of other producers by overcharging for its initial gathering services. Tennessee Gas further argued that section 5 of the OCSLA grants the FERC the authority to regulate OCS gathering facilities which fall outside the scope of the NGA.²⁴ After accepting the FERC’s response that it will determine appropriate measures for remedying discriminatory access to gathering facilities on a case-by-case basis, the court held that Tennessee Gas’ argument was not yet ripe.²⁵

The court found Tennessee Gas’ argument, that the voluntary pro rata allocation scheme under Order No. 509 would violate the abandonment protection afforded under the NGA was not yet ripe, would be addressed on a case-by-case basis.²⁶ Tennessee Gas also challenged the Order No. 509 requirement that when a shipper relinquishes transportation service through an onshore segment of an OCS pipeline, the petitioner must file an abandonment application and then apply for a new NGA section 7(c) certificate to serve the new shipper, and that the new shipper be charged the pipeline’s generally applicable rate rather than the old rate.²⁷ Tennessee Gas argued that the Commission lacked the authority to regulate onshore transportation in this manner under either the NGA or the OCSLA. It further argued that the NGA requires that the Commission find an existing rate unreasonable, and a new rate reasonable, before it may effect such a change.²⁸ The court remanded these issues to the Commission for further consideration, noting that there was no apparent authority for FERC’s regulatory treatment. The court stated that there was a “real question whether the mere reallocation of service from one customer to another, without a change in the quantum of service provided to the market, constitutes an abandonment within the meaning of section 7(b).”²⁹

22. *Id.*

23. 972 F.2d 376 (D.C. Cir. 1992).

24. *Id.* at 380.

25. *Id.* at 381.

26. *Id.*

27. *Id.* at 383.

28. *Id.*

29. *Id.* at 383-84.

D. *Federal Power Act (FPA)*

1. *Ohio Power Co. v. FERC*³⁰

The court held that, in setting an electric utility's wholesale rates, the FERC is prohibited from reducing a SEC-approved price which the utility paid for coal from its affiliate coal producer. The court determined that such a reduction would conflict with FERC regulations at 18 C.F.R. § 35.14(a)(7), which deem fuel prices subject to the jurisdiction of a regulatory body "to be reasonable and includable in the [utility's fuel] adjustment clause."³¹ Further, the court held that section 13(b) of the Public Utilities Holding Company Act (PUHCA)³² permits the SEC alone to set the price for such coal purchases and, thus, prohibits the FERC from lowering that price under its FPA "just and reasonable" rate setting authority.

2. *Michigan Public Power Agency v. FERC*³³

The court upheld Commission decisions holding that allegations that certain electric utility transactions would have anticompetitive consequences were unfounded, premature, and irrelevant, and that a hearing was not warranted. The court's review centered on petitions filed by the Michigan Municipal Cooperative Group (Group) which addressed three sets of Commission orders related to transactions involving Consumer Power Company (Consumers) and Palisades Generating Company (Palisades), an affiliate of Consumers. The three sets of orders included: (1) orders on Consumers' application under section 204(a) of the FPA to issue \$900 million of short-term securities in 1991 and 1992; (2) orders addressing a facility transfer from Consumers to Palisades; and (3) orders on the rates for a power purchase agreement between Palisades and Consumers. With respect to the first set of orders, the Commission approved the application, and refused to broaden the proceeding to include a hearing on issues related to anticompetitive consequences of the transaction. Likewise, the Commission set for hearing issues of how the transfer of facilities would affect Consumers' operating costs and rates, and established a hearing to ensure that the purchase power rates were not "unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful," but did not set for hearing the allegations of anticompetitive conduct. The court explained that under *Gulf States Utilities Co. v. FPC*,³⁴ it must review the FERC's determinations to ensure that the Commission did not disregard factors Congress intended it consider. The Commission must also ensure that its determinations are adequately explained. The court noted, however, that agencies still have substantial deference in ordering their proceedings. The court found that the Commission sufficiently considered the arguments of the petitioners. It was within the Commission's discretion to summarily dispose

30. 954 F.2d 779 (D.C. Cir. 1992), cert. denied, 61 U.S.L.W. 2255 (U.S. Nov. 9, 1992) (No. 92-548).

31. *Id.* at 383.

32. 15 U.S.C. §§ 79a-79z-6 (1988).

33. 963 F.2d 1574 (D.C. Cir. 1992).

34. 411 U.S. 747 (1973).

of the petitioner's claims since the contentions were hypothetical and without an adequate basis.

E. Hydroelectric

1. *Wolverine Power Co. v. FERC*³⁵

The District of Columbia Circuit Court of Appeals held that the FERC may not fine a project owner under section 31(c) of the FPA for failure to obtain a hydroelectric license. Section 31(c) was enacted in 1986 as part of the Electric Consumers Protection Act (ECPA).³⁶ Subsequently, the FERC issued a NOPR providing that, under the authority of section 31, it would assess civil penalties against "a person who engages in conduct requiring a license or exemption but fails to obtain one."³⁷ The FERC then attempted to assess a civil penalty against Wolverine Power Company for its operation of three unlicensed hydroelectric plants. On review, the court found the FERC's section 31(c) regulation to be *ultra vires*. Section 31(c) expressly limits the "FERC's civil penalty authority to violations committed by a 'licensee, permittee, or exemptee,'" and does not extend such authority to a non-licensee.³⁸ The court noted that "Congress had previously defined 'licensee' as a licensed person or entity."³⁹ The court explained, with regard to any violations of the FPA by non-licensed plants, the Commission could exercise its enforcement authority under sections 314 and 316.⁴⁰

2. *Department of the Interior v. FERC*⁴¹

The court upheld the issuance of sixteen hydroelectric licenses for projects in the Upper Ohio River Basin, finding that the FERC gave sufficient weight to the environmental and recreational concerns raised by the fish and wildlife agencies. During the licensing proceedings, the FERC denied the agencies' requests for studies on dissolved oxygen levels and the level of fish mortality due to entrainment, the passage of fish through turbines. On review, the agencies argued that the FERC had acted without substantial evidence and in violation of sections 4(e), 10(a), and 10(j) of the FPA.

The court stated that the FERC had balanced "power and non-power values" in a manner consistent with the statutory provisions on which the petitioners relied. The court also found that the FERC had relied on substantial evidence consisting of a U.S. Environmental Protection Agency water quality criteria document (criteria document) and several studies discussed in the FERC's final environmental impact statement (EIS), even though the criteria document and the EIS were inconclusive. The court stated that it could not remand on the basis of imperfect evidence, because of "the statutory stan-

35. 963 F.2d 446 (D.C. Cir. 1992).

36. Pub. L. No. 99-495, § 1(a), 100 Stat. 1243 (1986).

37. 963 F.2d at 448 (quoting Procedures for the Assessment of Civil Penalties under section 31 of the Federal Power Act, 52 Fed. Reg. 29,216, 29,217 (1987)).

38. *Id.* at 453.

39. *Id.* at 450.

40. *Id.* at 452.

41. 952 F.2d 538 (D.C. Cir. 1992).

dard that requires us to affirm any FERC factual finding supported by substantial evidence."⁴² The court also stated, "most importantly, FERC liberally used license conditions to protect against unknown risks."⁴³

The West Virginia Department of Natural Resources argued that the FERC did not defer to the state's water quality certification authority under section 401 of the Clean Water Act, and did not require the licensees to provide adequate access to tailwaters for sport fishing. The court stated that the FERC's orders gave it "no reason to doubt that any valid conditions imposed by West Virginia in its section 401 certificates must and will be respected by the Commission."⁴⁴ Regarding recreational access, the court stated that the "FERC has already mandated this action, where physically possible,"⁴⁵ and if the licensees fail to comply, "petitioners may seek redress from FERC."⁴⁶

3. *Platte River Whooping Crane Critical Habitat Maintenance Trust v. FERC*⁴⁷

Two hydroelectric projects, and their effects on threatened and endangered species, were at issue in the D.C. Circuit's *Platte River II* decision. In *Platte River I*,⁴⁸ upon consideration of the FERC's denial of intervenors' requests for interim fish and wildlife conditions in the two annual licenses, the court remanded on grounds that the FERC had abused its discretion, and should have considered "temporary, 'rough and ready' measures to prevent irreversible environmental damage pending relicensing."⁴⁹ On remand, the Commission concluded that under the FPA it may alter an annual license only with the licensee's consent. For one of the licenses, since no such consent had been provided, it declined to add habitat-protective conditions for fish and wildlife. Sufficient evidence of consent was found for the other license. In *Platte River II*, one of the parties contended that section 7 of the Endangered Species Act (ESA)⁵⁰ requires the FERC "to afford first priority" to protection of the Platte River critical habitat, and that the FERC could have found sufficient statutory authority in the FPA to amend both annual licenses.⁵¹ The court stated that "we cannot say that the Commission's interpretation of the [Federal Power] Act is unreasonable. That the Commission could revoke Central's license under certain circumstances, moreover, surely does not mean it has the power to impose protective conditions not authorized by the Act."⁵²

42. *Id.* at 546 (citation omitted).

43. *Id.* at 547 (citation omitted).

44. *Id.* at 548.

45. *Id.*

46. *Id.* at 549.

47. 962 F.2d 27 (D.C. Cir. 1992) [hereinafter *Platte River II*].

48. *Platte River Whooping Crane Critical Habitat Maintenance Trust v. FERC*, 876 F.2d 109 (D.C. Cir. 1989).

49. *Id.* at 116.

50. 16 U.S.C. § 153b (1988).

51. 962 F.2d at 34 (quoting *Tennessee Valley Auth. v. Hill*, 437 U.S. 153, 185 (1978)).

52. 962 F.2d at 33.

4. *Consolidated Hydro. Inc. v. FERC*⁵³

The court upheld the FERC's finding that a project site was within the FPA's definition of navigable waters of the United States, even though the site itself was not navigable. Recognizing the common use of a portage at the project, the court affirmed the FERC's finding of jurisdiction on the theory that "a need to portage around the Project is consistent with such a finding because the portage is an 'interruption between the navigable parts of streams or waters' that are used in interstate commerce."⁵⁴ The court found that the "FERC has cited specific evidence of commercial activity along the entire length of the waterway,"⁵⁵ and, therefore, the project was properly subject to the FERC's licensing authority under the FPA.

The project at issue is located in an area of Maine with a history of commercial logging and timber milling. The court found there was evidence showing that the waterway had been used to float logs, lumber, and timber. Further, the court found that canoe races had been held on a route including the site with the use of a portage of approximately one-tenth of a mile. The court discounted as irrelevant the project owner's argument that the body of water at the project site is distinct from the river which had been used for floating timber. Waterways are navigable as a matter of law "if they form 'in their ordinary condition by themselves, or by uniting with other waters, a continued highway over which commerce is or may be carried on with other States or foreign countries.'"⁵⁶

5. *Rock Creek Ltd. Partnership v. State Water Resources Control Board*⁵⁷

Here, the court considered the quest for attorneys' fees by an owner and operator of a federally licensed hydroelectric project. The litigation, was initiated by the licensee at the FERC and in federal district court, after the California Water Resources Control Board (Board) announced its more stringent minimum flow conditions.

The licensee petitioned the FERC for a declaratory order holding that the Board's minimum flow requirements conflicted with those established by the Commission. The petition eventually led to a U.S. Supreme Court ruling preempting the Board's action. The Board subsequently removed the conflicting conditions from its permit. During the pendency of this litigation, the licensee sought injunctive relief in federal district court, under 42 U.S.C. section 1983. Pursuant to 42 U.S.C. § 1988, the licensee also requested attorney's fees for the FERC and § 1983 litigation. After the Supreme Court upheld the FERC's declaratory order, the district court dismissed the section 1983 claim, and issued an order denying the request for attorneys' fees. The district court stated that the licensee was not a prevailing party within the meaning of sec-

53. 968 F.2d 1258 (D.C. Cir. 1992).

54. *Id.* at 1261 (citation omitted).

55. *Id.* at 1263.

56. *Id.* at 1260 (quoting *The Daniel Ball*, 77 U.S. (10 Wall.) 557 (1870)).

57. 972 F.2d 274 (9th Cir. 1992).

tion 1988, since there was no causal link between the section 1983 litigation and the Board's withdrawal of its minimum flow conditions.

On appeal, the Ninth Circuit agreed with the district court's analysis regarding the proceedings before the FERC. As to the section 1983 action, emphasizing that Rock Creek sought a temporary restraining order and preliminary injunction pending a final decision, the Ninth Circuit stated that the district court had failed to take into account the possibility "that the section 1983 action was causally related to the practical outcome realized and the non-enforcement of the illegal order."⁵⁸ Accordingly, the district court's order was vacated and remanded for reconsideration.

II. COST ALLOCATION AND RATE DESIGN

During 1992, the courts issued a number of decisions that helped to refine several important rate design/cost allocation principles. Affected areas include cost responsibility, the filed rate doctrine, marginal cost pricing, and changes in estimated costs.

A. Cost Responsibility

The D.C. Circuit issued two decisions on the same day which addressed the question of whether the Commission must match cost responsibility to cost causation.

1. *Carnegie Natural Gas Company v. FERC*⁵⁹

The *Carnegie* case involved a proposal by Carnegie Natural Gas Co. (Carnegie) to flow through to its customers gas inventory charges (GIC) incurred from Texas Eastern Transmission Corporation (Texas Eastern). Carnegie proposed to flow through its Texas Eastern GIC charges on the basis of its customers' purchase deficiencies. However, if Carnegie incurred GIC charges because it purchased gas on the spot market, and the price of the spot gas plus the GIC charge was less than the price of Texas Eastern's gas, Carnegie would flow the GIC charges through to all of its customers through its Purchased Gas Adjustment (PGA).

Carnegie argued that its proposal was superior to PGA recovery of Texas Eastern's GIC charges because its proposal better matched cost causation with cost responsibility. The Commission rejected Carnegie's proposal, however, finding that the proposal did not necessarily match cost causation to cost responsibility because Carnegie could incur GIC charges for reasons other than deficiency purchases by its customers, *e.g.*, by nominating too much gas from Texas Eastern, failing to convert enough service from sales to transportation, or by making purchases on the spot market. Because Carnegie's customers would not have the opportunity under Carnegie's proposal to review the prudence of these decisions, the Commission found the proposal to be unjust and unreasonable. The Commission affirmed its findings on rehearing.

58. *Id.* at 280.

59. 968 F.2d 1291 (D.C. Cir. 1992).

On appeal, the D.C. Circuit affirmed the Commission's decision, finding that the Commission reasonably required that Carnegie's customers have an opportunity to challenge the costs imposed upon them. The court also found that substantial evidence supported the Commission's findings that Carnegie could incur GIC charges for reasons other than the deficiencies of its customers. While acknowledging that the policy in favor of matching cost causation and cost responsibility is well-established, the court found that "it is far from absolute." The court found that there is no requirement in the NGA that rates precisely match cost causation with cost responsibility, and concluded that "the Commission may rationally emphasize other, competing policies and approve measures that do not best match cost responsibility and causation."⁶⁰

2. *KN Energy, Inc. v. FERC*⁶¹

The *KN Energy* case involves the implementation of the Commission's policies with respect to the allocation of take-or-pay costs as established in the Commission's Order No. 500. *KN Energy* is a section 7(c) transportation customer of Williston Basin Interstate Pipeline Co. (Williston). Pursuant to Order No. 500, Williston proposed to implement a take-or-pay cost recovery mechanism that included recovering 50% of its take-or-pay costs through a volumetric surcharge imposed only upon its sales customers. The Commission rejected the volumetric surcharge portion of Williston's proposal and required Williston to modify the surcharge and impose it upon all of its customers. *KN Energy* appealed, arguing that Williston's take-or-pay costs were not properly allocable to section 7(c) transportation customers. *KN Energy* argued that section 7(c) transportation customers did not cause Williston's incurrence of the take-or-pay costs, and therefore, under the cost incurrence principle, should not be required to pay such costs.

The D.C. Circuit agreed with the Commission that the unusual circumstances surrounding the take-or-pay problem justified the Commission's limited departure from the cost causation principle. The court also noted that the Commission's finding in Order No. 500 that all parties may be allocated a portion of a pipeline's take-or-pay costs because all parties benefit from the pipeline's open access status, may represent only a minor departure from the cost incurrence principle. While upholding the principle of allocating take-or-pay costs received through a volumetric surcharge to all parties, however, the D.C. Circuit remanded the *KN Energy* proceeding because the Commission failed to adequately explain how section 7(c) transportation customers benefit from Williston's status as an open access pipeline.

B. *The Filed Rate Doctrine*

The Filed Rate Doctrine, which is based upon section 4 of the NGA and section 205 of the Federal Power Act, requires a regulated utility to charge only the rate that is properly on file with the appropriate regulatory authority. The corollary rule against retroactive ratemaking prohibits regulatory author-

60. 968 F.2d at 1294.

61. 968 F.2d 1295 (D.C. Cir 1992).

ity from adjusting current rates to make up for a utility's over-or-under collection in prior periods. The courts issued several decisions in 1992 that elaborated on the parameters of the much-litigated Filed Rate Doctrine.

1. *Towns of Concord v. FERC*⁶²

In *Towns of Concord*, the D.C. Circuit Court of Appeals affirmed the Commission's refusal to order refunds of certain charges improperly collected by Boston Edison Company. Boston Edison admitted that it had recovered certain spent nuclear fuel disposal costs through a fuel adjustment clause during a period when Commission policy required that such costs only be recovered through regularly-filed rates. The Commission, having several times modified its policy with respect to the recovery of spent nuclear fuel costs, encouraged the parties to settle disputes involving these costs. Boston Edison submitted a settlement, to which petitioners objected. The presiding judge ordered Boston Edison to pay refunds. The Commission reversed. On rehearing, petitioners argued that the Commission's refusal to order a refund was inconsistent with the Filed Rate Doctrine. The Commission found that there was good cause in this case to waive the Filed Rate Doctrine. The Commission further determined that even if a waiver of the Filed Rate Doctrine was improper, it would decline to order a refund on equitable grounds.

On appeal, the D.C. Circuit questioned whether the Commission had the right to waive the Filed Rate Doctrine, indicating that any such right would belong to the customer. At any rate, the D.C. Circuit found no waiver in this case, finding that the Commission had exercised its remedial discretion. With respect to the Commission's discretion to decline order refunds on equitable grounds, the court stated that the FPA contains no statutory command mandating refunds of over-collections. According to the court, "to ask only whether the Filed Rate Doctrine mandates refund is to miss a central part of the inquiry. What says the statute? The FPA does not explicitly deprive the Commission of remedial discretion with respect to refunds; in fact, the Act quite clearly confers it."⁶³ Having found that the Commission has discretion to waive refunds under the FPA, the court then addressed the issue of whether the Commission's actions in this case represented an abuse of discretion. The court found that, based on the facts of this case, the Commission's refusal to order refunds was well-supported and did not conflict with the Filed Rate Doctrine's primary goal of providing rate predictability.

2. *Consolidated Edison Company of New York v. FERC*⁶⁴

In *Consolidated Edison Company of New York v. FERC*, the D.C. Circuit Court of Appeals considered whether the Commission violated the Filed Rate Doctrine when it approved a pipeline's out-of-cycle purchased gas adjustment (PGA) filing, effective the day after the filing was made. Section 4(d) of the NGA provides for a thirty-day notice period between the filing date of a rate

62. 955 F.2d 67 (D.C. Cir. 1992).

63. *Id.* at 73.

64. 958 F.2d 429 (D.C. Cir. 1992).

increase and the effective date of the changed rate. Section 4(d) also provides for a waiver of the thirty-day notice period upon a showing of good cause. In this case, Tennessee Gas Pipeline Company filed an out-of-cycle PGA on November 30, 1990. This increased its sales gas commodity rates. Tennessee requested a December 1, 1990, effective date for the rate increase. On December 27, 1990, the Commission accepted the filing and granted Tennessee's request for a December 1, 1990, effective date. Consolidated Edison (Con. Ed.) appealed, arguing that Commission approval of Tennessee's filing with an effective date preceding the date of the Commission's order approving the filing violates the Filed Rate Doctrine.

The court found that the Commission acted properly and upheld the Commission's order. Con. Ed. first argued that the plain language of section 4(d) precluded the Commission from approving a rate increase with an effective date preceding the date of the Commission's order. While finding Petitioner argument a "plausible reading of Section 4(d)", the D.C. Circuit found that this reading was not the only reasonable construction. The court stated that the requirements of section 4(d) would be satisfied so long as the pipeline's customers received "due notice" of the proposed rate increase, although not necessarily a thirty day notice. The court then found that under the facts of this case, Petitioners did receive adequate notice of the rate increase. The court found that the customers had actual notice of the proposed rate increase and the proposed effective date of the rate increase and, although they did not know the precise rate they would pay during the period prior to the Commission's order, the court noted that the customers must have been aware that the Commission has many times in the past retroactively waived the waiting period. The court also noted that the customers, when notified of the November 30 filing, knew both the lowest cost and the highest cost that they might be charged, and that the period of rate uncertainty was relatively brief. The court concluded that, under these circumstances, the customers received enough notice of the proposed effective date of the rate increase to provide the predictability required under the Filed Rate Doctrine.

3. *Taffet v. Southern Co.*⁶⁵

A third decision involving the Filed Rate Doctrine, *Taffet v. Southern Co.*, involved Eleventh Circuit review of the dismissal by two federal district courts of private suits brought under the federal Racketeer Influenced and Corrupt Organizations Act (RICO). The plaintiffs filed the RICO actions against Southern Company alleging that the utility conspired with its accounting firm to understate net income and thereby fraudulently obtain rate increases. The allegedly fraudulent rate increases had been approved by the state regulatory commissions in Georgia and Alabama. The federal district courts had dismissed complaints under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted, finding that exclusive authority to set electricity rates was vested in the state public service commission and that the Filed Rate Doctrine and the Primary Juris-

65. 967 F.2d 1483 (11th Cir. 1992).

diction Doctrine foreclosed application of RICO to a public utility after a rate has been approved by the state regulatory agency.

Although an Eleventh Circuit panel had reversed the district courts' findings, on rehearing *en banc* the Eleventh Circuit affirmed dismissal of the two complaints. The court found that the plaintiffs could not recover under RICO because they did not have the right to have been charged a lower rate than they actually were charged. The court based this finding upon the Filed Rate Doctrine's requirement that the utility could charge no rate other than that which has been approved by the state public service commission. Citing *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*,⁶⁶ the court stated that under the Filed Rate Doctrine "where a legislature has established a scheme for utility rate-making, the rights of the rate-payer in regard to the rate he pays are defined by that scheme," and that a customer can claim no rate as a legal right that is other than the filed rate.⁶⁷ The court noted that both Alabama and Georgia have regulatory schemes that permit only the payment of filed rates that are approved by the state regulatory agencies, and that allowing consumers to recover damages for fraudulent rates "would greatly disrupt the states' regulatory schemes and, in the end, would cost consumers dearly," because juries would begin second-guessing the findings of state regulatory commissions, rates would become much less predictable, utilities would begin anticipating damage awards in its rate filings, and frivolous litigation would be encouraged. Moreover, the court argued, the state regulatory commissions in both Alabama and Georgia could provide a remedy for utility fraud that would adequately compensate consumers:

The PSC can set a prospective rate low in order to compensate consumers for excessive rates they paid in the past or that were procured by fraud. . . . It would seem that a reasonable rate in a case in which the past rate was unreasonable because the utility defrauded the PSC would be low enough to ensure that consumers' future bills compensate for the excess they have paid in the past.⁶⁸

The court recognized that the rule against retroactive ratemaking "might suggest that the PSC could never award future low rates because of past misconduct," but noted that, under Alabama and Georgia law, past misconduct can be a relevant consideration in determining whether a prospective rate provides a fair return for a utility.

C. Marginal Cost Pricing

In *Town of Norwood v. FERC*,⁶⁹ the D.C. Circuit reviewed FERC's order approving New England Power Company's (NEPCO) proposed marginal cost rate design for its wholesale electric rates. The court noted that this proposed marginal cost rate design was the first approved by the FERC since the court's remand for additional record support in *Electricity Consumers Resource Council v. FERC*.⁷⁰ This time, the court upheld FERC's decision, finding that the

66. 341 U.S. 246 (1951).

67. See 967 F.2d at 1492.

68. See *Id.* (footnotes omitted).

69. 962 F.2d 20 (D.C. Cir. 1992).

70. 747 F.2d 1511 (D.C. Cir. 1984).

FERC in this case had provided adequate reasons for its decision to approve the proposed marginal cost rate design.

Under NEPCO's proposed marginal cost rate design, both the demand and the energy charges would be divided into two rates, one applicable to the customer's "initial block" and the other to its "tail block". Each customer's initial block would be equal to 80% of its average monthly maximum demand and energy use for a base year. The rate for this initial block would be derived from traditional historical or embedded costs. Demand and energy use in excess of the initial block would be billed at the tail block rate. This rate would be calculated on the basis of NEPCO's estimated long-run marginal cost for future capacity and energy. In addition, NEPCO proposed to determine each customer's demand charge on the basis of the customer's usage at the time that total demand on NEPCO's system peaks each month. This methodology is designed to impose upon each customer the cost of its contribution to NEPCO's need to increase capacity. Assuming that NEPCO's marginal costs exceeded its historical costs, then its proposed changes in rate design would increase the price of electricity to customers whose demand was increasing.

The D.C. Circuit affirmed the Commission's approval of NEPCO's proposed marginal cost rate design, finding adequate justification in the record for the Commission's findings. In support of this finding, the court cited statements by the presiding judge, the Commission, staff witnesses, and numerous authorities in the field of public utility regulation to the effect that marginal cost pricing maximizes efficiency, tracks costs more accurately than rates based upon embedded costs and sends more accurate price signals to the market. In addition, the court rejected the petitioner's argument that marginal cost pricing should not be adopted because it is historically more volatile than embedded cost pricing. The court found that prices based upon marginal costs would necessarily be more volatile if they accurately reflected market conditions. The court found that price volatility alone, therefore, did not justify rejecting the marginal cost proposal. The court also rejected the petitioner's argument that the use of past consumption levels as the basis for current pricing under the marginal cost proposal constituted retroactive ratemaking. The court found this argument to be "badly misguided," and distinguished past cases involving retroactive ratemaking, finding no attempt in this case to impose additional charges for past purchases. Here, the court found, the utility merely based its prices for future sales on past consumption patterns. The court concluded that "NEPCO's new rate structure is not retroactive in any meaningful sense."⁷¹ The court also affirmed the proposed change to coincident peak demand billing. Citing the Commission's finding that system peak demand more accurately matches the utility's incurrence of capacity costs with those responsible for imposing those costs, the court found the Commission's approval to be reasonable and rejected the petitioner's complaint that it would be difficult to anticipate the coincident peak. The court found the petitioner's inconvenience to be relevant but not dispositive.

71. 962 F.2d at 25.

D. Changes in Estimated Costs

*Southwestern Public Service Co. v. FERC*⁷² addresses the issue of when the Commission may properly adjust proposed rates to reflect actual costs that vary significantly from FERC cost estimates. Under the FPA, a utility filing a proposed rate increase with the FERC supports the filing with current estimates with future costs and revenues. The Commission normally will approve rates based upon whether the estimates were reasonable at the time of filing, disregarding events occurring between the time of the filing and the time of the decision. Under some circumstances, however, where it is shown that the use of the estimates would be unreasonable, even though the estimates were reasonable when made, the Commission will order "spot adjustments" based on more current data.

In this case, Southwestern filed to increase its wholesale electricity rates. The proposed rates were based upon historical data for the most recent twelve-month period (Period I) adjusted for estimated changes in costs and revenues for a future twelve-month period (Period II). After the end of Period II, but before the presiding judge issued his opinion, Congress enacted the Tax Reform Act of 1986, reducing the corporate income tax rate from forty-six percent to thirty-four percent. While Southwestern's estimates of its tax costs were accurate for Period II itself, they significantly exceeded the costs that would be incurred for the remainder of the period in which the rates would be effective. The Commission found that the changes in the tax rate rendered the Period II estimates unreasonable and rejected Southwestern's argument that the spot adjustments to account for the changed tax rate should be offset by increases in the cost of power that Southwestern purchased. The Commission thus ordered Southwestern to modify its rates based upon the new tax rate.

The D.C. Circuit affirmed the Commission's order in part and remanded in part. The court stated that it is Commission policy that spot adjustments are appropriate when it can be shown that the estimates were unreasonable when made or when subsequent events render use of the original estimate unreasonable. In addition, the Commission has found that subsequent events render an item unreasonable only if they use of the original estimate would result in a substantial error. The court rejected Southwestern's argument that the FERC has a general policy against treating tax rate changes as the kind of event that warrants a spot adjustment. In so holding, the court found the Commission's statement in *Public Service Co. of New Mexico*⁷³ that "there is no opportunity to go beyond Period II to adjust for known and measurable changes except in the area of rate of return," to be clearly erroneous. Citing several other Commission decisions, the D.C. Circuit found that it is the FERC's general policy that spot adjustments may be used to reflect: 1) changes in the rate of return regardless of how large or how small; and 2) in areas other than rate of return, substantial deviations between estimates and later data that would otherwise result in unreasonable rates. The court found

72. 952 F.2d 555 (D.C. Cir. 1992).

73. 10 F.E.R.C. ¶ 61,053 (1980).

that although there is “some disarray among FERC and circuit court precedence,” the Commission’s decision on this issue was not arbitrary.

With respect to Southwestern’s argument that any spot adjustment for a tax change should not be made if the change in rate is offset by other cost changes, the court found the record was unclear and remanded this issue to the Commission. The court rejected the Commission’s argument that any offset in changes must be related to the cost change triggering the spot adjustment. The court found no support for such a ruling in the cases cited by the Commission. On the record before it, the court found that the Commission’s alternative theory — that the treatment of any costs resulting from fuel price increases under a certain contract was settled in other proceedings — was unclear. Accordingly, the court remanded the case to the Commission in order to address the question of whether Southwestern’s fuel price increases should offset the change in corporate tax rates.

Steve Stojic, *Chairman*

Tom Rattray, *Vice-Chairman*

R. Frost Branon, Jr.

John H. Cheatham III

Michael J. Fremuth

C. Peck Hayne, Jr.

Robert P. Haynes III

Lyle D. Larson

Jean E. Sonneman

Toni Marie Sutliff