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THE QUEST FOR AN INVENTIVE UTILITY REGULATORY AGENDA

Hon. Curt L. Hebert, Jr.*

I. INTRODUCTION

The electric and natural gas utility industries of the United States are on the threshold of a transformed marketplace. Technology and competitive alternatives to traditional service are paving the way for customer choice with greater risks and rewards for the industry. In that spirit, economic efficiencies and conduct that furthers competition and improves customer choice should be encouraged. My purpose here is to compel the utility industry, regulators, stockholders and consumers to take a second look at the regulatory framework of today's utilities to ensure the most efficient service at the lowest cost to the consumer.

I begin by discussing the present day issues confronting the electric utility industry and how incentive rates would provide better, more efficient outcomes. I include a brief account of an incentive-based rate plan that the Mississippi Public Service Commission adopted while I served there. The experience in Mississippi shows opportunities and choices for the regulatory process that provide alternatives for the industry and the consuming public. Finally, I give a brief account of how incentive rates might work in the natural gas industry.

I hope thereby to begin a timely debate. Discussions are intensifying on the direction in which the energy industry should head. Much thought is taking place on alternative and inventive forms of regulation. However, the thought that leads to no action is not thought, it is dreaming. Dr. Alfred Kahn has taught us that "Regulation is a substitute for competition

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and competition is a substitute for regulation.”¹ This teaching being so, if we are moving towards one (competition), we should be moving away from the other (regulation). I query, are we doing as we have been taught? I suggest we should be doing more.

II. INCENTIVE RATES FOR ELECTRIC UTILITIES

The case for incentive rates in electricity is more compelling in the electric industry than in the gas industry.² Without claiming it as a panacea, I think that the approach would go a long way toward solving the series of complex problems that regulation hid, but the move toward competition has revealed. These problems fall under three related topics: system operation, reliability and transmission pricing. Throughout this section, I group the issues into those three categories.

A. The Need for Alternative Regulation

In Order No. 888, the FERC outlined at length the evolution of the electric utility industry from its inception until the threshold of competition.³ From the details, the following picture emerges. By definition, electric companies exist to sell power. Throughout most of their history, utilities did so by building generating plants close to their customers. Even as the local entities consolidated financially into holding companies, operationally they remained islands unto themselves. That reflected the state of technology at the time.⁴ If transmission entered anyone’s mind, it did so as an incidental service.

Eventually, utilities saw the light⁵ and began to take advantage of the efficiencies that the economics of transmission offered: the ability to build fewer (mostly bigger) generating plants; the possibility of pooling reserves; the chance to locate plants closer to the fuel source (for example, coal), rather than the customer; and the like. Until the 1980’s, transmission played a subordinate role to generation. That, vertical integration, and cost-of-service regulation helped obscure subsidiary issues from public view. While not as glamorous as safety and the environment, these considerations play an important role in the success of electric policy, in the form of good service to customers.

Many of the burning issues of today existed in the past, but utilities

¹. Dr. Alfred Kahn, Speech before the FERC, Chairman Hoecker’s Distinguished Speaker Series (Feb. 18, 1998) (notes of the author).
². The FERC has basically allowed market-based rates for generation. The incentives we advocate here relate to transmission, an activity that most observers agree will remain highly regulated.
⁴. For that reason, when Congress passed the Public Utility Holding Company Act to control abuses of holding companies, the law required integrated operation as one criterion for continued existence. 15 U.S.C. § 79k(b)(1) (1994).
⁵. In large measure, the Northeast Blackout of 1965 made them aware of the need.
could afford to ignore them altogether, solve them informally or "add them to the customer's tab," as we now see.

1. System Operation

Transmission expansion presented only a minor issue because utilities for the most part relied on building generating plants, and customers did not have a choice among suppliers. The transmission grid was not as heavily used as it is now. While state siting laws made construction difficult, the systems were getting by. Utilities operated control centers. Because each could be in a position of needing help from the others, companies acted in a non-discriminatory fashion in their dispatch decisions.\(^6\)

Inadvertent power (loop) flows that occurred when electricity traveled outside the contract path did not require compensation. Utilities inflicted these flows on each other, and the amount involved rarely rose to significance. Because of cost-of-service regulation, utilities could ignore the effect on the "bottom line."

Ancillary services (electricity for reserves in emergencies) and power needed to keep the grid working formed part of the costs utilities wrapped into the rate, along with the utility's other costs. The existence of vertical integration meant a lack of competition for the provision of these services. This led to the lack of attention paid to this issue by regulators and customers.

2. Reliability

As with other regulated industries in which competitive pricing did not exist (such as airlines), companies put a premium on quality: meals on flights and reliability in the electric utility industry. Therefore, for all practical purposes, customers could take reliability for granted. With integrated utilities as the major participants in the market, rarely did a question arise as to whether utilities enforced excessive reserve requirements.

When a controversy did occur, the issue came up in the context of a holding company in a rate case establishing reserves as part of the compensation companies with surpluses received from members deficient in that regard. Otherwise, reliability councils or the states established requirements and everyone assumed this exercise lay beyond the FERC's jurisdiction.\(^7\)

3. Pricing

Historically, cost-based rate making prevailed. In the era before Or-

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6. See, e.g., Central Iowa Power Cooperative v. FERC, 606 F.2d 1156 (D.C. Cir. 1979), in which the court used that rationale to find that members of power pools lack market power and, therefore, the Mid-Continent Area Power Pool agreement did not violate the antitrust laws.

7. Central & South West Services, Inc., 49 F.E.R.C. ¶ 61,118, at 61,502 (1989) ("we believe that the individual operating companies are . . . best guided by the reliability groups in which they operate and by the individual state commissions . . ."); 49 F.E.R.C. at 61,504 (1989) (Trabandt, Comm'r, concurring) ("the Commission has no . . . intent to regulate reliability.")
4. Restructuring

The move toward competition, especially the issuance of Order No. 888, brought major change to the industry. In addition, the enlargement in the scope of economic markets and technological improvements increased the distance over which buyers and sellers transacted. In turn, the new market requires a new philosophy of regulation. With new entrants and the movement away from vertical integration, the milieu of informal understanding as the means for resolving issues gave way to contracting and the need for structured organization. No longer would utilities accommodate each other with the knowledge that their fellow members of the club would reciprocate on another occasion when the roles of supplier and supplicant reversed.

Moreover, in this setting, the new entities, generators and marketers, including brokers, remained dependent on their competitors—transmission utilities that also owned generation—for economic survival. Other factors, including failed investment in nuclear generation, placed greater importance on making due with existing units. That placed more pressure on the transmission grid as the nerve center of the electric industry.

5. Order No. 888

In effect, the trade-off for restructuring amounted to deregulation of generation alongside more vigorous regulation of transmission. Order Nos. 888 and 889 reflect that decision. The FERC made the pro forma open access tariffs the centerpiece of the restructuring. This enables companies to compete as sellers in the market only in the business of generation, marketing, or brokerage.

Without having a direct stake as an owner or operator of transmission, these sellers would more likely tend to favor no-frills transmission, even to the extent of becoming free riders. In addition, as competitors to the generation portion of the business of integrated utilities, these new entrants have every motive to challenge, on competitive grounds, the existing ways of doing transmission business.

Another impetus toward factionalism in the industry came from the requirement in the open access rule that power pools must establish “non-discriminatory” criteria for companies to join. As a result, pools, which where comprised of transmitters only, had to open their membership to other entities—generators, marketers, brokers, and customers—with com-

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10. The other side of the coin—that companies would operate as transmitters only—forms the linchpin of the idea we advocate as the wave of the future in the transmission business: separate grid companies with incentive rates.
peting perspectives.\footnote{11} Not only did the new entrants have a reason to question expenditures for reliability or expansion, the FERC gave them a seat at the table from which to express their opposition. In effect, operation of the transmission grid would become like government by committee, where everyone's interest must be satisfied at least to some degree. This process leads to compromises that may be worse than picking the "wrong" solution. In matters that do not command immediate attention, such as long-term investments in the grid, the clashes between owners and customers may become intense. Yet, finding the right answer becomes vitally important.

In addition, Order No. 888 introduced a major change by ordering "functional unbundling."\footnote{12} Previously, when utilities sold electricity at wholesale, they charged one rate that not only included generation and transmission, but also all the underlying services. Now, utilities would separate costs for backup facilities, reliability, and electricity that the transmission grid uses in moving the power to its destination (ancillary services).

Besides allowing the customer to see each charge as a separate item on the bill, the purchaser would have redress. The FERC required the transmission utility to allow three choices in obtaining some types of ancillary services from: the transmission company, competing entities, or self-generation.\footnote{13} In one fell swoop, the FERC tore the roof off the tent within which utilities glossed over such potentially contentious issues as compensation for loop flows and paying for the costs of reliability. No longer could utilities afford to abide by their gentlemen's agreement. Just as in the telephone industry, where competition put an end to the practice of long distance subsidizing local services, restructuring required new economic arrangements between utilities and customers.

Order No. 889 also influenced the trend toward the breakdown of the traditional consensus.\footnote{14} Ostensibly, the OASIS rule dealt with posting information on the Internet in the form of Codes of Conduct. Underneath lay another fundamental change in the way the industry functioned and one which increased the pressure for abandoning the old methods. In particular, the Code of Conduct directs separation between transmission and marketing arms of integrated companies.

In turn, posting information about business opportunities allows other sellers to compete for the sale. It also creates incentives to keep costs at a minimum. In order to do so, utilities will not readily spend money on "hidden" items such as system operation and reliability. The idea of separation

\footnotesize{11. Order No. 888, supra note 3, at 31,727.}

\footnotesize{12. Id. at 31,653-56.}

\footnotesize{13. Id. at 31,715-17 (customers have choice in obtaining three ancillary services: regulation and frequency response; energy imbalance; and reserves).}

also leads to opportunities for complaints about alleged favoritism on the transmission grid.

Finally, as discussed later in detail, Order No. 888 recognized that competition necessitated changes in thinking about the organization of the grid and transmission operations. The Commission chose not to prescribe a particular type of ownership and control, leaving it up to utilities to choose. The thrust of Order No. 888, however, pointed towards Independent System Operators (ISO), for the FERC "encouraged" their formation. To that end, the Order listed "principles" that would ensure the FERC's approval of an ISO. These principles refer to fairness, inclusiveness and dispute resolution. This concept was alien to the old way of doing business and a departure from pure economic considerations.\(^\text{15}\)

In contrast to the historical situation, the following now prevails in each of the three areas of interest listed previously.\(^\text{16}\)

6. System Operation After Order No. 888

Transmission expansion becomes a major issue because utilities rely on using generating plants to serve load. Because customers have a choice among suppliers, the transmission grid must experience heavy use. State siting laws have made construction difficult. Add that to the fact that new entrants, as competitors of transmission owners, question the methods and decisions of the grid's operator-utilities.

The new tension within the electric industry, between integrated companies and new entrants and between suppliers and wholesale customers, spills over into the operation of control centers as well. Do competitive considerations, rather than those of objective engineering, determine dispatch decisions? In that regard, note the controversy in California over must-run (for reliability) plants and how the utilities designate them.\(^\text{17}\)

Inadvertent power loop flows represent a cost that the utilities must pay heed to, from a competitive point of view. Sellers cannot ignore the fact that the utilities, over whose lines the power flows, lose revenue belonging to them and see rivals earn undeserved money. In addition, the need for accurate pricing requires transmission companies to include loop flows in rates.\(^\text{18}\)

Ancillary services, like the flights to small communities after airline deregulation, no longer enjoy a hidden subsidy. Regulators must find ways to encourage generators to offer them, such as by allowing market-based rates.\(^\text{19}\)

\(^{15}\) Order No. 888, supra note 3, at 31,730-32.

\(^{16}\) See supra pp. 3-4.

\(^{17}\) California Independent System Operator, 82 F.E.R.C. ¶ 61,236 (1998), describes the efforts in California to designate must run units and the requirement for informational filing at the FERC.


\(^{19}\) In Ocean Vista Power Generation, LLC, 82 F.E.R.C. ¶ 61,114 (1998), the Commission estab-
7. Reliability After Order No. 888

Customers can no longer take reliability for granted, since price competition gives companies incentives to cut costs. Questions arise from competitors, customers that have become more price conscious, and regulators about whether utilities enforced excessive reserve requirements. The FERC and the Department of Energy have begun consideration of whether reliability councils or the states that historically established requirements need supplementation by legislation or an assertion of the FERC’s jurisdiction, assuming it has any. Those deliberations resulted in the Administration’s Comprehensive Electricity Competition Plan proposing that Congress “require” the FERC to “approve and oversee a self-regulating organization” that would set mandatory standards and that utilities must join.\(^2\)

8. Pricing After Order No. 888

The FERC never approved a formula besides cost-based rates. The Commission recognized, however, that the new order may call for other methods. I submit that incentive rates fits within the new approach.

In the rest of this part, I address the issues in each of these areas and why the FERC must adopt incentive rates.

B. New Ideas and Their Problems

1. System Operations

As far back as 1992, in the debate over the Energy Policy Act, the industry realized that grid operation would have to change as competition began to take hold. In fact, a provision for Regional Transmission Groups (RTGs) almost made it into the law.\(^2\) Proposed as section 216 of the Act, what the FERC later called the “consensus proposal” would have allowed members of the electric industry—generators, transmitters, and wholesale customers—“with an interest in” transmission services in the region to join the RTG. The participants would operate the grid, maintain reliability, plan for and pledge expansion when necessary and settle disputes.\(^1\)

The proposal contained at least two incentives to ensure success, one explicit and the other implicit. Section 216 (b) (3) allowed RTGs to exempt their members from the FERC’s wheeling orders under section 211—the explicit carrot—and section 216(a)(1)(G) gave members flexibility in transmission prices by stating that they must be consistent with the

\(^{20}\) Department of Energy, Comprehensive Electricity Competition Plan (1998) at 12.

\(^{21}\) Pricing Policy Statement, supra note 18; Order No. 888, supra note 3, at 31.666-67.


\(^{23}\) Id. at 47-48.
Energy Policy Act, rather than just and reasonable or cost-based—the implicit carrot.\textsuperscript{24}

With the failure of the consensus proposal, the FERC issued a Policy Statement Regarding Regional Transmission Groups.\textsuperscript{25} The statement made three blunders, one by subtraction and two by addition, to the consensus proposal that we must now remedy through incentive rates for a private transmission entity. In particular, the FERC shredded the carrots, as it removed the provision exempting RTG members from wheeling orders. In its place, the Commission gave a vague assurance of some sort of deference to an RTGs alternative dispute resolution.\textsuperscript{26}

In this way, a powerful reason for the transmission utilities to join RTGs fell by the wayside. Component 4 required the RTG to “incorporate the needs” of non-members.\textsuperscript{27} Here, the Policy Statement constructed a further obstacle to the effectiveness of RTGs. Under the consensus proposal, those not members risked being left out. By requiring the organization to take needs of non-members into account, the Commission now made it easier to stand on the outside looking in and become a free rider.

The FERC added a requirement that RTG members consult and coordinate with the states.\textsuperscript{28} As we see in our discussion of ISOs, this created a real potential for paralysis. While well intentioned, this provision, combined with the requirement for “fair governance,” led to the creation of the cumbersome superstructure that may sink effective operation of the grid.

In Order No. 888, the FERC expanded the notion of RTGs into that of independent system operators (ISO). The eleven ISO principles that the FERC promulgated show the practical difficulty in accomplishing the goals the FERC envisioned for these organizations. Principle 4 states that ISOs should have responsibility for reliability, while Principle 7 requires that they create incentives for efficient management of the grid. Yet, at the same time, Principle 1 states that ISOs must operate independently of the users of the grid.\textsuperscript{29}

In fact, the ISO must prevent “control and appearance of control” by any class of user.\textsuperscript{30} If the FERC concerned itself with the ISO being a vehicle for economic domination, to the detriment of competition, Order No. 888 should have required the ISO to operate for the benefit of all consumers. By removing control from any one group of users, the ISO principles either put everyone in charge or no one. The FERC removed accountability, a necessary ingredient in operating any enterprise.

\begin{itemize}
\item 24. \textit{Id.} at 48.
\item 26. \textit{Id.} at 30,877-78.
\item 27. \textit{Id.} at 30,875.
\item 28. \textit{Id.} at 30,874 (Component 2).
\item 29. Order No. 888, \textit{supra} note 3.
\item 30. \textit{Id.} at 31,731.
\end{itemize}
In addition, Principle 2 requires that operators relinquish financial interests in the grid. The ISO must establish strict rules for conflict of interest rules and arms length transactions with the transmission owners. Here, Order No. 888 neutralized the profit motive, the main engine of the success of free enterprise. Not-for-profit corporations have a place in a capitalist economy. No one has made the case for such an arrangement in transmission, a private business that requires large expenditures and risk-taking.

Finally, in a retreat from the consensus proposal, Principle 11 encourages the ISO to form a mechanism for alternate dispute resolution, but offers no word of deference from the FERC, let alone exemption from the FERC processes. The ISO principles created cumbersome structures. In the immediately preceding issue of the Energy Law Journal, Barker, et al., discuss system governance across the world. I draw the following conclusion: a totally disinterested management deprives the ISO of necessary expertise in fulfilling the goals of maintaining reliability and creating incentives for efficient management of the grid.

By the same token, creating a two-tiered system, with the operators having expertise and an oversight board with outside parties, has difficulty of its own. Cumbersome administration becomes the substitute for ignorance. Giving governance to all classes of participants—transmitters, generators, customers and states—creates paralysis. In addition, arguments arise for and against weighted voting, one-class veto, or super majority voting, as these arrangements must entail. If one adds the necessity for regulatory oversight, appellate jurisdiction, and standard setting, the potential for a complex and inefficient structure becomes very real.

The Secretary of Energy Advisory Board’s (DOE Advisory Board) description of the functions the ISO must perform shows the grave consequences of an organization established on mistaken principles. The severance of control from ownership inherent in an “independent” operator forces the ISO to convince the transmission owners to obtain permits and undertake—namely, pay for—construction (and maintenance) of the grid’s facilities.

In addition, according to the DOE Advisory Board, the ISO must accurately implement reliability standards; perform system security measures; re-dispatch the grid in emergencies; enforce penalties; and, in some

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31. Id.
32. The Appendix to the February 26, 1998 draft paper from the Secretary of Energy Advisory Board Task Force on Electric System Reliability (DOE Advisory Board) states that “Operating and Planning staffs will require heavy-duty system operations and planning skills [in] transmission planning.”
33. Order No. 888, supra note 3, at 31,832.
35. DOE Task Force, at II. B. 4.
36. Id. at II.C. 1.
cases, underpin the market by defining available capacity and performing scheduling activities. More than that, the ISO would file a tariff and set transmission rates, in the vision of the DOE Task Force's February draft paper.

Experience thus far with ISOs has shown some shortcomings of the idea. Just weeks ago, on April 15 and 16, the Commission conducted a conference on this subject. One idea stood out in the exercise: on its own, the ISO has a long way to go before solving the practical problems inherent in the concept. In fact, many fundamental questions remain about ISOs and either Congress (not very likely) or the FERC (not very easily) may have to use legal mandate or regulatory muscle to give these organizations a big push into being.

The Notice of Conference the FERC issued on March 13, 1998, in PL98-5-000, shows how complex it would be to establish a working ISO, if that goal even remains possible. The Commission divided the participants into seven panels on these topics: basic structure and role; regulation, governance and independence; role of the states; reliability; transmission pricing; market monitoring and the FERC regulation.

These panels discussed questions contained in a seven-page staff appendix. The appendix covered such basic issues as how to induce formation of ISOs. Forcing mechanisms ranged from requiring ISOs as a condition of mergers to holding that section 206 of the Federal Power Act, which prohibits undue discrimination, allows the FERC to compel the industry to join.

In addition, several panels spoke about how to ensure that the ISO carries out the responsibilities the FERC assigns to it. To panel 4, for example, the Appendix to the Notice of Conference asked whether the Commission should write rules giving ISOs access to reliability information and meshing their roles at wholesale with retail reliability.

All represent thorny problems the FERC must solve. Resolution requires detailed FERC involvement in the affairs of the industry. Government should avoid putting itself in such a position, unless there is no alternative. However, one does exist: the transco or grid company.

As doctors Vernon Smith and Stephen Rassenti pointed out in their paper, "[w]ith [a separate company owning transmission and distribution] the potential questions [of market power that lead to the ISO] would be eliminated. Generation entities would be free to apply power ... as the markets develop. The remaining [grid] companies would schedule power ... to minimize costs for customers ...." The issues that perplex the industry and regulators on ISOs would evaporate. The incentive

37. Id. at II. D.
38. Id.
40. Id. at 4.
would exist to create companies of the proper size and with the most qualified personnel as managers and dispatchers. The grid company would have no reason to favor particular generators, as it would have nothing to gain. In addition, the grid company would schedule and curtail without regard to the source of generation, since the generator would not own any part of the grid.

Price remains the one area that requires regulation. If a transco or grid company operates independently of generators, it still possesses a monopoly over transmission. As discussed in section C, incentive rates would give the monopoly a restraint against excess, with minimal regulatory oversight. This situation so far represents the experience in Mississippi, which is also described.

2. Reliability and Complaints About Customer Service

In addition to ISOs as against grid companies, the great issue at the FERC currently involves reliability. As mentioned earlier, before competition, customers and regulators had little reason to worry about reliability. With the changes in the industry, that no longer remains the case. Both the FERC, under its rate setting authority in section 205, and the Department of Energy, which bears responsibility for reliability under section 202(a) of the Federal Power Act, must increase their efforts in that regard. This will require incentive rates with substantive standards and new institutional arrangements.

The FERC recently conducted a conference of interested parties, a "roundtable" on reliability. The conference considered three alternate arrangements: filing a tariff at the FERC, similar to the open access tariff of Order No. 888; relying on complaints from customers; and requiring utilities to establish standards through declaratory orders. Each of these involves the FERC. As Deputy Secretary of Energy Moler testified, the legal authority of the FERC in the area remains "unclear," at best. Chairma Hoecker stated at the conference that he thought it imperative for Congress to legislate in the area to augment the FERC's authority. He maintained, as did the Deputy Secretary of Energy, that the current system of the North American Electric Reliability Council's (NERC) voluntary standards no longer work.

On that score, the testimony proved them right. Customers and new entrants argued with utilities, customers and new entrants emphasized allegedly anti-competitive motivation, while utilities argue about safety of

42. See discussion, supra p. 5.
45. Id. at 8.
46. Id. at 8, 147 (Chairman Hoecker); Id. at 13 (Deputy Sec. Moler).
Chairman Hoecker correctly expressed his concern about whether the FERC had the resources (and, in our view, the expertise) to undertake such a large job. 48

The NERC itself has entered the arena. On December 22, 1997, the NERC, in co-operation with Florida State University, convened a reliability panel, and issued its findings. 49 The report suggested a hybrid approach, similar to the private securities market. The North American Electric Reliability Organization (NAERO) would act as a self-regulating body, subject to the supervision of proper governmental bodies. The Administration's Comprehensive Electricity Competition Plan endorsed that mechanism. 50

Problems exist with that recommendation. Even here, superimposing this arrangement on the existing organization of the industry or on ISOs raises many of the same issues the ISO conference grappled with, arising out of the tension between new entrants looking at incumbents as anti-competitive in motivation and the incumbents looking at the new entrants as free-riders. 51

In addition, giving status to the self-regulating body requires legislation, especially in light of the fears of some utilities about antitrust problems. 52 Moreover, unless the Department of Energy indicates a willingness to use its authority under section 202(a) of the Federal Power Act to designate co-ordination districts; and the statute which requires that the designation remain voluntary appears adequate, Congress will have to legislate on the supervision. Congress will not likely act soon.

Customers have begun to question more than just the industry's reliability standards. In at least two formal filings with the FERC, wholesale customers contend that transmission utilities shortchange service through alleged over-booking, withholding capacity for their own needs and scheduling. 53 In its comments on the Symposium on Process and Reform: the Commission's Complaint Procedures, the Electric Power Supply Association urged the Commission to expedite relief in cases of failure of service. In filing, a petition for rulemaking, sixteen parties ranging from large industrial consumers to electricity marketers urged the FERC to enact regulatory changes, such as tightening the Code of Conduct and more

47. Id. at 90, 128-29 (Sue Kelly); Id. at 120 (Kurt Conger).
48. Id. at 144.
49. NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL, RELIABLE POWER: RENEWING THE NORTH AMERICAN ELECTRIC RELIABILITY OVERSIGHT SYSTEM (December 22, 1997) [hereinafter the NERC Task Force Report].
50. See supra note 20.
52. See, e.g., supra note 47.
regulation of the OASIS bulletin board, in addition to structural remedies.

C. A Solution: Incentive Rates

In the new era, the FERC needs to adopt an overarching policy as a means to ensure utility performance in the areas of reliability and customer satisfaction. Moreover, as transmission could remain a monopoly, regulation must assure as well a reduction in prices. In its recent report, the DOE Advisory Board stated:

Without a robust open market for transmission improvements there is minimal incentive for commercial entities to advance long-term transmission research. Research to advance transmission technology would then be in the public interest and open rather than proprietary. Funding mechanisms for this research will have to be developed.54

An incentive rate plan like the one the Public Service Commission (Mississippi Commission) developed with Mississippi Power Company (Mississippi Power) fills that need. In brief, the Performance Evaluation Plan (PEP) places equal weight on lower prices on the one hand (50%) and reliability and customer satisfaction (25% each).55

If the FERC finds the right combination of unleashing the economic self-interest of the profit motive and minimal regulatory review, establishing a grid company as the owner-operator of the transmission system would go a long way toward overcoming much of the difficulty with ISOs and the FERC reliability processes. Most importantly, the FERC would use existing authority under section 205 of the Federal Power Act to adopt the plan. Knowing that it could earn a profit from a grid company, the industry itself would voluntarily organize one.

In broad terms, the Commission would set an overall standard. Borrowing from the ISO concept, the FERC would require the grid or transco company to conform to independently set criteria. One commentator suggested using the variations in hourly cycles, or the heat rate of the grid.56 Another means might involve enlisting the NERC, or a group such as NAERO, as an independent, disinterested expert authority to establish standards for the grid company to implement through its personnel who operate the grid.

The actual means of fulfilling the standard would depend on the company, but the company would file the plan with the FERC. If the company exceeded the standard, it would reap monetary reward; if short, its shareholders would suffer monetary losses. An annual audit would verify results.57

54. SECRETARY OF ENERGY ADVISORY BOARD TASK FORCE ON ELECTRIC-SYSTEM RELIABILITY, INCENTIVES FOR TRANSMISSION ENHANCEMENT 8 (February 26, 1998) (draft paper).
57. Mississippi Power's PEP calls for a semi-annual evaluation. PEP, at 1.
1. The Plan Behind the Plan

At the infancy of the competitive market for electricity, ensuring proper transmission pricing and the expansion of a transmission grid are of central interest to policy makers and long-term planners. With the growth in transactions, the grid will experience greater levels of constraint. In Mississippi, our Public Service Commission faced these same issues, though in the context of retail service.

We concluded that, in the long run, complex regulatory schemes and codes of conduct could not ensure in a meaningful fashion the levels of reliability our country has become accustomed to, and constituents now require. We looked for a method of pricing and a program for innovation that would make the industry the engine of a successful result. The method would have to provide the carrot of profit in order to achieve the degree of efficiency experienced in the days of informal understandings and accommodations.

We saw no need to consign to the history books our Nation's experience with high levels of performance. To achieve the same results, however, the Mississippi Commission, as I think the FERC, would need to make adjustments in philosophy as well as policy. We regarded as a failing proposition the use of government "expertise" to outwit a monopoly's tendency for anti-competitive behavior. Instead, we relied on the fact that our capitalistic society rewards ingenuity and innovation. Indeed, entrepreneurial spirit, we thought, must form the most important ingredient of regulation, if we were to make a success of Mississippi's utility service. We at the Mississippi Commission concluded that incentive and performance-based pricing would increase customer satisfaction. In the same vein, I think incentive rates must underpin the competitive market Order No. 888 envisioned. On the federal level, I think such an approach in transmission can also provide the means to resolve the regulatory impasse between industry seeking higher return on the investment, and customers claiming that the monopolistic regime of transmission requires cost-based rates with low rates of return.

With additional opportunity for profit, the industry will build the type of transmission grid that will provide the level of reliability required by customers. The lower rates and improved customer service resulting will satisfy the demands of consumers. No matter how rigorously we regulate transmission, if the industry no longer provides a high level of certainty that the product will be delivered as agreed, we will have failed in our efforts.

I think that on the federal level, as in Mississippi, the required level of certainty can be ensured by requiring the grid or transco company to meet articulated standards, in exchange for an opportunity to earn a higher rate of return. The incentives work through a formulary calculation of the revenue requirement, and allow the utility to earn higher profits if it re-
duces its costs.\textsuperscript{58} Another way entails a specific or narrow incentive, such as accelerated depreciation on investment tied to the elimination of system constraints, or attributable to increased reliability.\textsuperscript{59} These incentives transform the transmission systems into a profit center which becomes the foundation for the economic success of restructuring.

2. Summary of the Plan

Incentive and performance based plans are carefully researched and negotiated formulas for the determination of the revenue requirements of a utility. Plans can be as different as night and day; however, the intended results are the same. The different components, formulas, indexes and calculations are only limited by the need for a sound basis upon which to determine a fair earned return on investment.

The PEP works as follows. Through the use of the formulary earned rate of return along with an adjustment for the performance of the utility in the areas of price, customer satisfaction, service reliability, this market surrogate permits light-handed regulation. The PEP calculates earned return on investment by using the rate base for the end of the review period and by using the expenditure and revenue items for the preceding historical period. Each of these components (rate base, expenditures and revenue) is separated on the basis of wholesale and retail. Further, each rate class must reach a level of parity analyzed in conjunction with the cost-of-service study filed pursuant to the plan.\textsuperscript{60}

The resulting operating income can then be divided by the total rate base in order to determine the after tax earned rate of return. Under an extremely simple explanation of an incentive and performance based plan, the comparison of the earned return on investment to the calculated performance benchmark return on investment would reveal whether the revenue requirement is to increase or decrease during the upcoming period.\textsuperscript{61}

Establishing a benchmark return on investment will be a function of the negotiated performance indicators and cost of capital calculations.\textsuperscript{62} While the earned return on investment is the threshold calculation, it is the performance based return on investment that provides the incentive. The result of the formula in determining the performance based return on investment is basically an adjustment to the cost of capital of the utility.\textsuperscript{63}

\begin{itemize}
\item \textsuperscript{58} The PEP envisions such a calculation. PEP, Appendix A at 5.
\item \textsuperscript{59} One of the industry participants at the Reliability Roundtable advocated allowing accelerated depreciation. Testimony of William Newman, Reliability Roundtable, supra note 44, at 127.
\item \textsuperscript{60} PEP at 2; PEP at Appendix A.
\item \textsuperscript{61} PEP at 1.
\item \textsuperscript{62} In Mississippi it happened that way, because the PEP represents a cooperative venture between Mississippi Power and the Mississippi Commission.
\item \textsuperscript{63} PEP, Appendix C.
\end{itemize}
Design of performance indicators into an objective formula is not limited to the indicators noted. The cost of capital is to be determined using a combination of interest on long-term debt, preferred stock and common equity reflecting the current structure of the utility. While the interest of long-term debt and preferred stock equity can be established through the books, filings and records of the utility, the common stock equity is generally more complex. An annual discounted cash flow model (utility comparison), risk premium model and capital asset pricing model can be utilized as well as other models, and in combination, for a figure reasonably acceptable to the stakeholders.

Next, a determination must be made as how to adjust the cost of capital in a meaningful way to provide the reward and penalty for the performance of the utility. An approach that is balanced when establishing the performance mixture prevents the utility from ignoring a specific component of the performance indicators in an attempt to game the plan.

An improper balance of the indicators can result in unintended consequences. It is obvious that low rates without service reliability or customer satisfaction would not be the desired result. As in a market economy, balancing all factors of the customer demands and needs results in the delivery of the best product or service, and in this case, product and service.

In Mississippi, the indicator of price is calculated by using the average retail price per kWh divided by a regional weighted average retail price per kWh. On the federal level, regional information can be compiled or designed in various ways to obtain an appropriate mix of data. Proper comparisons to achieve the standards are necessary for the evaluation of the performance of a particular utility. Data can be compiled from the Federal Energy Regulatory Commission (FERC) Form 1. The information would be updated annually and would form a common source of utility information. The resulting figure from the price comparison would then be used, along with a linear scale, for the final determination of price performance.

As expected, the price indicator should be weighted more heavily in the final calculation of the adjustment to the cost of capital. Even with reliability being vitally important to all consumers, price is the component of which all consumers are acutely aware.

In Mississippi we determined that service reliability, aside from price, is the paramount component which is taken for granted in the everyday life of the consumer. During the transformation from consumer (ratepayer) to customer, reliability will receive the lion's share of the attention.

64. PEP, Appendicies B and C.
65. PEP, Appendix C.
66. PEP, Appendix C.
67. PEP, Appendix B.
68. PEP at 1.
in the regulatory arena, as the gentlemen’s agreements are put aside for
the competitive advantages awaiting the utilities that are well positioned in
the starting blocks. The plan will have to bring the outages of a utility to a
level that is satisfactory to the customer base. Analysis of the total time
within the test period in which customers experienced interruptions in the
service and the number of customers affected provides an excellent indica-
tor of service reliability.

Ultimately, the indicator can be a percentage of the total hours of
electrical service or the amount of time during the test period that the cus-
tomer experienced service interruptions. As other reliability factors be-
come measurable, additions to the service reliability indicator can be de-
vised and useful for the desired standard.

The last performance indicator the PEP discussed is customer satisfac-
tion.69 Other than direct contact with the customer base and a customer
survey, the measurement of satisfaction is largely subjective. Surveys
should be closely reviewed to insure the result will have value to the analy-
sis of the utility, and questions should focus on extracting objective infor-
mation from each customer surveyed.

Once the performance indicators are determined from the variable
weighting of the indicators, the cost of capital is adjusted for the perform-
ance based return on investment. The comparison of the performance
based return on investment to the earned return on investment results in
the increase, decrease, or no change of the revenue requirement for the
upcoming period.70 As with any formulary scheme, changes within a cer-
tain range are unnecessary and problematic.

In order to minimize the number of rate changes that could result
from trying to match the earned return on investment to the perform-
ance based return on investment, a band or range of no change is established to
avoid nominal or de minimus alterations in the utility rates.71 The bench-
mark is the rate of return on investment used to compare the earned re-
turn on investment of the utility during the test period. It is the bench-
mark for a testing period and the treatment of the increases or decreases in
the revenue requirement which fall outside of the band or range of no
change that receive enormous amounts of attention during the design
stages.

This feature of the plan is also referred to as the deadband. Once out-
side of the deadband, the consumers assert a desire, and many regulatory
bodies agree, to share in the benefits of the performance of the utility.
Good business judgment and decisions in a fully competitive economic
market are, without doubt, the rewards of the entity. However, if the util-
ity is given an opportunity to earn a fair rate of return with reduced risk,
the consumer can and should share in some degree, since a portion of the
risk has and always will be borne by the consumers of the utility (i.e. dis-

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69. PEP at 1.
70. PEP, Appendix D.
71. PEP, Appendix C (contains the Mississippi formula).
In the event the earned return on investment falls far enough below the deadband to require an increase in the revenue requirement (in excess of 4% annually in the aggregate, or 2% for a review period, taking into account the sharing provisions), then a full hearing is required before the Mississippi Commission. The result of this statutory hearing requirement, if applicable, is to ensure the accuracy of the information used in the performance evaluation and the proper application and interpretation of the plan.

The customer is allowed the unrestricted ability to select the provider of the desired services, who does not bear the risk and should not, therefore, benefit from the performance of the entity. Sharing provisions in an incentive and performance based plan can and should be based on the design of the indicators noted. As the performance indicators show a high level in the areas of price, service reliability and customer satisfaction, the utility can and should retain the lion's share of the earnings above the band. The converse is true if the earnings are below the band. The quid pro quo drives at the very heart of the plan.

As the design of the plan develops, the discussion will turn to whether the revenue requirement for the period in question returns to the benchmark (performance based return on investment), or whether the revenue requirement returns to the bottom of the deadband.

If the revenue requirement returns to top or bottom of the band, the sharing mechanism can serve the intended purpose. It is obvious that returning to the benchmark eliminates the meaningful use of the sharing design of the plan. Sharing provisions can in some respect weaken incentives unless the performance indicators materially reflect the bottom line revenue to insure the integrity of the rate design.

The results of an incentive and performance based plan can be seen in the history of the PEP. Mississippi Power's average retail cents per kWh dropped from 5.51¢ (1985) to 4.93¢ (1997). Revenues of Mississippi Power have increased over 26% during the same period. Further, the performance indicators have sustained a high level in regard to price, customer satisfaction and reliability.

Even taking into consideration the growth of Mississippi Power, the results establish that incentives can produce a highly reliable product and service for a fair and reasonable price: thereby enhancing the economic growth and cost allocation reductions in favor of the entire customer base.

In summary, the earned rate of return is compared to the adjusted cost of capital of the utility in calculating the revenue requirement. The width of the range of no change (deadband) above and below the variable
benchmark (adjusted cost of capital) will be a direct factor of the frequency of rate changes and rate stability. The benefits received from the incentives to the industry and the stability of rates and service for the customer arise from the convergence of reliability and a far less intrusive regulatory hand.

Average Retail Cents Per kWh

Mississippi Power Company

<table>
<thead>
<tr>
<th>Cents per kWh</th>
<th>1985</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.0</td>
<td>5.51</td>
<td>4.93</td>
</tr>
</tbody>
</table>

Data from FERC Form 1

Retail Revenues
Mississippi Power Company

<table>
<thead>
<tr>
<th></th>
<th>1985</th>
<th>1997</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>$329,140,433.13</td>
<td>$417,241,698.11</td>
<td>26.77%</td>
<td></td>
</tr>
</tbody>
</table>
III. THE NATURAL GAS INDUSTRY

When the Commission issued Order No. 636 many in this industry saw incentive rates as almost a necessary response to the new straight/fixed variable (SFV) rate design. The Commission itself supported the utilization of incentive rates with its concomitant issuance of its Policy Statement on Incentive Regulation. With guaranteed fixed cost recovery under SFV, incentive ratemaking provided a vehicle which would facilitate the control of costs and maximization of efficiency on these systems. Economic pressures of the last few years, however, intervened and brought about most of the benefits experts thought would come through incentive ratemaking. For example, pipelines have significantly reduced their costs. The extent of this cost-cutting was aptly described by James Rubright of Southern Natural Gas Company at the Commission's January 30, 1998 Public Conference on Financial Conditions. He testified:

[T]he reason pipelines are not jumping on performance and incentive rates is just that the real opportunity in them is gone . . . . Incentive rates work great if you can reduce costs. Ten years ago, Southern Natural had 1,700 people in the field operating our 10,000 miles of pipelines. Five years ago, we had over 700. Today we have 400—400 people operating 10,000 miles of pipelines. If I keep reducing staff at the same rate, in ten years I'm going to operate the pipeline on minus 1,300 people.8

The Commission itself is aware that its Policy Statement on Incentive Rates has not been embraced by the natural gas industry. In fact, to determine why there had not been any incentive proposals under the policy established in Docket No. PL92-1-000, the Commission opened another proceeding soliciting comments.

An attraction of incentive rates rests on regulators using them as a benchmark for comparing the cost levels of one company with the cost levels of another company, and rewarding the higher achieving company accordingly. For this to work, cost saving potential must exist. The problem arises when expenses have already been restricted as far as they can reasonably be without jeopardizing either safety or service.

At this point the question becomes: where else can we develop incentives that will spur this industry to act more competitively? As the Commission is aware, the industry has not been in a position to do much to lower costs. Perhaps if the Commission were to consider alternative forms of ratemaking, it might be able to find a way to encourage the industry to act more competitively.

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mission itself has said, "the incentive rates policy is still emerging." I think we can find the incentives we are looking for in a more flexible approach to the issues of return on equity, certification, negotiated terms and conditions, and capacity release. More flexibility in these areas will enable this industry to respond to the stifling disconnect between FERC regulated prices and market-driven values.

A. Return on Equity

The fundamental rationale for determining an appropriate return on equity is that this mechanism rewards a regulated company for the business and financial risks it faces. In the seminal case on this issue the Supreme Court held "[t]hat return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." The current Commission practice of determining the appropriate rate of return on equity utilizes a two-stage Discounted Cash Flow (DCF) methodology. The two stages, one reflecting short-term growth estimates and one reflecting long-term growth estimates, are equally weighted and utilized in determining a range of reasonable returns. Within this range the highest, middle, and lowest point are identified. The presumption, though, is that most natural gas pipelines face risks that are within the broad middle of the zone of reasonableness. Under the Commission's current DCF methodology, this results in an applicable return on equity of approximately 10.88 percent for all but the riskiest or the safest pipelines in the industry.

A return on equity of 10.88 percent might not, in most cases, provide companies with the ability to adequately attract capital. In fact, at the Financial Conditions Conference many pipeline representatives indicated that the rates of return generated by the Commission's two-step DCF methodology were significantly below the levels needed to stimulate the investment that will be necessary to meet the anticipated gas needs for the future. As Keith Bailey, CEO of the Williams Companies stated, "A 10.88 percent expected return will simply not stimulate new investment and accommodate thirty Tcf of gas demand, this segment of the industry conservatively needs to spend twenty-five billion dollars between now and the year 2010." Mr. Bailey went on to underscore the impact of a 10.88 return on eq-

81. Alternatives to Traditional Cost-of-Service Ratemaking For Natural Gas Pipelines, 74 F.E.R.C. ¶ 61,076, at 61,238 (1996). As part of this order the Commission revised its incentive rate criteria to remove the quantification of benefits requirement and the cost-of-service cap. Id. at 61,237.
85. Projections for future U.S. gas demand are that demand will increase to 30 Tcf by the year 2010. Financial Conditions Conference, transcript at 9.
86. Financial Conditions Conference, transcript at 12.
uity when he argued, "If we are truly expected to live in a 10.88 percent world, Williams, for one, will not make any more expansion investments, and we will cease all but the most minimal project development activities."\(^7\)

For me to hear that pipelines see the current DCF-derived rate of return as failing to attract sufficient capital calls into question whether we are meeting our mandate to set rates at a level that attracts and rewards capital to the industry. . . . Accordingly, I suggest that the Commission use the potential of an increase above the current DCF-derived return as an incentive to spur the attraction of capital. As I explored at the Financial Conditions Conference, a pipeline that would be willing to forgo stranded cost collection for a new project and accept incremental pricing, could be rewarded with a rate of return higher than the DCF-derived return.\(^8\)

If the Commission would use a higher rate of return as an incentive, it would give the industry the incentive to respond to the anticipated, impending growth in demand, and, at the same time would protect ratepayers from the impact of stranded costs, while giving shippers alternatives.

The example of a higher rate of return in conjunction with new, incrementally priced construction illustrates how incentive rates can be used to encourage development in this industry. More important, once derived, the rate of return should be used with some flexibility as a tool that would mimic the pressures and influences that a free market would exert.

\section*{B. A Definable Certificate Policy}

As noted, current estimates are that natural gas demand will surge to an unprecedented level of thirty Tcf by the year 2010. Flexible application of the return-on-equity policy may provide the incentives needed to meet that demand. As was also noted at the Financial Conditions Conference, the return on equity policy must be addressed now as pipeline projects have a substantial lead-time and construction period before the systems are operational.\(^9\) The substantial lead-time that is necessary for new construction leads me to my second point: that a definable certificate policy will be a great incentive for ensuring that demand is met.

At this time, numerous certificate projects are pending before the Commission. In sum, those projects represent more than eleven billion dollars in potential investment and would provide thirty eight Bcf a day of new interstate capacity.\(^9\) The Commission's certification policy has, until recently, been that certification is authorized upon a showing of market need, and that need is presumed if the applicant provides evidence that a

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\(^7\) Id. at 13.

\(^8\) Id. at 67, 68.

\(^9\) Financial Conditions Conference, transcript at 15. Testimony of Keith Bailey, "Pipeline projects, even relatively simple ones, have long lead times. Major projects can and often do take up to seven years from start to finish."

\(^90\) Financial Conditions Conference, transcript at 19.
significant amount of capacity is subject to contract. 91

However, in the recent Granite State proceeding, 92 the Commission failed to authorize a project that not only met, but exceeded Commission precedent and policy on the market need standard. The majority's decision to forestall authorization on the basis of the alleged necessity for further evidentiary hearings hearkens back to the Commission's previous use of comparative hearings for determining certificate projects.

This approach is contrary to our stated policy and creates a negative incentive for companies considering a certificate application. The best incentive the Commission can put forward in the certificate arena is a definable policy that supports the current market need standard. As I argued in my dissent in Texas Eastern:

[T]he decision to require Commission inquiry into contracts beyond their compliance with the Commission's regulations is a step backward to the onerous burdens of a more invasive regulatory scheme.... This would be heavy-handed regulation at its clearest, chilling the ability of parties to contract for their needs while assured that they are free from regulatory second guessing.

The greatest incentive that the Commission can provide with relation to certificates is that business assessments of need, and contracts on the basis of such, will be respected. If such assessments prove to be incorrect, market forces will determine which projects go forward and which do not. I am concerned that the Commission's recent actions in these cases will stifle, rather than encourage, actions in the certificate arena. Instead, this Commission should remain faithful to its articulated policy of confining itself to the four corners of a contract and accepting applicable contracts as evidence of market need.

C. Negotiated Terms and Conditions

This Commission can provide a great deal of incentives to this industry by permitting the negotiation of terms and conditions. By permitting parties to tailor terms and conditions to the needs of their specific situations, the Commission can provide an incentive which will simulate innovation and creativity in pipeline services both for the provider and for the customer. As this proposal addresses many issues, I cannot speculate on the breadth of terms and conditions we may see negotiated, if permitted. Instead, I argue that use of this tool should not be foreclosed because its utilization will enable the industry to respond to competitive pressures in a creative manner and provide customers with more useful choices.

D. Capacity Release

Another area that is ripe for new incentives is the secondary market

for short-term capacity—specifically, capacity release. The first transac-
tion involving capacity release in the gas pipeline market occurred almost
five years ago. After recording annual increases, the industry is beginning
to see declining levels of capacity release volumes. By removing the arti-
ficial barriers that the FERC imposed on capacity release, the Commission
can give all parties a greater incentive to utilize released capacity. Specifi-
cally, we could remove price caps from released capacity. Without the ar-
tificial constraints caused by price caps, released capacity will be placed on
a better footing to compete with other short-term services, such as pipeline
interruptible, short-term firm and bundled sales in the grey market.

By treating released capacity in a manner similar to other short-term
services, which are not subject to limitations such as the price cap, the
Commission will be able to increase the ability of the industry to view all
short-term services as competitive options and this, in turn, will enhance
the overall competitive nature of the industry.

IV. CONCLUSION

William Faulkner said, “Don’t bother just to be better than your con-
temporaries or predecessors. Try to be better than yourself.” There are
no words more fitting for the natural gas and electric utility industries to-
day. Parallels to yesteryear or even yesterday will not suffice in the new
competitive utility arena. Any utility satisfied with standing still should
not complain when others in the industry provide less expensive and more
reliable energy, therefore passing them by.

The marketplace has manifested that regulators provide inventive ap-
proaches for the natural gas and electric utility industries. However, no
worthwhile advance will be made without significant heartache, contro-
versy, and debate. For some readers, I am certain we have provided all
three.

More than 65,000 awarded deals have been posted on the various proprietary pipeline elec-
tronic bulletin boards since 1994. Over 12,000 deals were exchanged in 1994, about 16,000 in
1995 and 18,400 in 1996. Only slightly fewer transactions occurred in 1997 - about 18,260 -
than in 1996. And in 1994, about 3 trillion cf of firm capacity was released by shippers.
About 4 trillion cf was released the following year . . . In 1997, the volume of released capac-
ity held has returned to those seen in 1995, falling to about 4.5 trillion cf.
95. The phrase “grey market,” to those at the FERC and in the industry means transactions that
tacitly bundle natural gas with transportation service.
TAKINGS AND BEYOND: IMPLICATIONS FOR REGULATION

Paul Turner* and Sam Kalen**

I. INTRODUCTION

This past decade marks a critical juncture in the evolution of the Fifth Amendment.1 Until recently, the Fifth Amendment "private property rights" debate occurred primarily among traditional land-use planners, zoning boards, and attorneys engaged in state and local land-use law. Yet with the advent of the expanded regulatory state in the 1970s, where everything from consumer protection to the environment and from communications to energy generation and transmission has become increasingly subject to federal control,2 it was only a matter of time before the "property rights" banner would be waved with a new fervency. The debate has broadened to include—if not been driven by—those involved in the ever-growing focus on environmental and natural resource protection, including recent sweeping changes in the energy field.

The Fifth Amendment provides, "[N]or shall private property be taken for public use without just compensation."3 The exploding cost of

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3. U.S. CONST. Amend. V.
protecting natural resources, coupled with increased awareness of the need for and type of protection necessary, have forced many to consider expansive command and control regulation. Environmental regulation and natural resource protection are expensive and, to some, a luxury afforded only by industrialized nations. Environmental compliance costs have escalated enormously since the early 1970s, when many of the environmental programs were first established. To these costs, the country must now add the expense of ensuring biological diversity through ecosystem protection, such as preserving wetlands or habitat areas for endangered or threatened species. With a majority of these resources occurring on private property, if the government were to acquire rather than simply regulate the use of these areas, the cost would be prohibitive. So instead of acquiring this property, advocates of resource protection press for regulation to control property use.

The regulatory takings issue is also receiving increasing interest in the energy field. Within the context of electric restructuring, for example, the treatment of stranded costs of the traditional utility forced into a new, competitive environment is a fundamental issue. It has been suggested that, unless the utility is given the opportunity to recover its stranded costs in full, a regulatory taking has occurred. Additionally, some commentators have argued that recent policy statements by the Federal Energy Regulatory Commission (FERC) relating to the relicensing of hydroelectric projects may raise serious regulatory takings issues.

Courts, therefore, are being asked more and more to resolve the balance between preserving effective regulatory control options and protecting private property. Many observers hoped that the Supreme Court's foray into the subject in 1992, with its decision in *Lucas v. South Carolina Coastal Council*, would provide much-needed guidance to lower courts—and to some extent, it did. But to many on both sides of the environmental versus property rights debate, the decision failed to provide the hoped for decisive victory. As a consequence, it has been left to the lower courts, primarily the United States Court of Federal Claims and the United States Court of Appeals for the Federal Circuit, to implement the Court's vision for regulatory takings.

4. Some argue that our focus on environmental regulation affects our international economic competitiveness and that we need to coordinate our international efforts and attempt to harmonize the international economic and environmental arenas. See Richard B. Stewart, *Environmental Regulation and International Competitiveness*, 102 YALE L.J. 2039 (1993).
TAKINGS OF UTILITY PROPERTY

These courts, following Justice Scalia's direction in *Lucas* to look to background principles to determine whether a property right has been taken, generally have looked only to state nuisance and property law to determine whether any limitations inhere in a landowner's title, thus usually defeating the claim that the governmental action constitutes a taking. However, such a narrow inquiry is neither mandated by *Lucas* nor appropriate. Both federal and state statutory and common law serve as relevant background principles which can shape the contours of property interests. Courts should recognize the appropriate role of state and federal statutory law, because such a recognition would better represent a balance between protecting an individual's property rights and allowing governments, both state and federal, to modify their regulatory schemes as progress in science and other fields illuminate problems and issues which previously were not known or understood.

Much is at stake in this widespread public debate, both practically and as a matter of constitutional theory. Senator Joseph Biden even began the Senate's questioning during the confirmation hearings on Associate Justice Clarence Thomas by brandishing a copy of University of Chicago Law Professor Richard Epstein's book *Takings: Private Property and the Power of Eminent Domain* and expressing concern that the nominee might sacrifice the environment under the guise of protecting private property rights, inserting into the Constitution what is called the "economic rights" philosophy or doctrine.

Supporters of "economic rights" argue that property "ownership" embraces a "bundle of rights" and that government interference with any particular strand in that bundle requires compensation, whether that interference is in the nature of zoning, economic controls or environmental regulation. To these advocates, compensation may be required when, for example, a landowner is limited by a height restriction to building only a four-unit apartment complex instead of a six-unit structure. In this instance, the government has interfered with one of the strands in the bundle of rights and rendered the property less valuable, and it must compensate for that loss if it cannot show a health or public safety justification. Similarly, if a landowner is required to obtain a federal permit before she can begin development on her property, then any economic loss, whether caused by governmental delay or by the inability to develop any portion of the parcel, would call for governmental compensation. Such a doctrine would effectively chill a considerable amount of regulation, and leave the economic market place as the guarantor of the form and pace of "progress"—both economic and environmental—in our society.

Until recently, however, most scholars generally believed that such principles of laissez-faire constitutionalism were successfully buried. These principles flourished in the late nineteenth and early twentieth centuries.  

During that period’s heyday, the Court held unconstitutional a variety of economic and social legislation that people now take for granted. After the mid-1930’s, the Court began to uphold the constitutionality of legislation that might have been suspect in prior years. This shift brought the Court into the modern era of giving considerable deference to the economic judgment of government. The movement, urging greater protection for “economic rights”, threatens to reverse this trend, possibly leaving in its wake a variety of economic, social, and environmental regulation supported by all but a very select group.

Conversely, some champions of the environment apparently believe that the public good not only justifies any environmental regulation but also that the public good warrants imposing on the individual landowner the cost of achieving these laudable societal goals. Yet, by uncritically elevating the rights of the community over the rights of the individual, this argument could be as destructive to traditional “liberalism” as is the “economic rights” movement. The argument necessarily embraces a “communitarian” governmental theory. In the past few years, legal and economic scholars have been engaged in a dialogue about “communitarian” rights, a notion that the community itself has rights that can trump individual rights. This perspective is shared by both liberals and conservatives, and the implications of this theory are only now being explored. What is important to note, however, is that the communitarian theory is being used to justify not only environmental and similar regulation, but also social legislation such as drug testing, abortion, hand gun control, and prayer in the school. For those who believe in traditional “liberal” values, a communitarian theory could then undermine commonly held precepts about the scope of individual rights.

Consequently, more is at stake in a case like Lucas v. South Carolina Coastal Council than whether individual property owners should be compensated when the government has rendered their property valueless. Hinging in the balance is the extent to which changes in science and in prevailing thought on regulated industries can be effectuated by new regulatory programs, and the degree to which individuals, rather than society as a whole, will be asked to shoulder the burden of progress.

The problem is the same as that which Justice Holmes faced in the bedrock case of regulatory takings, *Pennsylvania Coal v. Mahon.* He recognized that governmental regulation, if unchecked, could be as detrimental to private property as an out-and-out appropriation of the property. Writing for the Court, he stated "the natural tendency of human nature [would be] to extend the qualification more and more until at last private property disappears." This led Justice Holmes to pen the now famous phrase, "while property may be regulated to a certain extent, if regulation goes too far, it will be recognized as a taking."

The obvious question confounding scholars and courts alike, however, is how to tell when a regulation has gone too far. Every regulation renders some "right" to the unrestrained use of property worthless. With such high stakes, it is not surprising that, during Justice Clarence Thomas' first year on the Court, three property rights cases received considerable media attention.

Of those three cases, the Supreme Courts' decision in *Lucas v. South Carolina Coastal Council* has become the seminal case for scholars, pundits, and courts to begin their exploration into the scope of the Fifth Amendment takings jurisprudence. Yet before they stray beyond the pa

15. Id. at 415.
16. Id.
17. In the regulatory takings context, it is not the tangible property itself that is being taken; rather, it is the inchoate right to use the physical property in a certain manner which is taken.
rameters the Supreme Court established in that case, they should first understand what the Court held, what it did not hold, and the historical basis for its decision.

Part II of the article discusses the *Lucas* case. It explores the background and history of the case and provides an overview of the Supreme Court's decision. Next, Part III of the article canvasses some historical underpinnings and traces the development of the regulatory takings doctrine through *Lucas*. Finally, Part IV discusses a number of post-*Lucas* cases in the Court of Federal Claims and the United States Court of Appeals for the Federal Circuit, with an analysis and critique of some of the trends that appear in the implementation of the *Lucas* decision. It also addresses the effect of *Lucas* on takings analysis in the field of utility ratemaking.

II. PROTECTING THE SOUTH CAROLINA COAST: *LUCAS V. SOUTH CAROLINA COASTAL COUNCIL*

A. The South Carolina Beachfront Management Act

In 1988, the South Carolina legislature amended the South Carolina 1977 Coastal Zone Management Act by enacting the 1988 Beachfront Management Act. Under the 1977 Act, South Carolina participated in a federal program to protect coastal waters, tidelands, beaches, and primary oceanfront sand dunes. The 1977 Act restricted development in the dunes adjacent to the Atlantic Ocean. The 1988 Beachfront Management Act extended the areas protected from new development to a zone drawn from the mean high water mark to a set-back line established by the South Carolina Coastal Council. The set-back line was to be based on the greatest extent of erosion in the previous forty years, plus an additional twenty

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feet. Virtually no construction could take place seaward of the set-back line. Under the 1988 Act, there was no provision for waiver of the construction ban seaward of the line. The legislature enacted the 1988 amendments to protect life and property, provide the basis for tourism, provide habitat for numerous species of plants and animals (including endangered and threatened species), and provide a natural health environment for the citizens of South Carolina.

In 1990, South Carolina amended the 1988 Act to allow individuals to seek a waiver to the ban. A special permit allowing construction, however, could not be granted when the proposed construction would be on an active beach. Further, if a permit were issued, the recipient was required to agree to remove a structure if the Council so ordered because, in the Council's view, it was detrimental to the public health, safety, or welfare.

B. The Perils of David Lucas

David H. Lucas purchased two residential lots on the Isle of Palms, South Carolina, in 1986, for $975,000. He intended to build a single-family home on each lot, one for himself and one for resale. At the time he purchased the lots, there were no state or local regulations which would have prohibited the contemplated construction. Mr. Lucas' two lots were separated by an intervening lot on which a house had already been constructed. Additionally, there were homes already built on the other sides of the two lots. Mr. Lucas' property was 300 feet from the ocean. In 1988, the South Carolina legislature passed the 1988 Beach Management Act, as discussed. The set-back line established under the Act by the South Carolina Coastal Council was landward of Mr. Lucas' property. Thus, Mr. Lucas could not develop his land.

He filed suit in the South Carolina Court of Common Pleas, claiming that the 1988 amendments had effected a taking of his land. He argued that, regardless of whether the 1988 Act was a legitimate exercise of the state's police power by extinguishing the full value of his land, the state owed him just compensation.

The state trial court agreed. The court found that, at the time Mr. Lucas purchased the property, there were no restrictions on its use for residential development. The court went on to find that the 1988 amendments permanently prohibited Mr. Lucas from developing the lots, thus depriving him of any reasonable economic use of the lots and rendering them value-

28. Id.
30. Id. at 1008.
31. Id.
32. Id. at 1009.
The state trial court therefore concluded that the property had been “taken” by the Act of the legislature and ordered that just compensation be paid, $1,232,387.50.34

C. The South Carolina Courts Attempt to Protect the Coast

On appeal, the South Carolina Supreme Court disagreed, holding that the state did not owe Mr. Lucas just compensation even though South Carolina’s Beachfront Management Act of 1988,35 as applied, denied him all economically viable use of his property. The state Supreme Court framed the issue as one of “whether governmental regulation of the use of property, in order to prevent serious public harm, amounts to a ‘regulatory taking’ of property for which compensation must be paid.”36

The South Carolina Supreme Court, in holding that there had been no regulatory taking, left undisturbed the trial court’s finding that the property no longer had economic value. Rather, it reasoned that a taking does not occur when a valid regulation serves to prevent serious public harm.37 Because Mr. Lucas had not contested the validity of the legislative findings, the court accepted them as legitimate—that South Carolina’s shores are a valuable public resource, that development contributes to the erosion and destruction of the public resource, and that prohibiting new residential construction is necessary to prevent a public harm.38 The state supreme court rejected the argument that, by itself, the deprivation of all economically viable use by a regulation constitutes a taking. It concluded that existing cases supported the proposition that, although the duty to pay compensation may not be exclusive of the proper exercise of the state’s police power, when a regulation exists to prevent serious public harm, no compensation is due to an individual who claims a loss of value from the regulation, because no taking has occurred.39 The court therefore reversed the trial court, with two Justices dissenting.

D. The Debate Begins: The State, Lucas and Interest Groups Seek to Sway the Supreme Court

The United States Supreme Court granted Mr. Lucas’ petition for certiorari,40 which became the opening gambit for the parties and an array of special interests to attempt to influence the outcome of the case. To begin with, Mr. Lucas accepted the legitimacy of the state act, but sought to

33. Lucas, 505 U.S. at 1009.
34. Id.
37. Id. at 896 (citing Keystone Bituminous Coal Ass’n v. DeBenedictis, 480 U.S. 470 (1987)).
38. Lucas, 404 S.E.2d at 898.
TAKINGS OF UTILITY PROPERTY

persuade the Court that the "categorical nature of the nuisance exception—which would deny compensation whenever a legislature finds that a certain activity poses a public hazard—cannot be reconciled with the approach taken by . . . [the Supreme] Court in 'as applied' challenges of regulatory takings since at least 1922." Lucas also argued that, even if a nuisance exception existed, it would not apply here since the landowner was simply seeking to build a house—not a nuisance at common law. He argued that the lower court should have applied the Court's test for regulatory takings set forth in Penn Central Transportation Co. v. New York City. In Penn Central, the Court indicated that a regulatory takings analysis is essentially an ad hoc factual inquiry that explores several factors. Mr. Lucas then pressed the Court to adopt a per se rule requiring payment of just compensation whenever a regulation deprives a property owner of all economically viable use of her property, regardless of any "nuisance exception" that might exist in the abstract.

The South Carolina Coastal Council (Coastal Council), among other arguments, countered that the case was not ripe for review and that the Court should reject any bright-line economic impact takings argument. Characterizing Lucas' position as "extreme," the Coastal Council argued that the Court must examine several factors, and where, as here, "the restriction on development is necessary to prevent serious injury to public health and safety and substantial physical harm to nearby properties, no taking" should result. Lucas' sole emphasis on the economic impact of the regulatory regime, according to the state, ignored the other relevant aspects of the takings inquiry. The Coastal Council relied upon several cases, but offered Mugler v. Kansas as the quintessential case for its position. According to the Coastal Council, Mugler and other cases supported the principle that police power measures designed to protect the public health and safety outweigh the economic impact of any regulation in any takings analysis. Lastly, the Coastal Council argued that, even under a traditional takings analysis, Lucas should be denied compensation due to

42. Id. Counsel asserted that the cases relied upon by the lower court occurred before the rise of modern takings analysis, and those earlier cases were simply substantive due process cases in which the issue before the Court was whether the exercise of the police power was legitimate. Id. at 14.
45. Id. at 19. Petitioner raised other arguments as well, one argument asserting that the state act was designed to promote a public good, not prevent a public harm. Id. at 38. Another argument maintained that a valid exercise of the police power does not obviate the Fifth Amendment. Id. at 35.
47. Id. at 13.
48. Id. at 18-19.
49. 123 U.S. 623 (1887).
51. Id. at 26. The state emphasized that Lucas never challenged the asserted public health and safety justification for the state program. Id.
the unreasonableness of his investment-backed expectations.\textsuperscript{52}

Various groups and entities recognized the potential importance of this case and filed \textit{amicus curiae} briefs urging that the Court adopt a particular perspective. Many of these \textit{amicus} briefs were embroiled in semantics; they reflect the natural tendency toward developing simple categories. The asserted "nuisance" or "nuisance-like" exception to the takings clause is a prime example. A major issue before the Court was whether there was a "nuisance" exception to the takings clause, which might support the state's attempt to avoid compensation. Yet, the term "nuisance" is an ill-defined catch-all concept for categorizing particular uses of property; it reflects a legal conclusion rather than a mode of analysis from which constitutional principles can spring.

The United States Department of Justice (DOJ), for instance, supported the concept of a "nuisance exception" when the regulatory measure substantially furthers the public interest in preventing nuisance-type activities or serious harm to the public health or safety.\textsuperscript{53} Concerned that the exception does not swallow the rule—and thus be coterminous with a valid exercise of the police power, the DOJ proposed that "the regulatory measure must substantially further an established nuisance-prevention or public health and safety purpose, in terms of the nature, degree, proximity, and context of the harm concerned."\textsuperscript{54} The Institute For Justice (IFJ), along with University of Chicago law professor Richard Epstein, proffered an alternative view—that is, landowners must be compensated for the loss in value, whether great or small, for the "imposition of any restriction upon use, above and beyond those inherent in the law of nuisance."\textsuperscript{55} The IFJ urged that the Court adopt an approach that would require compensa-

\footnotesize{
\textsuperscript{52} Id. at 27.
\textsuperscript{54} Id. at 12-13. The Justice Department also relied heavily upon Mugler v. Kansas, 123 U.S. 623 (1887), and argued that against the historical background of allowing the abatement of nuisance-type activities, it was not inconsistent with notions of protecting private property to reject a Fifth Amendment claim in those instances in which the police power was being exercised to abate nuisances and protect the public health and safety from serious harm. Id. at 15-16. After all, "[i]f the use of property in a particular way was not part of the owner's 'bundle' at the time he acquired the property, he cannot claim the government has 'taken' from him the right to that use." Id. at 16. But the Justice Department limited its argument to those instances where the governmental regulation does not depart from the common law origins of a nuisance. Id. at 17.
\textsuperscript{55} Brief of the Institute For Justice as Amicus Curiae in Support of Petitioner at 10, \textit{Lucas}, 505 U.S. 1003 (1992) (No. 91-453). The Institute expressly disavowed the argument presented by Lucas: In his arguments throughout the case, Lucas has avoided one implicit consequence of his argument. Lucas takes the position that the regulation automatically requires full compensation where the restriction on use results in a total loss of value, but acknowledges that South Carolina is free to impose substantial restrictions on use where there is some residual use in question. In essence, Lucas has sought to develop a \textit{per se} rule that deals with the wipe-out case but does not extend his theory to any case of partial restrictions. This approach is conceptually inadequate because it creates a gratuitous and unprincipled conceptual gulf between total restriction on use and massive partial restrictions.

Id. at 11.
}
tion to be paid whenever valid regulatory programs adversely affect the value of private property, and the government regulation exceeds the legal remedies available to private parties. A ruling under this approach would have greatly expanded the set of instances when compensation is required, potentially chilling a vast array of appropriate state and local regulations.

Some environmental organizations argued that compensation is unnecessary if the government regulation legitimately relates to preventing "significant public harm." Similarly, Professor Humbach of Pace University Law School, in a brief on behalf of the National Growth Management Leadership Project, suggested that compensation should not be required when the legislature acts to restrain uses deemed "likely to harm or injure other persons or the community as a whole." The environmental community sought to persuade the Court that an exception to the compensation principle was necessary. Such an exception, however, effectively would have embraced a view that private property is subject to an implied "public good" limitation. In fact, an attorney for the Coastal Council, C.C. Harness, III, has since testified before Congress that the government should be able to ensure that use of property is consistent with the public good.

E. The Court's Decision

Such a divergence in argument, not surprisingly fostered a divided Court in Lucas. Although the Court produced a majority opinion; one Justice concurred in the judgment, two Justices filed dissenting opinions, and one Justice would have dismissed the writ of certiorari as improvidently granted.

In the majority opinion authored by Justice Scalia, the Supreme Court reversed. As an initial matter, the Court rejected South Carolina's argument that the case was not ripe. It reasoned that the prudential ripeness argument was not one that deprived the Court of jurisdiction and, because the South Carolina Supreme Court had eschewed the ripeness argument to reach the merits, it would do the same. On the merits of the case before it, the Court canvassed its regulatory takings jurisprudence and noted that

57. See Brief of Sierra Club, The Humane Society of the United States and the American Institute of Biological Sciences as Amici Curiae in Support of Respondent, Lucas, 505 U.S. 1003 (1992) (No. 91-453); Brief of Nueces County, Texas; Scituate, Massachusetts Conservation Commission; Chatham, Massachusetts Conservation Commission; American Littoral Society; Chesapeake Bay Foundation; Coast Alliance; Environmental Defense Fund; National Audubon Society; Natural Resources Defense Council; National Wildlife Federation; South Carolina Wildlife Federation; Dr. Joseph F. Donoghue; Dr. Paul T. Gayes; Dr. Joseph T. Kelley; Dr. Orrin Pilkey; Dr. Rutherford H. Platt and Dr. Stan Riggs as Amici Curiae in Support of Respondent, Lucas, 505 U.S. 1003 (1992) (No. 91-453).
58. South Carolina argued that, because the 1990 amendments provided a procedure by which an individual could apply for a special permit to build seaward of the setback line and Mr. Lucas had not availed himself of the procedure, the case was unfit for review. See Lucas, 505 U.S. at 1010-11.
59. Id. at 1012-14.
the inquiry has traditionally been an *ad hoc* one. However, the Court stated that in two contexts it has generally awarded compensation without case-specific inquiries: physical invasion and instances in which regulation "denies all economically beneficial or productive use of land." The Court indicated that the justification for the second category is severalfold. First, from the standpoint of the claimant, there is little difference between a total deprivation of beneficial use and a physical appropriation. Second, where all economically beneficial use vanishes, it is less realistic to assume that "the legislature is simply adjusting the benefits and burdens of economic life." Finally, when a regulation deprives the owner of all beneficial use of his land, there is a greater risk that the legislature is attempting to press the land into public service without paying compensation.

The Court, however, did recognize a limit to the compensation principle within this context:

Where the State seeks to sustain regulation that deprives land of all economically beneficial use, we think it may resist compensation only if the logically antecedent inquiry into the nature of the owner's estate shows that the prescribed use interests were not part of his title to begin with. This accords, we think, with our " takings" jurisprudence, which has traditionally been guided by the understandings of our citizens regarding the content of, and the State's power over, the "bundle of rights" that they acquire when they obtain title to property. It seems to us that the property owner necessarily expects the uses of his property to be restricted, from time to time, by various measures newly enacted by the State in legitimate exercise of its police powers . . . . And in the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, he ought to be aware of the possibility that new regulation might render his property economically worthless . . . . In the case of land, however, we think the notion . . . that title is somehow held subject to the "implied limitation" that the State may subsequently eliminate all economically valuable use is inconsistent with the historical compact recorded in the Takings Clause . . . .

The Court thus set out a rule that "confiscatory regulations" require compensation, unless the limitation involved inhered in the title itself, "in

60. Id. at 1014-16.

61. Lucas, 505 U.S. at 1015 (citations omitted). The court recognized in this latter category the denominator problem—that is, how does a court determine the property interest against which to measure the decline in economic value. See id. at 1016 n. 7. Simply put, suppose a developer has 100 acres of land which she would like to develop, and she is denied the ability to develop 10 acres. The denial restricts the developer's ability to develop 100% of the 10 acre parcel. Whether one looks at the large parcel or the smaller parcel as the relevant parcel controls the takings analysis when compensation turns on whether the owner has been deprived of all economically viable use of her land. This problem is generally referred to as the denominator problem. The Court's answer to the problem was to look at how the owner's reasonable expectations have been shaped by the state's property law—whether and to what degree the State's law has accorded legal recognition and protection to the particular interest in land with respect to which the takings claimant alleges a diminution in (or elimination of) value. Id.

62. Id. at 1017 (citations and quotations omitted).

63. Id. at 1018.

64. Lucas, 505 U.S. at 1027-28 (emphasis added). In reaching this conclusion, the Court noted that the statements in its earlier takings jurisprudence relating to "harmful or noxious uses" was merely an early attempt to get at the principles just described. Id. at 1022-26.
the restrictions that background principles of the State's law of property and nuisance already place upon land ownership. Courts must look to "existing rules and understandings that stem from an independent source such as state law" to determine whether, in being deprived of all economically viable use of her land, an owner is entitled to compensation. The Court then remanded the case to the South Carolina Supreme Court to apply the *Lucas* framework.

Justice Kennedy concurred in the Court's judgment. He wrote that the majority's focus on the common law of nuisance, in determining an owner's reasonable expectations, is too narrow. In his view, an owner's reasonable expectations had to be understood in light of the whole of our legal tradition.

Justices Blackmun and Stevens dissented. As an initial matter, Justice Blackmun thought the case was not ripe for review. On the merits, he nonetheless wrote that the Court's takings jurisprudence had long recognized the "principle that the State has full power to prohibit an owner's use of property if it is harmful to the public." Justice Blackmun also contended the Court's ruling was not supported by history. Justice Stevens, in his dissent, added that the Court erred first by adopting a categorical rule for regulatory takings, and second, by focusing too narrowly on state nuisance law. Lastly, Justice Souter would have dismissed the writ of certiorari as improvidently granted.

F. The Debate Over Lucas

The decision is far from momentous, but it does finally provide a much needed theoretical structure for analyzing how far the government may go in regulating private property without affording compensation to adversely affected landowners. Justice Scalia's opinion reflects an effort to instruct the supporters of an expansive view of the Fifth Amendment, as well as those who oppose compensation because of its chilling effect on land use and environmental regulations, that "takings" law is indeed premised on property interests, not talismanic categories or exceptions that are confusing to even the most astute taxonomist. It will now be in-

65. *Id.* at 1029.
66. *Id.* at 1030.
67. The South Carolina Supreme Court heard arguments on remand and determined that no background principles of South Carolina law would have prevented Mr. Lucas from developing his two lots. It therefore remanded to the trial court on the issue of damages, finding that a temporary taking had occurred between the time of the passage of the 1988 Amendments and the date of its remand order. See *Lucas v. South Carolina Coastal Council*, 424 S.E.2d 484 (S.C. 1992). The case was eventually settled for $1.5 million, and the state, at least at one point, ironically attempted to secure funding for the settlement by selling the lots for development. H. Jane Lehman, *Accord Ends Fight Over Use of Land*, WASH. POST, July 17, 1993, at E1.
69. *Id.* at 1051 (Blackmun, J., dissenting).
70. *Id.* at 1055-60.
cumbent for those on either side to focus on the relationship between the
effect of a governmental regulation and the asserted harm to a property
interest.

The commonplace notion of "property interests" reflects an attempt
to describe what interests the law will protect. *Property interests* are gen-
erally guided by an owner's reasonable expectations under relevant law at
the time the owner acquires title to the property. If state law and/or com-
monly accepted practice sanctions building homes in an area, then a per-
son could be said to have a reasonable expectation that she could build a
home on a lot in that area. Such an expectation might, under state law, rise
to the level of a protected *property interest*.

Conversely, if, for example, under state statutory or common law, a
property owner could not reasonably expect to develop the land into a
shopping mall, then no *interest* would be "taken" by denying the develop-
ment. Similarly, a person who buys land along the beach knowing that
construction is prohibited would not have a reasonable expectation that
she could build a house on the lot. Property owners may also reasonably
expect that the use of property will "be restricted, from time to time, by
various measures newly enacted by the State" when legitimately exercising
its powers.\textsuperscript{71}

This, also, is where the concept of "nuisance" applies. If a state or
private party could successfully bring a lawsuit to halt a particular use of
property, then state law cannot be said to create a reasonable expectation
to serve as the basis for a protected *interest*.

This focus on property interests is also applicable to instances where a
landowner has been denied something less than all economically beneficial
use of property, according to the majority opinion in *Lucas*. The Court
leaves it up to relevant background principals of property law to decide,
for example, whether owners can reasonably expect to build on one hun-
dred percent of their property as opposed to ninety percent, and it re-
affirms that the impact of a regulation on an owner's investment-backed
expectations must be considered when a government regulation does
something less than deprive an owner of all value.

G. Understanding History

Yet, is such an approach supportable? Regulatory takings jurispru-
dence has long relied upon history to prove its point—that a regulation
which diminishes the value of property either does or does not require
compensation. Courts have regularly looked to early American jurispru-
dence, citing examples of cases in which legislatures would take land or
other property interests by regulation and (1) not pay compensation, to
support a finding that no regulatory taking had occurred, or (2) pay the af-
feffect land owner compensation, to support a finding that just compensa-
tion is required. With that in mind, it is useful to review at the outset the

\textsuperscript{71} *Id.* at 1027.
evolution of the takings doctrine. Within this broad historical context, it is also important to consider that the very notion of what property is may not remain static over long periods but may change over time, thus making practical use of the history even more difficult.

III. THE EVOLUTION OF A NATIONAL PROPERTY RIGHTS DEBATE

A. The Idea of Property

Few concepts today are so taken for granted yet so elusive as the ideas of “property” and “ownership.” The notion that, when property is taken and pressed into public service, just compensation must be paid has a long lineage. It was not until the first half of the 19th century, however, that this concept ascended to a prominent place in American law. Understanding an overview of this history and the changing notion of property is important for placing the current regulatory takings doctrine in its proper context.

Early English experience provided some examples of the payment of compensation when the King took property for the public good. But it was John Locke, writing during the late seventeenth century, who provided the theoretical support for ensuring the protection of private property in a “democratic” society. John Locke explained that the primary function of government is to preserve that inalienable right to property. He argued that the tenet that a sovereign could not take an individual’s property without compensation derived from three fundamental principles. First, the right to own property, which he defined as a man’s life, liberty, and estate, was a natural right—one which predated society. Second, people left this state of nature and entered into society to make these property rights more secure. The great and chief end therefore, of Mens uniting into Commonwealths, and putting themselves under Government, is the Preservation of their Property. To which in the state of Nature there are many things wanting. Third, a sovereign has no claim to absolute dominion.

From these three propositions, Locke concluded that the principle that it is a mistake to believe that “the Supreme or Legislative Power of any Commonwealth, can do what it will, and dispose of the Estates of the Subject arbitrarily, or take any part of them at pleasure.”

72. 6 Hen. 8, ch. 17 (Eng.); 31 Hen. 8, ch. 4 (Eng.). See William B. Stoebeck, A General Theory of Eminent Domain, 47 WASH. L. REV. 553, 566 (1972). The Magna Charta has also been invoked in support of this compensation principle. See FRANK R. STRONG, SUBSTANTIVE DUE PROCESS OF LAW: A DICHOTOMY OF SENSE AND NONSENSE 3-25 (1986); cf. Young v. McKenzie, 3 Ga. 31, 44 (Ga. 1847).


74. Id. at 350.

75. Id. at 276.

76. Id. at 350-51.

77. Id. at 267-68.

78. Id. at 361. For an excellent critique of the Lockean model, see Myrl L. Duncan, Property as a
Writing seventy-five years after Locke, Sir William Blackstone similarly commented that the preservation of vested property rights is the chief end of government; when a property right is taken for the public good, it must be accompanied by the payment of compensation. 79 Like Locke before him, Blackstone wrote that rights to property are natural rights, 80 acquired originally on a use-based theory, 81 but that in the state of nature, these rights vested in someone only as long as the use continued, albeit leaving them somewhat insecure. 82 It was to remedy this situation, according to Blackstone, that people originally left the state of nature and formed societies. 83 As a consequence, Blackstone believed that when, Parliament asserts its eminent domain power, it acts indulgently and must provide a "full indemnification and equivalent for the injury thereby sustained." 84

B. The American Colonial Experience

To the modern observer, the American colonial period appears to demonstrate only a marginal adherence to these principles. 85 Many examples of the taking of property during this period involved the taking of land without compensation for public improvements, such as the construction of roads. 86 In these cases, compensation was generally not provided when unsettled land was taken, 87 but was often paid when cultivated or fenced-in land was pressed into public service. 88 It is arguable that this experience does not necessarily support the proposition that property rights could be freely appropriated. With extensive tracts of undeveloped land in America, many colonies may not have felt the need to pay compensation for

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79. 2 WILLIAM BLACKSTONE, COMMENTARIES 4 (4ed. 1876).
80. See Id. at 3-4.
81. Id. at 8.
82. Id. at 3-4.
83. "[t]he necessity to entertain conceptions of more permanent dominion; and to appropriate to individuals not the immediate use only, but the very substance of the thing to be used." Id. at 4.
84. 1 WILLIAM BLACKSTONE, COMMENTARIES 135 (4th ed. 1876). "All the legislature does is to oblige the owner to alienate his possessions for a reasonable price; and even this is an exertion of power, which the legislature indulges with caution..." Id.
86. William M. Treanor, The Origins and Original Significance of the Just Compensation Clause of the Fifth Amendment, 94 YALE L.J. 694, 695 (1985) [hereinafter Treanor].
87. Id. at 695; cf. Hart, Colonial Land Use, supra note 85, at 1260-61 (discussing colonial laws in Massachusetts and New York which provided for forfeiture of land that was not seated or improved within three years).
unimproved land because no property was taken. Two prevailing notions of property would have supported such a distinction between the taking of unimproved land without compensation and the taking of seated or improved land with a compensation requirement. Under the feudal concept of property, all land was held in the king—either mediately or immediately. Under such a system, the land holder did not "own" the property itself in a modern sense of the word, but rather had claims only to the improvements thereon and to the use of the land. Under an alternative concept of property where property was a natural right, unused land did not constitute a vested property right.

Also, professor Hart describes several other instances in which "property" is "taken" by the colonial legislatures and for which the owner received no compensation. For example, a law in the Plymouth colony provided that, if an individual did not operate his mine for the period of one year, the government could appoint another to exploit the natural resources. Another colony, Connecticut, enacted a mining law that went even further. The statute allowed mine owners who were operating their mines to be dispossessed of their mines if they did not exploit the natural resources quickly enough. Similar laws were in effect in Maryland and elsewhere to encourage the development of mills, foundries and forges. Colonial statutes also addressed issues more familiar to the modern observer, such as limits on property development for aesthetic and population density reasons.

Perhaps the most ironic group of colonial land use regulations, however, involved wetlands. Many of the colonies enacted laws requiring owners of land to drain their wetlands to make them suitable for cultivation. The statutes provided no compensation to the property holder. Such laws were passed in Massachusetts, Connecticut, New York, Pennsylvania, South Carolina, and New Jersey. Professor Hart's scholarship suggests that, at best, the American colonial experience, with respect to the protection of property rights, was a speckled one.

C. The New Nation

As the early American republic emerged, so too did two visions of the role of property in the American experience: one in which an individual's property was integral to the nation's survival as a democracy because it en-

89. This distinction between improved or cultivated land and unimproved land was implicit in Locke's distinction between land and property. "As much land as a Man Tills, Plants, Improves, Cultivates, and can use the Product of, so much is his Property." LOCKE, supra note 73, at 290.
91. See supra notes 80-84 and accompanying text.
92. See Hart, Colonial Land Use, supra note 85, at 1265. Again, this may not be as telling as Professor Hart suggests, given the then-prevailing concepts of vested property rights.
93. See Hart, Colonial Land Use, supra note 85, at 1265-66.
94. See Hart, Colonial Land Use, supra note 85, at 1267.
95. See Hart, Colonial Land Use, supra note 85, at 1268-69.
sured owners their independence, and another in which, although property was important, private interests were properly subordinated to the general good of the community. In this latter theory, property was held under an implied obligation to the state and to the public good.

Private Property... is a Creature of Society, and is subject to the Calls of that Society, whenever its Necessities shall require it, even to the last Farthing; its contributions therefore to the public Exigencies are... to be considered... the Payment of a just Debt.

To republicans such as Franklin, property, which was not a natural right, was an important creation of society, but the security of property had to take a secondary role to the needs of the community. This vision entrusted the liberties and security of the citizens to the legislature of the various states. However, the early American experience demonstrated that this trust was not warranted.

Although the post-revolutionary period demonstrated less than full devotion to an uncompromising protection of private property rights, with the adoption of the Constitution a more individualistic system was instituted, one with a fundamentally different view of society and property rights than had been previously held. The federalists, similar to Locke and Blackstone, saw the protection of property and other liberties as the chief end of government. Indeed, in Federalist 10, James Madison wrote that the protection of “the diversity in the faculties of men, from which the rights of property originate... is the first object of government.” Similarly, in Federalist 54, Madison wrote that “[g]overnment is instituted no less for the protection of property than of the persons of individuals.” To secure this protection, Madison introduced the clause in the Fifth Amendment: “nor shall private property be taken for public use, without just compensation.” Madison believed these protections to be funda-


97. Treanor, supra note 86, at 700 (quoting Benjamin Franklin).
98. Treanor, supra note 86, at 700 (quoting Benjamin Franklin); JENNIFER NEDELSKY, PRIVATE PROPERTY AND THE LIMITS OF AMERICAN CONSTITUTIONALISM 172 (1990) [hereinafter Nedelsky].
99. NEDELSKY, supra note 98, at 4; Treanor, supra note 86, at 704.
101. NEDELSKY, supra note 98, at 2-9; Treanor, supra note 86, at 712.
102. A student of this period has observed that “[t]he great focus of the Framers was the security of basic rights, property in particular...” NEDELSKY, supra note 98, at 92. Madison believed that “[t]he rights of property were based on natural rights.” Supra note 98 at 35. David Mayer aptly notes that even Thomas Jefferson likely believed that the right to property is founded in our “natural wants.”
105. U.S. CONST. Amend. V.
mental rights,\textsuperscript{106} and although the Fifth Amendment was legally binding only on the federal government, it had much broader implications.\textsuperscript{107} During the framing of the Constitution, the people were deemed to have an inalienable right to property—that is, a natural right to acquire, dispose of, and use property.\textsuperscript{108}

\textbf{D. Early State Development of Proto-Regulatory Takings}

Not surprisingly, therefore, during the nation’s formative years the requirement of just compensation was often based on fundamental or natural law.\textsuperscript{109} Few states had compensation clauses in their constitutions immediately after the revolution,\textsuperscript{110} but several others had provisions similar to Article 39 of the Magna Carta.\textsuperscript{111} Pennsylvania and Delaware had inserted compensation provisions into their constitutions by 1792.\textsuperscript{112} Throughout this period, the sanctity of property rights took root and began to blossom, as state legislatures and courts applied the requirement of just compensation when property was taken, even when there was no specific provision in the state constitution to do so.\textsuperscript{113}

In many of these early state cases, there were no explicit constitutional provisions dictating compensation.\textsuperscript{114} Rather, these courts based their decisions upon natural rights and justice—natural law—of which the Fifth Amendment was merely declaratory.\textsuperscript{115} In New York, for example,
there were several such cases in the first quarter of the nineteenth century. In *Gardner v. Village of Newburgh*,¹¹⁶ Chancellor Kent held a statute void for failing to provide compensation to an individual whose riparian rights were taken. Such compensation, according to Kent, was required by “natural equity.” In *People v. Platt*,¹¹⁷ Chief Justice Spencer, citing *Fletcher v. Peck*¹¹⁸ and *New Jersey v. Wilson*,¹¹⁹ found that while a statute which required dam owners to modify their dams to allow fish to pass did not render the grant to Platt (which allowed him to build the dam) null and void, it did impair a material and essential part of the grant. Under the statute, Platt would have had to change the dam substantially. Therefore, according to the court, the statute unconstitutionally impaired Platt’s contract. The court stated that “[p]rivate property may, in many instances, be appropriated to public use; but such appropriations are constitutional, legal, and justifiable, only when a fair and just equivalent is awarded to the owner of the property thus taken.”¹²⁰ Chief Justice Spencer again held a New York statute void because it violated this fundamental principle in *Bradshaw v. Rogers*.¹²¹ He held first that the Fifth Amendment did not apply to the state, and the New York constitutional provision requiring compensation was not yet operative.¹²² Nonetheless, he found that both of these provisions were “declaratory of a great and fundamental principle of government; and any law violating the principle must be deemed a nullity, as it is against natural right and justice.”¹²³

Throughout the early 19th century, state courts more and more required that statutes taking a citizen’s property for the public good be accompanied by compensation for the taking, even where the state constitution was silent and even when the takings involved regulation rather than appropriation.¹²⁴ New Jersey state courts began to hold that compensation was required when property was taken (in the 1830s and 1840s)¹²⁵ even though the New Jersey constitution had no such clause until 1848. Likewise, New Hampshire,¹²⁶ Georgia,¹²⁷ Iowa,¹²⁸ Massachusetts¹²⁹ and Mary-

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¹¹⁶ 2 Johns. Ch. 162 (N.Y. Ch. 1816).
¹¹⁷ 17 Johns 195 (N.Y. 1819).
¹¹⁸ 10 U.S. (6 Cranch) 87 (1810).
¹¹⁹ 11 U.S. (7 Cranch) 164 (1812).
¹²⁰ Platt, 17 Johns. Ch. at 215.
¹²¹ 20 Johns. Ch. 103 (N.Y. Ch. 1822). For other New York state cases awarding compensation without a constitutional provision, see Beekman v. Saratoga & Schenectady R. R. Co., 18 Wend. 9 (N.Y. 1831).
¹²² Bradshaw, 20 Johns. Ch. at 106.
¹²³ Id.
¹²⁴ See generally Kobach, supra note 109, at 1223-59; Grant, supra note 108.
¹²⁵ See Sinnickson v. Johnson, 17 N.J.L. 129, 145 (N.J. 1839) (the right to compensation is incident to the power of taking property); Bonaparte v. Camden & A.R. Co., 3 F. Cas. 821 (D. N.J. 1830) (the right of the owner to receive and the duty of the legislature to provide compensation is absolute.).
¹²⁶ Bristol v. New-Chester, 3 N.H. 524, 535 (1826) (when eminent domain is exercised, natural
land, held the concept of property to be a natural right requiring protection from uncompensated takings by state legislatures. In *Henry v. Dubuque*, for example, the Iowa Supreme Court held that “the plaintiff needed no constitutional declaration to protect him in the use and enjoyment of his property... To be thus protected and thus secure is a right inalienable, a right which a written constitution may recognize and declare, but which existed independently of and before such recognition, and which no government can destroy.”

The history of compensation in Pennsylvania in the early nineteenth century, on the other hand, appears, at first glance, out of line with many other states. In fact, in a dissent to *Lucas*, Justice Blackmun referred to an early Pennsylvania case as demonstrative of the proposition that many states in the nineteenth century viewed compensation for property taken for public benefit as a bounty rather than a requirement to the property owner. However, that proposition is not so clear. In *McClenham v. Curwin*, the defendant, a company incorporated pursuant to an act of the Assembly to construct a road from Philadelphia to Lancaster, entered onto the plaintiff’s land. The plaintiff brought an action for damages against the turnpike company. According to the court, in all the grants made by William Penn, his successors and the state, an allowance of six

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127. Young v. McKenzie, 3 Ga. 31, 39-44 (1847) (it is a great common law principle founded in natural justice that eminent domain gives the legislature control of property for public use; provided, just compensation be made to the citizen thereof); Parham v. The Justices of the Interior Court, 9 Ga. 341, 355 (1851) (the right of accumulating, holding, and transmitting property lies at the foundation of civil liberty).

128. Henry v. Dubuque & Pacific R.R. Co., 10 Iowa 540, 543-544 (1860) (to be secure in the possession of one’s property is an inalienable right).

129. Gedney v. Tewksbury, 3 Mass. 307, 310 (1807); Perry v. Wilson, 7 Mass. 393 (1811). Massachusetts did have a compensation clause in its constitution at the time of these cases and sporadically had provided compensation during the colonial period. See supra notes 87 & 95 and accompanying text. For a brief discussion of Massachusetts law and some controversy surrounding exceptions to the principle of just compensation, see GEORGE DRAGO, LAW IN THE NEW REPUBLIC: PRIVATE LAW AND THE PUBLIC ESTATE 30-35 (1983).


131. 10 Iowa 540, 543-44 (Iowa 1860).


133. There were exceptions to this trend, but most were more apparent than real. For example, until the early nineteenth century, the courts in Pennsylvania... continued to deny compensation to owners of lands seized by the state for highway construction, but the plausible rationale for this stance was that the proprietary land grants from which the claimants traced their title expressly provided that the grantees were receiving more acreage than they had purchased to enable government to lay out roads across the premises. (emphasis added)

Fisher, supra note 100, at 105.

134. 3 Yeates 362 (Pa. 1802).

135. Id. at 362-363.
acres per hundred was made at no cost to the grantee for roads and highways. The turnpike company in no way disputed that when private property was taken, compensation must be paid. However, because no value or consideration had ever been paid by the grantees for the additional six percent of land, the company argued, it was held in trust for the community. Thus, when the community needed property for public purpose, no compensation was owed. Chief Judge Shipen, delivering the opinion for the court, agreed. "The six percent additional allowance to a purchaser’s grant relieves the constitutional burden of paying compensation for the land in order to build public highways."  

In a case decided after Pennsylvania had adopted a just compensation provision in its constitution, the court declared that "the property of the citizen shall not be taken and applied to public uses without the consent of his representatives, and without just compensation being made." This fundamental concept of providing compensation for property taken for the public good was so compelling that throughout the early nineteenth century state courts frequently implemented this protection of property rights, even prior to having an applicable constitutional peg on which to hang their decisions. According to Kobach, although decisions declining to recognize regulatory takings as compensable continued to appear, there had developed a significant body of case law requiring compensation for such takings.

E. Property Rights and the New Court

This same appreciation of the importance of property rights was a dominant theme throughout the development of our federal constitutional jurisprudence. A prominent legal historian notes that the period from 1789-1910 marks a "broad tendency to stress the stability of property rights in the American Legal Order." Despite Chief Justice Marshall’s opinion in Barron v. The Mayor & City Council of Baltimore, holding that the Fifth Amendment to the United States Constitution did not apply to the

136. Id. at 363.
137. Id.
139. Id. at 294.
140. Professor Kobach summarizes the period this way: [N]umerous state courts recognized devaluative takings [i.e., regulations that devalued rather than appropriated property] to be compensable at an early stage in American legal history .... Although no single orthodoxy of devaluative takings gripped all the states, numerous shared principles emerged. The most prominent was undoubtedly the strong version of the bundle-of-sticks understanding of property .... Kobach, supra note 109, at 1259.
141. Kobach, supra note 109, at 1260.
143. 32 U.S. (7 Pet.) 243 (1833).
states, the Court’s cases prior to the Fourteenth Amendment nevertheless repeatedly confirmed the importance of protecting private property rights. However, many of the Court’s initial “property rights” decisions focused on the constitutional prohibition against impairing contracts. This should not be surprising, since the early nineteenth century witnessed a “conflation of property and contract rights.”

In its first opinion on the eminent domain power, the Court held that a state could exercise this power against a corporate franchise. In 1795, Vermont granted the West River Bridge Company the exclusive right to build and operate a toll bridge over the West River. Forty-four

144. Justice Story, for instance, commented “[t]hat government can scarcely be deemed to be free where the rights of property are left solely dependent upon the will of a legislative body without any constraint. The fundamental maximums of a free government seem to require that the rights of personal liberty and private property should be held sacred.” Wilkinson v. Leland, 27 U.S. 627, 657 (1829). Justice Story similarly noted the importance of securing private property rights in Terrett v. Taylor, 9 Cranch 43 (1815).

145. It is now well accepted that decisions during the Marshall Court protected vested property rights from encroachment. See Trustees of Dartmouth College v. Woodward, 17 U.S. 518 (1819); Fletcher v. Peck, 10 U.S. 87 (1810). See generally Charles P. Magrath, Yazoo and the New Republic: The Case of Fletcher v. Peck 102 (1966) (“The Court’s decision [in Fletcher v. Peck] elevated vested property to a position of primacy in the hierarchy of American constitutional values.”). Under Chief Justice Taney, the Court continued to protect property interests, but its decisions reflected an expanding concept of property that incorporated economic change. See Charles River Bridge Co. v. Warren River Bridge Co., 36 U.S. 420 (1837). See generally James Willard Hurst, Law and the Conditions of Freedom in the Nineteenth Century United States (1956); Stanley Kutler, Privilege and Creative Destruction: The Charles River Bridge Case (1971). Indeed, the Charles River Bridge case involved “competing values of stability and change, of maintenance of property rights and keeping the way clear for new developments.” Carl B. Swisher, The Oliver Wendell Holmes Devise History of the Supreme Court of the United States V: The Taney Period 1836-64 at 75 (1974). In making his argument about impairing the obligation of contracts, counsel for Charles River Bridge even argued that the act in question threatened to take his client’s property at the expense of the public. Id. at 81-82. A similar issue surfaced later on in the Sinking Fund Cases, 99 U.S. 700 (1878), where the Court addressed the ability of Congress to amend the character of a railroad company.


147. In Respublica v. Sparhawk, 1 Dall. 357 (1788), the question was whether compensation was required for the seizure of flour unreturned during the revolutionary war. Relying upon the law of nations, as well as general principles that warranted destroying property during exigent times, Chief Justice M’Kean concluded compensation was unnecessary. See generally Brookshire, supra note 20, at 902-905 (discussing “takings” in times of war).

148. West River Bridge Co. v. Dix, 47 U.S. 507 (1848).
years later, the state passed an internal improvement act sanctioning further development along the river, conditioned upon the payment of compensation for the taking of any property (including franchises). The West River Bridge Company challenged the new statute, claiming that the State could not, under the pretext of the eminent domain power, abrogate its contractual obligation with the company by taking its franchise right, even though it afforded compensation.\footnote{149} The Court upheld the exercise of the power as a necessary incident to sovereignty. In a separate concurrence, Justice Woodbury demonstrated that the weight of authority sanctioned the use of the eminent domain power, but only upon payment of compensation.\footnote{150}

The period of economic expansion and increased regulatory activity following the Civil War brought with it new efforts to test the scope of the states’ police powers, including the power to infringe upon property rights and take private property.\footnote{151} State and local exercise of the expanding police power invariably affected private conduct and use of private property. Prior to the Civil War, state court judges such as Lemuel Shaw already had begun to establish the ability of states to exercise regulatory power to protect the health, welfare and safety of citizens.\footnote{152} The degree to which government could regulate conduct and use of property became a principal focus of challenges to the exercise of the police power. Such challenges were based primarily on the newly adopted “due process” clause of the Fourteenth Amendment, which provided that “nor shall any State deprive any person of life, liberty, or property, without due process of law.”\footnote{153} The Court noted that until the Fourteenth Amendment “[i]t has never been seriously contended that such laws raised any question growing out of the Constitution of the United States.”\footnote{154}

\begin{itemize}
\item \footnote{149} Id. at 531. See also Swisher, \textit{supra} note 145, at 471.
\item \footnote{150} West River Bridge Co., at 539-49.
\item \footnote{151} The focus quite often was on whether the eminent domain power could be delegated, or whether the power was being used for a private use, or whether the power was the appropriate mechanism for determining compensation. See, e.g., Otis Co. v. Ludlow Mfg. Co., 201 U.S. 140 (1906) (upheld mill-dam statute, where compensation provided); Clark v. Nash, 198 U.S. 361 (1905) (whether valid condemnation for a public use); Fallbrook Irrigation Dist. v. Bradley, 164 U.S. 112 (1896) (upheld delegation of eminent domain power to irrigation district); Head v. Amoskeag Mfg. Co., 113 U.S. 9 (1885) (upheld mill-dam statute); Cole v. City of La Grange, 113 U.S. 1 (1885) (statute authorizing compensable taking of private property held not for a public use); Boom Co. v. Patterson, 98 U.S. 403, 406 (1879) (reconfirming inherent right of sovereign to exercise eminent domain power), \textit{overruled} by Olson v. United States, 292 U.S. 246 (1934); Holyoke Co. v. Lyman, 82 U.S. 500 (1873) (upheld claim of interference with fishery interest by construction of mill dam); Kohl v. United States, 91 U.S. 367 (1876) (upheld the Federal government’s exercise of eminent domain power).
\item \footnote{152} See generally Leonard W. Levy, \textit{The Law of the Commonwealth and Chief Justice Shaw} 229-265 (1957). Professor Levy observed that “Shaw revealed an almost precocious understanding of the central premise of the police power—the right of the legislature to ‘interfere’ with ‘liberty’ or ‘property’ for the sake of the common welfare.” \textit{Id.} at 243.
\item \footnote{153} U.S. Const. Amend. XIV, § 1.
\item \footnote{154} Bartemeyer v. Iowa, 85 U.S. 129, 132 (1874).
\end{itemize}
as a potential vehicle for curbing regulation of business activity, under the premise that the protection against deprivation of liberty and property without due process included the right to continue to engage in any activity lawful when first undertaken.\footnote{155}

The post-Civil War “due process” challenges generally were not based directly upon the just compensation clause. Not until the late 1890s did the Court hold that the requirement of “due process of law” incorporates the concept of “just compensation.”\footnote{156} Nevertheless, when resolving due process challenges prior to the incorporation of the Fifth Amendment, the Court often decided whether there was a “deprivation” of any protected “property” interest. The Court’s decisions defined two general categories of instances where no deprivation of property occurred. First, the Court ruled that damages resulting from regulation, without more, did not constitute a “deprivation” within the meaning of the Fourteenth Amendment. When governmental action neither regulated nor restricted the use of property, no \textit{deprivation} occurred if the value of property was only indirectly and incidentally affected. Second, the Court ruled that property owners did not have any vested \textit{property} interest in any particular continued use of property or in any particular conduct that interfered with the enjoyment of property by others.

The Court distinguished between the lawful exercise of the police power causing “incidental” or “consequential” damage and a “taking.” Reviewing various earlier cases, the Court noted that they “recogniz[ed]... the distinction between an incidental injury to rights of private property resulting from the exercise of governmental powers, lawfully and reasonably exerted for the public good, and the \textit{taking}, within the meaning of the Constitution, of private property for public use.”\footnote{157} The Court held that governmental activity neither directly burdening private property nor regulating its use did not “take” any “property” interest. Landowners, for instance, could not claim any vested right in the continued maintenance of

\footnote{155. During the post Civil War period until shortly after the turn of the century, the law of property converged with the notion of contractual liberty—unrestrained free enterprise. \textit{See} MARTIN J. SKLAR, \textsc{The Corporate Reconstruction of American Capitalism, 1890-1916} at 48 (1988). \textit{See generally} HERBERT HOVENKAMP, \textsc{Enterprise and American Law 1836-1937} (1991); ARNOLD PAUL, \textsc{Conservative Crisis and the Rule of Law: Attitudes of the Bench and Bar, 1887-1895} (1960); WILLIAM SWINDLER, \textsc{Court and Constitution in the 20th Century: The Old Legality 1889-1932} (1969). For example, Justice Holmes, when sitting as a state court judge, disagreed with the majority of the Supreme Judicial Court of Massachusetts that the State’s effort to restrict a mill owner’s right to make contracts with weavers violated the rights of property. \textit{See} SHELDON M. NOVICK, \textsc{Honorable Justice: The Life of Oliver Wendell Holmes} 197 (1989). For a survey of “takings” cases during the time of the Fuller Court, see James W. Ely, Jr., \textsc{The Fuller Court and Takings Jurisprudence}, 2 \textsc{J. Sup. Ct. Hist.} 120 (1996).


the status quo of surrounding land—i.e., a status quo that, if changed, would diminish a particular landowner's property value. In an opinion written by Justice Brewer, an ardent defender of property rights,58 the Court noted that the exercise of the police power was not invalid simply because it worked pecuniary injury when the governmental action was unrelated to the use of private property.59 Thus, landowners whose property fronted streets, for example, failed to persuade the Court to hold unconstitutional changes in street grading.60

Another common example of incidental damage occurred when governmentally authorized construction along navigable waterways incidentally affected riparian and other landowners. The Court held that the due process clause generally did not bar such an exercise of the police power,61 reasoning that such damages result from the "incidental consequence" of improvements on navigable highways, with the government exercising a dominant and pre-existing servitude rather than taking any private property.62

A good illustration is Northern Transportation Co. of Ohio v. City of Chicago.63 There, state-approved construction by the City of Chicago caused the interruption of a company's access to the Chicago River, where it maintained its dock and warehouse. The company brought a nuisance action against the city, claiming that it was entitled to compensation for consequential damages.64 The Court rejected this argument, holding that "acts done in the proper exercise of governmental powers, and not directly encroaching upon private property, though their consequences may impair its use, are universally held not to be a taking within the meaning of the constitutional provision."65 The Court many years earlier had rejected a similar challenge by a plantation owner along the Mississippi River, whose

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58. PAUL, supra note 155, at 70.
59. L'Hote v. New Orleans, 177 U.S. 587, 596-99 (1900) (upholding authorization of what otherwise might have been deemed a nuisance at common law).
61. See Manigault v. Springs, 199 U.S. 473 (1905); Bedford v. United States, 192 U.S. 217 (1904); Scranton v. Wheeler, 179 U.S. 141 (1900); Eldridge v. Trezevant, 160 U.S. 452 (1896). Cf. Yates v. Milwaukee, 77 U.S. (10 Wall.) 497 (1871) (compensation required upon removal of wharf, where there was no showing by the city that the wharf constituted a nuisance or obstruction to navigation).
63. 99 U.S. 635 (1879).
64. Id. at 641.
65. Id. at 642.
property was adversely affected by the State's efforts to re-direct some of the waters flowing to or from the Mississippi.\textsuperscript{166}

Conversely, in \textit{Pumpelly v. Green Bay Co.},\textsuperscript{167} the Court held that a taking occurred when there was a direct and substantial injury to property. There, the operation of a governmentally approved dam flooded certain private property, completely destroying its value. After rejecting statutory defenses and noting that the takings clause of the Fifth Amendment did not apply to the States, the Court examined the Wisconsin Constitution, which contained a just compensation provision similar to the Fifth Amendment. The Court noted that "this limitation on the exercise of the right of eminent domain is so essentially a part of American constitutional law that it is believed that no State is now without it. . . .\textsuperscript{168}" The Court then rejected the argument that the injury was consequential, and held that a taking could occur when there is a "serious interruption to the common and necessary use of property . . .\textsuperscript{169}"

The decisions upholding police power measures directly affecting private conduct and use of private property should not be interpreted as supporting the uncompensated taking of private property. In these cases, litigants frequently sought to establish a vested or property right in the status quo, often arguing that they were being deprived of a liberty or property interest when the exercise of the police power restrained their opportunity to engage in a particular conduct or previously allowed use of property.\textsuperscript{170} Such arguments prompted the Court to focus on the scope of the police power as well as the nature and use of property when considering a possible due process violation.\textsuperscript{171} No "taking" of "private property" occurred

\textsuperscript{166} Withers v. Buckley, 61 U.S. (20 How.) 84 (1858) (noting that the Fifth Amendment did not apply to the States and thus deciding the case on other grounds).

\textsuperscript{167} 80 U.S. (13 Wall.) 166 (1872).


\textsuperscript{169} \textit{Pumpelly}, 80 U.S. at 179. \textit{See also} \textit{Manigault v. Springs}, 199 U.S. 473, 484-85 (1905) ("Where there is a practical destruction or material impairment of the value of plaintiff's lands, there is a taking which demands compensation . . . ").

\textsuperscript{170} \textit{See generally} PAUL, supra note 155. Although the majority in the \textit{Slaughter-House Cases}, 83 U.S. (16 Wall.) 36 (1873), rejected the argument that a restraint on the exercise of a trade constituted a deprivation of property, Justice Bradley believed otherwise. \textit{Id.} at 127.

\textsuperscript{171} The focus on the "use" of property supported the Court's conclusion in \textit{Munn v. Illinois}, 94 U.S. 113 (1876), that businesses affected with the public interest could be regulated and that such regulation did not deprive a company of property without due process of law. \textit{See generally} Harry N. Scheiber, \textit{The Road to Munn: Eminent Domain and the Concept of Public Purpose in the State Courts, reprinted in Law in American History 329} (Donald Fleming & Bernard Bailyn eds., 1971). However, such businesses could not be required to transfer their property to private individuals. Missouri Pac. Ry. Co. v. Nebraska, 164 U.S. 403 (1896). No state could establish rates for such businesses when the effect would be confiscatory, without the payment of compensation or due process. \textit{See Chicago, Milwaukee & St. Paul Ry. Co. v. Minnesota}, 134 U.S. 418, 456 (1890); \textit{Stone v. Farmer's Loan & Trust Co.}, 116 U.S. 307 (1886); \textit{Wilcox v. Consolidated Gas Co.}, 212 U.S. 19, 41-44 (1909); \textit{City of Knoxville v. Knoxville Water Co.}, 212 U.S. 1, 16 (1909). \textit{But cf.} Fort Smith Light & Traction Co. v.
when the exercise of the police power affected a change in the status quo—even though particular economic interests may have relied on that status quo.

It became axiomatic both that the legislature could not contract away the police power and that “[n]o person has a vested interest in any rule of law, entitling him to insist that it shall remain unchanged for his benefit.” It was in this context that a commentator could confidently assert that “an act which came within the scope of the State police power could not be termed a deprivation of property.”

The Court held that states could constitutionally exercise their police power to regulate or prohibit an activity or use of property that interfered with another person’s equal enjoyment in the use of their property. Such police power measures did not deprive an owner of any vested property interest without due process because it had become well established that no person has the right to continue using property in such a way as to harm others. In Bartemeyer v. Iowa, for example, the defendant challenged his conviction for selling liquor, arguing that the prohibition on the sale of liquor violated the Fourteenth Amendment. The Court rejected the argument, but in so doing noted that if the prohibition applied to liquor manufactured prior to the prohibition, then a serious issue would arise as to whether it deprives an owner of property without due process of law.

Concurring, Justice Bradley emphasized that compensation is required when vested rights are taken away for the public good, but that no such property interest existed in Bartemeyer.

In organized society every man holds all he possesses, and looks forward to all he hopes for, through the aid and under the protection of the laws; but as changes of circumstances and of public opinion, as well as other reasons affecting the public policy, are all the while calling for changes in the laws, and as these changes must influence more or less the value and stability of private possessions, and strengthen or destroy well-founded hopes, and as the power to make very many of them could not be disputed without denying the right of the political community to prosper and advance, it is obvious that many rights, privileges, and exemptions which usually pertain to ownership under a particular state of the law, and many reasonable expectations, cannot be regarded as vested rights in any legal sense.

THOMAS COOLEY, A TREATISE ON THE CONSTITUTIONAL LIMITATIONS 437 (1868) (Footnotes omitted).


CHARLES WARREN, 2 THE SUPREME COURT IN UNITED STATES HISTORY 572 (rev. ed. 1947).

85 U.S. (18 Wall.) 129 (1873).

Id. at 133.

Justice Bradley explained that the law “was not in this case an invasion of property existing at the date of its passage, and the question of depriving a person of property without due process of law does not arise.” Bartemeyer, 85 U.S. at 136. Justice Field also concurred, distinguishing Bartemeyer from the Slaughter-House Cases, where the Court upheld a state grant of a partial monopoly to one
Similarly, in *Boston Beer Co. v. Massachusetts*, a company authorized to manufacture malt liquor argued that it had acquired such a vested right through its state incorporation and therefore was free from the exercise of the State's police power. The Court held liquor prohibition to be an appropriate exercise of the police power, which the state cannot divest. If the public safety or the public morals require the discontinuance of any manufacture or traffic, the hand of the Legislature cannot be stayed from providing for its discontinuance, by any incidental inconvenience which individuals or corporations may suffer. The Court added, however, that "[w]e do not mean to say that property actually in existence, and in which the right of the owner has become vested, may be taken for the public good without due compensation."

*Bartemeyer* and *Boston Beer* both confirmed the principle that police power could be constitutionally exercised to abate conduct and use of property that is noxious and harmful. The Court applied this same principle in *Northwestern Fertilizing Co. v. Hyde Park*, where the police power was exercised to abate a nuisance that had been previously permitted. The state incorporated a fertilizing company to transport, manufacture and convert dead animals and animal matter into fertilizer. Subsequently, the company was given two years to stop transporting matter through Hyde Park. In an action brought against the corporation for refusing to stop its business, the company argued that its charter created a contract (or property) right that could not be impaired unless through condemnation. The Court rejected the company's argument, holding that the activity clearly involved a nuisance and that the police power "rests upon the fundamental principle that everyone shall so use his own as not to wrong and injure another. To regulate and abate nuisances is one of its ordinary functions." And, since the government cannot contractually guarantee freedom from the exercise of the police power, the exercise in this instance was valid.

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company in the slaughtering business, thus excluding others from engaging in the business. *Id.* at 137-38. Justice Field later wrote that the right to acquire, dispose of and use property is an inalienable right, but limited to the extent that such use "will not impair the equal enjoyment by others of their property." *Crowley v. Christensen*, 137 U.S. 86, 90 (1890) (upholding prohibition on the right to sell liquor).  
179. 97 U.S. 25 (1878).  
180. *Id.* at 33.  
181. *Id.* at 32.  
182. *Id.*  
183. 97 U.S. 659 (1878).  
184. *Id.* at 667.  
Against this background, the Court decided *Mugler v. Kansas*, much heralded in the briefs before the Court in *Lucas* as establishing a “nuisance” exception to the just compensation principle. But *Mugler* was simply another example of the Court's evolving response to the parade of “due process” challenges to the exercise of the states' police power. Sellers and manufacturers of alcoholic beverages challenged Kansas' law prohibiting the manufacture and sale of liquor. The Court had to decide whether the state's police power could be constitutionally exercised in this fashion. Prior decisions had already established that the police power encompassed such regulation. Yet, counsel for the liquor sellers argued, *inter alia*, that the prohibition was an unconstitutional attempt to deprive parties of their right to engage in the continued operation of the brewery. The state replied, *inter alia*, that parties acquire no vested right to engage in a particular business “detrimental to the public health or public morals, because of the absence of any legislation on the subject.”

The Court held that the Fourteenth Amendment did not restrict the exercise of the state's police power to prohibit the manufacture and sale of liquor. The Court first reviewed prior decisions upholding the state's power to regulate the manufacture and local sale of liquor. It then rejected the argument that the police power could not regulate the right to manufacture liquor for one's own use, concluding that, as in the case of *Munn v. Illinois*, the power to regulate emanates from the power to protect society from the injurious consequences to others from the activity. The Court then explained that state legislatures have the power to determine what activity causes injurious consequences justifying the exercise of the police power, subject to the courts' constitutional responsibility to determine whether it is a legitimate exercise of that power.

The *Mugler* Court, therefore, rejected the parties' specific argument that the prohibition must fail because they had a vested right to continue to engage in the manufacture and sale of liquor. The Court held that the

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186. 123 U.S. 623 (1887).
187. Kansas charged Mugler with manufacturing and selling liquor without a license in violation of the law, and Mugler challenged his conviction by claiming that he “was denied rights, privileges and immunities guaranteed by the constitution . . . .” *Mugler*, 123 U.S. at 653. In a separate action, Kansas sought to close down Ziebold & Hagelin's brewery. *Id.* at 654.
188. Foster v. Kansas, 112 U.S. 205 (1884); Boston Beer Co. v. Massachusetts, 97 U.S. 25 (1878); Bartemeyer v. Iowa, 85 U.S. (18 Wall.) 129 (1873); License Cases, 46 U.S. (5 How.) 504 (1847), overruled by Leisy v. Harden, 135 U.S. 100 (1890).
190. *Mugler*, 123 U.S. at 660-62. “If, therefore, a statute purporting to have been enacted to protect the public health, the public morals, or the public safety, has no real or substantial relation to those objects, or is a palpable invasion of rights secured by the fundamental law, it is the duty of the courts to so adjudge . . . .” *Id.* at 661. Justice Harlan's majority opinion in *Mugler* echoed other opinions by Justice Harlan, in which the Court held that the exercise of the police power had to be reasonably related to a legitimate state objective. *See* Hennington v. Georgia, 163 U.S. 299 (1896); Brimmer v. Rebman, 138 U.S. 78 (1891); Minnesota v. Barber, 136 U.S. 313 (1890).
192. The Court summarized the parties' argument as follows:
State had not and could not contract away its police power, nor had it "give[n] any assurance, or come under an obligation, that its legislation upon that subject would remain unchanged." In accordance with prior decisions, the Court reaffirmed that "all property in this country is held under the implied obligation that the owner's use of it shall not be injurious to the community."

The Court also refuted defendants' reliance on *Pumpelly v. Green Bay Co.* emphasizing that *Mugler* did not involve the state's power of eminent domain; instead, "the question now before us arises under what are, strictly, the police powers of the [S]tate . . . [and] the present case must be governed by principles that do not involve the power of eminent domain . . . ." It ruled that a prohibition on use cannot be deemed a deprivation of property simply because it causes pecuniary loss "by reason of their not being permitted, by a noxious use of their property, to inflict injury upon the community." Lastly, the Court declined to construe the statute as necessarily authorizing the forfeiture of property lawfully in existence prior to the prohibition. The Court subsequently indicated, in *Lawton v. Steele*, that forfeiture of articles declared to be illegal and a nuisance, such as illegal fishing nets or diseased cattle, might rise to the level of a due process violation if the property being taken were of great value.

In his oft-repeated observation that "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking," Justice Holmes brought "due process" and "takings" analysis together. From this seminal decision in *Pennsylvania Coal Co. v. Mahon* evolved the contemporary concept of a regulatory taking, thus plaintiffs sought an injunction against the mining of coal underlying their property.

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[It is contended that, as the primary and principal use of beer is as a beverage; as their respective breweries were erected when it was lawful to engage in the manufacture of beer for every purpose; as such establishments will become of no value as property, or, at least, will be materially diminished in value, if not employed in the manufacture of beer for every purpose, the prohibition upon their being so employed is, in effect, a taking of property for public use without compensation, and depriving the citizen of his property without due process of law.]

*Mugler*, 123 U.S. at 664.

193. 123 U.S. at 669.

194. *Id.* at 665.

195. *Id.* at 668.

196. *Id.* at 669. *See generally* ERNST FRUEND, POLICE POWER, PUBLIC POLICY AND CONSTITUTIONAL RIGHTS 568-69 (1904) (explaining *Mugler* and the distinction between indirect pecuniary loss and taking, noting that the State cannot compensate for pecuniary losses incurred as result of prohibiting a specific noxious use of property). Justice Harlan, writing the majority opinion in *Mugler*, later wrote in *Chicago B. & Q. R. Co. v. City of Chicago*, 166 U.S. at 235-6, that the "[d]ue protection of the rights of property has been regarded as a vital principle of republican institutions."

197. 123 U.S. at 671-72.

198. 152 U.S. 133 (1894).


201. Plaintiffs had previously conveyed the subsurface estate to the company.
They alleged the removal of coal would cause the subsidence of their house, contrary to the state law known as the Kohler Act. The trial court refused to issue an injunction, holding instead the company had the right to remove the coal and that plaintiffs only sought to prevent a private injury. On appeal, the state supreme court held the Kohler Act was a police measure which did not "contemplate the taking of private property for public use," and it upheld the Act.\textsuperscript{2}

The U.S. Supreme Court reversed, first observing, as applied to Pennsylvania Coal Company's property, the statute destroyed the company's existing contract and property rights.\textsuperscript{203} The Court then balanced the extent of the taking, which it viewed as "great," against the public interest, which it viewed as minimal and not involving a common nuisance.\textsuperscript{204} Thus, the Court concluded "[i]f we were called upon to deal with the plaintiffs' position alone we should think it clear the statute does not disclose a public interest sufficient to warrant so extensive a destruction of the defendant's constitutionally protected rights."\textsuperscript{205} In the remainder of the opinion, the Court held, because the Act went too far and apparently did not

\begin{itemize}
\item \textsuperscript{202} Mahon v. Pennsylvania Coal Co., 118 A. 491, 493 (1922).
\item \textsuperscript{203} Pennsylvania Coal Co., 260 U.S. at 413.
\item \textsuperscript{204} \textit{Id.} at 413-414. Justice Holmes had earlier indicated that the line between an acceptable police power measure and a taking was a matter of degree. Hudson County Water Co. v. McCarter, 209 U.S. 349, 355 (1908); Rideout v. Knox, 19 N.E. 390, 392 (1889). \textit{See also} Portsmouth Harbor Land & Hotel Co. v. United States, 260 U.S. 327 (1922) (constant firing of ammunition over property may effect taking of easement). In Missouri Pacific Ry. Co. v. Nebraska, 217 U.S. 196 (1910), for example, the state sought to require the Missouri Pacific Railroad Co. to construct a connecting line and facilities, at its own expense, to a new grain elevator nearby. The railroad refused and was then sued. It argued, \textit{inter alia}, that the statute violated the Fourteenth Amendment. Justice Holmes began the Court's (Harlan and McKenna dissented) analysis by noting that "there is no provision in the statute for compensation to the railroad for its outlay in building and maintaining the side tracts required." \textit{Id.} at 205. And while Holmes observed that states may "cut down" or "modify" "property rights" to a "certain limited extent" when exercising the police power, he added that "railroads, after all, are property protected by the Constitution, and there are constitutional limits to what can be required . . . for taking such property away." \textit{Id.} at 206. Justice Holmes is viewed as having been progressive and fully supportive of the exercise of state regulatory power, and thus a noted biographer of Holmes treats the Mahon decision as somewhat of an aberration. G. Edward White, \textit{Justice Oliver Wendell Holmes: Law and the Inner Self} 392-403 (1993). For an insightful inquiry into Justice Holmes' opinion in Mahon, see Robert Brauneis, \textit{The Foundation of Our Regulatory Takings Jurisprudence: the Myth and Meaning of Justice Holmes' Opinion in Pennsylvania Coal Co. v. Mahon}, 106 \textit{Yale L.J.} 613 (1996). \textit{See also Joseph F. DiMento, Mining the Archives of Pennsylvania Coal: Heaps of Constitutional Mischief,} 11 \textit{J. Legal Hist.} 396 (1990); E.F. Roberts, Mining With Mr. Justice Holmes, 39 \textit{Vand. L. Rev.} 287 (1986); Carol M. Rose, Mahon Reconstructed: Why the Takings Issue is Still a Muddle, 57 \textit{S. Cal. L. Rev.} 561 (1984).
\item \textsuperscript{205} Pennsylvania Coal Co. v. Mahon, 260 U.S. at 414. The Court distinguished Plymouth Coal Co. v. Pennsylvania, 232 U.S. 531 (1914), where the court had upheld a statute requiring the maintenance of pillars while mining to protect the safety of miners. The coal company had argued that the method for determining the appropriate width of the pillar violated due process. \textit{Id.} at 540. Noted scholars have questioned whether this case even presented any serious issue warranting the Court's attention. \textit{See Alexander M. Bickel & Benno C. Schmidt, Jr., 10 The Oliver Wendell Holmes Devise, History of the Supreme Court of the United States: The Judiciary and Responsible Government} 1910-1921 at 306-307 (1984).
\end{itemize}
secure any "average reciprocity of advantage," it was an unconstitutional exercise of the police power. However, the Court indicated the State's exercise of the police power, in these circumstances, would be constitutional if accompanied by just compensation.207

For the most part, Mahon represented the extreme of the myriad of due process cases that reached the Court during this century's first seventy-five years. Aside from the Court's short foray into substantive due process, and protecting property rights through an acceptance of a laissez faire theory of economic liberty in cases such as Lochner v. New York,208 the Court generally upheld the exercise of the police power that involved restrictions on the use of property,209 including zoning.210 In Hadacheck v. Sebastian,211 for example, the owner had for many years conducted a perfectly legal brickyard business on a plot which overlay the clay deposits used in manufacturing the bricks. As the City of Los Angeles grew, however, it annexed the area in which the brickyard was located, which became primarily residential in character. The city then passed an ordinance only prohibiting the operation of the brickyard. The ordinance did not, for example, prohibit the extraction of the clay to be transported elsewhere, or any other business which might be conducted on the site. The owner was convicted of the misdemeanor of continuing to operate the brickyard and


207. The opinion concludes with the caveat that "we assume that an exigency exists that would warrant the exercise of eminent domain." Pennsylvania Coal Co. v. Mahon, 260 U.S. at 416.


brought a habeas corpus petition alleging that the statute violated the Due Process Clause. The Court was not asked to address whether just compensation should be paid; rather, the case focused on the effect the ordinance had in depriving the owner of his ability to continue conducting the business of the brickyard—just one of the many bundles of rights in the property.\textsuperscript{212} The lower court had stated the regulation was not precluded by the fact “the value of the investments made in the business . . . will be greatly diminished.”\textsuperscript{213} The Court rejected Hadacheck's plea, which one observer has described as simply another example of a property owner attempting to continue a “pig-in-the-parlor pattern.”\textsuperscript{214}

Miller v. Schoene,\textsuperscript{215} decided after Pennsylvania Coal Co. v. Mahon, is another instance in which the exercise of the police power was validated. In an effort to preserve the commercially valuable apple crop, the Virginia State Entomologist had directed that cedar trees near apple orchards be destroyed to eliminate the disease the cedar trees were suspected of transmitting. Certain cedar tree owners challenged the validity of the law. The statute provided for payment to the owners for the costs of removal of the trees and also reserved to them ownership of the felled trees. In this context, if a taking occurred, the only property interest arguably taken would have been the interest present in the trees while they were standing. The Court decided that the statute was a valid exercise of the State’s police power.\textsuperscript{216}

Next, in a case with facts somewhat similar to Hadacheck, the Court in Goldblatt v. Town of Hempstead,\textsuperscript{217} upheld an ordinance completely banning further sand and gravel mining operations. The town of Hempstead had grown such that residential development and schools now surrounded an extensive sand and gravel pit where prior excavations had created a twenty-acre lake. What had once been a perfectly legal and unobjectionable activity now had become incompatible with its surroundings. The town passed an ordinance that effectively prohibited the excavation activity, concededly the most beneficial use of the property. The Court in this case did consider whether the regulation required the payment of just compensation, but the posture of the case offered the Court the opportunity to avoid any lengthy analysis. After noting that “[t]here is no set formula to determine where regulation ends and taking begins”\textsuperscript{218} the Court stated that “[h]ow far regulation may go before it becomes a taking we need not now decide, for there is no evidence in the present record which even remotely suggests that prohibition of further mining will re-

\textsuperscript{212} Professor Arnold Reitze views this case as an early example of local air pollution regulation, although he notes that the ordinance regulated only a small portion of the city that was still largely undeveloped, yet developing. ARNOLD W. REITZE, JR., AIR POLLUTION LAW 15 (1995).

\textsuperscript{213} Hadacheck, 239 U.S. at 408.

\textsuperscript{214} STRONG, supra note 208, at 119-121.

\textsuperscript{215} 276 U.S. 272 (1928).

\textsuperscript{216} See generally, STRONG, supra note 208, at 155-158.

\textsuperscript{217} 369 U.S. 590 (1962).

\textsuperscript{218} Id. at 594.
duce the value of the lot in question." As a consequence, the Court simply held that the issue of whether a compensable taking had occurred could not be decided without further evidence and consideration of the private property owner's interest.

These three cases, Miller, Hadacheck, and Goldblatt, became coupled with the Court's decision in Mugler to form the basis for the decision in Keystone Bituminous Coal Ass'n v. De Benedictis. In Keystone, Pennsylvania coal operators brought a facial challenge to the validity of a statute which required that certain coal deposits be left in place to prevent subsidence, or settling, of the surface due to mining. The Court's opinion sets out the task before the Court: "[t]he two factors that the Court considered relevant [in Mahon] have become integral parts of our takings analysis. We have held that land use regulation can effect a taking if it 'does not substantially advance legitimate state interests, ... or denies an owner economically viable use of his land.' The opinion then states the essence of its holding: the application of both tests, not just one, demonstrates that the facial challenge must fail. First, unlike the Kohler Act, the character of the governmental action involved here leans heavily against finding a taking; the Commonwealth of Pennsylvania has acted to arrest what it perceives to be a significant threat to the common welfare. Second, there is no record in this case to support a finding similar to the one the Court made in Pennsylvania Coal, that the Subsidence Act makes it impossible for petitioners to profitably engage in their business or that there has been undue interference with their investment-backed expectations.

The Court first determined whether the statute served a legitimate public purpose. It described prior cases as expressing "[t]he Court's hesitance to find a taking when the state merely restrains uses of property that are tantamount to public nuisances." The Court said that this past "hesitance" to find a compensable taking when a State merely prohibits a nuisance was consistent with the notion of "average reciprocity of advantage" noted in Pennsylvania Coal. However, this did not end the analysis. In a footnote, the Court referenced the other rationale for the "hesitance," namely, the "simple theory" that since no individual has a right to use his property so as to create a nuisance or otherwise harm others, nothing is "taken" when the nuisance is enjoined. The Court further indicates in this footnote that any "nuisance exception" to the takings guarantee is "not coterminous with the police power itself."

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219. Id.
221. Id. at 485 (quoting Agins v. Tiburon, 447 U.S. 255, 260 (1980)) (emphasis added).
222. Id. at 485.
223. Id. at 491 (emphasis added).
224. Id. at 491 n.20.
225. 480 U.S. at 491 n. 20 (quoting Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 145 (1978) (Rehnquist, J., dissenting)). In his dissenting opinion in Keystone, the current Chief Justice elaborated on this language, stating among other things that the exception to the takings guarantee is in fact one based not on nuisance, but premised on allowing the government to prevent a "misuse or
Such was the relevant background when the Court reasoned in Lucas, in deciding whether a landowner who has been deprived of all economically viable use of her land is entitled to compensation, courts must look to an independent source such as the state property law, to determine whether the limit inhered in the title to the property.

IV. IMPLICATIONS OF Lucas

A. Implementation of Lucas

Since Lucas, courts have begun to explore the limits for finding a per se categorical regulatory taking. It is now commonplace to distinguish between categorical regulatory takings and partial regulatory takings. The former involve those situations where the government has deprived the owner of all economically viable use of the property, as in Lucas, while in the latter the government’s actions have not been so drastic. In order to prove that the government has effected a partial regulatory taking, a property owner must prevail under an ad hoc factual inquiry into the particular circumstances of the case, balancing the three factors first identified by the

illegal use” and is a “narrow” one. Keystone, 480 U.S. at 512 (quoting Penn Central (Rehnquist, J., dissenting)). In effect, if there is an exception, it is certainly wrong to label it a “nuisance” exception and it would appear to require considerably more illegality or harm than Lucas’s proposed construction of two houses. The Chief Justice’s dissent goes on to state that “we have not accepted the proposition that the State may completely extinguish a property interest or prohibit all use without providing compensation,” a fair description of the effect of the Beachfront Management Act on Lucas’s property. Id. at 513.

226. The per se categorical taking rule applies only to the taking of real property; consequently, programs that effectively deprive a property owner of money, whether through taxes, assessments, or otherwise, do not fit within the Lucas per se rule. See Branch v. United States, 69 F.3d 1571, 1576-1577 (Fed. Cir. 1995), cert. denied, 117 S. Ct. 55 (1996).  

Court in *Penn Central Transportation Co. v. New York City*:228 "(1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the governmental action."229 The application of this *ad hoc* balancing approach generally has not been rewarding for litigants,230 and thus the focus typically shifts to trying to establish a *per se* taking, whether as a physical occupation case, such as in *Lorreto v. Telepromter Manhattan CATV Corp.*231 or a *Lucas per se* categorical regulatory taking. This usually means wrestling with the "parcel as a whole" problem or determining whether *Lucas*’ logically antecedent inquiry limits the property use.

The "parcel as a whole" question involves determining whether, in the first instance, the property at issue reflects the entirety of the property for the takings analysis.232 The Court in *Lucas* largely left this issue open,233 with the Court of Federal Claims and the Federal Circuit filling in the gap.

To determine whether a mere diminution in value has occurred or whether the owner has in fact been denied all economically viable use, a court must compare the ratio of the land subject to restrictions with the plaintiff’s entire property or "the parcel as a whole" . . . . For this reason, a court’s determination of what constitutes the parcel as a whole—which has been called “the denominator problem”—is critical to this analysis. . . . In fact, the definition of the parcel often controls the entire takings analysis.234

In circumstances involving residential or commercial development of separately identifiable lots, these lower courts have made it clear that they will not necessarily examine the impact of any restrictions on a lot-by-lot basis.235 The inquiry, however, nevertheless turns on the unique facts of each case, with a taking typically occurring only when the relevantly burdened lot is distinguishable from the remaining property.236 Thus, in

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230. The difficulty with line drawing was discussed at length in *Florida Rock Indus., Inc. v. United States*, 18 F.3d 1560 (Fed. Cir. 1994), cert. denied, 513 U.S. 1109 (1995). In *Bowles v. United States*, 31 Fed. Cl. 37 (Fed. Cl. 1994), one of the few cases where the plaintiff has prevailed, the court applied both the *per se* and *ad hoc* balancing approach to find a taking. See also *Whitney Benefits, Inc. v. United States*, 926 F.2d 1169 (Fed. Cir. 1991); *United Nuclear Corp. v. United States*, 912 F.2d 1432 (Fed. Cir. 1990).
231. 458 U.S. 419 (1982).
233. *See supra* note 61 and accompanying discussion.
235. *Broadwater Farms Joint Venture*, 121 F.3d 727 (Fed. Cir. 1997); *Tabb Lakes, Ltd. v. United States*, 10 F.3d 796, 802 (Fed. Cir. 1993). *See also* *Clajon Prod. Corp. v. Petera*, 70 F.3d 1566 (10th Cir. 1995) (regulations limiting the number of permits available to hunt and a claim involving an alleged taking of hunting rights, with the court rejecting assertion that relevant property interest was the right to hunt).
236. *For cases prior to Lucas*, see *Ciampitti v. United States*, 22 Cl. Ct. 310 (1991); *Deltona Corp.*
Loveladies Harbor, Inc. v. United States, the Federal Circuit considered the relevant parcel to be the 12.5 acres limited by the application of the section 404 dredge and fill (wetlands) program, not the original 250 surrounding acres that included 199 acres of already-developed property. Conversely, in Broadwater Farms Joint Venture v. United States, the court held that all twenty-seven lots of a particular phase in the developer's project constituted the relevant parcel. The court looked to factors such as when the lots were purchased, how they were financed and how they were to be developed.

The next major issue involves determining whether there are any limitations that inhere in the owner's title that would preclude a taking. This first requires distinguishing between the "logically antecedent inquiry" and an owner's reasonable investment-backed expectations. As one court observed,

The initial inquiry by the court—whether the plaintiff has a property interest—is not determined by examining whether plaintiff has "reasonable investment backed expectations." Such an inquiry is only relevant when assessing whether government regulation has effected a taking by regulation of an acknowledged and existing property interest. . . . The presence of "reasonable backed expectations" does not aid in establishing the existence of the property interest.

Initially, the Court of Federal Claims concluded that federal laws can serve as relevant background principles for determining the scope of a property right. In M & J Coal Co. v. United States, for example, the...
federal circuit refused to find a taking in the federal regulation of coal mining activities that affected the public health and safety, observing that federal law can serve as a source of rules or understandings limiting the uses of property.\textsuperscript{244} For instance, consistent with\textsuperscript{Lucas} reference to the federal navigational servitude,\textsuperscript{245} lower federal courts have held that this federal servitude inheres in an owner's title and overrides any property interest in lands lying below the mean high water mark.\textsuperscript{246}

But the argument for applying federal laws as background principles has since been rejected. In a plurality opinion by the Federal Circuit in\textit{Preseault v. United States},\textsuperscript{247} the court dismissed the government's defense of the Rails-to-Trails program, when the government argued that decades of federal legislation over interstate railroads could serve as relevant "background principles" defining the scope of property rights.\textsuperscript{248}

In\textit{Forest Properties, Inc. v. United States (FPI)},\textsuperscript{249} this conclusion was then adapted to a regulatory taking case involving the denial of a dredge and fill permit under section 404 of the Clean Water Act. The United States argued in\textit{FPI} that federal laws must be considered when examining whether there were any pre-existing limits on the property owner's title.\textsuperscript{250} The court termed this the "notice defense"—\textit{i.e.}, that an owner who purchases property is on notice of pre-existing and valid laws restricting the development of that property.\textsuperscript{251} The court rejected this argument, noting that the issue is relevant only when examining reasonable investment-backed expectations:

[This Court believes that, where there is a regulatory permit procedure in effect, the plaintiff's compensable interest is best examined on the merits in

\begin{itemize}
\item \textsuperscript{244} Id. at 1153.
\item \textsuperscript{245}\textit{Lucas}, 505 U. S. at 1029.
\item \textsuperscript{246} Good v. United States, 39 Fed. Cl. 81 (Fed. Cl. 1997); Marks v. United States, 34 Fed. Cl. 387, 403 (Fed. Cl. 1995);\textit{c.f.}\textit{Applegate v. United States}, 35 Fed. Cl. 406, 414-415 (Fed. Cl. 1996).\textit{See also Lechuza Villas West v. California Coastal Comm'n}, 60 Cal. App. 4th 218, 70 Cal. Rptr. 2d 399 (1997) (limitations on development below the mean high tide, where those lands are considered state lands under state law).
\item \textsuperscript{247} 100 F.3d 1525 (Fed. Cir. 1996).
\item \textsuperscript{248} Id. at 1538. The analysis in\textit{Preseault} is questionable. It essentially focuses on the lack of any enforcement of a federal law to protect against any harm; the court also treats the case as a physical takings case and not a regulatory takings case. Id. at 1539-1540. Cf.\textit{The Chevy Chase Land Co. v. United States}, 37 Fed. Cl. 545, 583 (Fed. Cl. 1997) (following\textit{Preseault}, but questioning its reasoning by further suggesting that pre-existing federal limitations may provide such a basis for limiting rights in property). See\textit{ also Kim v. City of New York}, 681 N.E.2d 312, 314-315 (1997) (noting that antecedent inquiry applied to both physical and regulatory takings).
\item \textsuperscript{249} 39 Fed. Cl. 56 (Fed. Cl. 1997).
\item \textsuperscript{250} Id. at 71.
\item \textsuperscript{251} Id.
terms of the owner's reasonable investment-backed expectations and not as a threshold matter in terms of whether or not the landowner owned a compensable property interest.\(^{252}\)

The court proceeded to conclude that the proposed dredging and filling of the lakebottom property in *FPI* would not have been prohibited under state nuisance or property law "such that the use was not a part of the plaintiff's ownership interest."\(^{253}\)

This distinction between reasonable expectations\(^{254}\) and the logically antecedent inquiry is particularly significant if the latter inquiry is limited to state nuisance and common law. In *Store Safe Redlands Associates v. United States*,\(^{255}\) for instance, the Court of Federal Claims rejected the government's argument that expectations can define the property interest. It offered the following observation of where the government's argument could lead:

> Under such logic, Congress could pass a law that stated that no one could build on their property. After all property had passed hands once, the right to build on one's property would be lost to everyone. Such an argument is not based on the property law of any American state or upon the Constitution of the United States.\(^{256}\)

But, of course, this observation misses the mark. Just as state nuisance and property law do, federal and state statutory law define the contours of property interests.\(^{257}\) Congress could indeed pass such a law and subsequent purchasers ought to be foreclosed from arguing they have a

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252. *Id.* at 71-72.

253. *Id.* at 72.


255. 35 Fed. Cl. at 725.

256. *Id.* The court further reasoned that, because property rights run with the land, it would be illogical to preclude a property owner from challenging regulatory actions that predated the owner's purchase of the property. *Id.*

257. See *Blais*, supra note 240. See also *Kim v. City of New York*, 681 N.E.2d 312 (N.Y. 1997); *Anello v. Zoning Bd. of Appeals*, 678 N.E.2d 870 (N.Y. 1997); *Hunziker v. State*, 519 N.W.2d 367 (Iowa 1994). In *Kim*, the court observed that,

> [i]t would be an illogical and incomplete inquiry if the courts were to look exclusively to common-law principles to identify the pre-existing rules of State property law, while ignoring statutory law in force when the owner acquired title. . . . [T]o accept this proposition would elevate common law over statutory law, and would represent a departure from the established understanding that statutory law may trump an inconsistent principle of the common law. . . .

681 N.E.2d at 315. The court in *Kim* also distinguished a footnote in *Nollan v. California Coast Comm'n*, 483 U.S. 825, 833 n. 2 (1987), that at first glance might have suggested a contrary approach, noting that in that case there was no pre-existing restriction on the relevant property interest. *Id.* at 316 n. 3.
property right in the first instance. After all, "no one is considered to have a property interest in a rule of law." If the law changes and all development is precluded, just as if alcohol, cigarettes or firearms are subsequently banned, those who obtain the relevant property after the law is changed cannot argue they have been deprived of anything as a consequence of the changed law. Any other approach would turn the clock back to the nineteenth century, when businesses argued that they had a property interest in the continued ability to engage in certain businesses, free from governmental interference. The appropriate answer to the concern animating the court in *Store Safe* is to note that its hypothetical overlooks the obvious: existing owners would still be able to sue for a takings, and such a law effectively would freeze property ownership and force the takings lawsuits. In short, there would be no new owners.

Yet, even if federal law is irrelevant to the logically antecedent inquiry, it may nevertheless limit an owner's reasonable investment-backed expectations when a categorical *per se* taking is unavailable. Federal law may put a subsequent purchaser of property on notice of restrictions on the use of property, thus limiting that owner's reasonable expectations. "Generally, when an owner buys property with knowledge of restrictions upon the development of that property, he assumes the risk of any economic loss." In *Good v. United States*, for instance, the plaintiff argued that the denial of a permit to dredge and fill wetlands and access navigable waters constituted a taking. In dismissing plaintiff's claim, the court, in part, looked to the pervasive pre-existing federal regulatory regime as limiting the plaintiff's reasonable investment-backed expectations.

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259. As the Supreme Court has said:

> [E]ven with respect to vested property rights, a legislature generally has the power to impose new regulatory constraints on the way in which those rights are used, or to condition their continued retention on performance of certain affirmative duties. As long as the constraint or duty imposed is a reasonable restriction designed to further legitimate legislative objectives, the legislature acts within its powers in imposing such new constraints or duties.


260. *See e.g.*, *Cook v. United States*, 37 Fed. Cl. 425 (Fed. Cl. 1997) (change in law that precluded mining claimant on public land from obtaining fee simple title to property).

261. The court in *Anello v. Zoning Bd. of Appeals*, 678 N.E.2d 870 (N.Y. 1997), made this precise point. *See also* Basile v. Town of Southampton, 678 N.E.2d 489, 490-491 (N.Y. 1997) ("Whatever taking claim the prior landowner may have had against the environmental regulation of the subject parcel, any property interest that might serve as the foundation for such a claim was not owned by claimant here who took title after the redefinition of the relevant property interests . . . ").


264. 39 Fed. Cl. 81 (Fed. Cl. 1997).

265. *Id.* at 84.

266. *Id. Compare* United Nuclear Corp. v. United States, 912 F.2d 1432, 1436 (Fed. Cir. 1990). In *United Nuclear*, the court observed that the fact that United agreed that the leases would
These issues—the denominator problem, the independent source to which courts should look for guidance in evaluating whether a *Lucas*-like taking has occurred, and the role of an owner's reasonable investment-backed expectations—were not conclusively resolved by the Court in *Lucas*. Consequently, lower courts are left to grapple with these issues on their own with only limited guidance from the Supreme Court. With respect to the second of these issues, the Federal Circuit appears to be taking an overly restrictive approach. The *Lucas* court spoke of looking at background principles, such as state property and the common law, to determine whether a limitation inheres in the title to an owner's property; it did not command courts to look exclusively at this as a source. Background principles—state and federal, statutory and common law—play an important role not only in determining whether an individual's investment-backed expectations are reasonable, but also in the proper conception of property and property rights. *Lucas* did not foreclose the recognition of such broader principles.

B. *Lucas* and Utility Rate Setting

In another corner of the takings realm, *Lucas* is likely to have a less prominent role. Within the context of ratemaking, *Duquesne Light Co. v. Barasch*267 still stands out as the preeminent takings case.268 In *Duquesne*, the Supreme Court faced a claim by a utility that, by enacting legislation which prohibited the setting of rates based on physical plants until those plants became operational, the Pennsylvania legislature took the company's property without providing just compensation. *Duquesne Light Company* (Duquesne) joined a venture in 1967 to build seven nuclear power plants.269 After the oil price increases and the Three Mile Island accident in the 1970s, the outlook for the demand for nuclear energy fell, and the plans for four of the plants were canceled. Duquesne sought permission from the Pennsylvania Public Utility Commission (PUC) to recover the capital already invested in the canceled plants through a ten-year amortization.270 The PUC found that the investment in the nuclear facilities was prudent when made and granted the utility's request.271 The Pennsylvania Office of Consumer Advocate asked the PUC to reconsider in light

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269. See *Duquesne*, 488 U.S. at 302.
270. Id.
271. Id. at 302-03.
of a recent Pennsylvania legislative enactment, which limited consideration of certain costs in a utility's rate base.\textsuperscript{272} The PUC reaffirmed its decision, relying on the fact that, by allowing Duquesne to amortize the capital over ten years, the PUC was not allowing these costs in the rate base.\textsuperscript{273} The Office of Consumer Advocate appealed, and the Commonwealth court determined that the PUC had correctly interpreted the statute.\textsuperscript{274} The Pennsylvania Supreme Court, however, reversed.\textsuperscript{275} It rejected the utility's argument that the law took the utility's property without just compensation.\textsuperscript{276}

The Supreme Court of the United States granted certiorari and upheld the state supreme court's decision.\textsuperscript{277} In reaching its conclusion, the Court evaluated and rejected the utility's taking claim. The Court stated that the guiding principle for takings claims in the ratemaking context "has been that the Constitution protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be confiscatory . . . . If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments."\textsuperscript{278} In determining whether a rate is confiscatory, however, courts must look at the total effect of the rate order and recognize that the justness and reasonableness of a rate for a utility will depend on the risks under a particular rate-setting system.\textsuperscript{279} Performing this analysis, the Court concluded that the Pennsylvania rate system did not transgress constitutional bounds. "The Constitution within broad limits leaves the States free to decide what rate-setting methodology best meets their needs in balancing the interests of the utility and the public."\textsuperscript{280}

One would expect little change in the courts' analysis of takings claims within the utility rate-setting area after \textit{Lucas}. First and foremost, the Court in \textit{Lucas} focused primarily on the limits of the government's ability to restrict an owner's use of his land.\textsuperscript{281} Because this focus is significantly different from the focus in \textit{Duquesne}, the analysis for determining whether a rate has been set too low as to amount to a taking is unlikely to be affected. Second, one of the key issues in most regulatory takings cases outside the utility rate context is the denominator problem: against what parcel does a court measure the loss of economic value? When it comes to a

\begin{footnotesize}
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\item \textsuperscript{272} \textit{Id.} at 303 (citing S.B. 893, 181st Leg., 1987-88 Reg. Sess. (Pa. 1987)).
\item \textsuperscript{273} \textit{See Duquesne}, 488 U.S. at 304.
\item \textsuperscript{274} \textit{Id.} at 305 (citing Cohen v. Pennsylvania P.U.C., 494 A.2d 58 (Pa. Commw. 1985)).
\item \textsuperscript{275} \textit{Id.} (citing Barasch v. Pennsylvania P.U.C., 532 A.2d 325 (Pa. 1987)).
\item \textsuperscript{276} \textit{See Duquesne}, 488 U.S. at 305 (citing 532 A.2d at 335).
\item \textsuperscript{277} \textit{See Duquesne}, 488 U.S. at 316.
\item \textsuperscript{278} \textit{See Duquesne}, 488 U.S. at 307-08 (citations and quotations omitted).
\item \textsuperscript{279} \textit{Id.} at 310. The Court noted that one of the elements that is always relevant in evaluating whether a rate is confiscatory "is the return investors expect given the risk of the enterprise." \textit{Id.} at 314 (citing F.P.C. v. Hope Nat. Gas Co., 320 U.S. 591, 603 (1944)).
\item \textsuperscript{280} \textit{See Duquesne}, 488 U.S. at 316.
\item \textsuperscript{281} \textit{See Lucas}, 505 U.S. at 1027-28.
\end{itemize}
\end{footnotesize}
utility's claim that a rate is so low as to be confiscatory, the Court has already resolved the denominator problem. Rather than focus on any individual element of a rate order, courts are to evaluate the effect of the entire rate order on the utility's property. This, too, is likely to minimize the effect of \textit{Lucas} on rate-setting proceedings. Next, unlike the typical regulatory takings case, utilities do receive compensation for having their property devoted to public service—the rates charged and collected. The question in this context is simply whether the compensation is just: whether the rates charged are so unjust and unreasonable so as to be confiscatory. Such an inquiry is significantly different than the one the Court faced in \textit{Lucas}, where Mr. Lucas was deprived of all economic use of land. Rarely in a rate-setting context would a utility's claim rise to this level of economic deprivation.

Finally, \textit{Lucas} recognized that, as an antecedent inquiry, courts must look to background principles to determine whether the restriction complained of inhered in the title to the owner's property. Although this inquiry cannot be transposed directly to the utility rate-setting context—utilities voluntarily devote their property to public service in exchange for an adequate return on capital—an analogous inquiry can be made. A utility operates within a heavily regulated environment in which public utility commissions set the rates a utility may charge. Given such background principles, it would be unreasonable for a utility to demand the method for determining rates never change, unless the state is willing to pay compensation for every regulatory change. Under \textit{Duquesne}, states must pay compensation to utilities only if the change in methodology makes the set rates confiscatory. In short, the Court's pronouncements in \textit{Lucas} should have little effect on its decision in \textit{Duquesne}.

V. CONCLUSION

Is the decision in \textit{Lucas v. South Carolina Coastal Council} a "revisionist reading of venerable precedents" as stated by Justice Stevens or is it simply an unexceptional resort to existing principles? It is probably more of the latter than the former, although it is beginning to play a major role in the raging dialogue over striking the appropriate balance between private property and environmental regulation: how should we regulate wetlands yet protect property rights; how should we protect endangered species and their habitat without unwisely taking property rights; how should we handle utilities' stranded costs associated with moving to a more competitive electric industry; and, how should we control the flow of water in

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282. See \textit{Duquesne}, 488 U.S. at 310.
283. See \textit{Lucas}, 505 U.S. at 1003.
285. A Westlaw search reveals that only one federal case cites to both \textit{Lucas} and \textit{Duquesne}. See Garelick v. Sullivan, 987 F.2d 913 (2d Cir. 1993). The case does not involve utility rate setting, but instead is a case in which the court rejected regulatory takings claims that allege a federal statute setting limits on the amounts physicians could charge Medicare patients amounted to a compensable taking.
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western rivers and streams without depriving farmers of their irrigation water. These are vital issues to the nation’s future, and the lower courts are beginning to grapple with the more formidable issues left unresolved in the *Lucas* decision. In one area, for instance, they are applying Justice Scalia’s instruction—to look to background principles to determine if prohibition of a given use inheres in the title to the property—too narrowly. A broader antecedent inquiry is called for, as federal and state law, statutory and common law, shape individuals’ property interests.
SAFETY JURISDICTION OVER NATURAL GAS PIPELINES

Jim Behnke*

I. INTRODUCTION

On July 5, 1994, Congress enacted a revision of Title 49 of the United States Code.1 The expressed purpose of the bill was to restate in comprehensive form, but without substantive change, certain general and permanent laws relating to transportation and to enact those laws as subtitles II, III, and V-X of Title 49, United States Code, and to make other technical improvements in the Code.2 “In a codification law, the courts uphold the following presumption: the law is intended to remain substantively unchanged [citations omitted].” As to major pipeline facilities located within the United States, the enactment revised and recodified both the Natural Gas Pipeline Safety Act of 1968, as amended4 (NGPSA), and the Hazardous Liquids Pipeline Safety Act of 1979, as amended5 (HLPSA). The substantive provisions of the NGPSA and HLPSA were combined in the recodification and are now located in subtitle VIII of Title 49 - Pipelines comprising one Revised Pipeline Safety Act (RPSA).6

This article examines the claim that the RPSA effects no substantive change in the law as applied to natural gas pipeline safety. In doing so, this article reviews the allocation of jurisdiction over gas pipeline safety that exists among the Federal Energy Regulatory Commission (FERC), the United States Department of Transportation (DOT) and the several states, as well as areas of regulatory overlap, if any, among these entities. This is an important issue because at least one state has recently attempted to assert pipeline safety jurisdiction over pipelines that are exclusively within federal safety jurisdiction.7 The article concludes that the RPSA has

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created a technical ambiguity in the law that might mistakenly be interpreted to divest the several states of the jurisdiction that they possessed under the NGPSA and the Natural Gas Act (NGA) to impose additional or more stringent safety requirements with respect to so called “Hinshaw Pipelines.” On the other hand, the RPSA appears to clarify that states lack pipeline safety authority over lateral pipelines situated entirely within one state which are owned and used by interstate pipeline companies to transport gas in interstate commerce to an end-user purchasing natural gas for its own consumption. Such pipelines are not Hinshaw Pipelines because they are owned by interstate pipelines, rather than a separate entity or person, and ownership by a separate person is one of the legally distinctive characteristics of a Hinshaw Pipeline.

The RPSA benefits interstate natural gas pipelines transporting gas across state lines to large industrial and commercial consumers and delivering the gas so transported through such lateral pipelines by confirming the existence of exclusive federal safety jurisdiction over such lines, and rendering such pipelines free from additional and more stringent state safety regulation even if those state standards are compatible with the DOT pipeline safety standards. This is important to interstate pipelines whose business has become primarily that of “open-access” transporters of gas ever since the FERC promulgated Order No. 636. Moreover, it is not clear that the states ever had regulatory authority to impose safety regulation on direct sales consumer lines in addition to and/or more stringent than those safety regulations promulgated by the DOT because the FERC has always retained complementary safety jurisdiction with the DOT of such lines under sections 1(b) and 7 of the NGA.

In explaining the complementary scope of the DOT jurisdiction on the one hand, and the FERC and state jurisdiction in the area of natural gas pipeline safety on the other, as well as the potential ambiguity that the RPSA has generated with respect to Hinshaw Pipelines, the historical tension that has existed among the DOT, the FERC and the states is examined. Accordingly, this article is organized under five major headings: Jurisdictional Statements under the RPSA and the NGA; The Relationship of Law.

10. Hinshaw pipelines are pipelines satisfying the requirements of section 1(c) of the NGA. See Public Serv. Comm'n v. FERC, 900 F.2d 269, 275 n.4 (D.C. Cir. 1990).
of the FERC, the DOT and of the several states to Natural Gas Pipeline Safety Regulation; Evolution of the RPSA Choice of Regulation Rule; The Anomaly and Substantive Change in the Law Generated by the Revision of Title 49; and a Recommendation.

II. JURISDICTIONAL STATEMENTS UNDER THE RPSA AND THE NGA

Before undertaking an in-depth analysis, it may be helpful to preview the choice of regulation and jurisdictional rule by which the RPSA defines the safety powers of the DOT and other agencies over natural gas pipelines. That rule presently states:

A State authority that has submitted a current certification under section 60105(a) of this title may adopt additional or more stringent safety standards for intrastate [gas] pipeline facilities and intrastate [gas] pipeline transportation only if those standards are compatible with the minimum standards prescribed under this chapter. A State authority may not adopt or continue in force safety standards for interstate [gas] pipeline facilities or interstate [gas] pipeline transportation.

The RPSA further defines "interstate gas pipeline facility" and "intrastate gas pipeline facility" as follows:

"Interstate gas pipeline facility" means:
"... a gas pipeline facility... used to transport gas; and... subject to the jurisdiction of the [FERC] under the [NGA]... but... does not include a gas pipeline facility transporting gas from an interstate gas pipeline in a State to a direct sales customer in that State buying gas for its own consumption."

"Intrastate gas pipeline facility" means:
"... a gas pipeline facility and transportation of gas within a State not subject to the jurisdiction of [FERC] under the [NGA]... and... a gas pipeline facility transporting gas from an interstate gas pipeline in a State to a direct sales customer in that State buying gas for its own consumption."

Thus, the RPSA defines "interstate [gas] pipeline facilities" and "intrastate [gas] pipeline facilities" in most part, in terms of the well-established jurisdiction of the FERC. However, the RPSA choice of regulation rule, first quoted above, uses two terms, "interstate [gas] pipeline transportation" and "intrastate [gas] pipeline transportation," which are not themselves defined in the RPSA. The balance of this article is devoted to examining just what the choice-of-regulation rule and these two undefined concepts might mean.

Because the DOT's natural gas pipeline safety jurisdiction under the RPSA is in large measure defined in terms of FERC jurisdiction under the NGA, the examination commences with the NGA.

A. FERC Jurisdiction under the NGA

Regulatory authority over gas pipeline facilities is granted by Con-
gress to the FERC under the first clause of the NGA section 1(b)\(^{18}\) as limited by section 1(c).\(^{19}\) Section 7(c)\(^{20}\) deals with the construction and operation of facilities regulated by the FERC under the first clause of section 1(b). Section 1(b) grants the FERC general jurisdiction over certain activities involving interstate commerce in natural gas and reserves to the several states jurisdiction over other activities.

The relationship of section 1(b) and pipeline services and facilities regulated by the FERC is spelled out by section 7(c):

No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the [Federal Energy Regulatory] Commission, or undertake the construction . . . of any facilities therefor . . . or operate such facilities . . . unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations . . . (emphasis added).

Thus, the first clause of section 1(b) supplies subject matter jurisdiction over pipeline facilities used in:

1. “[T]he transportation of natural gas in interstate commerce.”\(^{21}\)
2. “[T]he sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use,” or
3. Facilities described by or used to provide both 1 and 2.\(^{22}\)

Facilities expressly excluded from FERC and NGA subject matter jurisdiction by the terms of the second clause of section 1(b),\(^{23}\) include facilities used for:

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18. 15 U.S.C.A. § 717(b) (West 1976). According to the committee reports explaining NGA section 1(b), the second clause of NGA section 1(b) does no more than state limitations that are implicit in the affirmative grant of the first clause of the section. Congress was urged to retain the limiting language of the second clause, because the language was present in previous drafts of such legislation and Congress believed that its removal might result in an overly expansive interpretation of the first clause. See Resolution Adopted by the Executive Committee of the National Association of Railroad and Utilities Commissioners on March 26, 1937, 75th Cong. (1937), included in H.R. REP. NO. 709, at 3-4 (1937); S. REP. NO. 1162, at 3 (1937).
23. Jurisdiction over the facilities expressly excluded from FERC regulation under the NGA is reserved to the several states, except in those situations which create conflict with FERC jurisdiction. See Northwest Cent. Pipeline v. Kansas Corp. Comm’n, 489 U.S. 493, 511 (1989).
1. "any other transportation" (referred to herein as "Intrastate Transportation Facilities").

2. "other ... sale of natural gas" (referred to herein as "Retail Sale Facilities").

3. the "local distribution of natural gas" (referred to herein as "Local Distribution Facilities").

4. "to the production" of natural gas (referred to herein as "Production Facilities").

5. "gathering of natural gas" (referred to herein as "Gathering Facilities").

Section 1(c) of the NGA, the Hinshaw Amendment, was enacted in 1954 and sets forth an important exclusion from the FERC's jurisdiction under the NGA for those section 1(b) Interstate Facilities that meet all three elements of the following test.

1. The facilities must be used by a person "to engage in the transportation in interstate commerce or the sale in interstate commerce for resale of natural gas," and receive gas "from another person," i.e. a person other than the person owning and operating the pipeline facility that receives the gas.

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24. See, e.g., Cascade Natural Gas Corp. v. FERC, 955 F.2d 1412 (10th Cir. 1992); Public Util. Comm'n v. FERC, 900 F.2d 269, 274-276 (D.C. Cir. 1990).


27. See Northwest Central Pipeline, 489 U.S. 493.

28. Natural Gas Pipeline Co. v. R.R. Comm'n of Tex., 679 F.2d 51, 54 (5th Cir. 1982); Conoco, Inc. v. FERC, 90 F.3d 536 (D.C. Cir. 1996).

29. Thus, pursuant to sections 1(b) and 7 of the NGA, the FERC has jurisdiction over all facilities used in the transportation or sale of natural gas for resale or interstate commerce, but not Intrastate Transportation Facilities, Retail Sales Facilities, Local Distribution Facilities, Production Facilities or Gathering Facilities. All facilities used to perform the activities named in section 1(b), whether subject to regulation by the FERC or reserved to regulation by the several states under the NGA, are referred to in this article as section 1(b) Facilities. Any reference to State-regulated section 1(b) Facilities would therefore include Intrastate Transportation Facilities, Retail Sale Facilities, Local Distribution Facilities, Gathering Facilities and Production Facilities. Facilities that would be subject to the FERC's jurisdiction under the first clause of section 1(b), even where eligible for section 1(c) Hinshaw Amendment exception, are referred to in this article as section 1(b) Interstate Facilities.
2. The facilities must receive the gas "within or at the boundary of a State," and the gas received by such facilities must be "ultimately consumed within such State" and

3. The rates and service of the facilities and the person using the facilities must be "subject to regulation by a State commission." 30

Section 1(b) Interstate Facilities satisfying the above test are referred to as section 1(c) Hinshaw Facilities in this article.31 Hinshaw pipelines are usually located in gas consuming states, but the FERC has asserted jurisdiction over intrastate lines in producing states where they are part of an interstate transmission system containing co-mingled interstate and intrastate gas and function as part of a "backhaul" system.32

Under section 1(c) and federal case law, if an interstate pipeline regulated by the FERC transports natural gas in a transmission pipeline to a state line or across a state line into a second state where the gas is delivered to a gas pipeline owned and operated by a "person" who is different than the person owning and operating the FERC-regulated interstate transmission pipeline, then the FERC has no jurisdiction to regulate the receiving facility if the state does so.33 If, on the other hand, the person owning and operating the FERC-regulated interstate transmission pipeline is the same person that owns and operates the receiving lateral, the FERC will retain jurisdiction of the lateral,34 even if the other elements of the section 1(c) Facilities test are satisfied.35 The FERC and state jurisdictional relationships are summarized in Appendix A, infra.

B. NGA Sections 1(b) and (c) Codify the Evolution of Federal Jurisdiction over Facilities Used in Interstate Commerce and a


31. Thus, under the foregoing definitions, section 1(b) Interstate Facilities, excepting any section 1(c) Hinshaw Facilities, constitute facilities that are subject to the FERC's jurisdiction under the NGA. Such facilities are FERC-regulated section 1(b) Facilities. State-regulated section 1(b) Facilities and section 1(c) Hinshaw Facilities are referred to as State-regulated section 1 Facilities.

32. See, e.g., Oklahoma Natural Gas Co. v. FERC, 28 F.3d 1281 (D.C. Cir. 1994) (although the gas in this case physically moved in a high pressure transmission line from a gathering system to an end user located within the same state, the FERC asserted jurisdiction over the matter as involving transportation in interstate commerce because the transportation was part of a "backhaul" transaction in which a downstream and out-of-state seller of natural gas arranged to transport and deliver its gas to the instate end-user in question).


34. Cascade Natural Gas Corp. v. FERC, 955 F.2d 1412 (10th Cir. 1992).

35. In cases where a potential Hinshaw pipeline facility is owned and operated by a corporate affiliate of a FERC regulated interstate transmission line the FERC is given considerable latitude in deciding whether the affiliate owning and operating the potential Hinshaw pipeline constitutes a different person than the affiliate owning and operating the interstate transmission pipeline. See, e.g., Altamont Gas Transmission Co. v. FERC, 92 F.3d 1239 (D.C. Cir. 1996).
Corresponding Limitation on State Authority

Sections 1(b) and 1(c) of the NGA can be understood as the Congressional reaction to the case by case attempt by the United States Supreme Court to define “interstate commerce” in natural gas, first under the so-called “dormant” commerce clause of the United States Constitution, and then under the NGA, as states and then the Federal Power Commission (FPC) asserted jurisdiction over the transportation and/or sale of natural gas by pipeline during the first half of this century.36

Congress enacted the Natural Gas Act of 1938 on June 21, 1938, to fill the regulatory void created by the dormant commerce clause jurisprudence of the United States Supreme Court.37 Although Congress initially adopted the constitutional limit of permissible state regulation as established by the Supreme Court as the corresponding limit of FPC jurisdiction under the NGA,38 in the mid-1950's this limit was readjusted by enactment of the Hinshaw Amendment.

1. Interstate Pipeline Transportation and Sales as Characterized in the Supreme Court's Dormant Commerce Clause Cases

The United States Supreme Court characterized interstate commerce and transportation of gas or electricity during the period 1910-1938 as transmission of gas or electricity through a pipeline or wire, as the case might be, from one state to another up to the point that it was delivered to local distribution mains or retailing facilities. The Court decided that wholesale rate regulation of interstate commerce in natural gas and electricity were fields of activity that the states had no constitutional authority to regulate. Transportation of gas or electricity from one state to another was identified as interstate commerce. By contrast, sales by local or out-of-state companies at retail were determined to be within state jurisdiction to regulate. The Court thus declared a portion of commerce in natural gas beyond state regulatory authority, but carefully reserved state jurisdiction over intrastate rates.39

2. Interstate Pipeline Transportation and Sales under the NGA

Congress enacted the NGA to assure federal regulation of wholesale sales of natural gas and transportation of natural gas in interstate commerce, adopting the constitutional framework for defining the permissible extent of state regulation that had been previously outlined by the United States Supreme Court under the commerce clause.40 Consequently, it

36. See General Motors Corp. v. Tracy, 117 S.Ct. 811, 820-22 (1997), and infra note 39.
40. The “bright-line” analysis of what constitutes an undue burden on interstate commerce un-
should not have been surprising when, in 1950, the Court carried over into its interpretation of the NGA roughly the same concepts of interstate gas pipeline transportation and intrastate gas pipeline transportation that it had developed in its previous constitutional cases.\textsuperscript{41} In Federal Power Commission \textit{v.} East Ohio Gas Co.,\textsuperscript{42} the Court was specifically asked to construe the phrase "transportation of natural gas in interstate commerce" in section 1(b) of the NGA. The Court decided that a pipeline company receiving high pressure natural gas at a state line from a different pipeline company situated outside the state, which the receiving pipeline then \textit{transported} and sold to a third person located within the state of receipt, was engaged in the transportation of natural gas in interstate commerce under section 1(b) and subject to the regulatory jurisdiction of the FPC for purposes of accounting and reporting.\textsuperscript{43}

In terms of the analytic categories summarized in Appendix A, \textit{East Ohio} established that section 1(b) Interstate Facilities located entirely within one state were subject to the FPC's jurisdiction.\textsuperscript{44} The facilities downstream of the point of pressure reduction and introduction into local main gas pipeline facilities constituted state regulated section 1(b) Facilities, namely Intrastate Transportation Facilities, Retail Sales Facilities and Local Distribution Facilities.\textsuperscript{45}

\textsuperscript{41} Supra note 39.
\textsuperscript{42} FPC \textit{v.} East Ohio Gas Co., 338 U.S. 464 (1950).
\textsuperscript{43} Justice Black described the facts of the case and its holding as follows:

\textit{East Ohio owns and operates a natural gas business solely in Ohio selling gas to... Ohio consumers through local distribution systems. Most of this natural gas is transported into Ohio from Kansas, Texas, Oklahoma and West Virginia through pipelines [of other companies].... Inside the Ohio Boundary these interstate lines connect with East Ohio's large high pressure lines in which the imported gas... flows continuously more than 100 miles to East Ohio's local distribution systems.... That this continuous flow of gas from other states to and through East Ohio's high pressure lines constitutes interstate transportation has been established by numerous previous decisions of this Court. The gas does not cease its interstate journey the instant it crosses the Ohio boundary or enters East Ohio's pipes, even though that Company operates completely within the state where the gas is finally consumed... the meaning of interstate commerce in [the NGA] is no more restricted than that which theretofore had been given it in opinions of this Court... We hold that the word 'transportation' like the phrase 'interstate commerce' aptly describes the movements of gas in East Ohio's high-pressure pipelines [citations omitted].}

\textsuperscript{44} See Appendix A, A.1 and A.2.
\textsuperscript{45} See Appendix A, B.1-B.3.
3. The Hinshaw Amendment and Transportation of Gas in Interstate Commerce

The *East Ohio* decision, although predictable and consistent with the Supreme Court's previous commerce clause decisions, created dissatisfaction among local distribution companies and others owning and operating transmission facilities within a single state because the decision specifically upheld the FPC's authority to require East Ohio Gas Company to keep accounts and submit reports to the FPC under sections 1(b), 5, 6, 8, 10 and 16 of the NGA, potentially resulting in federal rate and operational regulation of these pipelines. In 1954, Congress enacted the Hinshaw Amendment, which added section 1(c) to the NGA and eliminated the possibility of such regulation in those cases where a state subjected the rates and facilities of the pipeline in question to regulation.

Enactment of section 1(c) of the NGA was the first significant addition to state jurisdiction over the transportation and sale of gas in interstate commerce since the United States Supreme Court began to develop its dormant commerce clause jurisprudence with respect to natural gas. Section 1(c) of the NGA expressly reserved to state public utility commissions and other state agencies authority to regulate interstate transportation and/or sale of gas satisfying the conditions of the test it specified. Section 1(c), however, did nothing to modify the interstate character of such transportation and, in fact, the language expressly applies to facilities used in transportation in interstate commerce and sale in interstate commerce for resale. Despite the Hinshaw Amendment, *East Ohio* continues to be cited for its definition of interstate transportation of natural gas by pipeline because, among other things, the FERC retains jurisdiction over these facilities unless the state affirmatively regulates the facilities in question.

Under the analytic categories displayed in Appendix A, section 1(c) diminished the FPC's and FERC's regulatory authority over section 1(c)

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46. 15 U.S.C.A. §§ 717(b), 717(d), 717(e), 717(g), 717(i) and 717(o) (West 1976).
48. A significant expansion of federal jurisdiction under the NGA by the Supreme Court at the expense of the States occurred during the year the Hinshaw Amendment was enacted, when the Court imposed federal regulation and price controls on natural gas producers selling gas for resale into the interstate market and to interstate pipelines. See Wisconsin v. Phillips Petroleum Co., 347 U.S. 672 (1954). This ruling did not subject to regulation intrastate sales in the state of production, but the consequences flowing from this decision and the long term gas contracting practices of gas pipelines ultimately helped to create the shortage of natural gas in the interstate market that motivated Congress to enact the Natural Gas Policy Act, 15 U.S.C.A. §§ 3301-3432. See United Distribution Cos. v. FERC, 88 F.3d 1105, 1123 (D.C. Cir. 1996); Northwest Cent. Pipeline Corp. v. State Corp. Comm'n of Kan., 489 U.S. 493, 502 (1989).
49. See Public Util. Comm'n. of Cal. v. FERC, 900 F.2d 269, 275 (D.C. Cir. 1990) (interstate transportation continues to the point of pressure reduction and delivery to local mains). Cascade Natural Gas Corp. v. FERC, 955 F.2d 1412, 1418 (10th Cir. 1992) (interstate transportation includes tap and meter facilities at point of local delivery). In *Cascade* the Court of Appeals applied the *East Ohio* pressure reduction test to the facts before it, but reserved the issue in other situations. 955 F.2d at 1420 n.9.
INTERSTATE FACILITIES

By adding section 1(c) Hinshaw Facilities to the State Regulated section 1(b) Facilities that were regulated by the several states.\(^{50}\) As will be shown later, this transfer of regulatory authority has important consequences for the RPSA.

C. **FERC Jurisdiction under Section 1 of the NGA and its Application to Interstate Gas Pipeline Facilities and Intrastate Gas Pipeline Facilities under the RPSA**

FERC jurisdiction under the NGA and the relation of section 1(b) subject matter jurisdiction to its constitutional origin has been reviewed in order to explain in detail the RPSA definitions “interstate gas pipeline facility”\(^{51}\) and “intrastate gas pipeline facility.”\(^{52}\) Because such gas pipeline facilities are defined, in part, in terms of whether or not a facility is “subject to the jurisdiction of [the FERC] under the [NGA],” the RPSA cannot be understood without first understanding FERC jurisdiction under the NGA. However, these terms are not alone decisive on the issue of whether a given facility may be regulated by the states. The concepts of interstate pipeline transportation and intrastate pipeline transportation also have an important part to play.

1. **Common Elements and Distinguishing Features**

The RPSA definitions for “interstate gas pipeline facilities” and “intrastate gas pipeline facilities” both involve “gas pipeline facilities” that are “... used in transporting gas.”\(^{53}\) “Transporting gas” means in relevant part “transmission or distribution of gas by pipeline ... in interstate commerce.”\(^{54}\) “Interstate commerce” means, for these purposes, “... commerce ... between a place in a State and a place outside that State.”\(^{55}\)

A third element which distinguishes interstate from intrastate pipeline facilities is the general relationship of the natural gas pipeline facility in question to the FERC jurisdiction under the NGA. “Interstate gas pipeline facilities” would generally include all facilities “subject to the jurisdiction of [the FERC] under the [NGA].”\(^{56}\) By contrast, “intrastate gas pipeline facilities” generally includes all facilities “not subject to the jurisdiction of [the FERC] under [the NGA].”\(^{57}\)

The definition of “interstate gas pipeline facilities” under the RPSA is, however, also subject to an exception for certain facilities that are subject at least in part to the FERC jurisdiction under the NGA. That exception is for “a gas pipeline facility transporting gas from an interstate gas

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53. 49 U.S.C.A. §§ 60,101(6)(A) and (9)(A) and 60101(3) (West 1996).
pipeline in a State to a direct sales customer in that State buying gas for its own consumption."\textsuperscript{58} At the time this exception was introduced under the NGPSA, the direct sales customer generally purchased gas directly from an interstate pipeline that owned the gas in question and transported it to the purchaser. In this article, a gas pipeline facility satisfying this additional and express exception from "interstate gas pipeline facility" will be referred to as a "Direct Sales Customer Line."

While there is an exclusion of Direct Sales Customer Lines from the "interstate gas pipeline facility" definition in the RPSA, there is an express inclusion of Direct Sales Customer Lines in the definition of "intrastate gas pipeline facility."\textsuperscript{59} Therefore, "interstate gas pipeline facilities" under RPSA are FERC regulated section 1(b) Facilities excluding any Direct Sale Customer Lines.\textsuperscript{60}

2. Distinguishing Among NGA section 1(c) Hinshaw Facilities, Direct Sales Customer Lines and Interstate Transportation Laterals

Direct Sales Customer Lines, NGA section 1(c) Hinshaw Facilities and what might be termed Interstate Transportation Laterals, necessarily constitute "intrastate gas pipeline facilities" under the RPSA. All three types of facilities are located entirely within one state, service a customer or customers located within that state, and all the gas delivered by these facilities is consumed in that state. The three types of facilities are also used in transportation of gas in interstate commerce by pipeline. However, under the RPSA these three types of facilities differ significantly in that a Direct Sales Customer Line, which is used by an interstate pipeline to make direct sales of gas to a consumer, is expressly excepted from the general rule defining "interstate gas pipeline facility" to be a pipeline facility used to transport natural gas subject to the jurisdiction of the FERC under the NGA. By contrast, an NGA section 1(c) Hinshaw Facility, is excluded from the RPSA definition of "interstate gas pipeline facility" because NGA section 1(c) necessarily excludes NGA section 1(c) Hinshaw Facilities from the FERC's jurisdiction under the NGA and thus an express definitional exclusion under the RPSA is not required. An Interstate Transportation Lateral, on the other hand, merely transports gas in interstate commerce directly to an end-user without that transportation being legally connected with the sale of the gas that is delivered.

NGA section 1(c) Hinshaw Facilities and Direct Sales Customer Lines constitute two similar but materially different types of "intrastate gas

\textsuperscript{60} 49 U.S.C.A. § 60,101(9)(B) (West 1996).
\textsuperscript{61} See Appendix A, A.1.
pipeline facilities” under the RPSA. Both types of facilities are involved in interstate gas pipeline transportation under NGA section 1, but NGA section 1(c) Hinshaw Facilities cannot be subject to the FERC’s jurisdiction under the NGA whereas Direct Sales Customer Lines must be subject to FERC transportation jurisdiction. No pipeline facility can be in both legal categories at the same time. The material factual distinction between these two types of gas pipeline facilities under the RPSA is that a NGA section 1(c) Hinshaw Facility is owned and operated by a person or entity different from the person or entity that owns and operates the natural gas transmission line supplying natural gas to the owner and operator of that NGA section 1(c) Hinshaw Facility and is subject to state regulation in most respects. The owner and operator of a Direct Sales Customer Line, on the other hand, is the same person or entity as the owner and operator of the interstate natural gas transmission line that supplies natural gas to the Direct Sales Customer Line. The Interstate Transportation Lateral is owned and operated by the interstate pipeline transporting the gas in question but is not used to deliver gas that is transported and sold by the pipeline to the end-user in a single “bundled” transaction. In the case of the Interstate Transportation Lateral, both the transportation of gas and underlying pipeline that transports gas from the transmission line to the end-user is subject to the FERC’s jurisdiction for transportation rate purposes and for purposes of requiring a certificate of public convenience and necessity pursuant to NGA section 7(c).

III. THE RELATIONSHIP OF THE FERC, THE DOT AND THE SEVERAL STATES TO NATURAL GAS PIPELINE SAFETY REGULATION

The complexity of the definitions of “interstate gas pipeline facilities” and “intrastate gas pipeline facilities” is a consequence of the history of the concepts of interstate gas pipeline facility, intrastate gas pipeline facility, interstate gas pipeline transportation, intrastate gas pipeline transportation and the precedent natural gas pipeline safety statutes that were ultimately revised and recodified as the RPSA. That history is a tale of jurisdictional conflict and territoriality, with the FERC, the DOT and the several states at one time or another attempting to establish, expand or protect their respective authority to regulate the safety of natural gas pipelines relative to the other.

Upon a cursory reading, the relationship between the FERC under the NGA and the DOT under the RPSA would appear to be governed by the RPSA’s choice of regulation rule, with most, if not all, jurisdiction to establish natural gas pipeline safety standards having been transferred to the DOT. Moreover, the RPSA states:

In a proceeding under section 3 or 7 of the Natural Gas Act (15 U.S.C. 717b or 717f), each applicant for authority to import natural gas or to establish, construct, operate, or extend a gas pipeline facility subject to an applicable

63. 49 U.S.C.A. § 60,104(c) (West 1996).
safety standard shall certify that it will design, install, inspect, test, construct, operate, replace, and maintain a gas pipeline facility under those standards and plans for inspection and maintenance under section 60108 of this title. The certification is binding on the Secretary of Energy and the Commission except when an appropriate enforcement agency has given timely written notice to the Commission that the applicant has violated a standard prescribed under this chapter.64

The meaning of this section of the RPSA, however, is more subtle than a cursory reading reveals. As discussed below, under the statutes that preceded the RPSA, the language quoted above was enacted to achieve two different and important Congressional goals: (a) preservation of the concurrent safety jurisdiction of the FERC and the DOT with respect to the FERC Regulated section 1(b) Facilities; and (b) limiting those situations in which it would be necessary for the FERC to examine pipeline safety issues in detail in a proceeding for a certificate of public convenience and necessity under sections 7(c)65 and 1(b).66

Jurisdictionally, the FERC has authority over pipeline transportation of natural gas in interstate commerce pursuant to the first clause of section 1(b) of the NGA as modified by the Hinshaw Amendment.67 Section 7(c) requires a company to obtain a certificate of public convenience and necessity from the FERC before constructing and operating FERC Regulated section 1(b) Facilities. Section 7(e) authorizes the FERC to place reasonable conditions on such certificates.68 As part of its authority to issue certificates of public convenience and necessity, found in sections 1(b) and 7, the FERC is required to conduct a wide ranging review of all aspects of a proposed project including gas supply, demand for gas, cost of facilities, land use, environmental considerations, and, in appropriate cases, pipeline safety in determining whether a proposed project or pipeline facility is in the public interest and a certificate of public convenience and necessity under section 7(c) should issue to the pipeline project proponent.69

Pipeline safety, then, is one of the many issues that the FERC can and does address in a certificate proceeding under sections 1(b) and 7, and that can be the legitimate subject of a section 7(e) condition. This is confirmed by the history of federal pipeline safety regulation that preceded enactment of the RPSA.

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64. 49 U.S.C.A. § 60,104(d)(2) (West 1996).
A. The Natural Gas Pipeline Safety Jurisdiction of the FERC under the NGA

1. NGPSA and Chattanooga Gas

Under the authority of sections 1(b), 7(c) and (e), the FPC exercised authority to regulate the safety of interstate natural gas pipelines prior to the passage of the NGPSA (1968).70 In 1974, the question whether the FPC retained any safety jurisdiction over interstate natural gas facilities under the NGA after the passage of the NGPSA (1968) was raised directly by the FPC when the FPC ordered Chattanooga Gas Company to cease operating a liquified natural gas (LNG) facility previously certificated by the FPC under section 7 of the NGA.71 That certificate had been expressly conditioned on compliance with National Fire Prevention Association Standard No. 59-A-1972.72 In Chattanooga, the FPC took emergency action because Chattanooga's operation of the LNG facility, as certificated by the FPC, violated safety conditions requiring compliance with the National Fire Protection Association Standard No. 59A. The FPC subsequently denied rehearing, stating:

Chattanooga's contention that this Commission has no authority to impose safety standards on pipeline facilities certificated by it because the Secretary of Transportation has jurisdiction over such matters [under the NGPSA], is an interpretation of applicable statutes which entirely ignores our responsibilities under the [NGA]. While the Secretary indeed has certain jurisdiction over the establishment of specific safety standards such jurisdiction is not exclusive of [FERC's] powers in considering the "public convenience and necessity." We have in the past consistently exercised our authority over pipeline safety under Section 7 of the [NGA] as part of our jurisdictional responsibility to determine public convenience and necessity.73

The committee reports discussing the Natural Gas Pipeline Safety Act of 196874 support the FPC majority position in Chattanooga. Chattanooga ultimately settled with the FPC approval and a dissenting opinion, based on the rationale of a prior dissent75 asserted that when the NGPSA (1968) was enacted, the Office of Pipeline Safety of the DOT was granted exclusive safety jurisdiction over interstate pipelines because of section 7 of the NGPSA.76 These FPC orders brought to light a clear jurisdictional conflict

between the DOT and the FPC which has been reflected in the committee reports of subsequent amendments to the NGPSA. Today, outside the area of LNG safety where agreement has been reached, that conflict remains largely dormant. Thus, until its amendment in 1976, FPC, DOT and state jurisdiction over gas pipeline safety was as summarized in Appendix B.

2. The Natural Gas Pipeline Safety Amendments of 1976

The FPC orders in Chattanooga appear to have been one of the reasons for the amendment of the NGPSA in 1976 (hereinafter the "1976 NGPSA Amendments"). Federal Power Commission v. Louisiana Power & Light (hereinafter Louisiana Power & Light I)\(^7\) appears to have been another reason for the amendments, although the case did not directly relate to pipeline safety issues.

a. The Louisiana Power and Light/United Gas Pipeline Company Litigation

The factual background and procedural history of the litigation involving Louisiana Power and Light (LP&L), United Gas Pipeline Company (United) and the FPC are complex. That litigation resulted in two important decisions: the 1972 United States Supreme Court case noted above\(^7\) and the decision by the United States Court of Appeals for the Fifth Circuit cited previously in connection with the explanation of the Hinshaw Amendment.\(^8\)

The litigation involved two pipelines owned and operated by United and situated entirely in Louisiana.\(^9\) United's so-called "Black System" carried natural gas originating in Louisiana to pipelines that ultimately transported and delivered the gas outside Louisiana. The gas carried in the "Black System" was considered gas transported or sold for resale in interstate commerce and subject to the jurisdiction of the FPC under the NGA along with the facilities that carried it. United's "Green System," although connected to the "Black System" through a series of valves and pipeline interconnections, was physically distinct from it. Prior to the events that provoked the LP&L litigation, the "Green System" transported gas originating in the state of Louisiana owned and sold in bundled intrastate transactions to direct sale customers, such as LP&L, also located and consuming the gas in Louisiana.\(^10\) As such the "Green System" was used to transport and sell gas in intrastate commerce and was subject to

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79. Id.
80. Louisiana Power & Light Co. v. FPC, 483 F.2d 623 (5th Cir. 1973).
82. Id.
regulation in all respects by the Louisiana Public Service Commission.\textsuperscript{83} LP&L had a long-term contractual relationship with United that required United to make direct sales of natural gas to its power plants located on the “Green System” for their immediate consumption.\textsuperscript{84}

In the late sixties and early seventies, a combination of federal regulation of producer prices and long term gas supply contracting practices resulted in a shortage of natural gas in interstate markets.\textsuperscript{85} In response the FPC, issued a series of so-called “curtailment” orders and regulations,\textsuperscript{86} in which the FPC established certain favored uses of gas (e.g. use by residential customers, hospitals, and schools) and disfavored uses of gas (e.g., power plant and boiler uses), and required natural gas companies subject to FPC jurisdiction under the NGA to modify their respective interstate natural gas sales and transportation tariffs to implement FPC curtailment policies.\textsuperscript{87} Thus, subject to any applicable contractual liabilities between the parties, the FPC authorized natural gas companies to modify obligations to existing direct sales customers with industrial users and power plants not directly subject to FPC jurisdiction in order to comply with the FPC’s curtailment policy.

After the issuance of FPC curtailment requirements, United decided to introduce relatively small amounts of interstate gas from its “Black System” into its “Green System” and petitioned the FPC for a certificate of public convenience and necessity to do so, as well as for a declaratory order that the “Green System” was subject to the FPC orders pertaining to curtailment.\textsuperscript{88} At risk of unilateral modification of its long term direct sales gas supply contracts for plants located on the “Green System,” LP&L filed suit against United in the United States District Court for the Western District of Louisiana.\textsuperscript{89} United prevailed in the District Court, but that decision was reversed by the United States Court of Appeals for the Fifth Circuit. United appealed the decision to the United States Supreme Court. The Supreme Court decided in \textit{Louisiana Power & Light I} that the FPC possessed sufficient authority over transportation of natural gas in interstate commerce under section 1(b) of the NGA to consider and decide, in the first instance, whether the FPC had jurisdiction over United’s “Green System.”\textsuperscript{90} Thus, on primary jurisdiction grounds, the Supreme Court vacated the order of the Court of Appeals, noting that that Court would have jurisdiction to review the curtailment decision of the FPC in connection with United and LP&L under section 19 of the NGA.\textsuperscript{91} If ap-

\begin{itemize}
\item \textsuperscript{83} \textit{Louisiana Power \\ \\ & Light Co. v. FPC}, 483 F.2d 623, 625 (5th Cir. 1973).
\item \textsuperscript{84} \textit{FPC v. Louisiana Power \\ & Light Co.}, 406 U.S. 621, 624 (1972).
\item \textsuperscript{85} See discussion supra note 48.
\item \textsuperscript{86} \textit{FPC Order 431}, 36 Fed. Reg. 7505 (1971).
\item \textsuperscript{87} \textit{FPC v. Louisiana Power \\
\item \textsuperscript{88} \textit{Id.} at 625.
\item \textsuperscript{89} \textit{Id}.
\item \textsuperscript{90} \textit{Id.} at 648.
\item \textsuperscript{91} 15 U.S.C. § 717r (1976).
\end{itemize}
Shortly after the Supreme Court's decision the FPC decided that it had jurisdiction over United's "Green System" due to the introduction of interstate gas (amounting to approximately 3.4% annually of aggregated deliveries). LP&L appealed the FPC decision to the United States Circuit Court of Appeals for the Fifth Circuit. Deferring to the FPC's decision, the Court of Appeals upheld the FPC's determination as well as a determination that the Hinshaw Amendment was inapplicable to the "Green System." Thereafter, the Court of Appeals denied rehearing and the United States Supreme Court denied certiorari and rehearing. Thus, United succeeded in transforming its intrastate system into an interstate system, subjecting that system to FPC curtailment priorities.

The producing states and others feared that state safety jurisdiction over such historically intrastate direct sales pipelines such as the "Green System" could be defeated simply by commingling relatively minor amounts of gas dedicated to interstate commerce into such systems, thus converting intrastate to FPC regulated interstate transportation. Congress was petitioned to remedy the situation. Clearly, gas producing states that had historically regulated intrastate pipelines such as the United "Green System" were facing a challenge to their pipeline safety jurisdiction. In view of the NGA section 1(c), the Hinshaw Amendment, however, state regulators in non-producing states did not realistically face such a challenge.

b. Attempt to Divest FPC of Safety Jurisdiction Fails

It followed from the assertion of jurisdiction by the FPC over the curtailment decisions of United with respect to its "Green System" under NGA section 1(b), as well as from Chattanooga, that direct sales customer lines were subject to FPC jurisdiction under NGA sections 7(c) and (e), and that the FPC had safety jurisdiction with respect to direct sales customer lines under the NGA and FPC certificate authority. Because the NGPSA (1968) had defined DOT safety jurisdiction in terms of FPC jurisdiction under NGA section 1(b), it followed from the Louisiana Power & Light I and Louisiana Power & Light Co. v. Federal Power Commission (hereinafter Louisiana Power & Light II) decisions that state safety regulation of direct sales customer lines was preempted by the NGPSA (1968), just as Chattanooga had clarified that the FPC actively asserted safety jurisdiction over FERC Regulated NGA section 1(b) Facilities. By 1976, bills to amend the NGPSA (1968) had been proposed to and

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94. Id. at 631-34.
95. Id. at 631-34.
97. Id.
98. See Appendix B.
considered by Congress. The bills amounted to an assault on FPC pipeline safety jurisdiction that, for the most part, failed. A compromise between the House and Senate produced the 1976 NGPSA Amendments. Under the compromise, the House bill, H.R. 12168, was passed in lieu of the Senate bill, S. 2042, after the House bill was amended to include much of the Senate text. The Senate bill had proposed to overrule Chattanooga by expressly eliminating natural gas pipeline safety jurisdiction reserved to the FPC under the NGA as recognized in section 7 of the NGPSA (1968). The Senate Report issued in connection with this bill explained that S. 2042 would have prevented the FPC from attaching any safety conditions to a certificate of public convenience and necessity other than standards established by the DOT. 98

Not surprisingly, the FPC opposed elimination of FPC safety jurisdiction under the NGA. The FPC emphasized that the NGPSA (1968) was not intended to diminish the safety jurisdiction of the FPC under the NGA and detailed the FPC’s efforts with the DOT and the Coast Guard to enter into a jurisdictional Memorandum of Understanding (MOU) with respect to safety jurisdiction over liquefied natural gas (LNG) facilities, a matter that was concluded some years later. 99

One of the principal purposes of S. 2042 was to eliminate FPC safety jurisdiction over interstate gas transmission facilities in its entirety. Consequently, the bill, if enacted, would have eliminated FPC pipeline safety jurisdiction over all natural gas pipeline facilities including Direct Sale Customer Lines. However, the 1976 NGPSA Amendments as enacted did not include S. 2042 language divesting the FPC of pipeline safety jurisdiction, but did include direct sales customer lines in its new definition of “intrastate pipeline transportation.” 100

Thus, the passage of the 1976 NGPSA Amendments failed, as a technical matter, to remove pipeline safety jurisdiction from the FPC under the NGA, and did not make exclusive the DOT’s jurisdiction to establish federal safety standards over FERC Regulated NGA section 1(b) Facilities. At best, the FPC and the DOT were left by Congress to work out an allo-

99. Jurisdictional disputes between the DOT and other federal agencies still continue to plague the Office of Pipeline Safety. One such dispute would be resolved statutorily by S. 2042. The dispute stems from the fact that the FPC regulates the interstate sale of natural gas for resale through a certification process. In so doing, it has from time to time imposed safety conditions on those natural gas facilities over which it has authority.

Id. at 4676.
100. Id. at 4694.
101. H.R. REP. NO. 94-1660, at 7 (1976), reprinted in 1976 U.S.C.C.A.N. 4701, 4703. This House Report dealt with the issue of FPC safety jurisdiction and stated that although the Senate amendment would have forbade the FPC from attaching safety standards to certificates of convenience and necessity if such condition requested safety standards other than those imposed by the DOT, the Senate had receded to the House position, which did not include any diminution with respect to the authority of the FPC.
cation of jurisdictional responsibilities between themselves. The 1976 NGPSA Amendments did exclude Direct Sales Customer Lines from "interstate gas transmission facilities" and included such lines in the definition of "intrastate pipeline transportation." This exclusion, to the extent that it did affect the jurisdictional relationships of the FPC and the several states with respect to the NGA section 1(b) Facilities, did so merely with respect to Direct Sales Customer Lines whose gas sales were otherwise regulated by state regulatory commissions. The exclusion was clearly a congressional reaction to the potential for application of preemptive federal safety jurisdiction by the DOT over State Regulated NGA section 1(b) Facilities like those involved the United/LP&L litigation, which were located entirely within a gas producing state and served industrial or commercial end-users.

From the perspective of applying the choice of regulation rule of the NGPSA (1976), the 1976 NGPSA Amendments meant that Direct Sales Customer Lines constituted "intrastate pipeline transportation." Although the NGPSA appeared to suggest that states might establish additional or more stringent standards as to Direct Sale Customer Lines than those established by the DOT, such regulation theoretically trespassed upon a field of regulation considered by the Supreme Court to belong to the transportation jurisdiction of the FPC under the NGA section 1(b). Congress did not revoke or expressly modify FPC jurisdiction under the 1976 NGPSA Amendments. Thus, safety regulation of these facilities by states remained theoretically subject to preemption under Louisiana Power & Light I and the NGA.

Jurisdictional relationships for pipeline safety purposes, upon enactment of the 1976 NGPSA Amendments, are summarized in Appendix C.

3. Pipeline Safety Act of 1979

The Pipeline Safety Act of 1979 (PSA) provided Congress with another opportunity to eliminate or adjust the FERC's safety jurisdiction under the NGA. By 1979, the safety regulation of LNG facilities and hazardous liquids pipeline transportation had become serious legislative concerns. Congress addressed these issues in the PSA, but again refused to eliminate safety jurisdiction from the FERC under the NGA. The FERC retained safety jurisdiction even though the legislative explanation set forth in Senate Report No. 96-182 for S. 411, the bill that was passed as the PSA in lieu of the competing House bill, continued to identify lack of co-

104. Id.
106. The functions of the FPC were transferred to the Secretary of Energy, and with regard to natural gas matters subject to the NGA, to the FERC within the Department of Energy by The Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565 (1977).
operation and coordination between the FERC and the DOT with respect to pipeline safety as a problem. The committee noted, however, that the FERC and the DOT were working on a MOU with respect to their respective safety jurisdiction over LNG, and thus deferred legislation on the subject.\textsuperscript{107}

A MOU regarding LNG facilities and the roles of the FERC and the DOT with respect to LNG safety was finally executed and published on May 9, 1985.\textsuperscript{108} That MOU expressly recognized the FERC's authority to exact more stringent safety requirements than the DOT with respect to any LNG facility that is subject to the FERC's jurisdiction under the NGA sections 1(b) and 7. In any event, the MOU appears to have ended, as to LNG facilities, the jurisdictional controversies between the DOT and the FERC.\textsuperscript{109}


Neither the Pipeline Safety Act of 1992 (PSA of 1992)\textsuperscript{110} nor the Accountable Pipeline Safety and Partnership Act of 1996 (APSPA)\textsuperscript{111} addressed FERC jurisdiction with respect to pipeline safety under the NGA. Consequently, neither the NGPSA (1968), the 1976 NGPSA Amendments, the PSA, the PSA of 1992, nor the APSPA have eliminated FERC safety jurisdiction under the NGA.

B. Arguments Arising Under the NGA Against Assertion of State Safety Jurisdiction

Because the FERC retains safety jurisdiction under NGA sections 1(b), 7(c) and (e) with respect to the FERC-regulated NGA section 1(b) Facilities, the same doctrines that militate against state regulation of matters falling within the purview of a FERC certificate of public convenience and necessity under the NGA sections 1(b) and 7 apply to state regulation of pipeline safety. For example, if a state attempted to impose natural gas pipeline safety standards in addition to or more stringent than those imposed by the DOT on a Direct Sales Customer Line or an Interstate Transportation Lateral transporting gas to an end-user, and such line is constructed and operated under a certificate of public convenience and necessity issued pursuant to NGA section 7, federal preemption under the NGA and other doctrines preserving FERC authority under the NGA theoretically apply.

\textsuperscript{109} The FERC continues to place safety conditions in excess of those required by the DOT Code in certificates of public convenience and necessity issued under the NGA section 7. See, e.g., Columbia Gas Transmission Corp., 71 F.E.R.C. ¶ 61,347 (1995).
1. Federal Preemption under the NGA

Unlike DOT jurisdiction under the NGPSA or the RPSA, pipeline safety preemption under the NGA and the Supremacy clause of the Constitution is not express. Federal preemption under the NGA is a form of "implied preemption." There are, in turn, at least two types of implied preemption, "field" and "conflict." Field preemption arises when an activity purportedly regulated by a state falls within a field of activity that is pervasively regulated by federal law and has been exclusively reserved by law to federal regulation. Conflict preemption arises when competing federal and state directives apply to the same action or regulated activities and state law interferes with or is an obstacle to the purposes of Congress.

Field preemption would appear to be a more expansive case of conflict preemption because any state regulation occurring within a field exclusively reserved to federal regulation necessarily conflicts with that reserved authority, whether or not the federal agency in question has actually promulgated a rule or order regulating the issue at hand. Ordinarily, the issue in a field preemption case is which sovereign, federal or state, has paramount or pervasive authority to regulate in that field. The issue in a conflict preemption case is generally actual interference of conflicting regulations promulgated under the delegated authority of two different sovereigns, one federal, the other state.

In the natural gas industry, section 1(b) of the NGA created a field of exclusive federal regulation and a field of regulation reserved to the states. As this paper has previously discussed, with the exception of section 1(c) of the NGA, the Hinshaw Amendment, the field of exclusive federal regulation under the NGA is roughly the same field the Supreme Court determined the states were forbidden to regulate under the "dormant" Commerce Clause during the first three decades of this century.

Thus, FERC authority and state authority to regulate commerce in natural gas are complementary. The FERC was granted exclusive authority to regulate "transportation of natural gas in interstate commerce" and/or "the sale in interstate commerce of the natural gas for resale for ultimate consumption for domestic, commercial, industrial, or any other..."
Additionally, under section 7(c) of the NGA, the FERC's exclusive authority under section 1(b) of the NGA expressly applies to the construction and operation of pipeline facilities engaged in "transportation or sale of natural gas subject to the jurisdiction of [the FERC]." On the other hand, authority to regulate state-regulated section 1(b) Facilities and section 1(c) Hinshaw Facilities as shown in Appendix A, sections A.2 and B.1-5, was reserved to the states.

As for the safety regulation of natural gas pipeline facilities used to transport or sell natural gas for resale in interstate commerce and requiring a certificate of public convenience and necessity under section 7 of the NGA, such safety regulation appears to fall squarely within the field of the FERC's authority over FERC-regulated section 1(b) Facilities and not within the reserved authority of states to regulate the Intrastate Transportation Facilities, Retail Sales Facilities, Local Distribution Facilities, Production Facilities, Gathering Facilities or section 1(c) Hinshaw Facilities. Thus, the FERC-regulated section 1(b) Facilities, including Direct Sales Customer Lines, are presumably subject to safety regulation by the FERC as well as by the DOT. State pipeline safety regulation of FERC-regulated section 1(b) Facilities is thus theoretically subject to preemption under the NGA, as well as the NGPSA and its successor the RPSA.

2. Prohibition Against Collateral Attack of FERC Orders under Section 19 of the NGA

A doctrine of federal administrative law that may also apply to foreclose imposition of state pipeline safety requirements that are, in addition to or more stringent than those required by the DOT Code under the RPSA, is the doctrine that prohibits collateral attack of federal agency orders properly issued within the scope of the agency's jurisdiction. In the event that a final certificate of public convenience and necessity is issued under section 7 of the NGA with respect to a FERC-regulated NGA section 1(b) Facility, the doctrine would apply, at a minimum, to foreclose state safety regulation in connection with any matters addressed in the certificate because section 19 of the NGA establishes exclusive administrative

118. Under NGA sections 1(b) and 7, the FERC reviews all matters pertinent to the public interest in deciding whether or not to issue a certificate of public convenience and necessity under the NGA. Atlantic Refining Co. v. Public Serv. Comm'n of N.Y., 360 U.S. 378, 391 (1959).
119. State regulation in these reserved areas which conflicts with the FERC's ability to regulate the FERC-regulated section 1(b) Facilities as shown in Appendix A, section A.1 may be preempted. Northwest Cent. Pipeline Corp. v. State Corp. Comm'n of Kan., 489 U.S. 493, 518 (1989).
121. Excluded from the FERC's jurisdiction and preemption, of course, is state regulation of intrastate sales of gas to the consuming end-user. When sales are made outside the state, however, the state has no jurisdiction over the sale. See supra note 26.
122. See section A.1 of Appendices A, B and C.
The two doctrines of preemption and the prohibition against collateral attack apply to the FERC-regulated NGA section 1(b) Facilities as shown in Appendixes A-C, & E of this article. Such facilities include the Direct Sale Customer lines and Interstate Transportation Lateral lines which are regulated by the FERC under its NGA section 1(b) “transportation” authority, even though Direct Sale Customer Lines are excluded from the RPSA’s definition of “interstate gas pipeline facilities” and are included in RPSA’s definition of “intrastate gas pipeline facilities.” Thus, federal preemption under the NGA and the doctrine prohibiting collateral attack of FERC orders, properly granted, appear to apply to prevent state safety regulation of Direct Sale Customer Lines subject to the FERC’s certification authority, even though under the NGPSA Direct Sale Customer Lines are considered “intrastate pipeline transportation” and under the RPSA such facilities are considered “intrastate gas pipeline facilities.”

Intrastate Transportation Facilities, Retail Sale Facilities, Local Distribution Facilities, Production Facilities, Gathering Facilities, and NGA section 1(c) Hinshaw Facilities, on the other hand, may be subject to more stringent or additional state safety regulation, as shown in Appendixes B and C, because those facilities fall outside the field of exclusive regulatory authority granted to the FERC under NGA section 1(b) and within the complementary field of authority reserved to the several states under NGA section 1(b) and (c).

IV. THE EVOLUTION OF THE RPSA CHOICE OF REGULATION RULE

After enactment of the 1976 NGPSA Amendments, regulation of pipeline safety by the several states under the NGPSA was expressly preempted by the DOT’s minimum pipeline safety, with respect to all FERC-regulated NGA section 1(b) Facilities except Direct Sales Customer Lines. Contrary to the language of House Report No. 105-180, quoted at the beginning of this article, the RPSA choice of regulation rule appears to have changed the prior law. The change appears to correspond, in part, to the change in the interstate natural gas pipeline industry wrought by FERC Order No. 636 series.


125. See Appendix C.

126. See Appendix E.


128. The RPSA’s choice of regulation rule is found at 49 U.S.C.A. § 60,104(c) (West 1996).

129. Order No. 636, supra note 13.
A. NGPSA Choice of Regulation Rule

The original NGPSA choice of regulation rule stated:

> Any State agency may adopt such additional or more stringent standards for pipeline facilities and the transportation of gas not subject to the jurisdiction of the Federal Power Commission under the Natural Gas Act as are not incompatible with the Federal minimum standards [i.e., the DOT Code], but may not adopt or continue in force after the minimum Federal safety standards referred to in this subsection become effective any such standards applicable to interstate transmission facilities.\(^{130}\)

Thus, determination of whether "additional or more stringent" natural gas pipeline safety standards of the several states were preempted by DOT standards and/or FPC regulatory authority under the NGA was straightforward. Regulation by the FPC under the NGA determined whether the pipeline facility could be subject to permissible state regulation under the NGPSA (1968).\(^{131}\)

B. The 1976 NGPSA Amendments

The 1976 NGPSA Amendments changed the choice of regulation rule of the NGPSA (1968) to the following: "Any State agency may adopt additional or more stringent standards for intrastate pipeline transportation if such standards are compatible with the Federal minimum standards. No State agency may adopt or continue in force any such standards applicable to interstate transmission facilities, after the Federal minimum standards become effective."\(^{132}\)

This amendment introduced a statutorily defined concept of "intrastate pipeline transportation" to complement the preexisting definition of "interstate transmission facility." In response to *Louisiana Power & Light I* and *II*, the 1976 NGPSA Amendments also modified the definition of "interstate transmission facilities" which had applied to all pipeline facilities regulated by the FPC under the NGA, by excluding from it any "pipeline facilities within a State which transport gas from an interstate pipeline to a direct sales customer within such State purchasing gas for its own consumption."\(^{133}\) The complementary concept of "intrastate pipeline transportation," on the other hand, was defined as:

> Pipeline facilities and transportation of gas within a State which are not subject to the jurisdiction of the Federal Power Commission under the Natural Gas Act.

\(^{130}\) 49 U.S.C. § 1672(b) (1970). The NGPSA (1968) defined "interstate transmission facilities" to mean "pipeline facilities used in the transportation of gas which are subject to the jurisdiction of the Federal Power Commission under the Natural Gas Act," 49 U.S.C. § 1671(8) (1970), "pipeline facilities" to include "any equipment facility or building used in the transportation of gas or the treatment of gas during the course of transportation," 49 U.S.C. § 1671(4) (1970); and "transportation of gas" to mean "the gathering, transmission or distribution of gas by pipeline or its storage in or affecting interstate commerce . . . ." 49 U.S.C. § 1671(3) (1970).

\(^{131}\) Compare Appendices A and B.


\(^{133}\) 49 U.S.C. § 1671(8) (1976). As discussed previously there is some reason to think that this language was only intended to apply to gas producing states.
r al Gas Act, except that it shall include pipeline facilities within a State for which transport gas from an interstate gas pipeline to a direct sales customer within such State purchasing gas for its own consumption.\textsuperscript{134}

Thus, the 1976 NGPSA Amendments retained a two category test for permissible state regulation. A pipeline facility's character as an "interstate transmission facility" or "intrastate pipeline transportation" determined whether it could be regulated by a state under the NGPSA (1976). Direct sales customer lines, however, were defined as intrastate pipeline transportation, even though such lines might be subject to FPC authority over natural gas transportation in interstate commerce.

In terms of the analytical categories summarized in Appendix C, the choice of regulation rule established by the 1976 NGPSA Amendments stipulated that the DOT pipeline safety standards would preempt all additional and more stringent state pipeline standards applicable to FERC-regulated NGA section 1(b) Facilities except Direct Sales Customer Lines. On the other hand, additional and more stringent pipeline safety regulation by the several states, subject to DOT Code compatibility was not to be preempted \textit{by the DOT Code} with respect to Intrastate Transportation Facilities, Retail Sales Facilities, Local Distribution Facilities, Production Facilities, Gathering Facilities, NGA section 1(c) Hinshaw Facilities, \textit{and Direct Sales Customer Lines}.\textsuperscript{135} Thus, the 1976 NGPSA Amendment, for purposes of interpreting the NGPSA choice of regulation rule, transferred Direct Sales Customer Lines from the NGPSA category that prohibited all natural gas pipeline safety regulation by the several states in excess of the DOT Code requirements to the NGPSA category that permitted such regulation, provided those state standards were compatible with the DOT Code. As discussed previously however, the 1976 NGPSA Amendments failed to terminate or modify the FPC's authority under NGA sections 1(b) and 7 to impose more stringent and additional pipeline safety requirements with respect to the FERC-regulated NGA section 1(b) Facilities including Direct Sales Customer Lines.\textsuperscript{136}

\textsuperscript{134} 49 U.S.C. § 1671(9) (1976).
\textsuperscript{135} DOT counsel issued an internal policy memorandum that interpreted the 1976 through 1992 versions of the NGPSA choice of regulation rule to authorize additional or more stringent safety regulation of direct sale customer lines by the several states. In the memorandum, the DOT counsel did not consider any of the following: the history of the United/LP&L litigation; direct sales by interstate pipelines; FERC natural gas pipeline safety jurisdiction under the NGA; or the failure of Congress to deprive the FERC of such safety authority. The memorandum is not an official order or regulation of the DOT, and hence is not entitled to deference under \textit{Chevron U.S.A., Inc. v. Natural Resources Defense Council}, 467 U.S. 837 (1984). However, even if the interpretation were a formal act of the DOT, \textit{Chevron deference} would be questionable in view of the overlap of jurisdiction between the FERC and the DOT. See Appendix D.

\textsuperscript{136} Any argument that, by creating the definitions of "interstate transmission facilities" and "intrastate pipeline transportation" the 1976 NGPSA Amendments, in effect, amended the NGA to exclude direct sales customer lines from FERC jurisdiction under the first clause of NGA section 1(b), necessarily fails. A comparison of the definitions of these two types of pipeline facilities under the NGPSA (1976) indicates that direct sales customer lines are treated, for NGPSA purposes, as a definitional exception from pipeline facilities that were and remained subject to FPC jurisdiction under the NGA. The definitional exception under the NGPSA did not change the character of FPC regulation.
natural gas pipeline safety of Direct Sales Customer Lines remained theoretically subject to FPC preemption under NGA sections 1(b) and 7, and the prohibition against collateral attack of FPC orders under NGA section 19, even though these issues appear never to have been litigated.

C. Pipeline Safety Act of 1979

The Pipeline Safety Act of 1979 (PSA) renumbered but did not materially affect the NGPSA (1976) choice of regulation rule, as applied to natural gas pipeline safety. It did, however, make some significant modifications to other aspects of pipeline safety.

1. 1979 Additions to NGPSA (1976)

The PSA added extensive statutory provisions dealing with the safety of liquefied natural gas (LNG) facilities, including, but not limited to, complex provisions as to the application of location, design, engineering and construction standards to such LNG facilities. It also clearly applied the choice of regulation rule for pipeline safety found under NGPSA (1979) to such LNG facilities and clearly demarcated the respective limits of DOT and Coast Guard safety authority over onshore LNG Facilities pursuant to the NGPSA (1979).

2. Addition of HLPSA

Title II of the PSA also enacted the HLPSA, which included a choice of regulation rule with respect to hazardous liquids pipelines. The concept of “intrastate pipeline facility” and the four category approach to a choice of regulation rule, was later adopted by the RPSA, appears to have originated in Title II of PSA.

The HLPSA (1979) choice of regulation rule states:

Any State agency may adopt additional or more stringent safety standards for intrastate pipeline facilities and the transportation of hazardous liquids associated with such facilities, if such standards are compatible with the Federal standards issued under this title. No State agency may adopt or continue in force any safety standards applicable to interstate pipeline facilities or the

over Direct Sales Customer Lines.

141. The DOT issued safety regulations interpreting such facilities to include all lateral lines within a single state that connect to an interstate transmission line. The regulations were upheld on appeal. See Southern Pac. Pipe Lines, Inc. v. U.S. Dept. of Transp., 796 F.2d 539 (1986). It is important to note, however, that the DOT's safety jurisdiction under the HLPSA does not overlap or compete with the safety jurisdiction of the FERC. Thus, under the HLPSA, the DOT could issue interpretations, rulings and orders that unilaterally define the relative bounds of state and federal safety jurisdiction over hazardous liquids pipeline transportation. Such was not the case under the NGPSA and the field of natural gas pipeline safety due to the FERC's retention of independent natural gas pipeline safety authority under section 7 of the NGA.
transportation of hazardous liquids associated with such facilities (emphasis added).

Thus, the HLPSA (1979) is the origin of a four category federal choice of regulation rule with respect to facilities that are either: (1) “interstate pipeline facilities” and/or (2) transport substances associated with such facilities. This four category concept is different on its face than the two category preemption concept set forth in the NGPSA (1979), even though the Senate Report which explains the HLPSA states that the analysis of the rule generally corresponds to the NGPSA (1979) choice of regulation rule and “therefore, need not be repeated.”

Neither the NGPSA (1979) nor the HLPSA (1979) defined “interstate pipeline transportation.” This concept also remains undefined in the RPSA.

D. Pipeline Safety Act of 1992

The PSA of 1992 made a number of additions to the NGPSA (1979) in the field of gas regulation pertaining to environmental protection, pipelines in high density population areas, gathering lines and underwater abandoned facilities, none of which directly affected the choice of regulation provisions discussed in this article.

Section 116 of the PSA of 1992 did, however, add the requirement that state agencies be certified by the DOT as a condition of imposing additional or more stringent pipeline safety standards on intrastate pipeline transportation.

E. The Accountable Pipeline Safety and Partnership Act of 1996

The APSPA, among other things, required a cost benefit analysis in connection with the promulgation of new safety standards, established a risk management demonstration project program, required the filing of pipeline maps in effected municipalities, required the DOT to establish standards for defining gathering lines and modified existing provisions pertaining to so-called “smart-pigs.” The APSPA did not directly affect the RPSA choice of regulation rule.

The APSPA also authorized the DOT to define “gathering line” and “regulated gathering line” without being restricted by the FERC’s classifications with respect to gathering facilities under section 1(b) of the NGA. This modification is an implicit Congressional recognition that the NGPSA and the RPSA are otherwise to be construed consistent with

146. See 49 U.S.C.A. § 60, 104(c) (West 1996).
the NGA, as discussed in *Natural Gas Pipeline*.\(^{148}\) It also created the opportunity for more complexity in the application of the RPSA choice of regulation rule. As a result of the APSPA, there are now at least three jurisdictional possibilities for gathering lines. First, if a pipeline facility is defined by the DOT's regulations as a gathering line and is also an interstate transportation pipeline regulated by the FERC under the first clause of section 1(b) of the NGA,\(^{149}\) then the DOT establishes minimum safety standards but the FERC may theoretically establish more stringent requirements for the facility under the FERC's certificate powers. Second, if a pipeline facility is defined by the DOT's regulations as a gathering line and is also a gathering facility under section 1(b) of the NGA, then the DOT establishes minimum pipeline safety standards for the facility, but the states are free to establish additional or more stringent safety standards provided the state authority is certified by the DOT and the state standards are compatible with DOT standards. Finally, if a pipeline facility used in gathering is expressly excluded from the DOT's definition of gathering line, and is also excluded from FERC jurisdiction under section 1(b) of the NGA, the facility will be subject to state safety jurisdiction.\(^{150}\)

F. Applying RPSA's Choice of Regulation Rule

At long last, a detailed and meaningful analysis of the RPSA choice of regulation rule is possible.\(^{151}\) That rule states:

A State authority that has submitted a current certification under § 60105(a) of this title may adopt additional or more stringent safety standards for intrastate pipeline facilities and intrastate pipeline transportation only if those standards are compatible with the minimum standards prescribed under this chapter. A State authority may not adopt or continue in force safety standards for interstate pipeline facilities or interstate pipeline transportation (emphasis added).\(^{152}\)

The rule is significantly different from the choice of regulation rule in the NGPSA, as its use of the conjunctive, "and," in the first sentence and the disjunctive, "or," in the second, creates a four category test (apparently inherited from the HLPSA) for identifying permissible state regulation in place of the previous two category test. Not surprisingly, this four-part test seems to take into account changes in the natural gas industry brought about by the FERC Order No. 636 series.\(^{153}\)

The four categories created by the RPSA and their corresponding

\(^{148}\) *Natural Gas Pipeline Co. of America v. Railroad Comm'n of Tex.*, 679 F.2d 51 (5th Cir. 1982).

\(^{149}\) The FERC distinguishes between pipelines used in transportation in interstate commerce and Gathering Facilities by applying a "primary function" test to the pipeline in question. *See* *Conoco, Inc. v. FERC*, 90 F.3d 536 (D.C. Cir. 1996).

\(^{150}\) *See* Appendix E.

\(^{151}\) This article considers in detail only application of the rule to natural gas pipeline facilities and transportation.

\(^{152}\) 49 U.S.C.A. § 60,104(c) (West 1996).

\(^{153}\) *See* Order No. 636, *supra* note 13.
preemption results are as follows: (a) intrastate gas pipeline facilities used in intrastate pipeline transportation may be regulated by a state; (b) intrastate gas pipeline facilities used in interstate pipeline transportation may not be regulated by a state;[154] (c) interstate gas pipeline facilities used in intrastate pipeline transportation may not be regulated by the state;[155] and (d) interstate gas pipeline facilities used in interstate pipeline transportation may not be regulated by the state.

Consequently, the RPSA choice of regulation rule[156] to be applied to these four categories is summarized as follows. First, if state standards apply to intrastate gas pipeline facilities and those facilities are used in intrastate pipeline transportation, a state may adopt additional or more stringent safety standards (provided the DOT certification and compatibility tests are met). Second, as to interstate gas pipeline facilities or interstate gas pipeline transportation, state authorities may not adopt or continue to enforce state safety standards. Applying the two preemption rules to the four categories of facilities and activities above, state authorities may only regulate facilities qualifying under category (a) above. In the other three categories either an "interstate gas pipeline facility" or an "interstate pipeline transportation" or both are involved. Hence, the states may not impose additional or more stringent pipeline safety standards than the DOT.

As discussed previously, the RPSA expressly defines "interstate gas pipeline facility" and "intrastate gas pipeline facility."[157] The critical question remains as to what constitutes "interstate pipeline transportation" and "intrastate pipeline transportation," terms that are not expressly defined in the RPSA. Existing case law, however, would seem to provide adequate guidance in construing these terms.

G. RPSA's Undefined Choice of Regulation Concepts: Interstate Pipeline Transportation and Intrastate Pipeline Transportation

Since the terms "interstate pipeline transportation" and "intrastate pipeline transportation" are not expressly defined under the RPSA, a review of related definitions under the RPSA, as well as judicial decisions under the NGA and the Commerce Clause is appropriate in determining

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154. This result seems particularly appropriate given the FERC Order No. 636 series. As a practical matter the FERC regulated interstate pipelines are no longer involved in making direct sales of gas to end-users. Rather, such pipelines are now almost exclusively engaged in interstate transportation subject to the FERC's authority to regulate transportation under sections 1(b) and 7 of the NGA. Consequently, the justification for state regulation of pipelines owned by interstate companies that were formerly used to make direct sales of gas on grounds that the states regulated their rates has, as a practical matter, been eliminated by the FERC Order No. 636 series. Since such companies no longer use such high pressure lateral lines to make direct sales and the FERC certifies the facilities and regulates the transportation rates of such pipelines, it is appropriate that federal, not state, safety regulation apply. From a practical perspective there are few, if any, direct sale customer lines left. They have been replaced by what this article has termed "interstate transportation laterals."

155. There are no pipeline facilities that can satisfy this category. See FPC v. East Ohio Gas Co., 338 U.S. 464 (1950).

156. 49 U.S.C.A. § 60,104(c) (West 1996).

what these undefined terms mean given the purposes of the RPSA. To the extent that FERC Order No. 636 series may influence the construction of these terms, its influence must also be taken into account.

1. Related RPSA Definitions Self-Contradictory

Review of related definitions under the RPSA makes it very clear that the meaning of the terms “interstate [gas] pipeline transportation” and “intrastate [gas] pipeline transportation” must be found outside the RPSA. The term “pipeline transportation” means “transporting gas” in relevant part,158 and “transporting gas” means the “gathering, transmission or distribution of gas by pipeline . . . in interstate or foreign commerce”159 but does not include gathering activities in certain rural areas. “ Interstate or foreign commerce,” in turn, means commerce between “a place in a State and a place outside that State.”160 Thus, using the RPSA definition of “pipeline transportation” to interpret the RPSA term “intrastate pipeline transportation” involves a logical self-contradiction. Applying the definition of “pipeline transportation” to “intrastate pipeline transportation” necessarily characterizes such intrastate pipeline transportation as commerce between a place in a State and a place outside that State and that, in turn, constitutes interstate commerce in RPSA and interstate pipeline transportation as ordinarily understood. Given this logical inconsistency, an appeal to the previous treatment that these concepts have been afforded under NGA and the Commerce Clause of the United States Constitution is appropriate.

2. Interstate Pipeline Transportation and Intrastate Pipeline Transportation under the Constitution and the NGA

As the discussions of the U.S. Supreme Court’s “dormant” Commerce Clause jurisprudence prior to 1938 and East Ohio Co.161 have disclosed, the federal courts have evolved well developed concepts of pipeline transportation of natural gas in both interstate and intrastate commerce. At least one federal court has expressly held that case law interpreting the NGA may be used and is dispositive in interpreting the predecessor to the RPSA, the NGPSA.162

In order for natural gas to be transported by pipeline in interstate commerce under the NGA and the Commerce Clause, two elements must be satisfied: (a) the natural gas that is being transported must have physically (or in the case of “back-haul,”163 constructively) crossed at least one

162. See Natural Gas Pipeline Co. v. Railroad Comm'n of Tex., 679 F.2d 51, 54 (5th Cir. 1982) (applying the terms “production” and “gathering” as construed by the courts under the NGA section 1(b) to define these terms under the NGPSA).
163. “Back-haul” is also referred to as “displacement.” It arises when different natural gas trans-
state line and (b) the natural gas must be transported at high pressure up to the point that it is delivered to another legally distinct person for distribution or consumption. The point of delivery to another, when accompanied by pressure reduction, is the point at which interstate commerce ceases and intrastate commerce commences. The FERC regulates transportation and facilities upstream of the delivery point, while the states regulate downstream of the delivery point. The two concepts of interstate and intrastate gas pipeline transportation are mutually exclusive because the FERC and state regulatory authority is to be complementary. Thus it is contradictory from a regulatory standpoint to characterize high pressure transportation of natural gas through a single facility as both interstate and intrastate pipeline transportation.165

Applying these traditional, judicially created concepts of intrastate and interstate gas pipeline transportation to the analytical categories previously developed in this article would certainly appear to be appropriate given existing case law under the NGA and the NGPSA. This is true, particularly in view of the fact that the FERC has restructured the interstate gas pipeline industry to eliminate virtually all sales of gas by pipelines and to limit the role of the pipelines strictly to the FERC regulated interstate transportation. Given prior case law, the following classifications would appear to result.165

a. Interstate [Gas] Pipeline Transportation

This concept requires gas to have been transmitted across a state line at high pressure. Such transportation terminates upon pressure reduction and delivery to a customer. Interstate gas pipeline transportation has had at least four important manifestations for purposes of applying the RPSA choice of regulation rule.

(1) 
FERC Regulated NGA section 1(b) Facilities. These facilities are used in interstate transportation of natural gas or sale of natural gas for resale, as described in the first clause of the NGA section 1(b) and exclude the NGA section 1(c) Hinshaw Facilities. All such FERC Regulated NGA section 1(b) Facilities are necessarily involved in the transportation of natural gas in interstate commerce because the gas these facilities carry must have crossed, or be mixed with natural gas that has crossed a state line either physically or constructively (as "back-haul") and must be transported at high pressure in these facilities up to the point of delivery to a legally distinct person.

(2) Direct Sales Customer Lines. As discussed previously these facilities are interconnected. It ordinarily involves an exchange of natural gas in interstate commerce between two pipelines allowing a pipeline interconnecting with another at a downstream point to make an upstream delivery off of the other pipeline system. The exchange occurs by having the other pipeline make the upstream delivery off of the other's system on behalf of the "back hauling" pipeline in return for the "back hauling" pipeline making an equivalent delivery of gas on behalf of the other pipe at a point downstream of the interconnection.

165. See Appendix E.
ties were FERC Regulated NGA section 1(b) Facilities and thus were necessarily involved in interstate gas pipeline transportation. Since the promulgation of the FERC Order No. 636, series direct sales by pipelines through such facilities has virtually ceased. As a consequence, the Direct Sales Customer Line exception to Interstate [Gas] Pipeline Facilities under the RPSA currently appears to have little, if any, practical application.

(3) **Interstate Transportation Laterals** to end-users are pipelines owned and operated by interstate natural gas pipelines to transport gas from their respective interstate transmission systems to end-users. They may be, in all respects, the same as Direct Sale Customer Lines, except the pipeline in question does not sell a bundled gas and transportation service to the end-user.

(4) **NGA section 1(c) Hinshaw Facilities** are expressly excluded from the FERC's regulation by the NGA section 1(c). However, such facilities are otherwise involved in the interstate pipeline transportation of gas, because prior to its delivery to the NGA section 1(c) Hinshaw Facility, such natural gas has been transported to or across at least one state line, either actually or constructively, and after such delivery is transported by that NGA section 1(c) Hinshaw Facility at high pressure to a consumer located in the state of receipt. Treatment of the NGA section 1(c) Hinshaw Facilities under the RPSA choice of regulation rule creates a technical anomaly in natural gas pipeline safety regulation relative to the NGPSA, because under the RPSA, NGA section 1(c) Hinshaw Facilities appear to be exempt from the FERC but not the DOT's safety jurisdiction, and are technically regulated by state authorities for all purposes except safety. This point is discussed more extensively in Section V below.

b. Intrastate [Gas] Pipeline Transportation

Intrastate gas pipeline transportation involves transmission of natural gas that is not interstate gas pipeline transportation. Intrastate gas pipeline transportation conforms to those facilities and activities properly within the scope of state regulation under the NGA section 1(b) and *East Ohio Co.* as follows:

(1) **Intrastate Transportation Facilities.** These are pipeline facilities that are not used in the transportation of gas by pipeline in interstate commerce. Such pipeline facilities are neither FERC Regulated NGA section 1(b) Facilities nor NGA section 1(c) Hinshaw Facilities both of which are used to transport natural gas in interstate commerce. Intrastate Transportation Facilities must transport natural gas that either (i) has not crossed a state line (either physically or as back-haul) or (ii) has been reduced in pressure after delivery by an interstate transporter.

(2) **Retail Sale Facilities.** Retail Sale Facilities are facilities used in making sales of natural gas that do not involve transportation of or sales of such gas for resale in interstate commerce. Such facilities may be used for

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wholesale, retail or direct sale of natural gas that has not crossed a state
line or for retail sales of natural gas that has been transported in interstate
commerce after pressure reduction and delivery to a customer main.\footnote{167}

(3) \textit{Local Distribution Facilities}. Such facilities are used in distribut-
ing gas on the retail level and are not used in transporting natural gas or
selling natural gas for resale in interstate commerce. These facilities in-
clude Retail Sale Facilities.\footnote{168} Thus Local Distribution Facilities must be
used to transport natural gas that has not crossed or been commingled with
gas that will cross a state line (either actually or constructively), or must be
situated downstream of the point of pressure reduction and delivery by an
interstate transporter of natural gas.\footnote{169}

(4) \textit{Production Facilities}. These pipeline facilities are used in the
production of natural gas and are located upstream of any pipeline trans-
mission system. Unless the input side of a natural gas Production Facility
is situated in one state and the output side of that Production Facility is
physically situated in a different state, these facilities are involved in intra-
state gas pipeline transportation.\footnote{170}

(5) \textit{Gathering Facilities}. These facilities are used in the gathering of
natural gas from wells and collecting such natural gas for pipeline trans-
mission in interstate or intrastate commerce. Gathering facilities are also
located upstream of any transmission facilities. Unless a gathering facility
is physically situated to cross a state line, these lines would necessarily ap-
pear to be involved solely in intrastate commerce.\footnote{171}

Thus, intrastate gas pipeline transportation as defined under the NGA
and the commerce clause would appear to include natural gas transportation in
Intrastate Transportation Facilities, Retail Sale Facilities, Local
Distribution Facilities, Gathering Facilities and Production Facilities. In-
terstate gas pipeline transportation, on the other hand, would appear to in-
clude natural gas transportation in the FERC-regulated NGA section 1(b)
Facilities (including Direct Sale Customer Facilities and Interstate Trans-
portation Laterals) and the NGA’s section 1(c) Hinshaw Facilities.

3. Application of Analytic Categories to RPSA’s Choice of
Regulation Rule

The foregoing discussion of the FERC, the DOT, and state pipeline
safety authority under the RPSA, of the statutorily defined concepts of
“interstate gas pipeline facilities” and “intrastate gas pipeline facilities,” on
the one hand, and the undefined concepts of “interstate [gas] pipeline transportation” and “intrastate [gas] pipeline transportation,” on the
other, is summarized in Appendix E.

\footnote{167}{See Cascade Natural Gas Co. v. FERC, 955 F.2d 1412 (10th Cir. 1992).}
\footnote{168}{Id.}
\footnote{169}{See California v. Lo-Vaca Gathering Co., 379 U.S. 366 (1965).}
\footnote{170}{Northwest Central Pipeline v. Kansas Corp. Comm’n, 489 U.S. 493 (1989).}
\footnote{171}{Natural Gas Pipeline Co. v. Railroad Comm’n of Tex., 679 F.2d 51 (5th Cir. 1982).}
V. THE ANOMALY AND SUBSTANTIVE CHANGE IN THE LAW OF PIPELINE SAFETY GENERATED BY THE REVISION OF TITLE 49

Under the RPSA a state may not regulate natural gas pipeline safety in cases where an "interstate [gas] pipeline facility" or "interstate [gas] pipeline transportation" is involved. This rule shall be referred to as the RPSA's Federal Preemption Rule. Under the RPSA, a state may impose additional (or more stringent) pipeline safety requirements than the DOT Code only in those instances where an "intrastate pipeline facility" and "intrastate pipeline transportation" are involved, provided the state has been satisfactorily certified by the DOT and the increased standards that it is to apply are consistent with the DOT Code. This rule shall be referred to as RPSA's State Regulation Rule.

The RPSA choice of regulation rule appears to have created two problems. First, relative to the NGPSA, the RPSA State Regulation Rule and the RPSA Federal Preemption Rule appear to have created a previously non-existent technical anomaly (discussed below) in the federal law of pipeline safety. Second, in creating the anomaly, the literal wording of the RPSA also appears to have substantively changed the federal law of pipeline safety jurisdiction over NGA section 1(c) Hinshaw Facilities. With respect to both these issues, understanding the status of NGA section 1(c) Hinshaw Facilities and Direct Sale Customer Lines under the NGPSA relative to their new status under the RPSA is crucial. As previously discussed, the material difference between these two types of facilities is in the ownership and operation of the interstate pipeline that transports natural gas to these facilities.

A. The Anomaly

Prior to the passage of the RPSA, natural gas pipeline safety jurisdiction had been divided into three jurisdictional spheres, namely that of the DOT, the FERC and the several states. Under the NGPSA, a natural gas pipeline facility of any type, whether a FERC-regulated NGA section 1(b) Facility, a State-regulated NGA section 1(b) Facility, or an NGA section 1(c) Hinshaw Facility, was always subject to the minimum pipeline safety standards imposed by the DOT Code. In addition, each such natural gas pipeline facility was subject either (i) to the safety jurisdiction of the FERC, in the case of FERC Regulated NGA section 1(b) Facilities; or (ii) to the jurisdiction of the several states, in the case of State Regulated NGA section 1(b) Facilities and NGA section 1(c) Hinshaw Facilities. In the later case, states had authority to impose additional or more stringent safety standards than the minimum safety standards imposed by the DOT Code. Thus, prior to the passage of the RPSA, every natural gas pipeline

175. Compare Appendices B and C.
NATURAL GAS PIPELINE SAFETY

facility was potentially subject to two jurisdictional authorities for pipeline safety purposes, either (i) the DOT and the FERC or (ii) the DOT and the several states. There were no exceptions to this rule.

With the enactment of the RPSA, this three-party jurisdictional scheme appears to have been disrupted so that in the case of NGA section 1(c) Hinshaw Facilities alone, as a technical matter, neither the FERC nor the several states can impose additional or more stringent pipeline safety standards than the DOT Code minimums. In the case of the FERC, additional or more stringent safety regulation is prohibited because the NGA section 1(c) Hinshaw Facilities are expressly excluded from the FERC's jurisdiction under the NGA. In the case of the several states, safety regulation is technically prohibited even if the state has received a DOT certification and the proposed state standards are compatible with the DOT Code, because the NGA section 1(c) Hinshaw Facilities are necessarily involved in “interstate [gas] pipeline transportation.” State safety regulation is preempted under the RPSA Federal Preemption Rule. Such treatment is unique to the NGA section 1(c) Hinshaw Facilities under the RPSA, and is without precedent under all versions of the NGPSA regulation that preceded the RPSA. The RPSA’s treatment of NGA section 1(c) Hinshaw Facilities is anomalous and appears to have been a drafting oversight introduced by the inherent complexities of attempting to create a single and uniform rule for hazardous liquids and natural gas under the two statutes that the RPSA recodified.

B. Change in Substance of NGPSA

1. Hinshaw Facilities

A NGA section 1(c) Hinshaw Facility is not subject to safety regulation by the FERC under NGA sections 1(b) and 7 and thus the owner and operator of a NGA section 1(c) Hinshaw Facility can not possibly assert the existence of the FERC jurisdiction to claim federal preemption or prohibition against collateral attack of the FERC’s orders with respect to state safety regulation otherwise allowed by the RPSA. Moreover, from and after the date of enactment of the 1976 NGPSA Amendments, an owner and operator of a NGA section 1(c) Hinshaw Facility could not assert express NGPSA preemption of additional or more stringent state standards compatible with the DOT standards, because a NGA section 1(c) Hinshaw Facility was not subject to the jurisdiction of the FERC under the NGA, and thus constituted “intrastate pipeline transportation” under the statutory definitions of the NGPSA (1976)-(1992) and the NGPSA federal preemp-

178. The APSPA amendment to the RPSA may have also created an anomaly relative to the NGPSA treatment of gathering lines, in that there theoretically appears to be at least one type of gathering line that is not subject to the DOT Code. See Section III.E. of this article.
Thus, as to the NGA section 1(c) Hinshaw Facilities, the RPSA choice of regulation rule, although generally asserted by its authors to be a recodification of prior law, actually appears to have created a technical change in the substantive federal law of natural gas pipeline safety preemption. Prior to the enactment of the RPSA, states could regulate pipeline safety of the NGA section 1(c) Hinshaw Facilities free of federal preemption under the NGPSA or the NGA subject only to the DOT's certification and compatibility with the DOT standards. After the passage of the RPSA, if the literal wording and logic of the statute is to be taken seriously, DOT standards under the RPSA preempt all state safety regulation of NGA section 1(c) Hinshaw Facilities, because such facilities are involved in "interstate [gas] pipeline transportation."

2. Direct Sales Customer Lines and Interstate Transportation Laterals

As for Direct Sales Customer Lines, the RPSA choice of regulation rule also theoretically created a formal and technical change in the preemptive effect of the DOT Code relative to state regulation. Like the NGA section 1(c) Hinshaw Facilities, prior to the passage of the RPSA, Direct Sales Customer Lines were included in the definition of "intrastate pipeline transportation" under the NGPSA (1992), and were thus subject to the DOT's certification and compatibility requirements. The NGPSA "permitted" states to impose additional or more stringent pipeline safety standards than the DOT; such "permission" was, however, potentially a nullity because such state standards were theoretically preempted by the existence of the FERC's authority under NGA sections 1(b) and 7 to impose more stringent or additional pipeline standards than the DOT Code minimums. Consequently, although the RPSA effected a technical change in the federal preemption law of natural gas pipeline safety as to Direct Sales Customer Lines, its passage did not seem to have effected a practical or substantive change in the law with respect to state safety regulation of such Direct Sales Customer Lines. With the promulgation of the FERC Order No. 636 series and the practical elimination of direct sales by FERC regulated pipelines, this issue now appears to be moot. The express recognition of interstate gas pipeline transportation in the RPSA, on the other hand, as a separate preemption category also appears to make it clear that Interstate Transportation Laterals are not to be regulated for safety purposes by the states and this constitutes a new statement of, if not a change in, substantive law.

180. 49 U.S.C.A. § 60,104(c) (West 1996).
182. 49 U.S.C.A. § 60,104(c) (West 1996).
C. Dealing with the Anomaly

There are at least three ways of dealing with the technical anomaly that has been created by the RPSA Federal Preemption Rule and the RPSA State Regulation Rule.

1. Clarifying State Safety Power over Hinshaw Facilities

First, one could argue that Congress, in drafting the RPSA choice of regulation rule, did not in the case of NGA section 1(c) Hinshaw Facilities intend to create a substantive change in the federal law of pipeline safety. Acceptance of this position means that judicial and administrative construction of the RPSA Federal Preemption Rule should allow application of the RPSA State Regulation Rule to NGA section 1(c) Hinshaw Facilities. The legal justification for that construction would be that Congress, in enacting the RPSA, did not generally intend to change the substantive law of natural pipeline safety regulation, and the inclusion of NGA section 1(c) Hinshaw Facilities under the RPSA Federal Preemption Rule was a technical and unintentional oversight.184

From the perspective of federal preemption of state law, this approach seems entirely sensible and returns the legal situation to that prevailing under the NGPSA (1992)185 with one other formal and technical exception. With respect to NGPSA (1992), Direct Sales Customer Lines constituted “intrastate pipeline transportation.” Even so, it appears from a theoretical standpoint that state safety regulation of Direct Sales Customer Lines by the several states was at least debatable (other than fact situations analogous to that which triggered the United/LP&L litigation) because such lines were subject to pipeline safety regulation in excess of DOT Code standards by the FERC under NGA sections 1(b) and 7. Theoretically, federal field preemption of any state safety regulation of Direct Sales Customer Lines applied under the NGA, but express preemption under the NGPSA did not. With the enactment of the RPSA, not only does FERC safety jurisdiction under the NGA section 1(b) and 7 arguably preempt state safety requirements in excess of the DOT Code, but as a theoretical matter Direct Sale Customer Lines also constitute “interstate pipeline transportation” under the RPSA Federal Preemption Rule. Therefore, the RPSA as well as the NGA may now be interpreted to prohibit pipeline safety regulation of Direct Sales Customer Lines by the states. However, in view of the changes in the interstate gas industry rendered by the FERC Order No. 636 series, this issue, from a practical perspective, now appears moot.

2. Treating the Transportation Terms of the RPSA as Surplusage for Natural Gas Purposes

Second, in applying the RPSA Federal Preemption Rule and the

RPSA State Regulation Rule, one could recreate the NGPSA choice of regulation rule by reading the terms “intrastate pipeline transportation” and “interstate pipeline transportation” out of the RPSA, either by ignoring them entirely for natural gas pipeline purposes, or by construing these terms as meaning the same as the contrasting terms “intrastate pipeline facility” and “interstate pipeline facility” respectively. Like the first approach, this approach requires rendering an administrative and judicial correction to the actual language used by Congress. Under the second approach, whether a state natural gas pipeline safety regulation is preempted by the RPSA would be determined solely on the basis of whether the pipeline facility constitutes an “interstate gas pipeline facility” rather than an “intrastate gas pipeline facility.” Under the first approach, independent meaning for the concepts of “intrastate pipeline transportation” and “interstate pipeline transportation” would be reserved solely for application to hazardous liquids if at all. Under the second approach, Direct Sales Customer Lines and the NGA section 1(c) Hinshaw Facilities would be subject to the RPSA State Regulation Rule, but pipeline safety regulation of Direct Sales Customer Lines by the several states would theoretically continue to be preempted by the FERC’s authority to impose more stringent and additional safety requirements under the NGA sections 1(b) and 7, a matter that the FERC Order 636 series has rendered virtually irrelevant. Thus, from a practical standpoint, the federal preemption result under this approach is the same as the result under the first approach. The difference is that the second approach recreates the exact, but confused, legal situation that prevailed under the NGPSA (1992) for purposes of applying federal preemption doctrines under the RPSA and the NGA. Under this second approach, the RPSA Federal Preemption Rule does not prevent state safety regulation of Direct Sales Customer Lines; rather, federal preemption of state regulation is theoretically possible because the FERC retains the authority under the NGA sections 1(b) and 7 to impose safety requirements in excess of the DOT Code on Direct Sales Customer Lines.

This second approach conforms the RPSA to the situation under the NGPSA (1992), but the difference in the federal preemption result between this approach and the first approach seems highly formal and technical—in essence, a distinction without substance or practical effect. Under either approach, states may not regulate FERC Regulated NGA section 1(b) Facilities, including Direct Sales Customer Lines and Interstate Transportation Laterals, but may regulate State Regulated NGA section 1(b) Facilities and the NGA section 1(c) Hinshaw Facilities in appro-

187. As to hazardous liquids pipeline facilities, given the regulatory interpretations upheld in Southern Pacific Pipelines, it seems quite likely that the DOT, not having to deal with the FERC’s authority, and a prior history of judicial interpretation under the NGA, will use this second approach in dealing with hazardous liquids pipelines.
188. 49 U.S.C.A. § 60,104(c) (West 1996).
appropriate circumstances. The principal shortcoming of the second approach is its underlying assumption, namely, that the undefined concepts of "intra-state pipeline transportation" and "interstate pipeline transportation" were intended by Congress to be ignored in applying the RPSA Federal Preemption Rule and the RPSA State Regulation Rule to natural gas pipelines. The language actually used by Congress does not support the approach, and the approach necessarily requires two judicially or administratively created exceptions to the language of the RPSA to be generated rather than one.

3. Dealing Separately with Facilities and Transportation

A third approach might be to articulate a meaningful and intelligible distinction between pipeline facilities and regulation of pipeline transportation (as an activity). For example, in applying the RPSA Federal Preemption Rule to a Direct Sale Customer Line, the pipeline facility would be subject to more stringent or additional state regulation, but the activity of transporting the natural gas through the pipeline would be free of such state regulation. Although the third approach appears theoretically possible, it appears virtually impossible to separate pipeline facilities from pipeline transportation, thereby implementing the approach on a principled basis. Establishing standards for gas pipeline facilities necessarily establishes standards governing how those pipeline facilities may transport their contents. Conversely, establishing a standard for pipeline transportation necessarily sets a standard that applies to a pipeline facility. Moreover, this analytical difficulty is exacerbated by the practical difficulties and confusions that arise when two regulatory authorities, one state and the other federal, are to have authority to establish standards that may potentially apply to one and the same facility.

Given these three possibilities, the author’s inclination is to favor option one. It is the simplest and most direct. The approach creates the least disruption to the multi-agency regulatory scheme that applies to natural gas pipeline safety. It also recognizes that Congress, in enacting the RPSA choice of regulation rule, in a technical oversight unintentionally changed the NGPSA choice of regulation rule applicable to natural gas pipeline safety in the case of the NGA section 1(c) Hinshaw Facilities. Furthermore, it recognizes that if federal preemption of state pipeline safety regulation as it existed prior to the enactment of the RPSA is to remain a reality, an administrative or judicial construction may be required to validate application of the RPSA State Regulation Rule to the NGA section 1(c) Hinshaw Facilities. Alternatively, a technical amendment to the RPSA could be petitioned directly to Congress. This amendment would formally define "interstate [gas] pipeline transportation" for purposes of the RPSA as transportation of natural gas in interstate commerce through a pipeline subject to FERC jurisdiction under the NGA section 1(b), but expressly exclude transportation of natural gas by pipeline in NGA section

190. 49 U.S.C.A. § 60,104(c) (West 1996).
Correspondingly, a technical amendment could define “intrastate [gas] pipeline transportation” for purposes of the RPSA as transportation of natural gas by pipeline that is not interstate gas pipeline transportation.

VI. RECOMMENDATION

Ever since the passage of the NGPSA (1968), federal regulation of natural gas pipeline safety has been a complex matter involving complementary allocations of safety jurisdiction among the DOT, the FERC, and the several states. In recodifying all the transportation laws of the United States in Title 49, including revision of the regulation of safety of natural gas and hazardous liquids, Congress undertook an ambitious task that appears to have been subject to certain technical shortcomings in the important area of natural gas pipeline safety due to the exceedingly complex jurisdictional rules that Congress and the courts have created in this area. In effect, the jurisdictional complexities of this area of the law may have exceeded the capacity of Congress to keep track of all the technical distinctions attendant to the law that it previously enacted. Although Congress did not generally intend its recodification to change preexisting law in any substantive manner, it is clear, given the complexity of the NGPSA and the NGA, their respective histories and the size of the task that Congress undertook, that the recodification of the pipeline safety laws resulted in an unintentional anomaly and a technical change to the substance of prior law. In the recodification, Congress inadvertently rescinded the states’ safety power over Hinshaw Facilities. Moreover, if Congress ever intended to grant states safety jurisdiction over Direct Sales Customer Lines, the FERC Order No. 636 series now seems to have rendered the issue moot. States, of course, retain safety powers over what this article has described as Intrastate Transportation Facilities, Retail Sales Facilities, Local Distribution Facilities, Gathering Facilities, and Production Facilities. The FERC continues to assert safety powers over interstate facilities as defined under the NGA, although in a NGA section 7(c) proceeding, the FERC must accept certification of compliance with the DOT standards in absence of evidence to the contrary.

In the opinion of the author, the RPSA cannot be properly interpreted without a thorough consideration of the complex history of natural gas pipeline regulation. Consequently, the author recommends judicial and administrative recognition of the fact that the RPSA preserves state safety authority over NGA section 1(c) Hinshaw Facilities. In this manner, the preexisting natural gas pipeline safety jurisdiction of the DOT, the FERC and the several states may be preserved with minimum disruption to the integrity of the RPSA.
### Appendix A

**Summary of FERC and State Jurisdiction Over Natural Gas Pipeline Facilities Under NGA Section 1**

<table>
<thead>
<tr>
<th></th>
<th>FERC Jurisdiction</th>
<th>State Jurisdiction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. NGA § 1(b) Interstate Facilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. FERC Regulated NGA § 1(b) Facilities: facilities used for transportation or sale of natural gas for resale in interstate commerce (includes transportation jurisdiction over Direct Sales Customer Lines)</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>2. NGA § 1(c) Hinshaw Facilities</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>B. State Regulated NGA § 1(b) Facilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Intrastate Transportation Facilities</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>2. Retail Sales Facilities</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>3. Local Distribution Facilities</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>4. Production Facilities</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>5. Gathering Facilities</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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191. Transportation by a natural gas pipeline in interstate commerce of natural gas that has crossed a state line ends at the point of pressure reduction and delivery to a customer main. See FPC v. East Ohio Gas Co., 338 U.S. 464 (1950).
## Summary of DOT, FPC and State Safety Jurisdiction under the NGA and NGPSA as of 1968

| NGA § 1(b) Facilities | FPC
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Safety Jurisdiction</td>
<td>DOT Safety Jurisdiction</td>
<td>State Safety Jurisdiction</td>
</tr>
</tbody>
</table>

A. NGA § 1(b) Interstate Facilities

1. FERC Regulated NGA § 1(b) Facilities:
   - Facilities used for transportation of natural gas in interstate commerce and sales of natural gas for resale in interstate commerce (including Direct Sales Customer Lines)
     - Yes
     - Yes
     - No

2. NGA § 1(c) Hinshaw Facilities
   - No
   - Yes
   - Yes

B. State Regulated NGA § 1(b) Facilities

1. Intrastate Transportation Facilities
   - No
   - Yes
   - Yes

2. Retail Sale Facilities
   - No
   - Yes
   - Yes

3. Local Distribution Facilities
   - No
   - Yes
   - Yes

4. Production Facilities
   - No
   - Yes
   - Yes

5. Gathering Facilities
   - No
   - Yes
   - Yes

---

192. The FPC may impose pipeline safety requirements in excess of the DOT standards under section 7(e) of the NGA, but is bound in most instances by certification by an applicant under section 7 of the NGPSA that the DOT Code will be observed. State natural gas pipeline safety regulation is preempted by the NGPSA. 49 U.S.C. § 1672(b) (1970). It is also theoretically preempted under the NGA. 15 U.S.C. § 717f (1994). See Section III.B.1. of this article. The prohibition against collateral attack of federal licensing orders may also have been applicable. See Section III.B.2. of this article.

193. State pipeline safety regulation is allowed by the NGPSA, 49 U.S.C. § 1672(b) (1970), if the state standards are in addition to or more stringent than DOT minimums, provided such standards are compatible with DOT minimum standards.

194. The DOT is to establish minimum natural gas pipeline safety standards for all natural gas pipeline facilities whether the FERC or the state regulates.


<table>
<thead>
<tr>
<th>FPC Safety Jurisdiction</th>
<th>DOT Safety Jurisdiction</th>
<th>State Safety Jurisdiction</th>
</tr>
</thead>
<tbody>
<tr>
<td>NGA § 1(b) Facilities</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

A. NGPSA - Interstate Transmission Facilities

1. FERC Regulated NGA § 1(b) Facilities: Facilities used for transportation of natural gas or sale of natural gas for resale in interstate commerce (excluding Direct Sales Customer Lines).

B. NGPSA - Intrastate Pipeline Transportation

1. Direct Sales Customer Line (a FERC Regulated NGA § 1(b) Facility) See Yes See Note 196
2. NGA § 1(c) Hinshaw Facilities No Yes Yes
3. State Regulated NGA § 1(b) Facilities
   (a) Intrastate Transportation Facilities No Yes Yes
   (b) Retail Sales Facilities No Yes Yes
   (c) Local Distribution Facilities No Yes Yes
   (d) Production Facilities No Yes Yes
   (e) Gathering Facilities No Yes Yes

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196. See Appendix B for an explanation of the prohibition against or preemption of state regulation. In cases like the United/LP&L litigation, involving as it did a wholly intrastate facility in a producing state and (except for application of DOT Code minimum safety standards) regulated entirely by that state, there is every reason to believe that Congress intended to preserve state authority to require additional and more stringent safety requirements.

197. 49 U.S.C.A. § 1672(b) (West Supp. 1981) and 49 U.S.C.A. app. § 1672(a) (West Supp. 1992) do not preempt states from the safety regulation of Direct Sales Customer Lines, but theoretically the FERC's regulation under the NGA, sections 1(b) and 7 could do so. See Sections III.B.1 and 2 of this article, which raise the theoretical ineffectiveness of the 1976 Amendment to the NGPSA in requiring Direct Sales Customers Lines to be considered as intrastate pipeline transportation. In situations where the FPC retained certificate authority over the line in question, it theoretically retained safety authority with arguable preemptive effect.
As you requested, we have examined the question of what constitutes a direct sales customer for the purpose of determining what is included in intrastate pipeline transportation subject to State jurisdiction under the Natural Gas Pipeline Safety Act. Our analysis, which is attached, is intended to be applied on a case-by-case basis depending on the particular facts in a given situation. If you have any questions of need further assistance, please contact this office.

Direct Sales Provision

The question has arisen as to what is included in the definition of "intrastate pipeline transportation" in the Natural Gas Pipeline Safety Act of 1968 (NGPSA). "Intrastate pipeline transportation" is defined as:

pipeline facilities and transportation of gas within a State which are not subject to the jurisdiction of the Federal Energy Regulatory Commission under the Natural Gas Act, except that it shall include pipeline facilities within a State which transport gas from an interstate gas pipeline to a direct sales customer within such State purchasing gas for its own consumption.

The definition was amended in 1976, in response to a 1972 U.S. Supreme Court decision to avoid inadvertent shift of safety regulator responsibility from a State to OPS. Federal Power Commission v. Louisiana Power & Light Company, 406 U.S. 621 (1972). In that decision, the Court held that facilities transporting gas within a State to a direct sales customer in that State (direct sales provision) are subject to the transportation (as opposed to the rate-setting) jurisdiction of the FPC, now the Federal Energy Regulatory Commission (FERC), under the Natural Gas Act (NGA).

The legislative history of the 1976 amendment to the NGPSA is sparse, but the Senate Report indicates that "(m) [sic] ant States had regulated direct sales lines prior to the Supreme Court's decision, and this amendment would clarify that they may continue to do so without Federal preemption under the Natural Gas Pipeline Safety Act." S. Rep. No. 94-852 (94th Cong., 2d Sess. at 6).

It should be noted at the onset that jurisdiction under the NGA differs from jurisdiction under the NGPSA. The NGA regulates only the transportation of natural gas in interstate commerce, whereas the NGPSA regulates both interstate and intrastate pipeline transportation. Both interstate and intrastate pipeline transportation are subject to the standards set under the NGPSA; the only difference is whether the regulatory authority is the Federal Government or a State.
Neither the NGA nor the NGPSA defines "direct sales customer" or "direct sales lines," but the Court in \textit{FPC v. LPL} clearly indicated that the "direct sales" customers referred to were those purchasing gas for their own consumption as opposed to "resale" [sic] customers, purchasing gas for distribution to ultimate consumers.” 406 U.S. 621, 623. The court variously contrasted direct sales and sales for resale id. at 631; direct sales customers and resale customers, id. at 632; and direct industrial sales customers and ultimate consumers, including schools, hospitals, and homes, id.

OPS has not defined the term "direct sales customer." It would appear reasonable for OPS to interpret the term as having the generally understood meaning of an end-user or consumer who receives gas directly from an interstate pipeline company, rather than from a distribution company. This allows recognition of the function of the line as essentially distribution, even though the line is part of an interstate transmission line subject to FERC jurisdiction.

An additional issue concerns the point at which a pipeline facility ceases to be an "interstate transmission facility" and becomes "intrastate pipeline transportation" under the NGPSA. The plain language of the statute states that a pipeline facility must: (1) be within a State, (2) transport gas from an interstate gas pipeline, and (3) transport the gas to a direct sales customer (purchasing for its own consumption) in the same State. Therefore, the pipeline facility must be wholly located within a single State, connected to an interstate pipeline, and delivering gas to a direct sales customer (as we understand the term). The statute is silent as to the ownership of the various pipelines operator, the operator of the within-State pipeline, and the end user; or the point of sale, the ownership of the gas, or any other contract provisions. The lack of specificity in the statute indicates that the Secretary of Transportation has considerable latitude to define the jurisdictional boundaries. The logical point at which to draw the line between the interstate pipeline and the intrastate pipeline is the point where gas intended solely for the end user leaves the interstate transmission line. Normally, there will be a meter or valve at this point. The point of sale, the ownership of the pipeline, and the relationship of the various entities are all irrelevant to this determination.

To illustrate this point, we use an actual example raised by a State. An ultimate consumer, a city electric department located in State A, plans to purchase gas from Company X located in State B. The gas would be transported from State B via an interstate pipeline operated by an interstate operator (Company Y). Company Y plans to build a 2.2 mile pipeline from an existing meter station on the interstate pipeline to terminate at a meter station to be constructed on a portion of the power plant owned by the city. The 2.2 mile pipeline would be located entirely within State A, the gas would be transported directly from an interstate transmission line, and the gas is intended for consumption by the city. Therefore, the 2.2 mile pipeline is an intrastate pipeline facility subject to the jurisdiction of State A.
**APPENDIX E**

**SUMMARY OF DOT, FERC AND STATE SAFETY JURISDICTION UNDER THE NGA AND RPSA (1994) TO DATE**

<table>
<thead>
<tr>
<th>NGA § 1(b) Facilities</th>
<th>FERC Safety Jurisdiction</th>
<th>DOT Safety Jurisdiction</th>
<th>State Safety Jurisdiction</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. RPSA Interstate Gas Pipeline Facilities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. FERC Regulated NGA § 1(b) Facilities; Facilities used for transportation and sale for resale of natural gas in interstate commerce (excludes Direct Sales Customer Lines) but includes Interstate Transportation Laterals - i.e. lateral lines located entirely within a state used to transport gas from transmission lines to an end-user.</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>II. RPSA - Intrastate Gas Pipeline Facilities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. Direct Sales Customer Lines <em>(See III.B below)</em></td>
<td><em>(See III.B below)</em></td>
<td><em>(See III.B below)</em></td>
<td></td>
</tr>
<tr>
<td>B. NGA § 1(c) Hinshaw Facilities</td>
<td>No</td>
<td>Yes</td>
<td>See Note 202</td>
</tr>
</tbody>
</table>

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198. *See supra* note 192.
199. *See supra* note 194. The DOT must also certify the state.
201. *Direct Sales Customer Lines are Intrastate Gas Pipeline Facilities but also constitute interstate [gas] pipeline transportation under the RPSA and thus theoretically should not be regulated by the several states under the second sentence of 49 U.S.C.A. § 60,104(c) (West 1996). This result, however, has been rendered moot for all practical purposes by the FERC Order 636 series, which has eliminated the use of these pipelines by the FERC regulated pipelines to make direct sales to end-users.
202. NGA section 1(c) Hinshaw Facilities are involved in Interstate [Gas] Pipeline Transportation. *See FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950). As such, they constitute Intrastate [Gas] Pipeline Facilities involved in Interstate [Gas] Pipeline Transportation under the RPSA, and technically neither the FERC under the NGA nor the several states under the RPSA may impose standards in...
C. State Regulated NGA § 1(b) facilities

1. Intrastate Transportation Facilities No Yes Yes
2. Retail Sales Facilities No Yes Yes
3. Local Distribution Facilities No Yes Yes
4. Production Facilities No Yes Yes
5. Gathering Facilities No Yes Yes

D. Gathering Lines (as defined under 49 U.S.C.A. § 60,101(b) and the DOT Code §§ 192.3 and 192.9)

No Yes

III. RPSA Interstate Pipeline Transportation:

A. FERC Regulated NGA § 1(b) Facilities: Facilities used for transportation in interstate commerce under the NGA (excluding Direct Sales Customer Lines but including Interstate Transportation Laterals)

Yes Yes No

B. Direct Sales Customer Lines (FERC Regulated NGA § 1(b) Facility)

Moot Moot Moot

C. NGA § 1(c) Hinshaw Facilities No Yes See Note 202

IV. RPSA - Intrastate Pipeline Transportation:

A. State Regulated NGA § 1(b) Facilities:

1. Intrastate Transportation Facilities No Yes Yes

addition to or more stringent than those imposed by the DOT Code. Cf. NGA section 1(c) and the second sentence of 49 U.S.C.A. § 60,104(c) (West 1996). This is the technical anomaly in the law of pipeline safety created by the RPSA. Despite this technical anomaly, it is the author's view the RPSA should not be construed to eliminate state pipeline safety authority over NGA section 1(c) Hinshaw Facilities.

203. A natural gas gathering pipeline facility that is expressly excluded from DOT Code regulation by 49 U.S.C.A. § 60,101(b) (West 1996) and 49 C.F.R. §§ 192.3 and 192.9 (1995) and is not considered a FERC Regulated NGA section 1(b) Facility is subject solely to state pipeline safety regulation.
<table>
<thead>
<tr>
<th></th>
<th>Retail Sales Facilities</th>
<th>No</th>
<th>Yes</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.</td>
<td>Local Distribution Facilities</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>4.</td>
<td>Production Facilities</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>5.</td>
<td>Gathering Facilities</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>B.</td>
<td>Gathering Lines (as defined under 49 U.S.C.A. § 60101 (b) and the DOT Code §§ 192.3 and 192.9)</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

204. See Section IV.E. of this Article.
CONOCO v. FERC: GATHERING AND FERC'S JURISDICTION

I. INTRODUCTION

Interstate gas pipeline companies, regulated by the Federal Energy Regulatory Commission pursuant to the Natural Gas Act, are responding to changes in the regulatory scheme by modifying their corporate structures. These companies were once gas merchants, selling gas to local distribution companies (LDC) at prices that included charges for the associated services of gathering and interstate transportation. Over the past fifteen years, orders by the Federal Energy Regulatory Commission (FERC) designed to increase competition have led to a restructuring of the natural gas industry so that interstate pipeline companies are now predominantly in the business of gas transportation rather than gas sales.

In addition to requiring the unbundling of gas sales from transportation, Order No. 636 also required that the pipelines file separate rates for the transportation functions of gathering and interstate transportation. Once they were required to publish separate rates, these companies saw an opportunity to remove part of their operations from federal jurisdiction.

2. Gathering is one of a number of services associated with the delivery of natural gas. The gas produced by a number of wells is gathered, generally to a single point, by a series of relatively short, relatively small-diameter pipelines to get it ready for entry into a high pressure transport pipeline. Conoco Inc. v. FERC, 90 F.3d 536, 543-544 (D.C. Cir. 1996), cert. denied, Amoco Energy Trading Corp. v. FERC, 117 S. Ct. 1017 (1997). It then travels through the transport pipeline, generally to a Local Distribution Company (LDC), and finally through the LDC's delivery system for supplying the consumer. Gas may also be stored for some time before it is delivered.
3. Adam D. Samuels, Reliability of Natural Gas Service for Captive End-Users Under the Federal Energy Regulatory Commission's Order No. 636, 62 GEO. WASH. L. REV. 718, 721-722 (1994). The LDCs had no choice but to buy the gas and the services as one package. Id.
7. Cody L. Graves & Maria Mercedes Seidler, The Regulation of Gathering in a Federal System,
To get out from under federal regulation, the interstate pipeline companies decided to “spin-down” their gathering activities into separate, affiliated companies. Company proposals before the FERC required that the FERC decide whether to treat the spin-downs as though they were independent local gathering systems exempt from regulation under the Natural Gas Act (NGA), or whether they were still sufficiently connected to the interstate transport of gas that the FERC still had jurisdiction.

After holding a public conference on gathering, the FERC determined that it would implement its new policy by issuing a series of orders rather than by promulgating new rules. In a leading case in the group, *Arkla Gathering Services Co.*, the FERC decided that it did not have jurisdiction over an affiliated gatherer, but that it would have jurisdiction if the gatherer acted collusively with its parent company. The FERC decision was appealed by a group of producers and affirmed by the D.C. Circuit Court of Appeals in *Conoco v. FERC*.

This Note analyzes the Court’s decision in light of the purposes of the NGA and Order No. 636. Part II provides background information on the regulatory goals of the NGA and Order No. 636 and briefly discusses their effects on gathering regulation. Part III discusses the FERC decision under review and the D.C. Circuit’s holdings in the case. Part IV analyzes the Court’s interpretation of precedent and discusses how the Court balanced the requirements of the NGA and Order No. 636 in affirming the FERC’s decision to regulate a gathering affiliate only if it took advantage of its relationship with its parent pipeline and engaged in anti-competitive behavior. The Note’s conclusion is that the Court’s decision, while reasonable with respect to precedent and the current regulatory scheme, may create confusion and delay in dealing with anti-competitive gatherer behavior should it arise.

II. BACKGROUND

A. The Natural Gas Act

The various segments of the natural gas system are subject to regulation by either the states or the federal government. States regulate production to protect the correlative rights of the various owners of the mineral rights in a field. At the other end of the system, states regulate LDCs

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15 ENERGY L.J. 405 (1994).
8. The NGA authorizes the FERC to regulate interstate transportation of natural gas and interstate sale of gas for resale. *Natural Gas Act of 1938*, 15 U.S.C. §§ 717-717w (1994). The argument is that if a gathering company does not sell gas interstate or provide interstate transportation, the FERC has no jurisdiction over it.
to ensure reasonable rates and adequate supplies for local consumers. Early in the history of the natural gas industry, abuses in the interstate transportation of gas, which could not be reached by the states, revealed the need for federal regulation.\textsuperscript{13} Congress enacted the Natural Gas Act of 1938\textsuperscript{14} to make sure that no part of the system was left open to abuse due to monopoly. The NGA provides for FERC regulation of natural gas companies,\textsuperscript{15} but excludes production and gathering from regulation under the act.\textsuperscript{16} Historically, production and gathering were under the authority of the state governments,\textsuperscript{17} and the NGA was not intended to usurp state authority but to provide regulation in areas which the states could not reach.\textsuperscript{18} Despite its indicated exclusion under section 1(b), however, gathering has been regulated when it is part of a “bundled”\textsuperscript{19} system offered by an interstate pipeline company because NGA sections 4\textsuperscript{20} and 5\textsuperscript{21} provide for regulating rates of activities “in connection with” interstate transportation.\textsuperscript{22}

\begin{enumerate}
\item A few holding companies controlled the pipelines from the Appalachian area to the markets and, therefore, controlled both the producers’ market and the consumers’ supplies. The holding companies organized their businesses such that some end of the business was outside the reach of any one state commission. Consequently, the cost of natural gas to consumers increased at a greater rate than the price of oil, even though, except for the element of competition, the conditions of production were about the same. FPC v. Hope Natural Gas Co., 320 U.S. 591, 637-638 (1944).
\item The NGA defines a natural gas company as one which sells natural gas interstate for resale or provides interstate transportation of gas. 15 U.S.C. § 717a(6) (1994).
\item NGA § 1(b) states:
   The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.
\item 15 U.S.C. §717(b).
\item Graves & Seidler, supra note 7.
\item H.R. REP. No. 709, at 1-2 (1937).
\item “Bundled” service is provided by a pipeline which purchases gas at the wellhead and then includes charges for gathering and transportation in the price of the gas. Samuels, supra note 3, at 718.
\item NGA §4 states:
   All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.
\item NGA §5 states:
   No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.
\item 15 U.S.C. §717c(b).
\item Northern Natural Gas Co. v. FERC, 929 F.2d 1261 (8th Cir. 1991).
\end{enumerate}
B. The Effects of Order Nos. 436 and 636

By the 1980s, the natural gas industry was not in the best of shape. A gas shortage had been replaced by a gas surplus, pipelines were struggling with take-or-pay contracts left over from the shortage days, and outdated regulations were unable to deal with the current situation which was creating artificially high prices for gas consumers.\(^{23}\) The FERC interpreted the Natural Gas Policy Act of 1978\(^ {24}\) (NGPA) as a comprehensive natural gas regulatory statute and its section 601(a)(2) as a mandate to regulate to achieve more efficient transportation of gas.\(^ {25}\) In 1985, the FERC issued Order No. 436, which started the process of unbundling gas transportation from sales. The primary goal of that order was non-discriminatory access to pipelines, and participation was voluntary.\(^ {26}\) Order No. 436 forbade any discrimination in transportation charges assessed to the gas of others relative to gas owned by the transporting pipeline. Basically, pipelines were allowed to charge the cost of the transportation plus a reasonable rate of return which would be scrutinized by the FERC.\(^ {27}\) In 1992, the FERC completed the process it started with Order No. 436, issuing Order No. 636 as the finalization of "structural changes in the Commission's regulation of the natural gas industry."\(^ {28}\) This order was intended to address the concerns of non-pipeline gas sellers, pipelines and LDCs which had arisen since the implementation of Order No. 436\(^ {29}\) and to create a "regulatory environment in which no gas seller has a competitive advantage over another gas seller."\(^ {30}\) Order No. 636 requires pipelines to unbundle their


\(^{24}\) Prior to Orders 436 and 636, the pipelines had few incentives to control costs. When gas was in short supply in the 1970s, pipelines bought gas wherever they could get it, at whatever price was demanded. Many of the contracts they entered into contained provisions which required the pipelines to pay for the contracted amount of gas whether the pipeline took it or not (take-or-pay). Id.

\(^{25}\) 15 U.S.C §§ 3301-3432. Price-controlled interstate gas was causing gas shortages because producers had no incentive to sell gas at prices which were below the cost of production. The purposes of the NGPA were to remove the distinction between intra and interstate gas and to merge regulation of the two under the FERC, and to gradually decontrol natural gas prices at the wellhead. Fox, supra note 23, at 116.

\(^{26}\) Fox, supra note 23, at 125-126. The FERC needed some authority from Congress to change the regulatory scheme to address problems in the gas industry, and the FERC interpreted section 601 of the NGPA as providing it. Id. at 120-121.

\(^{27}\) The FERC tied special benefits to compliance with the regulations of Order No. 436. A pipeline which provided open access could obtain blanket authorization under section 7 of the NGA to transport gas for others without applying for authorization for each additional transaction. Fox, supra note 23, at 128.

\(^{28}\) Fox, supra note 23, at 127.

\(^{29}\) Order No. 636, supra note 4, at 30,391.

\(^{30}\) Nonpipeline sellers complained that under Order No. 436 they were hampered in long-term sales because their transportation was not comparable to that in bundled service, especially during peak usage. Pipelines complained that improvements in their transportation were limited by obligations to meet the LDCs' requirements. LDCs were concerned about the reliability of transportation in the absence of bundled services. Order No. 636, supra note 4, at 30,932.

\(^{30}\) Order No. 636, supra note 4, at 30,393.
transportation charges from gas sales and to transport all gas, whether the pipeline is the merchant or not, at the same rates. This new regulatory environment prompted interstate pipelines to spin-down their gathering operations to affiliated companies in an attempt to remove them from federal regulation.31

C. The FERC's Approach to Regulation After Order Nos. 436 and 636

The FERC first dealt with regulation of gas gathering in the unbundled world in Northwest Pipeline Corp.32 The FERC held that gathering by affiliates is subject to regulation under the NGA,33 but decided not to use the traditional methods of regulation.34 Instead, the FERC decided to regulate only if it received complaints about abuse of the corporate relationship by the affiliate and its parent. Affiliates were not automatically required to file gathering rates and conditions of service with the FERC, but they would be required to if the FERC received evidence of discriminatory rates or practices.35

The industry move to spin-down gathering led the FERC to consider the implications of discretionary regulation of interstate pipeline affiliates. It proposed a public conference to review the extent to which the FERC should exercise jurisdiction over pipelines and gatherers affiliated with pipelines under sections 4 and 5 of the NGA.36 After the conference, rather than issuing a set of generic rules, the FERC began implementing its new policies in a series of case orders.37

III. STATEMENT OF THE CASE

In 1993, in the leading case dealing with regulation of gatherer affiliates, NorAm Field Services (NAField, formerly Arkla Gathering Services)

33. The general rule ... is that an agency may disregard the corporate form in the interest of public convenience, fairness, or equity .... Corporations may be regarded as one entity for the purposes with which the agency is immediately concerned even though they are legitimately distinct for other purposes .... No bad intention on the part of the corporations is necessary; the inquiry is simply a question whether the statutory purposes would be frustrated by the corporate form.
Id. at 61,425 (quoting Opinion No. 255, 37 F.E.R.C. 61,149 at 61,356 (1986)).
34. Traditional methods of regulation would require the company to be certificated under section 7 of the NGA and to file gathering rates and conditions of service with the FERC.
36. The FERC prepared a list of questions for those participating to consider. These questions indicated issues the FERC thought relevant to determining the approach to gathering regulation. They included questions concerning: competition among gatherers, a requirement that FERC regulate gathering, the adequacy of state regulation, the adequacy of the proposed complaint procedure, and whether pipeline gathering and pipeline affiliate gathering should be treated differently. Natural Gas Gathering Services Performed by Interstate Pipeline and Interstate Pipeline Affiliates—Issues Related to Rates and Terms and Conditions of Service, 65 F.E.R.C 61,136, at 61,691-61,694 (1993).
37. Pain, supra note 10, at 3-5.
sought a declaratory order from the FERC that the gathering facilities it would receive from NorAm Gas Transmission Company (NAGas, formerly Arkla Energy Resources Company) would not be subject to FERC regulation under NGA section 1(b).\(^1\) NAField would acquire the gathering operations in a spin-down from NAGas designed to remove the company's gathering facilities from FERC jurisdiction so they would compete more favorably with independent, non-FERC-regulated competitors.\(^2\) A number of interested consumers and producers protested the request.\(^3\)

NAField, anticipating that the FERC might not grant its exemption, proposed as an alternative that the gathering rates be subject to "light handed regulation... through future complaint mechanisms."\(^4\)

The FERC appeared to accept NAField's suggestion. In deciding *Arkla Gathering Services*, the FERC first used the primary function test and determined that the NAField facilities fit the definition of gathering facilities.\(^5\) Second, it granted the requested exemption from federal regulation provided that the companies do not engage in anti-competitive practices based on the close ties of the gatherer to the interstate pipeline company.\(^6\) Third, to protect NAGas' current customers, the FERC required NAField to negotiate new contracts with NAGas' existing customers or offer default contracts with terms similar to those offered by independent gatherers in the area.\(^7\)

The first two of the FERC holdings were challenged by a number of producing company petitioners (Producers) which believed they would be disadvantaged by FERC's decision not to regulate affiliate gatherers.\(^8\)

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\(^1\) Conoco v. FERC, 90 F.3d 536, 541 (D.C. Cir. 1996).

The third determination, requiring default contracts, was challenged by a group of pipeline/gatherer petitioners and intervenors. The five orders pertaining to the NAField spin-down were reviewed by the D.C. Court of Appeals in Conoco v. FERC. The Producers argued that the FERC decision to classify the facilities at issue as gathering facilities was due to a misapplication of the primary function test. They argued that the FERC erred in declining to regulate the gathering rates charged by an affiliate because only the physical aspects of gathering are exempt under section 1(b) of the NGA. The Producers also argued that the FERC's decision is internally inconsistent, that it makes no sense for the FERC to find that it does not have jurisdiction over affiliate gatherers, but that jurisdiction can be created by discriminatory activity by the affiliate. The pipeline/gathering petitioners argued that the FERC had no authority to require default contracts.

The D.C. Circuit held that the FERC adequately considered the factors which are used to define gathering, and therefore refused to substitute the court's judgment for the expertise-based judgment of the FERC. The court granted Chevron deference to the FERC's decision regarding jurisdiction over gathering rates charged by pipeline affiliates because there is no controlling precedent and the NGA is ambiguous in this area. The court overruled the FERC's decision regarding default contracts, however, holding that once the FERC found that it did not have jurisdiction over affiliate gatherers under NGA section 1(b), it could not invoke other sections of the NGA to require default contracts.

The Producers' petition for a writ of certiorari was denied. Only the second issue, exemption of affiliated gathering from regulation under the NGA, will be discussed in this paper.

IV. ANALYSIS

A. Exemption Under Section 1(b) of the NGA-Analysis of Case Precedent

The D.C. Circuit summarized the questions presented to the FERC in Conoco as (1) whether the FERC has jurisdiction over the rates charged

Resources Department and Vesta Energy Company.
46. Pipeline and gatherer petitioners: NAField, NAGas, and GPM Transmission Corporation.
Pipeline and gatherer intervenors: Interstate Natural Gas Association of America and Williams Field Services Company.
49. Id.
50. Chevron v. NRDC, 467 U.S. 837 (1984). If Congress has been silent or ambiguous in a statute, a court reviewing an agency interpretation of the statute must decide only whether the agency's interpretation is reasonable.
52. Id. at 552-53.
by a gatherer that is not a natural gas company,\(^5\) and (2) whether the FERC has jurisdiction over a gatherer which is not a natural gas company if the gatherer is affiliated with a jurisdictional pipeline.\(^5\) The FERC's answers were "no" and "it depends," respectively, and the D.C. Circuit found those answers reasonable.

1. FERC Jurisdiction Over the Rates Charged by a Gatherer

Interstate transportation of gas and interstate sale of gas for resale are both regulated under section 1(b) of the NGA.\(^5\) Gathering and production, however, are specifically excluded from jurisdiction under section 1(b).\(^5\) The Producers argued that the Supreme Court has interpreted section 1(b) as treating regulation of the physical aspects of gathering differently from the regulation of the rates charged for gathering.\(^5\) This distinction has been made because the physical aspects of these activities are truly local in character, while the price charged for the gas or the gathering service is usually passed on to the customers in the interstate market.\(^5\)

The Producers relied on *Colorado Interstate Gas v. FPC* to support their contention that the affiliated gatherer's rates are not exempt under NGA section 1(b). In *Colorado Interstate Gas*, three companies developed a business arrangement by which one company would produce gas in the Panhandle field in Texas, the second company would construct pipelines and transport the gas to Colorado markets, and the third company would arrange for sale of the gas into the local Colorado markets.\(^5\) Although separate companies were involved, the FPC "found that their properties have been operated as a single enterprise."\(^5\) In determining whether the rates charged by the group were excessive, the FPC incorporated the production and gathering facilities into the rate base. Even though section 1(b) of the NGA excludes production and gathering from federal regulation, the Supreme Court held that this methodology was proper when all sections of the NGA were considered.\(^5\) The Court found the use of gathering and production facilities in determining the rate base not to be in

54. For a definition of natural gas company, see *supra* note 15.
55. *Conoco v. FERC*, 90 F.3d 536, 541 (D.C. Cir 1996).
56. NGA § 1(b), *supra* note 16.
57. NGA § 1(b), *supra* note 16.
58. The physical aspects of gathering excluded from federal regulation are those "physical processes closely connected with the natural gas wells themselves." Russell G. Donaldson, Annotation, *What Constitutes "Production and Gathering of Natural Gas" Excluded from Coverage of Natural Gas Act (15 USCS §§ 717 et seq.),* 44 A.L.R. Fed. 843, 848 (1979). For gathering, this includes the activity of collecting the gas after production and the facilities used to collect and process the gas. *Id.* at 848-50.
59. *Conoco*, 90 F.3d at 545.
60. *Interstate Natural Gas Co. v. FPC*, 331 U.S. 682, 692-93 (1947).
62. *Id.* at 585.
63. Because sections 9(a) and 14(b) of the NGA address rate-making, the court finds that § 1(b) must be consistent with them. There is no conflict among the sections if production and gathering facilities are included in the rate base. *Id.* at 602.
conflict with section 1(b) because the Court interpreted the exclusion of production and gathering in section 1(b) to apply to the activities of production and gathering, such as "the drilling and spacing of wells and the like." The FPC had only used the values of the facilities in a calculation and had not regulated the facilities themselves. The Producers argued that the circumstances in Conoco, where only the rate and not the activity of gathering is being regulated, are analogous to those in Colorado Interstate Gas. They claim, therefore, that the affiliate is not exempt under section 1(b) and must be regulated.

The D.C. Circuit, however, interpreted Colorado Interstate Gas as holding that the Commission is permitted to "consider gathering costs 'for the purposes of determining the reasonableness of rates subject to its jurisdiction.'" The Court drew a distinction between the agency actions in the two cases. In Colorado Interstate Gas, the Court approved agency inclusion of gathering facilities in a rate base to determine rates for jurisdictional bundled services; in Conoco, the court approved the agency decision not to directly regulate unbundled (non-jurisdictional) gathering rates. The D.C. Circuit therefore ruled that it is not inconsistent to reach different results in the two cases.

The D.C. Circuit countered the Producer's Colorado Interstate argument with FPC v. Panhandle Eastern Pipeline Co., in which the Supreme Court decided that a natural gas company could sell a significant quantity of its reserves without the authorization of the FPC. The natural gas company had used its reserves to justify expanding its pipeline system, and the FPC was concerned that the sale might jeopardize the company's ability to supply its customers with gas. Despite the FPC's concern about the effect on the interstate market, the Court decided that the prohibition against regulation of production meant the FPC had no authority to prevent the sale of gas leases. The Court concluded that using gathering costs for rate making as applied in Colorado Interstate Gas was "not a precedent for regulation of any part of production or marketing.

The Producers also urged the court to consider Interstate Natural Gas Co. v. FPC, in which the Supreme Court again distinguished between regulation of the physical aspects of gathering and regulation of the rates charged for the service. In Interstate Natural Gas, the petitioner gathered gas and sold it to three pipeline companies. The Supreme Court agreed

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64. Id. at 603.
66. Id.
67. The D.C. Circuit listed the precedent cited by the Producers and then cited Panhandle Eastern as stating a position clearly contrary. Conoco, 90 F.3d at 545 n.19.
69. NGA § 1(b), supra note 16.
71. Panhandle Eastern, 337 U.S. at 506.
72. 331 U.S. 682 (1947).
with the FPC that the petitioner was not exempt under section 1(b) of the NGA, even though it performed a gathering service, because it engaged in the jurisdictional activity of interstate sale of gas.\(^3\) Although the Court recognized that the purpose of the NGA was to regulate in areas where the states could not,\(^4\) it found that the rates charged for gathering, as opposed to the physical aspects of gathering, were of national rather than local importance.\(^5\) The D.C. Circuit distinguished *Interstate Natural Gas* from *Conoco* because the gatherer in *Interstate Natural Gas* engaged in the jurisdictional activity of interstate sales as well as gathering, where the gatherer in *Conoco* did not.\(^6\)

In summary, the D.C. Circuit found reasonable the FERC's decision that the affiliate was not a natural gas company engaged in interstate sale or transportation of gas as required under section 1(b) of the NGA, so the affiliate's rates were exempt from FERC regulation. While some Supreme Court cases held that the physical aspects of gathering or production, rather than rates, were the aspects of the natural gas system exempted under section 1(b), the D.C. Circuit held these cases inapposite because they involved situations in which the gathering was done in connection with a jurisdictional activity, such as transportation or sales.\(^7\) The question remained, however, of whether gathering done by a pipeline affiliate is done “in connection with” the jurisdictional activity of the pipeline and therefore subject to regulation.

2. FERC Jurisdiction Over a Gatherer Affiliated With a Jurisdictional Pipeline

The Producers argued that there is a jurisdictional hook to bring affiliate gathering under the jurisdiction of the FERC. They analogized the affiliate’s situation to that of any other pipeline-owned gatherer, and cited the Eighth Circuit’s finding of jurisdiction under sections 4 and 5 of the NGA in *Northern Natural*.\(^8\) In that case, the Eighth Circuit reviewed a FERC decision relating to the regulatory changes of Order No. 436. That order sought to increase competition in the natural gas market by reducing the regulation of pipelines which offered unbundled gas transportation.\(^9\)

73. *Id.* Although the gatherer's pipelines did not cross state lines, its gas sales were held to be in interstate commerce. Gas flowed from the gatherer's wells into the gatherer's pipelines where it was commingled with gas purchased by the gatherer from other producers (which had already been gathered). It then flowed to the purchasers' pipeline in a continuous process with no interruption for storage or processing. *Id.* at 684-85.
74. *Id.* at 690.
75. *Id.* at 692.
76. The Producers also cited several other cases to support their contention that only the physical aspects of gathering are exempt under NGA § 1(b). *Conoco*, 90 F.3d at 545 n.19. The D.C. Circuit found that in each case which allowed jurisdiction over gathering, the gatherer also engaged in some other jurisdictional activity. *Id.* at 545.
77. *Id.* at 545.
79. *Id.* at 1263-64.
To receive the streamlined treatment, the pipelines were required to accept third party gas for transport and publish separate charges for gathering, storage and transportation. A pipeline company challenged FERC’s jurisdiction over gathering and therefore over its ability to require a statement of gathering rates. The court held that gathering is not exempt under NGA section 1(b) when the gathering is part of a bundled service provided by an interstate pipeline company. The court’s interpretation of NGA sections 4 and 5 was that the FERC could regulate rates charged for a pipeline’s own gathering facilities because the gathering was done in connection with interstate transportation. In a footnote, the court went so far as to define gathering facilities owned by a pipeline as including “facilities owned or operated directly or indirectly by a pipeline or its parent, affiliate, subsidiary or lessors.”

Because the court in Northern Natural concluded that the FERC could regulate gathering rates on a pipeline’s own facilities in connection with jurisdictional transportation, and included affiliated facilities in the definition of a pipeline’s “own,” the Producers argued in Conoco that the gathering rates of the affiliate may be regulated. The D.C. Circuit rejected these arguments. First, it found an appreciable difference between the bundled service analyzed in Northern Natural and the unbundled, affiliate-provided service in Conoco. According to the court, gathering was still bundled to interstate transportation in Northern Natural, but not in Conoco. The court refused to give much weight to the footnote in Northern Natural which directly linked pipeline affiliates to its statement that NGA sections 4 and 5 permit the FERC to regulate gathering rates for a pipeline’s own facilities. The court indicated that because the issue of affiliate gathering was not before the court in Northern Natural, the full ramifications of its comment in the footnote may not have been sufficiently considered.

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80. See supra note 26.
81. Northern Natural, 929 F.2d at 1264.
82. Northern Natural, 929 F.2d 1261.
83. Id. The Tenth Circuit apparently disagreed with the Eighth Circuit on this issue. See Northwest Pipeline Corp. v. FERC, 905 F.2d 1403 (10th Cir. 1990); Pain, supra note 10, at 3-5; Angela S. Chitwood-Beehler, Comment, A Conflict in the Circuits: The FERC’s Jurisdiction Over Gathering Rates, 13 ENERGY L.J. 375 (1992). Pain criticizes the Northern Natural decision because 1) the Court ignored the phrase “subject to the jurisdiction of the Commission” which is part of NGA §§ 4 and 5, 2) the FERC gets its authority from section 1 of the NGA and not from sections 4 and 5, and 3) a perceived need for regulation can’t create jurisdiction when the statute specifically excludes gathering. Pain, supra note 10, at 3-5.
84. Northern Natural, 929 F.2d at 1273.
85. Id. at 1263 n.2.
86. Conoco v. FERC, 90 F.3d 536, 546 (D.C. Cir. 1996).
87. Northern Natural, 929 F.2d at 1263 n.2.
88. The court said “[t]he question is not before us of whether gathering performed by producers or independent gatherers for transportation in interstate commerce by an interstate pipeline is sufficiently connected to interstate transportation to justify rate regulation under §§ 4 & 5.” Id. at 1274.
89. Conoco, 90 F.3d at 546-47.
The significance of the footnote depends on how similar the *Northern Natural* court found pipeline-owned gathering and affiliate gathering to be. At one end of gatherer/pipeline relationships is the independent-gatherer or producer-gatherer, which has no corporate connection with any interstate pipeline. At the other end is the gatherer which is part of the interstate pipeline company. In between these two extremes is the organization created in a spin-down in which the gathering operation is run by an affiliate of the interstate pipeline. The Eighth Circuit specifically stated that it was not deciding whether the independent-gatherer or producer-gatherer would be subject to FERC jurisdiction. But in stating the issue of the case as “whether the [FERC] may, in implementing [Order 436], regulate the rates that natural gas pipeline companies charge third-party interstate transportation shippers for moving natural gas on *gathering facilities owned by the pipeline*” (footnote omitted, emphasis added), the Court defined the *gathering facilities owned by the pipeline* as including facilities owned or operated directly or indirectly, and included a pipeline affiliate. The Eighth Circuit defined the scope of its analysis and, contrary to the D.C. Circuit’s reading, it appears to have included pipeline affiliates, such as the one at issue in *Conoco*, in the category of pipeline-owned gathering. The Eighth and D.C. Circuits appear to disagree about sections 4 and 5 jurisdiction for pipeline affiliate gatherers.

Finally, the Producers argued that the FERC cannot both deny that it has jurisdiction over affiliate gathering and claim that it has jurisdiction under certain circumstances. They argued that if the FERC claimed gathering could be regulated under some circumstances, then the FERC was acknowledging that it had jurisdiction. In response to this argument, the court discussed the rationale that the FERC had used in some of its orders relating to its regulation of affiliates. The court quoted FERC orders in *Northwest Pipeline* and *Arkla II* which indicate that the FERC has the flexibility and the obligation under the NGA to assert jurisdiction when

90. *See supra* note 88.
91. *Northern Natural*, 929 F.2d at 1262-63.
92. *Id.* at 1263 n.2.
93. “[T]he commission cannot have it both ways. Either it has jurisdiction over the gathering service spun down to the affiliate or it does not. By asserting the potential of future exercise of jurisdiction, the Commission is acknowledging that it has jurisdiction.” *Conoco*, 90 F.3d at 548 (quoting *Conoco’s* brief).
94. The FERC has relied on:
   (the general rule ... that an agency may disregard the corporate form in the interest of public convenience, fairness, or equity. This principle of allowing agencies to disregard corporate forms is flexible and practical in nature. Corporations may be regarded as one entity for the purposes with which the agency is immediately concerned even though they are legitimately distinct for other purposes.
95. The FERC has:
   no authority to regulate an affiliated gatherer because it is not a natural gas company under the NGA ... [I]f circumstances develop that would allow the pipeline and its affiliated gath-
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corporate behavior indicates a need for regulation. The court explained
that the FERC, realizing the potential for abuse, required the pipeline
NAGas to add open-access, non-discrimination and anti-tying provisions
to its tariff and described some of the affiliate abuses which would result in
its asserting jurisdiction. The court summarized the FERC position as
being aware that the potential for illegally cooperative behavior exists and
found that the FERC has consistently regulated gathering when it is inter-
twined with jurisdictional activity, which it would be in Conoco only if the
gatherer affiliate and pipeline acted cooperatively.

The Producers then argued that the FERC was being inconsistent in
its decisions about whether or not it has jurisdiction over affiliate gather-
ers. In an earlier decision, the FERC found that it did have jurisdiction
over affiliates, but chose not to exercise it. In the decision on appeal in
Conoco, the FERC stated that it did not have jurisdiction, but that jurisdic-
tion would be created if the affiliate and pipeline act in collusion. The
Producers claimed that the FERC continued to be inconsistent when it
next found that its jurisdiction could not be defeated by the use of affili-
ates. The Producers cited cases in which interstate pipelines were affili-
ated to effectively create an interstate pipeline. The court did not recog-
nize any inconsistency because the cases cited involved “chains of inter-
connected intrastate affiliates that functioned as interstate pipelines.” The court found this result consistent with previous FERC deci-
sions which held that gathering intertwined with jurisdictional activities
will be regulated by the FERC.

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96. Conoco, 90 F.3d at 548. Abuses related specifically to the relationship between the pipeline and affiliate would trigger FERC assertion of jurisdiction. Suspicious actions include the gatherer tying gathering to the pipeline’s transportation, the pipeline giving discounts to those using the affiliate’s gathering service, and cross-subsidization of affiliate gathering and pipeline transportation rates. Arkla I, 69 F.E.R.C. ¶ 61,280 at 62,087 (1994) (discussing Northwest Pipeline, 59 F.E.R.C. ¶ 61,115 at 61,435-36).

97. Conoco, 90 F.3d at 549.

98. Id. at 548 n.25.


100. Conoco’s Joint Initial Brief at 24, Conoco Inc. v. F.E.R.C., 90 F.3d 536 (D.C. Cir. 1996) (No. 94-1724) [hereinafter Conoco’s Brief].


102. Conoco, 90 F.3d at 548 n.25.

103. Conoco, 90 F.3d at 549.
The Producers also argued that jurisdiction is not discretionary.104 They argued that the Conoco situation is similar to that in Maislin Industries v. Primary Steel, Inc., in which the Interstate Commerce Commission (ICC) decided to allow a shipper to pay a negotiated rate which was lower than the filed rate.105 The Supreme Court disagreed with this policy, saying that it conflicted with the governing statute.106 With motivation similar to that of the FERC in the instant case, the ICC was trying to adjust its regulations to suit a more competitive environment.107 The Supreme Court found that “[a]lthough the Commission has both the authority and expertise generally to adopt new policies when faced with new developments in the industry, . . . it does not have the power to adopt a policy that directly conflicts with its governing statute.”108

The Producers also cited MCI Telecommunications Corp. v. AT&T109 as supporting their claim that jurisdiction is not discretionary. The Federal Communications Commission (FCC) had issued a series of orders which essentially deregulated the nondominant110 long distance telephone companies, even though the Communications Act of 1934, section 203(b)(2),111 required that common carriers file their rates and charge only the filed rate. Even though the FCC acted to further the “broad purpose of promoting efficient telephone service,” the Supreme Court held that its Maislin logic applied.112 Without specifically discussing either Maislin or MCI, the D.C Circuit agreed with the FERC that determination of jurisdiction over gatherer affiliates is discretionary and that their decision was not internally contradictory and was entitled to judicial deference.113

While Maislin and MCI at first seem analogous, a closer examination of the statutes involved indicates that those cases are not determinative of the issue in Conoco. The statutes in Maislin and MCI had been interpreted by the courts as specifically requiring regulation, and the agencies had no discretion with respect to regulation. In contrast, the courts had not determined the scope of agency discretion to regulate gathering under the NGA. The D.C. Circuit held that there was no precedent prescribing whether an affiliate gatherer comes under FERC jurisdiction; similarly, there was no precedent which prevented the FERC from treating jurisdiction as discretionary.

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106. Id. at 134-135. The purpose of the Interstate Commerce Act is to ensure that rates charged by motor common carriers in interstate commerce are just and reasonable. The Act requires a motor common carrier to publish and file its rates with the ICC and specifically prohibits charging any rate other than the filed rate.
107. Id. at 133.
108. Id. at 134-135.
110. American Telephone and Telegraph Company was the only dominant long distance carrier.
112. MCI, 512 U.S. at 232.
B. Policy Considerations

In Conoco, the court observed that the decisions cited by the Producers to demonstrate how the courts have interpreted section 1(b) all pre-dated Order Nos. 436 and 636, orders which caused a major restructuring of the natural gas industry. It appears that the FERC has some potentially conflicting responsibilities under the NGA and the recent FERC orders.

1. Responsibilities Under the NGA

Under the NGA, the FERC is charged with protecting gas consumers from the exercise of monopoly power by pipelines in order to ensure consumers of an adequate supply at reasonable prices. The federal agency was not meant to replace state regulation, but to provide regulation where the states could not act.

Early in its evaluation of whether to regulate gathering rates, the FERC decided that regulation of the rates, terms, and conditions of gathering under the open-access provisions of Order No. 436 is of national, rather than local, concern so that federal, rather than state, regulation is most appropriate.

The FERC's view was that because Congress' intent was to "close all gaps in the regulation of the movement and sale of natural gas," it gave the FERC authority to regulate the rates, terms and conditions of gathering performed in connection with open-access transportation. When there is some doubt as to whether the state can practically regulate in an area, the FERC found that federal authority governs.

The Conoco court recognized the need to regulate to prevent anti-competitive behavior. The court observed that the Eighth Circuit in Northern Natural was motivated to find jurisdiction over a pipeline-owned gatherer by a concern that unregulated gathering would effectively permit the pipeline to provide favorable rates for its own gas compared to third-party shippers. The court stated that this particular concern was the part of the Northern Natural opinion which best supported the Producer's argument. The Conoco court acknowledges the potential for abuse, but seems willing to allow the FERC to test the waters of deregulation brought

114. Id. at 545.
115. Samuels, supra note 3.
117. Authority for regulation of production and gathering has historically belonged to the states. States have reason to regulate when independent gatherers have enough market power to control producer's access to the market. Graves & Seidler, supra note 7, at 407. The effects of anti-competitive behavior by gatherers may be felt most strongly at the state level by producers which are disadvantaged in the marketplace because their wells are connected to high priced gathering systems. Graves & Seidler, supra note 7, at 423.
119. Id. at 62,162.
120. Id.
121. Northern Natural Gas Co. v. FERC, 929 F.2d 1261, 1270 (8th Cir. 1991).
122. Conoco v. FERC, 90 F.3d 536, 547 (D.C. Cir. 1996).
about by Order Nos. 436 and 636.

2. New Goals of a Competitive Market

Order Nos. 436 and 636 indicate a shift in the policies of the FERC to deregulation of the natural gas industry which will result in competition and market-based prices. The industry has been transformed by unbundling gas transmission costs and providing open-access to interstate pipelines. Now, competition rather than regulation is the force protecting the consumer from unjust pricing. This shift has occurred at the initiative of the FERC without any changes in the underlying enabling acts, and for the most part, the courts have gone along with the FERC's innovations.

3. The Compromise

Order No. 636 should make regulation of gathering less necessary. With the price of gas deregulated and the interstate pipelines open to third-party shippers on an equal basis, end-users can bargain for the best supplies of gas. The FERC's approach is that deregulation should be the best method for optimizing the price and service for the consumer, but that the FERC must remain vigilant in preventing any abuses due to monopoly. Therefore, the FERC's decision to regulate an affiliate gatherer only when there is abuse of the affiliate/parent relationship represents a compromise between its responsibilities under the NGA and its vision of an efficient, market-driven natural gas industry. The D.C. Circuit joins other courts in allowing the FERC to interpret, essentially on its own, the direction the natural gas industry should take.

C. Consequences

The Conoco court reviewed a FERC decision which balanced the regulatory requirement of the NGA against the deregulated, market-driven approach of Order No. 636. The balance tipped in favor of Order No. 636 because the FERC will not regulate unless there is evidence of anticompetitive action on the part of the gatherer and its affiliated pipeline. Whether there will be abuse under this system and how effectively discretionary regulation will handle anticompetitive situations remains to be seen. Perhaps gathering is sufficiently competitive that problems will be few. In 1995, only about thirty percent of gathering was done by interstate pipelines. The other seventy percent of the activity "aroused very little controversy or complaint."

123. Graves & Seidler, supra note 7, at 413.
124. Fox, supra note 23, at 113.
125. Graves & Seidler, supra note 7, at 418-19.
126. See Fox, supra note 23, at 113-14. The Fifth Circuit also affirmed a FERC decision that an affiliated gatherer is not subject to FERC regulation. Pacific Gas & Elec. Co. v. FERC, 106 F.3d 1190 (5th Cir. 1997).
127. Pain, supra note 10, at 3-3.
128. Id.
An obvious problem is uncertainty as to what circumstances will trigger FERC jurisdiction. *Conoco* itself provides the first illustration of the problem. One of the FERC decisions reviewed in *Conoco*, which was not discussed in this Note, was to exercise jurisdiction and require assurances that the gathering service provided to existing customers "would not be arbitrarily terminated in the event of a spin-down . . . or offered only at unreasonable terms, conditions, and rates." The FERC required NAGas to show that it had either negotiated private contracts with its existing customers or had offered them default contracts with terms similar to those offered by independent gatherers in the same area. FERC required default contracts to "provide a transitional period during which a pipeline's existing customers could consider their options and the states could implement any policies they deemed necessary in the absence of federal regulations of gathering." The Court overruled the FERC's attempt to exercise jurisdiction and require these contracts, stating that once the section 1(b) exclusion was found to apply, the provisions of sections 4, 5, and 7 could not be applied to create jurisdiction.

Thus, the FERC itself had trouble identifying the circumstances under which it can exercise jurisdiction. If the FERC has problems interpreting the new regulatory scheme, the industry will have difficulty also. As an alternative to seeking relief from the FERC, those harmed by unlawful gatherer activity have the options of state law and federal antitrust law to provide remedies.

V. CONCLUSION

The *Conoco* court held that an affiliate gatherer is not a natural gas company; therefore, it is not subject to regulation by the FERC unless its activities are intertwined with jurisdictional activities. An interstate pipeline company's gathering will be viewed as intertwined with jurisdictional activities, and subject to regulation by FERC, if the gatherer and affiliated pipeline engage in anticompetitive behavior.

This approach to regulation of affiliate gatherers is a compromise between the NGA's goals of consumer price protection and adequate supply and Order No. 636's goal of increased competition in the natural gas market. The flexibility of the approach should lower gas gathering rates, but creates some uncertainty about how the regulatory scheme will deal with abuses.

*Janet Gulbis, Ph.D.*

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129. *Conoco*, 90 F.3d at 541-542.
130. *Id.* at 542.
132. *Conoco*, 90 F.3d at 552.
133. First Nat'l Oil, Inc. v. FERC, 102 F. 3d 1094, 1097 (10th Cir. 1996).
As a general policy, the Federal Energy Bar Association does not take positions in published Committee Reports on substantive issues that are the subject of pending litigation.
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I. RESTRUCTURING

A. Federal Energy Regulatory Commission

1. Open Access Transmission Service

The Federal Energy Regulatory Commission (FERC) in 1997 upheld its landmark final rule on open access transmission service and stranded costs, Order No. 888.1 The FERC's Open Access Rule requires each "public utility" that owns, operates or controls interstate electric transmission facilities to (i) provide transmission service to its customers on a basis comparable to that which it provides transmission service for itself on behalf of its own customers, (ii) offer generation, transmission and ancillary services on an unbundled, separately-priced basis, and (iii) separate its marketing and transmission functions. The pro forma open access transmission tariff, which sets forth the standard terms and conditions under which public utilities must of-

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fer open access transmission service, implements the principle of comparability of service. As indicated by the FERC, "unbundled electric transmission service will be the centerpiece of a freely traded commodity market in electricity in which wholesale customers can shop for competitively-priced power."

a. Order No. 888-A

In Order No. 888-A, the FERC generally reaffirmed and clarified the principal provisions of Order No. 888.

i. Contract Reform

Order No. 888 provides that utilities can modify existing contracts to seek recovery of "stranded costs," or costs that cannot be recovered (i.e., that become "stranded") when a customer uses the open access transmission tariff to purchase power supplies elsewhere. In Order No. 888-A, the FERC clarified that as a balance to utilities' rights to modify their contracts, customers would be allowed to seek to amend their Mobile-Sierra contracts to modify any contract term or to terminate the contract, without having to show that the contract is contrary to the public interest (the Mobile-Sierra standard). Such customers would have to show that the contract provisions are no longer just and reasonable.

ii. Comparability

The FERC modified the definition of "eligible customer" under the proforma tariff to clarify that, with respect to service that it is prohibited from ordering under section 212(h) of the Federal Power Act (FPA) (i.e., direct retail wheeling and "sham" wholesale wheeling), otherwise eligible entities may obtain service under the tariff only if it is pursuant to a state requirement or if offered voluntarily by the transmission provider. The FERC also clarified that if a transmission provider supplies direct unbundled retail transmission service (whether pursuant to a state requirement or by voluntary offer), it must do so under the open access tariff. The FERC clarified that it has the authority to order indirect unbundled retail transmission services, reaffirming its conclusion that it has jurisdiction over the rates, terms and conditions of unbundled transmission service provided to retail customers. Finally, the FERC clarified that transmission providers do not have to take service under the open access tariff for the transmission of power purchased on behalf of their bundled retail customers. The FERC concluded that it does not have jurisdiction over such bundled retail

sales.\(^8\)

iii. Ancillary Services

The FERC clarified that a transmission provider's sale of ancillary services associated with providing basic transmission service is not a wholesale merchant function and thus does not violate the standards of conduct requiring the separation of transmission and merchant functions.\(^9\)

iv. Pro-Forma Tariff Provisions

The FERC clarified that a network customer may not take transmission service for only a portion of its load. It suggested several alternatives (short of a section 206 complaint) for the customer to pursue to avoid double payments where a network customer also had a bundled power purchase contract.\(^10\) The FERC also made clear that the firm point-to-point transmission rate represents a maximum rate or cap for non-firm point-to-point transmission rates, and emphasized that in order to reflect the inferior, interruptible nature of non-firm service and promote efficient use of the transmission system (i.e., encourage throughput), non-firm service was expected to be priced below the price cap.\(^11\) Finally, the FERC reiterated its policy enunciated in Arizona Public Service Company\(^12\) that in-kind transactions must be provided on a non-discriminatory basis and be unbundled, and that associated transmission must be obtained under the open access transmission tariff.\(^13\)

The FERC modified the language of the force majeure provision to clarify that acts of negligence or intentional wrongdoing were not covered.\(^14\) The FERC declined to impose an indemnification obligation on the transmission provider like that imposed on the customer for third-party claims arising from the transmission provider's performance of its obligations under the tariff, and also declined to extend the indemnification obligation so that it would apply even in cases where the transmission provider had been negligent.\(^15\)

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10. Using network service, for example, the customer could designate its existing generation supply contract(s) as a network resource and the associated load served under such contract(s) designated as network load; the customer could then (i) negotiate with the transmission provider to obtain a credit on its network service bill for any separate transmission arrangements or for the unbundled transmission rate component of the existing generation supply contract, or (ii) seek to have any separate transmission or the unbundled transmission rate component of its generation supply contract eliminated in recognition of the network transmission service being provided and paid for under the tariff. Using point-to-point service, the customer could identify the discrete points of delivery being served under existing generation supply and existing transmission contracts and acquire additional point-to-point transmission service under the tariff for any remaining load at those discrete points of delivery. Order No. 888-A, at 30,261.
14. See Section 10.1 of the pro-forma tariff.
The FERC extended the "umbrella" service agreement approach to short-term firm transactions. Thus, a transmission provider need only submit an umbrella service agreement (i.e., an agreement of general applicability) to cover short-term firm transactions with a particular customer.\(^6\)

The FERC also made a variety of clarifications with respect to the \textit{pro-forma} tariff. For example, in addition to changes to reflect the clarifications and modifications discussed elsewhere in this report, the FERC:

- Modified Sections 13.2 and 14.2 of the \textit{pro-forma} tariff to establish specific time frames within which a customer must respond to a longer-term competing request for transmission service.\(^7\)
- Clarified that the requirement to curtail service proportionally to all customers extends only to those transactions (whether firm or non-firm) that alleviate the constraint, and that such curtailments must be made on a non-discriminatory basis, including the transmission provider's own wholesale uses of the system.\(^8\)
- Clarified that the ability to reserve capacity to meet the reliability needs of a transmission provider's native load applies equally to present transmission facilities and transmission facilities that are built in the future.
- Modified Schedule 2 of the \textit{pro-forma} tariff to allow a transmission customer to supply at least part of the reactive power service it requires.\(^9\)
- Clarified that Energy Imbalance Service supplies energy for mismatches between scheduled deliveries and actual loads but does not apply to mismatches between energy scheduled and energy generated.\(^20\)
- Raised the "dead band" as to which the Energy Imbalance Service charges apply from the lesser of 1.5\% or 1 MW to the lesser of 1.5\% or 2 MW. The FERC also clarified that a transmitting utility and a customer could negotiate a different bandwidth.\(^21\)
- Clarified that its transmission discounting policy applies to the discounting of ancillary service charges.\(^22\)
- Modified the \textit{pro-forma} tariff to allow a customer to designate as a network resource a \textit{leased} generating resource (not just \textit{owned} or \textit{purchased} resources).\(^23\)

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16. Order No. 888-A, at 30,302-30,303. The FERC also made several minor modifications to the service agreement forms attached to the tariff to facilitate the umbrella approach. Order No. 888-A, at 30,303.


19. Order No. 888-A, at 30,228. The FERC also modified Schedule 2 to refer to generating facilities that are under the control of the control area operator, instead of in the control area, since the control area operator must be able to control the dispatch of reactive power from the generating facilities. Order No. 888-A, at 30,228.


v. Discount Policies

The FERC modified its discounting requirements in three significant ways: (i) all offers of and requests for discounts of transmission and ancillary services must be posted on the transmission provider's Open Access Same-time Information System (OASIS); (ii) once the transmission provider and customer agree on a discount, the details of the discounted service (price, points of receipt and delivery, and length of service) must be posted immediately on the OASIS; and (iii) when a discount is offered over one path, the transmission provider must also provide the discount only over unconstrained paths that go to the same point(s) of delivery as the discounted service being provided on the transmission provider's system. This narrowed the policy established by Order No. 888, which provided that the discount had to be offered over all unconstrained paths on the provider's system. The FERC also clarified that a transmission provider may limit its offers of discounts over the OASIS to particular time periods.

vi. Reciprocity

The FERC upheld the reciprocity requirement that a customer receiving transmission service under the pro-forma tariff must, as a condition of receiving that service, agree to provide reciprocal (or comparable) service to the transmission provider, but clarified the requirement in a number of respects, including the following:

- A public utility may waive the reciprocity condition by offering transmission service to a non-public utility without requiring reciprocal service in return, but must still provide transmission service through the pro-forma tariff.
- A non-public utility cannot avoid its responsibilities by obtaining transmission service through other customers; and the seller as well as the buyer in the chain of a transaction involving a non-public utility will have to comply with the reciprocity condition.
- A non-public utility may satisfy the reciprocity obligation through a bilateral agreement with the transmission provider, rather than an open access tariff of general applicability.
- The FERC clarified that the reciprocity provision applies even to those utilities that do not own or control interstate transmission facilities, i.e., foreign utilities and those utilities located in the insular Electric Reliability Council of Texas region.

26. Order No. 888-A, at 30,285-30,286. In contrast to its position in Order No. 888, the FERC held in Order No. 888-A that bilateral contracts for transmission service provided by a public utility are not permitted.
27. Order No. 888-A, at 30,287. Section 6 of the pro-forma tariff was modified accordingly.
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- The FERC also made a number of clarifications to its policies with respect to private activity and local furnishing bonds.

The FERC later clarified the reciprocity condition as it applies to Canadian sales of electric power to United States utilities at the U.S.-Canada border. In response to a Canadian utility's motion to stay the effectiveness of the reciprocity condition to Canadian utilities, the FERC clarified that the reciprocity condition of the pro-forma tariff does not impose the reciprocity condition in circumstances where a Canadian utility sells power to a U.S. utility located at the U.S.-Canada border, title to the electric power transfers to the U.S. border utility, and the power is then sold to a U.S. customer that has no affiliation with, and no contractual or other tie to, the Canadian utility.  

b. Order No. 888-B

In Order No. 888-B, the FERC affirmed, with certain clarifications, the "fundamental calls" made in Order No. 888-A. In particular, the FERC made the following modifications or clarifications:

- Clarified that a public utility should provide transmission service only under the pro-forma tariff (except in "unusual circumstances"), but that a non-public utility customer providing service pursuant to the reciprocity condition may provide such service under a bilateral agreement.
- Clarified that an existing transmission customer exercising its right of first refusal will be required to match the term of service requested by another potential customer and may be required to pay the transmission provider's maximum filed transmission rate (for substantially similar service of equal or greater duration).
- Clarified that transmission associated with a single, indivisible power purchase made on behalf of both wholesale and retail native load must be obtained under the open access tariff for the entire transaction.
- Modified the pro-forma tariff to permit the filing of an unexecuted network operating agreement to avoid delaying the commencement of service in the event the customer and the transmission provider cannot agree on all the terms of service.
- Clarified that a transmission provider should not receive double payments for providing either transmission service or ancillary services to

32. Order No. 888-B, at 62,085.
34. Order No. 888-B, at 62,095.
the same portion of a transmission customer's load.\textsuperscript{35}

c. Tariff Implementation and Compliance Issues

i. Compliance Filings

In late 1996 and early 1997, the FERC issued a series of orders on the non-rate terms and conditions of the \textit{pro-forma} tariffs filed by public utilities in response to Order No. 888. The FERC accepted proposed deviations to the \textit{pro-forma} tariff that reflect regional practices, based on the public utility's "good faith representation that the identified regional practice is legitimate."\textsuperscript{36} In this regard, the FERC generally accepted the scheduling deadlines and other regional practices proposed by utilities, but did not hesitate to reject modifications that were not supported as regional practices.\textsuperscript{37} The FERC accepted the proposed available transmission capability (ATC) assessment methodologies, with certain modifications to ensure comparable treatment of customers; the FERC again declined to require a generic ATC methodology applicable to all utilities.\textsuperscript{38} The FERC also required utilities to submit more detailed system impact study methodologies that identify the "key components of the analytical process."\textsuperscript{39} Finally, the FERC accepted network service and operating agreements as "prototypes" subject to later modification to address the circumstances of individual network customers. Other utilities that did not include such agreements in their tariffs were directed to submit, at a minimum, a "summary of principles and list of issues to be addressed" in the network service and operating agreements.\textsuperscript{40}

The FERC rejected all other deviations from the \textit{pro-forma} tariff that were not specifically permitted by the tariff. The FERC noted that modifications to the \textit{pro-forma} tariff could be sought in Section 205 proceedings.\textsuperscript{41} The FERC also explained that a number of issues raised with respect to the Order No. 888 compliance filings were not ripe or could be addressed in the service agreements on rehearing of Order No. 888 or in other proceedings.\textsuperscript{42}

ii. Other Compliance Issues

In a July 31, 1997, omnibus order on compliance tariff rates,\textsuperscript{43} the FERC

\textsuperscript{35} Order No. 888-B, at 62,096.
\textsuperscript{37} Allegheny, 77 F.E.R.C. ¶ 61,266, at 62,100-01; AEP, 78 F.E.R.C. ¶ 61,070, at 61,259-62.
\textsuperscript{38} Allegheny, 77 F.E.R.C. ¶ 61,266, at 62,102-03; AEP, 78 F.E.R.C. ¶ 61,070, at 61,262-63.
\textsuperscript{39} Allegheny, 77 F.E.R.C. ¶ 61,266, at 62,103; AEP, 78 F.E.R.C. ¶ 61,070, at 61,263-64.
\textsuperscript{40} Allegheny, 77 F.E.R.C. ¶ 61,266, at 62,103-04; AEP, 78 F.E.R.C. ¶ 61,070, at 61,264.
\textsuperscript{41} Allegheny, 77 F.E.R.C. ¶ 61,266, at 62,104-05; AEP, 78 F.E.R.C. ¶ 61,070, at 61,264-66.
\textsuperscript{42} Allegheny, 77 F.E.R.C. ¶ 61,266, at 62,105-08; AEP, 78 F.E.R.C. ¶ 61,070, at 61,266-69.
\textsuperscript{43} Allegheny Power Sys., Inc., 80 F.E.R.C. ¶ 61,143 (1997).
accepted for filing, those compliance tariffs that made only rate changes "necessitated" by Order No. 888: (i) changes in the structure of ancillary services and the addition of a requirement that rates be separately stated for each ancillary service; (ii) the change in the minimum term for firm point-to-point transmission service from one hour to one day; and (iii) the addition of penalty charges for unauthorized use or excess use of services. The FERC rejected rate changes other than those "necessitated" by Order No. 888.

In the July 31 omnibus order, the FERC also clarified the compliance tariff implementation procedures: Any customer that had executed a service agreement or was taking service under a utility's open access transmission tariff filed prior to the issuance of Order No. 888 was automatically transferred to that utility's compliance tariff on July 9, 1996 (the effective date of Order No. 888).

Public utilities were also directed to file service agreements placing themselves under their own open access transmission tariffs for use on their own system. The FERC required the transmission providers in those filings to comply with the requirements of their tariffs and to provide the operational conditions and limitations under which they engage in point-to-point and network transmission service. For example, the FERC has directed utilities to revise their service agreements to designate the individual network loads of network customers and to specify network resources.

The FERC also has taken a hard line with respect to public utilities' filings of service agreements under the open access transmission tariffs. The FERC has not hesitated to reject filings that do not comply with the terms and conditions of the tariff.

The FERC, in the July 31 omnibus order, disposed of a number of other rate issues on a summary basis. As to rates for ancillary services, for example, the FERC held that companies could offer packages of ancillary services bundled together, but that they must also offer such services on an unbundled, separately-priced basis. As to transmission service rate issues, the FERC imposed a cap on penalty provisions for excessive use of transmission

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44. Id. at 61,528-29.
45. Id. at 61,529. The three most common unacceptable changes were "(i) the adoption of a twelve-monthly coincident peak (12-CP) divisor for firm point-to-point transmission service; (ii) updating the test year to develop revised transmission rates; and (iii) [the] adoption of a new formula for formulary rates." Id. at 61,529-30.
50. See, e.g., Western Resources, Inc., 81 F.E.R.C. ¶ 61,269 (1997) (rejecting transaction-specific transmission service agreements for failure to specify the actual receipt and delivery points and directing the service agreements to be revised to reflect specifically whether or not each of the six ancillary services would be provided under the service agreements).
services at a level equal to twice the standard rate for the service at issue, adopted minimum periods of time before a transmission provider may assess a penalty for failure to curtail, and clarified that where a transmission provider has not proposed an express crediting provision for the interruption of non-firm point-to-point customers, the transmission provider must compute its bill to an interrupted non-firm customer as if the term of service actually rendered were the term of service reserved.

The FERC also addressed proposals on a company-specific basis. For example, the FERC rejected a public utility's proposal to purchase four of the six ancillary services under its proposed wholesale generation tariff because the utility must obtain the services under the open access transmission tariff just like any third-party customer. The FERC also held that the functional unbundling requirement may not be avoided simply by renegotiating a pre-existing (i.e., before July 9, 1996) agreement during the original term of the agreement. The FERC noted that otherwise the unbundling requirement "could be avoided indefinitely as long as each new agreement was negotiated during the term of the then-existing agreement."

The FERC also announced a policy with respect to the filing of power sales agreements or tariffs. As part of the functional unbundling of wholesale services required by the Open Access Rule, the prices for wholesale generation, transmission, and ancillary services must be separately stated for sales under requirements or coordination contracts executed after July 9, 1996. However, a number of utilities had failed to comply with that requirement. Therefore, the FERC announced that any future filing of a power sales agreement or tariff that failed to provide for unbundling of transmission and ancillary services would be rejected by the FERC. Market-based power sales tariffs must provide that (i) when transmission and ancillary services to effectuate power sales transactions under the market-based tariff are to be obtained by the selling utility, the utility must file a service agreement placing itself under its open access transmission tariff, and (ii) when the customer itself is obtaining transmission and ancillary services from the market-based selling utility, the utility must file a service agreement placing the customer under its open access transmission tariff.

Finally, the FERC accepted for filing, as modified, the joint system-wide

52. Id. at 61,545-46. The FERC accepted the penalty provisions in pre-Order No. 888 tariffs (subject to refund) and held that issues regarding penalty provisions of any tariffs set for hearing may be raised at that hearing.

53. The period is ten minutes if the curtailment is for reliability purposes, and twenty minutes if for economic purposes. Id. at 61,546.

54. Id. at 61,549-50.


57. Central Hudson Enter. Corp., 79 F.E.R.C. ¶ 61,390, at 62,654-55 (1997). The FERC's policy applies to any filing after the date of the order. Filings prior to the date of the order that failed to reflect the unbundling requirement would be held "deficient." Id. at 62,655 n.7.

open access tariff submitted by the utility operating companies of the Central and South West Corporation (CSW). They incorporated the terms and conditions of the pro-forma tariff, with additional provisions under which transmission service would be offered consistent with the transmission access and pricing rules of the Texas Public Utilities Commission, and provided for separate transmission rates for service within ERCOT and the Southwest Power Pool. The FERC allowed a number of deviations from the pro-forma tariff that reflect ERCOT practices, but rejected other deviations from the pro-forma tariff that did not reflect regional practices and were not otherwise justified.

iii. Implementation of the Open Access Tariff

Secondary Receipt and Delivery Points. Under Section 13.7(a) of the pro-forma tariff, a customer may obtain service at secondary receipt and delivery points on a firm or non-firm basis. A utility argued that service redirected from one delivery point on a non-firm basis to a different delivery point was subject to separate charges because the customer had not changed its own receipt and delivery points but had “divert[ed] a portion of its transmission service to a second customer’s delivery point.” The FERC disagreed, explaining that Section 13.7(a) “allows a customer to change its receipt and delivery points without restriction as to load. Any delivery point designated by a customer, whether primary or secondary, would be ‘its’ delivery point even if the load were different.”

Reassignment of Capacity. The FERC clarified that a transmission provider’s wholesale merchant function may reassign transmission capacity that is taken under the provider’s pro-forma tariff. As an eligible customer under the tariff, the transmission provider may reassign its rights to capacity. The FERC also clarified that when the transmission provider’s merchant function reassigns capacity, all of the non-rate terms and conditions that otherwise would apply to the transmission provider’s sale of transmission capacity continue to apply: “the transmission provider cannot abdicate any of its obligations as a transmission provider under Order Nos. 888 and 888-A, including the posting of discounts and other information, by acting as a reseller of transmission capacity.”

Consistent with Order Nos. 888 and 888-A, charges for transmission service reassigned by a transmission provider under its transmission reassignment rate schedule must be capped at a price not to exceed the highest of: (i) the original rate paid by the assignor, (ii) the transmission provider’s

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60. See id. at 62,434-437. The FERC rejected those provisions for the ERCOT portion of the CSW system that reflected neither the pro-forma tariff nor the Texas commission’s tariff. Id. at 62,437.
61. Id. at 62,437-38.
63. Id. at 61,220.
65. Id. at 62,336.
maximum filed rate at the time of the transmission reassignment, or (iii) the assignor's own opportunity costs, capped at the transmission provider's cost of expansion at the time of the resale. Incremental opportunity costs in connection with the resale of transmission service may not be charged unless charges for such costs are first filed separately with the FERC.66

The FERC also indicated that the requirement that a public utility, in order to reassign transmission rights, have on file a tariff for capacity reassignment applies to all public utilities, including power marketers.67 Power marketers (including the marketing affiliates of public utilities with franchised service territories) must file information with respect to capacity reassignments in their quarterly transaction reports.68

Right of First Refusal. The FERC found that a transmission provider's own reservation of its transmission capacity had priority over that of a customer seeking to extend its service. The transmission provider had filed on July 8, 1996 (the day before the effective date of Order No. 888 and the transmission provider's pro-forma tariff) a service agreement reserving transmission capacity. Because its pre-Order No. 888 tariff, under which the customer had taken service, did not provide for a right of first refusal, and because it had reserved the disputed transmission capacity prior to the effective date of Order No. 888 and the pro-forma tariff, the transmission provider had priority over the customer to the disputed transmission capacity.69 In short, any right of first refusal by the customer was subject to whatever transmission capacity reservations were already in place -- including the transmission provider's, which had been made the day before the effective date of the pro-forma tariff.

Confirmation Procedures. The FERC accepted a utility's addition of confirmation procedures (consisting primarily of time limits for making confirmations of service requests) to its short-term firm point-to-point transmission service agreement. The FERC found the procedures "not . . . unreasonable" and acceptable until industry-wide procedures are adopted by the FERC.70

Application for Service. The FERC denied a utility's claims that a customer's application for firm point-to-point transmission service in connection with supplying power to a wholesale load was deficient. The FERC found that the failure to specify a precise service commencement date did not ren-


67. Southwestern Public Serv. Co., 80 F.E.R.C. ¶ 61,245, at 61,906 (1997). The FERC, citing Order Nos. 888 and 888-A, also rejected an argument that such a filing requirement would be "unduly burdensome" and "serve no purpose." Id.


under the application deficient, because the customer’s original plans to initiate service had been frustrated by legal proceedings instituted by the transmission provider. The FERC also directed the utility to evaluate the requested transmission capacity, which included a range of figures, and to treat any additional amounts requested as a modified application under the pro-forma tariff. Finally, the FERC held that the pro-forma tariff does not require that delivery points be in existence on the date of the application; applications for future service can reference future delivery points and, when they do, need not separate reservations among such future delivery points (since any such attempt would be premature).71

Waiver of Deposit. The FERC accepted a utility’s proposed revision to the pro-forma tariff to allow it to waive, in certain circumstances, the deposit requirement for applications for firm point-to-point transmission service. Where the customer already has established its creditworthiness, the utility would waive the deposit requirement and bill the customer for its reasonable costs in evaluating the application.72

Conditional Reservations. In a complaint proceeding, the FERC addressed the issue of whether a transmission customer with a conditional reservation for short-term firm point-to-point service has the right to match a use by a long-term network customer under section 13.2 of the pro-forma tariff. The FERC explained that only competing short-term firm point-to-point requests triggered the matching option under section 13.2, i.e., a short-term customer may match a competing long-term request before having its reservation bumped. The matching option is available “strictly for the purpose of rationing, during the conditional reservation period, ATC between competing short-term firm uses. It is not for the purpose of allowing a short-term customer to bump a long-term customer.”73 Therefore, the transmission provider (a long-term network customer) was not required to offer the short-term customer a matching option before canceling its conditional short-term point-to-point reservation.

Use of Interface Capacity by Network Customer. In a dispute between a utility and its network customer, with respect to the customer’s attempted designation of network resources at the utility’s interface with the customer’s new power supplier, the FERC explained that, while there is no “load ratio” limitations on a network customer’s use of interfaces in designating network resources, the issue of the amount of capacity available for new transmission service is to be addressed in accordance with the pro-forma tariff’s application procedures, including a determination of ATC for the new service.74 The FERC set for hearing factual issues with respect to the amount of interface capacity available and the upgrades that would be required to serve the cus-

74. Sierra Pacific Power Co., 81 F.E.R.C. ¶ 61,136, at 61,637-38 (1997). Nor was the transmission provider required to “provide service for which there is inadequate firm capacity and then to respond to those problems through redispatch where the costs are shared by all network users.” Id. at 61,639.
Network Transmission Rate Calculation. A utility's unopposed proposal “to revise the calculation of network transmission rates to adjust the load ratio share once a year, rather than each month on a rolling basis,” was accepted by the FERC. The utility stated that the change would “significantly reduce administrative costs” and would be “revenue neutral.”

Unbundled Retail Transmission Service. The FERC requires unbundled retail transmission service to be taken under the terms and conditions of the pro-forma tariff. Absent a request by a state commission for a separate tariff or variations in the pro-forma tariff (and the FERC's agreement thereto), a proposed retail transmission service tariff that deviates from the pro-forma tariff will be rejected. The FERC granted requests for variations from the pro-forma tariff to accommodate retail transmission service.

d. Tariff Modifications

In addition to deviations from the pro-forma tariff expressly permitted to accommodate regional practices, the FERC addressed many of the proposed modifications to the pro-forma tariff in series of orders on non-rate terms and conditions in early 1997. Other modifications were addressed in utility-specific orders.

For example, the FERC accepted Florida Power Corporation's (FPC) network contract demand transmission service (NCDTS), which incorporates some of the features of both point-to-point and network transmission service under the pro-forma tariff. The FERC found NCDTS provided additional benefits above the pro-forma tariff, while services under the pro-forma tariff remain available without an increase in rates but directed the FPC to modify the service to ensure comparable treatment of customers. The FERC also noted that “it would be much preferable for departures” from the pro-forma tariff to be “proposed on a regional basis within the context of a proposed ISO.” Regional proposals will give the FERC “greater confidence” that a proposed departure is consistent with or superior to the pro-forma tariff and

75. Id. at 61,638.
81. Id. at 62,067.
82. Id. at 62,067 n.15.
will eliminate any patchwork of terms and conditions.\textsuperscript{83}

However, the FERC rejected a proposal to replace the entire \textit{pro-forma} open access tariff with a "unified service arrangement" tariff that included load-based pricing for transmission services through or outside of the transmission provider's system. The FERC could not "tell on the basis of the information provided by [the utility] whether its proposal will result in service consistent with or superior to the services provided in the \textit{pro-forma} tariff."\textsuperscript{84} The FERC gave the utility the option of proceeding with a hearing on the tariff or making a new filing.\textsuperscript{85}

e. Tariffs of Non-Jurisdictional Transmission Providers

In accordance with the "safe harbor" procedures, several transmission-owning utilities not subject to the FERC's general "public utility" jurisdiction sought, and were granted, declaratory orders finding their transmission tariffs satisfied the FERC's comparability standards and were therefore acceptable reciprocity tariffs under the \textit{pro-forma} tariff.\textsuperscript{86} Under the safe-harbor procedures, if the FERC finds that the terms and conditions of a non-public utility's transmission tariff are consistent with or superior to those of the \textit{pro-forma} tariff, the FERC will deem it to be an acceptable reciprocity tariff and require public utilities to provide open access transmission service upon request to that particular non-public utility.\textsuperscript{87} In addition, the reciprocity provision in the \textit{pro-forma} tariff extends to members of power pools or regional transmission groups (RTGs); therefore, a non-public utility would be subject to reciprocity regarding service to the other members of the pool or RTG.\textsuperscript{88}

\textsuperscript{83} \textit{Id.}
\textsuperscript{84} \textit{Duquesne Light Co.}, 78 F.E.R.C. ¶ 61,115, at 61,445 (1997).
\textsuperscript{85} \textit{Id.}


\textsuperscript{88} See, e.g., \textit{Omaha}, 81 F.E.R.C. at 61,269 (Omaha is subject to reciprocity regarding service to other members of the Mid-Continent Area Power Pool (MAPP)). In \textit{Omaha}, the FERC declined Omaha's request that it establish a presumption that a FERC-approved reciprocity tariff necessarily satisfies the comparability requirements imposed by MAPP on its members. \textit{Omaha}, 81 F.E.R.C. at 61,270.
Generally, the reciprocity tariffs have conformed to the terms and conditions of the pro-forma tariff. The FERC has required the non-public utilities to conform their tariffs to the non-rate terms of the pro-forma tariff revised in Order Nos. 888-A and 888-B. The FERC also rejected challenges to the non-rate terms and conditions of the reciprocity tariffs that were collateral attacks on the non-rate terms and conditions of the pro-forma tariff.

In addition to changes to reflect regional practices, the reciprocity tariffs also contain minor deviations from the pro-forma tariff to reflect the non-jurisdictional status of the utilities. The FERC also allowed a modification to the pro-forma tariff to reflect a cooperative’s limited resources; the cooperative was allowed to respond to a request for determination of ATC within sixty minutes, rather than the thirty minutes required by the pro-forma tariff, because it had only a limited number of transmission personnel to handle such requests. Finally, the FERC has accepted changes designed to ease administrative burdens.

However, the FERC rejected a number of proposed reciprocity tariff provisions as unjustified or unexplained deviations from the pro-forma tariff. For example, the FERC found “unacceptable for a reciprocity tariff” the failure to include power marketers expressly within the definition of “eligible customer,” the use of deadlines for requests for non-firm service that are inconsistent with and inferior to the pro-forma tariff’s advance notice provisions, the use of service agreements that are not consistent with or superior to the service agreements in the pro-forma tariff, and the use of an energy deviation band in the energy imbalance schedule of one megawatt instead of two megawatts.

Finally, the FERC has denied all protests of proposed rates under the

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89. See, e.g., OUC, 81 F.E.R.C. at 62,826 (requiring revising of tariff to conform with the one change to the pro-forma tariff under Order No. 888-B); Colorado Springs, 81 F.E.R.C. at 61,849 (requiring revising of tariff to conform to the pro-forma tariff under Order No. 888-A); Hoosier, 81 F.E.R.C. at 61,695 (requiring revising of tariff to conform to the pro-forma tariff under Order No. 888-A); Santee Cooper, 80 F.E.R.C. at 61,742 and 81 F.E.R.C. at 61,853 (approving changes to reciprocity tariff filed to conform to pro-forma tariff under Order Nos. 888 and 888-A).

90. See, e.g., Southern Illinois, 80 F.E.R.C. at 62,127 and n.7; Santee Cooper, 80 F.E.R.C. at 61,742 and n.3. The FERC also rejected as collateral attacks on Order Nos. 888 and 888-A challenges to the FERC’s standard of review of reciprocity tariffs. Santee Cooper, 81 F.E.R.C. at 61,851-52.

91. E.g., Southern Illinois, 80 F.E.R.C. at 62,128 (changes to reflect regional scheduling deadlines).


94. Bonneville, 80 F.E.R.C. at 61,373.

95. Bonneville, 80 F.E.R.C. at 61,374.

96. Bonneville, 80 F.E.R.C. at 61,375. On rehearing, the FERC granted Bonneville’s request that it be allowed to demonstrate in its compliance filing that its alternative scheduling deadlines are reasonable and generally accepted in the region. Bonneville, 81 F.E.R.C. at 61,722.

97. Bonneville, 80 F.E.R.C. at 61,375-76. The FERC also held that Bonneville could tailor its service agreements to fit the individual circumstances of individual customers, but that it must still abide by its published tariffs and cannot treat individual customers in an unduly discriminatory or preferential fashion. Bonneville, 80 F.E.R.C. at 61,376.

98. OUC, 81 F.E.R.C. at 62,826.
reciprocity tariffs. To determine if proposed reciprocity rates are consistent with the FERC's comparability standards, the non-public utility must submit "sufficient information [for the Commission] to conclude that the non-public utility's rate is comparable to the rate it charges others." If the FERC concludes, based on the submitted information, that the proposed rates for transmission and ancillary services are comparable to the rates it charges itself, then the FERC will find that the tariff meets the standard for an acceptable reciprocity tariff.

f. Section 211 Complaints

During 1997, the FERC issued only a handful of decisions concerning applications filed under sections 211 and 212 of the FPA. These cases addressed an assortment of issues.

In Missouri Basin Municipal Power Agency, the FERC set for hearing the question of whether the requested transmission service could be provided over a discrete portion of certain interconnected facilities. The applicant, Missouri Basin Municipal Power Agency (Missouri Basin), requested the FERC to order the Western Area Power Authority (WAPA) to provide various types of transmission service, using only the federally-owned portion of the Joint Transmission System established under the Missouri Basin Systems Group Pooling Agreement, which also includes facilities owned by a group of municipals and cooperatives. WAPA contended that the federally-owned facilities could not reliably provide the service, and instead offered Missouri Basin service over the integrated system's federal and non-federal facilities. Missouri Basin contended: (i) that the non-federal facilities were unnecessary for the service it required; and (ii) that the comparability principle required WAPA to provide the federal-only service to third parties because WAPA itself has, under the Joint Transmission System Agreement, taken transmission service that utilized only the federal facilities. Without discussing the comparability argument, the FERC set for hearing the issue of whether the requested transmission services could be provided without impairing the continued reliability of affected electric systems.

Cinergy Services, Inc. (Cinergy) involved an application for an order directing the Tennessee Valley Authority (TVA) to deliver power to the City of Bristol, formerly a requirements customer of the TVA. Cinergy contended that, although the TVA agreed to provide network transmission service, it had unreasonably sought to condition the service. In its application, Cinergy asked the FERC to resolve three issues: (i) whether the TVA

102. 81 F.E.R.C. 1 61,324 (1997).
103. 81 F.E.R.C. 1 61,243 (1997).
could demand stranded cost reimbursement as a condition to the service; (ii) whether the TVA should have the right to unilaterally modify the rates, terms and conditions of the service; and (iii) whether TVA’s transmission rate to Cinergy should be capped at the transmission component of the TVA’s retail rate to industrial customers.

Although the TVA’s requirements contract with Bristol contained a four-year notice provision which created a rebuttable presumption of no reasonable expectation of continued service, the FERC set the stranded cost issue for hearing. The FERC noted that the TVA had made arguments “regarding its 20- to 25-year planning horizon” and that Bristol had paid construction work in progress on new TVA projects without objection. However, the FERC refused to uphold the TVA’s claim that it could unilaterally implement changes to the initial rate to be charged for transmission services ordered under sections 211 and 212 of the FPA. Rather, the FERC reaffirmed its policy of employing procedures similar to those under FPA sections 205 and 206 for transmitting utilities that are not public utilities. Accordingly, said the FERC, the TVA could file proposed rate changes upon 60-days’ prior notice, during which time the FERC would act on the proposal. In addition, the transmission customer could file a complaint, which would be acted upon as soon as possible. To further accommodate the TVA’s desire to implement proposed rate changes without delay, the FERC also stated that upon request by a party or on its own motion, a rate change could be effectuated on an interim basis, subject to refund.

The FERC next considered Cinergy’s request to “cap” the network transmission rates charged by the TVA at the transmission component of the rates the TVA charges to its retail customers. The request was motivated by Cinergy’s concern that the TVA was attempting to “cherry-pick” Bristol’s industrial customers by offering to undercut Bristol’s retail prices. Putting aside the parties’ jurisdictional arguments, the FERC declared that its obligation to establish non-discriminatory rates under section 212(a) “may require us to . . . ensure that there is no undue discrimination between the transmission costs” recovered in the TVA’s retail rates and the rates for section 211 transmission service. Nevertheless, the FERC rejected Cinergy’s proposed rate-cap condition because Cinergy had not specifically objected to any aspect of the rate level or methodology the TVA proposed for its net-

105. Establishing interim rates, the FERC observed, would be consistent with its decisions in previous cases in which interim rates were implemented in connection with final orders requiring transmission service when insufficient information was available to establish final rates with precision. The FERC cited a number of cases in which it had employed this procedure: City of College Station, 76 F.E.R.C. ¶ 61,138, at 61,744 (1996); Tex-La Elec. Coop. of Texas, Inc., 69 F.E.R.C. ¶ 61,269, at 62,043 (1994), reh’g pending.
106. Because TVA’s rates are not state-regulated, Cinergy claimed, its rate-cap request did not implicate the jurisdictional concerns cited by the FERC in Order No. 888 in deciding not to order retail unbundling. TVA asserted, in response, that Cinergy’s request amounted to asking the FERC to unbundle its retail rates, stating that such a requirement had not even been imposed on public utilities.
work transmission service.

In City of College Station, Texas, the FERC interpreted section 212(k) of the FPA, which pertains to requests for transmission service to be provided in whole or in part within the Electric Reliability Council of Texas (ERCOT) by ERCOT non-public utilities. Section 212(k) requires that in setting the compensation for such services the FERC must defer, "insofar as practicable and consistent with subsection [212](a)," to the ratemaking methodology used by the Public Utility Commission of Texas (TPUC).

The FERC had made a preliminary determination that an order requiring the City of Bryan, Texas (Bryan), and the Texas Municipal Power Agency (TMPA) to deliver electric energy from Texas Utilities Electric Company to College Station, would meet the standards of sections 211 and 212 of the FPA, and directed the parties to negotiate the rates, terms, and conditions of the transmission service "after the Texas Commission establishes a rate for Bryan's and TMPA's wholesale transmission services to College Station..." The question in College Station II was one of timing -- at what point in the course of a series of orders issued in connection with Texas' open access transmission initiative did the TPUC's transmission ratemaking methodology become sufficiently established such that the parties should begin negotiations. That guidepost was reached, said the FERC, when the TPUC set permanent ERCOT-wide transmission rates. In so ruling, the FERC rejected contentions that: (i) the appropriate juncture had been reached earlier in the TPUC proceeding, where TPUC set temporary rates for transmission service to College Station but explicitly said that they were to be replaced by permanent ERCOT-wide transmission rates as soon as they were established; and (ii) the appropriate juncture would not be reached until the TPUC's order became final under Texas law.

2. Order Nos. 889-A and 889-B

Order No. 889 obligates any public utility that owns, operates, or controls facilities used for the transmission of electric energy in interstate commerce to develop or participate in an Open Access Same-Time Information System (OASIS) and abide by certain standards of conduct.

Order No. 888-A made changes in the policy on discounts and necessitated that the FERC enact amendments to the posting requirements and

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109. 80 F.E.R.C. ¶ 61,375 (1997) [hereinafter College Station I].
standards of conduct which the FERC did in Order No. 889-A. 114 Order No. 889-A requires a utility to publicize on an OASIS—and may do so anywhere else—any offer of discounts on basic transmission service. The same rule applies to discounts on ancillary services in support of the transmission provider’s basic transmission service. On the other hand, a utility need not post on OASIS offers of discounts for other ancillary services.

Order No. 889-A also changes the content of notification. Utilities must post transactions involving affiliates and unaffiliated providers in the same fashion, except that identifying the affiliate and the identity of parties may no longer be masked. Except for next-hour service, parties must post requests for transmission and ancillary services on the OASIS before utilities respond to them.

Implementation of the OASIS proceeded along two lines: the OASIS working groups and compliance filings. In Order No. 889-A, the FERC declared that all negotiations between transmission providers and customers must take place on the OASIS and directed the How Working Group to propose the necessary changes in the Standards and Protocol document to accomplish that goal. However, the FERC suspended, until after review of the How Working Group’s report, (1) the requirement in Order No. 889 and 889-A that the data elements that comprise the templates in the OASIS Standards and Protocols document be fixed in sequence and number, without any additions or deletions, and not differ from OASIS node to OASIS node; and (2) the requirement that all ancillary services provided in support of basic transmission service be purchased exclusively and individually in transactions conducted on the OASIS.115

Recently, the FERC ordered utilities to post on the OASIS organization charts and job descriptions for transmission and marketing departments as well as parts of the company involved in retail wheeling.116 Utilities must indicate which generation and ancillary services employees perform marketing duties and which deal with transmission. The FERC Hotline will furnish guidance in writing to utilities seeking clarification of the standards, such as what matters employees may communicate outside the OASIS. Utilities must also indicate the type of security they will create to ensure separation of information between marketers and transmission employees. The FERC ordered utilities to revise their standards of conduct accordingly.

A waiver of the OASIS requirements is appropriate (1) if the applicant owns, operates, or controls only limited and discrete transmission facilities, or (2) if the applicant is a small public utility117 that owns, operates, or controls an integrated transmission grid, unless it is a member of a tight power pool, or other circumstances are present which indicate that waiver would not be

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114. Id.
117. To qualify as a small public utility, the applicant must meet the Small Business Administration definition of a small electric utility, i.e., disposes of no more than 4 million Mwh of electricity annually. 81 F.E.R.C. ¶ 61,369, at n.23 (citing Order No. 888, at 31,896-97).
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justified.\textsuperscript{118} Any waivers of Order No. 889 will remain effective until the FERC takes action in response to a complaint.\textsuperscript{119} The FERC will consider requests for waivers of Order No. 889 made by non-public utilities using the same standards it applies to requests for waiver made by public utilities.\textsuperscript{120}

The FERC permits, but does not require, utilities to use a regional OASIS.\textsuperscript{121} While it is acceptable to post a notice about approved changes in tariff terms and conditions on the OASIS, any revised terms and conditions must be reflected in the tariff and cannot be self-effected by reporting them on the OASIS.\textsuperscript{122} The FERC has established a timetable for available ATC implementation based upon implementation of Phase II of the OASIS. Until Phase II of OASIS implementation is completed, the FERC will entertain complaints that the ATC was computed improperly or that it is being applied with undue discrimination, but will not entertain complaints that the descriptions are unclear or not standardized.\textsuperscript{123}

3. Deregulation of Power Sales: Market-Based Pricing

At the end of 1997, 300 independent marketers (i.e., unaffiliated with a public utility) had received authority from the FERC to charge market-based rates for wholesale sales of energy and capacity; ten applications were pending. Seventy-nine marketers affiliated with a public utility had received market rate authority; twelve applications were pending. Sixty-two investor-owned public utilities had received authority; six were pending. Finally, nine non-FERC-regulated entities had received market-rate authority; three applications were pending.

a. Inter-Affiliate Transactions

The FERC generally precludes a market-rate applicant from selling power to or purchasing power from an affiliate\textsuperscript{124} except pursuant to a separate filing under Section 205 of the FPA. Most efforts by utilities to limit the scope of this requirement have not been successful.\textsuperscript{125}

The FERC, however, did accept tariff amendments filed by Detroit Edison Company (Detroit Edison) that would allow it to sell power to affiliates

\begin{enumerate}
\item[120.] \textit{Southern Illinois Power Coop.}, 80 F.E.R.C. ¶ 61,341 (1997).
\item[121.] \textit{American Elec. Power Serv. Corp.}, 78 F.E.R.C. ¶ 61,070 (1997).
\item[122.] \textit{id. at 61,268. See also Allegheny Power Sys., Inc.}, 80 F.E.R.C. ¶ 61,143, at 61,547 (1997).
\item[124.] Note that once a utility publicly releases its intention to merge with another utility or utilities, the FERC will rescind that utility's ability to sell or purchase energy at market-based rates to the companies it intends to merge with, even before any merger pleadings are filed. \textit{See Delmarva Power & Light Co.}, 76 F.E.R.C. ¶ 61,331, at 62,583 (1996).
at negotiated rates subject to a cost-based price cap. Detroit Edison represented that sales under the proposed tariff would be at a price no lower than its system's incremental cost of energy, and no higher than the cost-based price caps set forth in another previously-accepted Detroit Edison tariff that provided for cost-based sales to unaffiliated customers. Detroit Edison committed in the filing that if it sells to DTE Energy Trading at a discount below the cost-based ceiling rate, it will offer the same discount to similarly-situated unaffiliated customers.

As filed, the FERC stated that it was concerned that Detroit Edison may have an incentive to transact in ways harmful to its captive ratepayers. Thus, the FERC conditioned its acceptance of the tariff on Detroit Edison's commitments: (1) "to sell power to DTE Energy Trading only at a rate that is no lower than the rate it charges non-affiliates," (2) "with respect to any power it offered to its affiliates, Detroit Edison must make the same offer to unaffiliated entities at the same time through its electronic bulletin board," and (3) Detroit Edison must simultaneously post the actual price charged to DTE Energy Trading for all transactions. 27

b. Arms Length Transactions

Generally, the FERC will grant an applicant authority to engage in wholesale sales of power and energy with unaffiliated entities at market-based rates if the applicant and its affiliates do not have, or have adequately mitigated, market power in generation and transmission and cannot erect other barriers to entry.

i. Generation Market Power

In analyzing an applicant's generation market power, the FERC will assess whether the applicant's and its affiliates' market shares of installed and uncommitted capacity exceed levels that the FERC has previously found to be acceptable. However, if an intervenor presents specific allegations of transmission constraints that are relevant to the generation dominance analysis, the FERC will generally only conditionally approve the market-rate tariff and set the issue of generation dominance relative to the alleged transmission constraints for hearing. An applicant may, however, avoid a hearing on this issue by committing not to sell at market rates within areas affected by the

transmission constraint.\textsuperscript{130}

To define the relevant market for the generation dominance analysis, the FERC relies on the traditional hub-and-spoke methodology. The FERC has rejected arguments that it is inconsistent to rely on a hub-and-spoke analysis for determining generation dominance in the market-based rates context,\textsuperscript{131} despite the fact the FERC, in the Merger Policy Statement, stated that the hub-and-spoke methodology has certain drawbacks. The FERC noted that merger applications do not present the same time constraints as do market rate applications, which must be acted on within the sixty-day FPA notice period. Moreover, since merger applications present more significant issues of competitiveness and market power, due to the potential reduction in the number of market participants and the impracticality of undoing a merger once approved, concerns not present in the market rate application context, the FERC concluded that it was neither necessary nor appropriate to change from the traditional hub-and-spoke generation dominance screen.\textsuperscript{132}

ii. Transmission Market Power

If the market-rate applicant is a transmission-owning public utility or an affiliate of a transmission-owning public utility, the filing of an open access transmission tariff by the transmission-owning utility is usually sufficient for the FERC to find that transmission market power has been sufficiently mitigated.

iii. Affiliate Abuse/Reciprocal Dealing

The FERC also requires that there be no reciprocal dealing\textsuperscript{133} or abuse of affiliate relationships. Interested parties can monitor transactions reported by utilities selling at market-based rates for any reciprocal dealing and can file a complaint alerting the FERC as to any circumstances that may justify the suspension of market-based rate authority. An applicant can generally meet the affiliate abuse requirement by filing a code of conduct governing the interaction of the applicant and its affiliates. This code of conduct must require that any market information the applicant shares with its affiliates be simultaneously disclosed to the public. This requirement extends to "any communication concerning the power or transmission business, broker related or not, present or future, positive or negative, concrete or potential, significant or slight."\textsuperscript{134}


\textsuperscript{134} Montana Power Co., 78 F.E.R.C. § 61,005, at 61,012 (1997). See also Consolidated Edison of
There is no need for a code of conduct, however, where the market rate applicant is a cooperative utility unaffiliated with any utility with captive ratepayers. Since a cooperative’s ratepayers are also its owners, any profits earned by the cooperative will inure to the benefit of the cooperative’s ratepayers.\(^\text{135}\) There is also no need for a code of conduct if the utility is not affiliated with a registered holding company and has no affiliates engaged in electric service.\(^\text{136}\)

For market rate applicants that are affiliated with a natural gas or oil pipeline or distribution company, the FERC routinely notes that if the market rate applicants or any of their affiliates “deny, delay or require unreasonable terms, conditions, or rates for fuel or services to a potential electric competitor” of the applicants, then the competition may file a complaint with the FERC that could result in a revocation of the applicants’ market rate authority.\(^\text{137}\)

Market rate applicants must explicitly state separate prices for generation, transmission, and ancillary services in their market rate tariff.\(^\text{138}\) This can be accomplished by stating in the tariff that the market rate applicant will file a service agreement pursuant to its open access tariff for any transmission or ancillary services it or its customer needs with respect to power sold under the market rate tariff.\(^\text{139}\)

4. Stranded Costs

The FERC set for hearing Duke Power Company’s (Duke) request to recover stranded costs as transmission service surcharges in future transmission rates from two departing wholesale requirements customers.\(^\text{140}\) The FERC rejected Duke’s request to recover stranded costs as exit fees contained in proposed amendments to its existing power sale agreements with its customers. Duke argued it had a reasonable expectation that it would continue to serve the customers and that the $19.4 million it sought to recover was derived from the revenues lost formula in the Open Access Rule and from additional related operational costs.

El Paso Electric Company’s (El Paso) franchise agreement with the City of Las Cruces, New Mexico, expired in 1992, and Las Cruces indicated its intention to form a municipal electric utility and purchase power from another supplier. Las Cruces, currently a retail customer of El Paso, subsequently ini-


tiated proceedings to condemn and acquire El Paso's distribution facilities in order to form an operating municipal utility system. Unable to reach agreement on the reasonableness of El Paso's stranded cost estimate, Las Cruces requested a determination from the FERC that El Paso had no reasonable expectation that it would continue to serve the city and, therefore, that Las Cruces would not owe stranded costs to El Paso if it purchases power from another supplier using El Paso's transmission system. El Paso disputed Las Cruces's claim, arguing that it had a reasonable expectation to continue serving Las Cruces at retail. The FERC set the issue for hearing.4

At the request of the City of Alma, Michigan (Alma), the FERC set for hearing the issue of whether Consumers Energy Company (Consumers) may recover stranded costs from Alma, an existing retail customer that will become a competitor and wholesale customer when it constructs a municipal electric system.142 Alma argued that Consumers will not have the $56.1 million in stranded costs that it claims because Consumers needs new resources to meet its growing load. Consumers, conversely, have argued that it has a reasonable expectation of serving Alma for the next thirty years.

The FERC also rejected a proposed stranded cost surcharge by Central Vermont Public Service Corporation (Central Vermont). Central Vermont had submitted for filing a notice of cancellation of the rate schedule under which it provides wholesale requirements service to its affiliated distribution subsidiary, Connecticut Valley Electric Company (Connecticut Valley). Connecticut Valley had been directed by the New Hampshire Public Utilities Commission to terminate its wholesale contract with Central Vermont as part of New Hampshire's retail open access plan for the state. Central Vermont proposed to add a stranded cost surcharge to its open access transmission tariff for deliveries of power over its transmission system to retail customers in the service area of Connecticut Valley. Because Central Vermont did not propose to assign stranded costs directly to Connecticut Valley, but rather to its retail customers, the FERC ruled that Central Vermont's filing did not qualify as an appropriate stranded costs recovery proposal. Instead, the FERC stated it would allow a wholesale supplier to seek to recover stranded wholesale costs either through an exit fee amendment to the requirements contract or through rates for wholesale transmission services to a departing wholesale requirements customer that obtains power from a new generation supplier through the use of the utility's open access transmission tariff.

The FERC also rejected Central Vermont's alternative request that the FERC approve the stranded cost recovery proposal by treating this case as one with cost-shifting potential arising in a multi-state context or as one involving a utility restructuring. The FERC noted however, that since the parties contemplated termination of Connecticut Valley's contract prior to its expiration date, Central Vermont could make a filing to amend the contract

141.  See City of Las Cruces, New Mexico, 80 F.E.R.C. ¶ 61,160 (1997).
and include an exit fee. 143

5. Reliability

Reliability issues have received increased attention in the past year. Among the more notable developments are:

- The Department of Energy's Reliability Task Force issued a series of interim reports concluding that the authority of the FERC over reliability should be expanded and that a self-regulating reliability organization with the authority to enforce mandatory compliance is needed.
- The President's Council on Critical Infrastructure Protection recommended a new federal structure to anticipate and respond to various types of attacks, including "cyber attacks," on all of the nation's infrastructure, including electric utilities.
- NARUC adopted a resolution calling on Congress to authorize states to form voluntary regional bodies with broad authority over issues such as transmission siting.
- The North American Electric Reliability Council issued its "Blue Ribbon Panel Report" recommending a federally sanctioned and overseen, self-regulating entity with authority over reliability and the continued need for regional reliability organizations.
- The Western Systems Coordinating Council adopted the concept of a regional reliability organization with broad representation from all segments of system users. The organization would derive its authority by contracts among all system users, filed as tariffs at the FERC.
- Members of the New York Power Pool proposed the first statewide reliability organization, the New York State Reliability Council (NYSRC), to address reliability issues that are of special concern in New York. The ISO will implement and enforce rules created by the NYSRC.
- Three pieces of legislation were introduced this past year that have possible impacts on reliability. In the first proposed bill, the FERC would have authority to establish national electric reliability standards and could establish national and regional reliability councils whose reliability recommendations the FERC could adopt. 144 The second proposed bill would establish ISOs to operate portions of the national grid, and vest the FERC with authority to oversee ISOs and ensure transmission reliability. 145 The third proposed bill would establish a national electric reliability council under FERC oversight which would establish reliability standards and have the ability to enforce those standards. 146

B. Congress

The First Session of the 106th Congress witnessed many hearings, speeches, and bill introductions addressing the restructuring of the electricity industry, but little movement toward enactment of legislation.

Only one bill was acted on by a legislative committee, and this occurred in the Senate. The “Public Utility Holding Company Act of 1997” would repeal the provisions of the 1935 Public Utilities Holding Company Act (PUHCA) and replace them with a far less restrictive regulatory scheme applicable to utility holding companies. More specifically, this bill would do away with the restraints on geographic and product diversification contained in PUHCA, while clarifying and enhancing the authorities of federal and state regulators to gain access to information about the activities of affiliates of electric and natural gas public utilities.

In the House, Representative Dan Schaefer re-introduced the electricity restructuring legislation he had introduced in the previous Congress. This legislation is intended to provide all customers with a choice of suppliers by no later than the end of the year 2000. The bill does not force states to adopt retail access programs, but provides them an opportunity to do so which, if not taken, triggers a requirement imposed on the FERC to establish and implement such retail access. Among the other provisions of the legislation is one which requires sellers of electricity to meet a portfolio standard for generation of renewable energy.

Another piece of legislation introduced in this Congress would require the states to implement retail access programs and would prohibit utilities from recovering costs rendered uneconomic by the introduction of competition. Other proposed legislation would not impose a customer choice mandate upon the states, but instead would allow utilities to make the decision on providing open access and reward them with certain deregulation benefits, including repeal of PUHCA, if they choose to do so.

C. The States--Legislation, Regulatory Actions, Stranded Costs, Restrictions on Utility Affiliates

1. California

California continued to be at the forefront of electricity restructuring in 1997. However, the California Public Utilities Commission (CPUC) delayed implementation of electric competition in the state from the originally anticipated date of January 1, 1998, to no later than March 31, 1998, due to problems in implementing new software systems. The FERC ruled that the California restructuring should not take effect until “all of the necessary fea-

149. See also EDISON ELECTRIC INST., RETAIL WHEELING & RESTRUCTURING REPORT (Norman Jenks ed., 1997).
tures are in place to ensure reliable grid operations . . . [and there has been] . . . sufficient pre-operational testing."

The CPUC approved utility plans to allow consumers direct access to other power providers and issued plans for introducing competition into the provision of billing and metering. The CPUC also determined that utilities and their affiliates should be treated as separate corporate entities and keep separate books and records.

The CPUC also established rules for the recovery of transition and un-economic costs. Under these rules, above-market costs related to generation, such as generation plants, nuclear settlements, and QF contracts, will be recovered through a "competition transition charge" (CTC) in effect through the year 2001. Costs associated with power purchase contracts, including QF contracts in place as of December 20, 1995, will be collected for the duration of the contract. Employee-related transition costs will be covered by the CTC through 2006.

In an additional effort to facilitate the transition to competition and allow customer savings during the transition cost recovery period, the CPUC approved the rate reduction bond applications of the three major investor owned utilities. The bond issuance should allow a ten percent cut in total electric bills for the 1998-2001 transition cost recovery period. The bonds, which will be retired in 2008, will be repaid by assessing an additional charge on residential and small business customer bills of less than two cents per kWh beginning in 2002.

2. Illinois

On December 16, 1997, Governor Jim Edgar signed into law a bill restructuring the state's electric utility industry and providing most residential customers with a fifteen percent rate reduction beginning August 1, 1998, and an additional reduction of five percent on May 1, 2002. The new restructuring law also introduces a competitive electricity market on May 1, 2002, under which all electricity purchasers in the state will be allowed to choose their supplier. The new law provides for recovery of stranded costs through a transition charge mechanism. That mechanism is available through the end of 2006, but can be extended for up to an additional two years for utilities that still have unrecovered stranded costs after 2006.

3. Maine

Maine mandated retail competition as a matter of state energy policy.

through its enactment of comprehensive restructuring legislation in May.\textsuperscript{154} Customer choice will begin on March 1, 2000, and the larger investor-owned utilities must divest all of their generation assets and purchased power contracts by then. The Maine Yankee nuclear power plant must be divested by January 1, 2009. The distribution utilities, Central Maine Power and Bangor Hydro-Electric, must connect the distribution service customers in their service areas but they cannot sell power to them at retail.\textsuperscript{155}

4. Maryland

The Maryland Public Service Commission (PSC) decided that retail competition should be phased in beginning in April 1999.\textsuperscript{156} The timetable provides for one-third of each rate schedule's load to choose its electricity supplier by July 1, 2000, progressing to two-thirds by July 1, 2001, and full open access by July 1, 2002.\textsuperscript{157} The PSC stated that it will provide Maryland utilities with a fair opportunity to recover their verifiable and prudently incurred stranded costs subject to full mitigation.

5. Massachusetts

Governor Paul Cellucci signed a new electric restructuring bill that would implement retail access in March of 1998.\textsuperscript{158} The new law also gives state ratepayers a ten percent reduction on their electricity bills on March 1, 1998. It would lock in that cost reduction for a seven-year period and provide for an additional five percent reduction on September 1, 1999. The new law allows recovery of 100 percent of utility stranded costs. These costs are recoverable over a ten-year transition period provided that the costs were incurred prior to March 15, 1995. Massachusetts utilities will be allowed to recover 100 percent of their stranded costs through securitization only if they divest their non-nuclear plants or transfer them to an affiliate. The new statute also requires all Massachusetts electric utilities that have not previously filed restructuring plans to do so.

6. Michigan

The Michigan Public Service Commission has ordered the state's utilities to make available to all customer classes incremental blocks of 2.5% of direct access capacity annually from January 1, 1998, through January 1, 2001. All remaining customers will have customer choice as of January 1, 2002.

\textsuperscript{154} H.R. 1274, 118th Leg., 1st Spec. Sess. (Me. 1997).
\textsuperscript{155} Maine Public Service is exempt from many of the law's restructuring provisions.
7. Montana

In 1997, a comprehensive restructuring statute was enacted that allows large customers (with a load of greater than 1000 kW) to have retail choice beginning on July 1, 1998. Smaller customers can either aggregate their loads (provided that their demand is in excess of 300 kW) or participate in a pilot starting on the same date.\(^{159}\)

8. Nevada

Nevada’s Public Utility Commission (PUC) is to begin the introduction of retail competition on December 31, 1999, for any electricity-related services found to be “potentially competitive.” The restructuring law does not mandate a specific phase-in schedule.\(^{160}\) It does, however, authorize the PUC to order divestiture and provides for the licensing of alternative sellers and full stranded cost recovery for the costs that the PUC determines to be recoverable.

9. New Hampshire

The New Hampshire Public Utility Commission (PUC) released its final plan for restructuring the state’s electric industry which adhered generally to the preliminary PUC restructuring plan.\(^{161}\) The original target date for full retail competition, January 1, 1998, has now slipped to July 1, 1998.

The most controversial feature of the plan is the PUC’s decision to limit recovery of utility stranded costs by means of a benchmark based on average electric rates for New England utilities. The stranded cost limitation would disallow approximately forty percent of stranded costs expected to be incurred by New Hampshire utilities. Generation plants with “negative stranded costs,” i.e., with value in excess of book value, would be netted against other plants to derive total stranded cost for a utility.

The stranded cost recovery limitations of the plan provoked an immediate reaction from Public Service Company of New Hampshire (PSNH), the state’s largest utility. PSNH sued in U.S. District Court in Rhode Island to enjoin the PUC’s application of the new stranded cost provisions. PSNH obtained the requested injunction, which was subsequently broadened to clarify the enforceability of a 1989 agreement between New Hampshire and Northeast Utilities, PSNH’s parent.\(^{162}\) Efforts to resolve this litigation through mediation were unsuccessful. The district court’s assertion of jurisdiction and injunction are now pending on appeal before the U.S. Court of Appeals for the First Circuit.

\(^{159}\) S.B 390, 55th Leg., Reg. Sess. (Mont. 1997).
10. New Jersey

The New Jersey Board of Public Utilities’ (Board) restructuring plan calls for a phase-in of retail competition beginning in October 1998, with full retail choice by July 2000, the opportunity to recover stranded costs by means of a four to eight year market transition charge, and rate reductions in the range of five to ten percent. Pursuant to the plan, each electric utility submitted a rate unbundling filing, a stranded cost filing, and a restructuring filing on July 15, 1997.

11. New York

The New York Public Service Commission (NYPSC) continued to press forward with its own restructuring program. On May 16, 1996, the NYPSC issued an order to introduce retail competition in the state, proposing that retail wheeling be made available to all customer classes by 1998. The order required all of the state’s utilities (except Niagara Mohawk, which began its restructuring plan before issuance of the NYPSC’s order) to file restructuring plans addressing, among other issues, the details of how best to implement retail wheeling. During this past year, the NYPSC, individual utilities, and customers negotiated the terms of the individual restructuring plans.

12. Oklahoma

Oklahoma enacted its Electric Restructuring Act of 1997, which ensures that direct access by retail consumers is implemented by July 1, 2002. The start date for retail access will be deferred if a more uniform state tax structure has not been adopted by then.

13. Oregon

The House Committee on Power Deregulation introduced a bill which addressed electric utility restructuring. However, the bill was not forwarded to the floor prior to the end of the legislative session. If enacted, the bill would have allowed all Oregonians to choose electricity suppliers by the year 2000. The bill has been recast and will be debated when the legislature meets again in 1999. The Oregon Public Utility Commission also opened a docket to examine how a utility’s stranded costs should be calculated. A final order in this docket is expected in early 1998.

14. Rhode Island

The Utility Restructuring Act of 1996 (the URA) provides for the

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phasing in of retail open access in Rhode Island under a three-step process beginning on July 1, 1997. The FERC has approved settlements involving New England Power Company and Montaup Electric Company implementing the URA.

II. STRUCTURAL CHANGE IN THE INDUSTRY

A. Mergers

1. Generally

Since the Merger Policy Statement, the FERC has cleared its backlog of merger cases, issuing fifteen final orders in 1997 and a major clarification of the scope of its FPA section 203 jurisdiction. The FERC approved all but one of the proposed mergers, though it conditioned several mergers upon acceptance of various market power mitigation remedies. Applicants accepted the FERC's conditions in some cases, while others terminated their merger proceedings or later collapsed under subsequent state orders.

In its Merger Policy Statement, the FERC promised that those merger applications passing the Competitive Analysis Screen laid out in Appendix A would be reviewed on a fast track with no hearing and a final order ordinarily within five months. Other cases would be reviewed on a regular track with a final order ordinarily within twelve to fifteen months. So far the FERC has met its timelines. Nine of the fifteen cases were decided on a fast track in five months or less, while the six other cases took between seven and nineteen months. The two cases taking longer than fifteen months both began well before the Merger Policy Statement.

The FERC has suggested an extra fast track for dispositions of power


173. Turnaround time is measured from the date of the applicants' last amendment to their merger application to the date of the final order.
marketer jurisdictional facilities and for mergers of entities not in a jurisdictional business but owning jurisdictional subsidiaries.\textsuperscript{174} Such mergers could use an abbreviated or no Appendix A Competitive Analysis Screen and may not require the usual sixty day intervenor comment period. However, requests for expedited action must be fully supported and should discuss "how long it took from the time the contract was signed until the date of filing with the FERC."\textsuperscript{175}

A “completed” application supplying the data required by Appendix A speeds the FERC’s analysis,\textsuperscript{176} but Appendix A does not specify all the data required. The Merger Policy Statement recognized the problem and promised a further rulemaking on filing requirements.\textsuperscript{177} That rulemaking has not yet been issued, but it is expected soon.

2. Jurisdiction

This past year the FERC announced a major clarification of its merger jurisdiction.\textsuperscript{178} Regardless of the form of the corporate rearrangement, the FERC will now assert FPA section 203 jurisdiction whenever direct or indirect control over a public utility and its jurisdiction facilities is transferred from one company to another. Thus, in \textit{Enova}, a merger between two holding companies that were not public utilities still required FERC approval, because the merger resulted in the transfer of the jurisdictional facilities of Enova subsidiaries, San Diego Gas & Electric Company and Enova Energy (a power marketer), to a new holding company. The FERC made it clear that FPA section 203 jurisdiction also attaches to the transfer of paper facilities alone, such as the books and records and wholesale power sale contracts of a power marketing subsidiary.\textsuperscript{179}

3. Effect on Horizontal Competition

Horizontal market power issues are posed by a merger’s concentration of power supply in a relevant market.\textsuperscript{180} The Merger Policy Statement

\textsuperscript{174} \textit{Enova Corp.}, 79 F.E.R.C. at 61,496-97 (1997) (commenting that such cases “may be amenable to expeditious action”). \textit{See also Morgan Stanley Capital Group, Inc.}, 79 F.E.R.C. \$ 61,109 (1997) (approving the merger of Morgan Stanley with Dean Witter in slightly more than one month).

\textsuperscript{175} \textit{Enova Corp.}, 79 F.E.R.C. \$ 61,107, at 61,497.


\textsuperscript{177} \textit{Merger Policy Statement}, 3 F.E.R.C. STATS. & REGS. \$ 31,044, at 30,111 n.3.


\textsuperscript{179} \textit{Noram Energy Serv., Inc.}, 79 F.E.R.C. at 61,500 (1997) (merging holding company NorAm Energy and its affiliate NorAm Energy Serv., Inc. with holding company Houston Industries and its subsidiary Houston Lighting & Power Company). \textit{See also Portland General Elec. Co.}, 81 F.E.R.C. \$ 61,317 (1997) (asserting FPA section 203 jurisdiction over the transfer of related purchase and sales contracts from one subsidiary to another). Where there are no physical or paper jurisdictional facilities involved, the FERC has no jurisdiction.

\textsuperscript{180} When a merger partner lacks control over any generation or when the merger is between subsidiaries, there is no concentration of supply and thus no need for a horizontal market analysis.
adopted the market power analysis of the Department of Justice Federal Trade Commission Horizontal Merger Guidelines.  

Intervenors have suggested a variety of market power mitigation conditions, but proposals for generation divestiture, stranded cost waivers, prohibitions of applicant dynamic scheduling, and contract open seasons have been rejected by the FERC for failure to show a nexus between the remedy requested and harm done by the merger. The FERC's position on requiring applicant participation in an ISO arrangement, however, appears to have evolved from rejecting it as a condition for the merger to accepting it as an applicant commitment with a broad remedial power.

So far the FERC has consistently refused to involve itself in retail rate issues, specifically refusing to consider the merger's effect on retail competition or rates. In addition, the FERC left for state determination the effect of consolidating gas and electric territories and the possible dumping of expensive gas supplies on the captive customers of an electric utility merger partner. However the FERC advised in dicta, that "as retail markets evolve into regional power markets, it may become more difficult for individual states adequately to examine a merger's impact on such markets."

Ordinarily, the FERC dismisses transmission market power concentration issues by observing that the applicants' open access transmission tariffs (OATTs) fully mitigate any such market power. In three cases, however, applicant control over a physically limited transmission interface could not be mitigated by OATTs. Both the Primergy and the IES cases concerned the Wisconsin Upper Michigan Systems (WUMS) interface connecting the MAPP and MAIN reliability areas. In IES, the FERC emphasized that, with two of the three applicants not economically competing in the WUMS subregion, the FERC's competitive concern was with IES's use of enhanced

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control over the interface to cut off access of WUMS subregion competitors to power outside of WUMS. Likewise, in Public Service Company of Colorado the FERC's concern was with the ability of the merged non-interconnected utilities to maintain the transmission constraint on the western side of Southwest Public Service (SPS), cutting off access of SPS competitors to power from the west. In IES and PSC of Colorado, the applicants agreed to market power mitigation conditions that provided for joint participation in transmission upgrades and guaranteed access. The FERC's suggested conditions were not acceptable to the applicants in Primergy.

4. Effect on Vertical Competition (Convergence Mergers)

In its Merger Policy Statement, the FERC acknowledged that it needed to articulate standards for mergers between electric utilities and natural gas companies, known as vertical or convergence mergers. In its first two vertical merger cases, the FERC laid out its concerns with the incentive of a merged company to restrict gas transportation to electricity generators competing with its electric utility partner, but found no cause for concern since there were sufficient alternative gas suppliers to competing generators.

In three other vertical merger cases with less significant competitive concerns, the FERC added to its vertical market power analysis. In Destec Energy, Inc., the FERC analyzed upstream competitive conditions in two upstream markets, delivered gas and wellhead gas (gas reserves, gathering facilities, and production area pipelines), and how those markets affected four geographically scattered downstream markets where NGC Corporation and Destec Energy, Inc. both owned generation facilities. The wellhead gas market posed no competitive concerns because the market had already been recognized as workably competitive in Order Nos. 436 and 636. The delivered gas market posed no problems due to the many alternative gas suppliers and the lack of contractual control of pipeline capacity. Thus, the FERC did not analyze the downstream electricity market and summarily approved

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193. 79 F.E.R.C. ¶ 61,373 (1997) (merging Destec Energy, an independent power producer, with NGC Corporation, a holding company for two natural gas pipeline companies, a power marketer, and other subsidiaries).
the merger without conditions. In *Long Island Lighting Co.*, the FERC considered the merger of a natural gas local distribution company with an electric and gas utility where neither the gas nor electricity service territories overlapped. The FERC summarily approved the merger. Finally, in *PG&E Corp.*, the FERC considered the merger of a power marketing subsidiary of a natural gas holding company with a gas and electric utility. Again, the FERC summarily approved the merger.

5. Effect on Rates

The Merger Policy Statement replaced an analysis of the cost and benefits of a merger with a requirement that applicants negotiate direct wholesale ratepayer protections from merger-related harms such as a rate increase moratorium, or a contract open season. In *Union Electric Company*, the FERC reversed an initial decision that considered the issue of certain contract customers stuck paying more than tariff customers to be a "hybrid issue" requiring an evaluation of the merger's savings. The FERC held that the hybrid analysis improperly revived a cost-benefit analysis of mergers. In *Primergy*, the FERC clarified that rate increase moratoriums are only rate caps that do not prohibit rate decreases, while in *Duke Power Company*, the FERC echoed its Merger Policy Statement, in dicta, that rate increase moratoriums may not provide enough protection if a rate decrease is justified.

6. Effect on Regulation

Where a merger results in a registered holding company, utilities must agree to abide by the FERC's policies concerning intra-corporate transactions for non-power goods and services. The requirement does not apply where the merged company will be an exempt holding company.

Where a state can regulate a merger, or at least has not told the FERC that it cannot so regulate, the FERC finds that the merger has no adverse

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199. Id. at 61,739.
effect on state regulation and will not defer its action until after a state acts. Also, a merger's diminution of state ratemaking authority by transferring state oversight to the FERC is not a valid objection to the merger when the state can regulate the merger.

**B. Independent System Operators**

1. California

Under the directives of state enabling legislation, California and the stakeholders involved in the negotiation process have elected to create a non-profit public benefit corporation, the California Independent System Operator Corporation (ISO) to run the transmission system, and a second, separate corporation to conduct a daily energy auction, the California Power Exchange Corporation (PX).

The ISO is to provide all eligible customers open and non-discriminatory access to the ISO Controlled Grid, which are the facilities that Participating Transmission Owners (PTOs) turn over to the control of the ISO. All access to the ISO Controlled Grid will be through Scheduling Coordinators, which are the only entities allowed to schedule with the ISO. This feature is designed to permit retail direct access and allow the ISO a manageable number of scheduling entities.

The PX will administer a day-ahead and hour-ahead auction of energy by accepting bids from suppliers and purchasers, including demand-side bids. The PX tariff also provides procedures for it to deal with overgeneration conditions that can exist during periods of low demand and requires that the PX make itself available to forward bids for ancillary services to the ISO. The PX will also forward adjustment bids to the ISO, which the ISO will use to manage congestion. The PX will calculate market-clearing prices based on an iterative set of bids. The PX also is authorized to conduct an auction for ancillary services for those Market Participants that wish to self-supply ancillary services for PX energy.

The initial filings of the ISO and PX tariffs generated a substantial volume of initial and reply comments. The FERC, perceiving that the filed tariffs were the subject of ongoing negotiation and evolution, directed the stakeholders to “put down their pens” and submit revised tariffs that reflected all revised proposals. In response to the ISO’s and PX’s revised tariffs, the FERC provided interim and conditional authority for the corporations to commence operations, under certain conditions and subject to future studies and reporting by the ISO and PX. With respect to the governance of both the ISO and the PX, the FERC accepted the general

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principle of governance by stakeholder boards as they were proposed. However, the FERC rejected, as inconsistent with its jurisdiction, a role for a state-created Oversight Board that was proposed to have a continuing function in the appointments of Governors to the ISO and PX Boards and some review of ISO decisions. The FERC also rejected the proposal to allow ISO and PX employees to own limited shares of the stock of Market Participants.

In late December 1997, the ISO and PX announced that the need to test their data processing systems and provide additional training to their staffs required that they postpone commencement of operations until no later than March 31, 1998. The FERC directed that both entities provide fifteen days advance notice before operations are set to commence. 209

2. PJM

The FERC conditionally approved a proposal by nine of the ten members of the Pennsylvania-New Jersey-Maryland Interconnection (PJM) to restructure the PJM Power Pool and establish an ISO. 210 The FERC approved a “two tier” governance structure under which an independent seven member Board of Managers (PJM Board) would be responsible for supervision and oversight of the day-to-day operations of the PJM Power Pool. A Members Committee, consisting of five sectors representing generation owners, other suppliers, transmission owners, electric distribution and end-use customers, would elect and provide advice to the PJM Board.

The FERC accepted the proposed zonal rate design, subject to its being replaced by a regional system-wide rate design methodology within five years. The FERC also accepted the proposed locational marginal pricing (LMP) methodology for recovery of transmission congestion costs, but acknowledged that the lack of price certainty is a limitation of LMP. To address this concern, the ISO was directed to initiate a process for the development of a congestion pricing proposal that provides greater price certainty.

The FERC also questioned whether PJM’s historical practice of withholding firm transmission interface capability as a substitute for installed generating reserves is consistent with its open-access policies. Contradicting its own recent precedents, 211 the FERC ordered that all existing bilateral transmission service and bundled wholesale power agreements be modified to eliminate the potential for incurrence of multiple (pancaked) transmission service charges within the PJM control area.

3. NEPOOL

The thirty-third amendment to the New England Power Pool

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209. Id.
Committee on Electric Utility Regulation

NEPOOL Agreement effected a comprehensive restructuring of NEPOOL through, in part, an amendment to transfer control of the region’s transmission grid and generation operation to an ISO. NEPOOL filed a supplement to the Agreement providing for interim arrangements crucial to planning for regional needs during the 1997 summer period. The FERC conditionally accepted the agreement on an interim basis and required NEPOOL to comply with eleven conditions with respect to the establishment of the ISO. The FERC presented these conditions as FERC ISO Principles, which seek mainly to ensure fairness, reliability and efficiency in the management of the ISO and the independence of its operations from the owners of the transmission grid. Later in 1997, NEPOOL filed the thirty-fourth agreement to meet those eleven conditions and asked for authorization of market-based rates for power sold by its members.

4. NYPP

The proposed restructuring of the New York Power Pool (NYPP), pending before the FERC, presents certain matters of generic interest, including locational marginal pricing (LMP) of transmission congestion and the formation of three new institutions—an ISO, the New York Power Exchange, and the New York State Reliability Council (Council). NYPP’s ISO governance structure is based to a large extent on the NEPOOL governance proposal approved by the FERC. NYPP proposes that the ISO’s Board of Directors be comprised of ten members, none of which will have any affiliation with any market participant.

NYPP’s plan to form an ISO and related market institutions differs from other electric restructuring proposals in that a separate body, the Council, would be created to establish bulk power system reliability rules and monitor the ISO’s compliance with those rules. The proposed Council would be governed by a thirteen-member Executive Committee consisting of representatives from each of the eight NYPP member transmission providers, one representative each from non-utility generators, large industrial and commercial customers, and municipal electric systems, respectively, and two representatives who are not affiliated with any market participant.

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213. These filings are pending before the FERC.
214. See Central Hudson Gas & Elec. Corp., Nos. ER97-1523-000 and OA97-470-000. (Several parties, including certain power marketers, independent power producers, cooperative and municipal customers, electricity consumers, and the New York Public Service Commission, have either protested NYPP’s restructuring filing or supported modifications to the proposal).
5. Midwest

Initially envisioned as spanning eleven states and 90,000 miles of transmission lines, the Midwest ISO appears to be back on the drawing board as utilities consider whether a geographically smaller, less diverse ISO would make more sense. In December 1997, concerns were raised by a majority of the original members that inclusion of the American Electric Power system would make development of an ISO too difficult. Members questioned whether such a large ISO was needed, especially in light of the pace and scope of restructuring efforts. American Electric Power continues to support a geographically large ISO, believing it will increase reliability and simplify pricing.

6. Pacific Northwest

After over a year of planning, the Pacific Northwest Rockies ISO (IndeGO) looked as if it would be ready for filing at the FERC by the late summer of 1997. But no consensus was reached as more questions were raised regarding cross utility rate subsidies, the significant cost of the system relative to any potential benefits, and whether the Bonneville Power Administration (BPA) should or can legally join. In addition to the questions raised about the BPA, at least one of the original signatories to the plan to develop an ISO has dropped out and another has indicated that it is considering it due to concerns about the impact on retail customers.

Public support seems to be building for an Independent Grid Scheduler (IGS) which would manage scheduling for the coordinated system but would not be responsible for reliability and dispatch. These functions would continue to be handled by the member utilities and the WSCC. How the FERC might view an IGS or IndeGO is unclear, but in the Northwest there is strong sentiment that the system worked well in the past, access was available, and that the ISO concept does nothing to improve the system reliability, scheduling, and dispatch.

C. Federal PMAs

Issues related to the federal power program continue to be a topic of discussion in Congress. A bill to abolish the United States Department of Energy and transfer the United States Power Marketing Administration (PMAs) to the U.S. Army Corps of Engineers, pending a final decision on their status, was introduced. Legislation outlining plans to privatize the Western Area Power Administration, Southeastern Power Administration and the Southwestern Power Administration, was also introduced. Other legislation introduced would require the U.S. Army Corps of Engineers and

218. Of the three ISO proposals that the FERC has reviewed—California, NEPOOL and PJM—none were accepted as filed because they did not sufficiently address the eleven standards of Order No. 888. Neither IndeGO nor the IGS concept meets all eleven standards.
the Bureau of Reclamation to outsource maintenance and improvement work on the generating units at federal dams to the highest bidder. Successful bidders would receive a percentage of the energy resulting from the projected increase in the output of electricity from the projects.

1. Bonneville Power Administration

In the House, two PMA privatization bills contained Bonneville Power Administration (BPA)-related provisions which called for privatizing the BPA and transferring responsibility over BPA to the U.S. Department of Interior. In the Senate, a bill was introduced that would: (1) apply the FERC’s transmission rules to transmission service provided by the BPA; (2) direct the FERC to develop a transition stranded-cost recovery mechanism that assures no undue risk for the United States Treasury or bondholders of securities backed by the BPA; (3) enable the BPA to use proceeds from the sale of any renewable energy credit to repay its debt to the United States Treasury and Washington Public Power Supply system bondholders, and; (4) assure the BPA participation in a FERC-approved and regulated ISO in the Pacific Northwest. Two other significant proposals related to the BPA were unveiled shortly before Congress adjourned for the year, but not introduced, which address concerns related to the future viability of the BPA, and provide a comprehensive restructuring proposal. Both proposals would authorize the BPA to participate under certain conditions in a FERC-approved and regulated ISO in the Pacific Northwest.

2. Tennessee Valley Authority

There were important changes on the appropriations front for the Tennessee Valley Authority (TVA) in 1997. The TVA requested that Congress eliminate the TVA’s $100 million annual federal appropriations for non-power programs, and shift those activities to another arm of the federal government. While legislators from the TVA region expressed serious concerns about the plan, Congressional appropriators still reduced TVA’s fiscal year 1998 funding to $70 million, and called for an elimination of such funding in fiscal year 1999.

Meanwhile, significant legislative proposals related to TVA are pending in Congress. One proposal would require TVA and its distributors to become subject to wholesale and retail competition on January 1, 2002. This bill would also allow TVA to compete in wholesale electricity markets outside its region. Other proposals include allowing potential competitors to compete against TVA within its territory, while keeping TVA’s sales within its existing region, and establishing a twelve-member commission appointed

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225. Id.
by the President to study TVA operations and assess its future role.226

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I. INTRODUCTION

This report focuses on recent developments in environmental law which have the potential to substantially impact the energy industry. Considered first is the United States Environmental Protection Agency’s (EPA) proposal under the Clean Air Act (CAA) to require individual states to revise their environmental regulations concerning the transport of ground-level ozone, the most harmful component of smog, and ozone-precursors in the eastern United States. While couched in general terms, the EPA’s ozone proposals could have a significant and disproportionate impact on the electric power generation industry, particularly older, fossil-fuel electric generating facilities previously subject to relatively little regulation under the CAA. The report examines the EPA’s proposed alternative interpretations of section 110(a)(2)(D) of the CAA and discusses how
resolution of the competing interpretations will determine, to a great extent, the ultimate burden of the EPA's proposal on the electric generation industry. Also discussed are related developments concerning the EPA's response to petitions by several northeastern states to reduce ozone-related emissions from older, coal-fired electric generation facilities.

Second, the report examines environmental enforcement-related developments in the citizen suit area with actual or potential impact on the energy industry. In this regard, the report describes the substantial and growing level of private or "citizen" suit enforcement actions under environmental statutes. The report also examines the basis and nature of citizen suits, including the prerequisites of notice and diligent administrative enforcement, the ongoing violation requirement and recent decisions on standing. As a result of the CAA Amendments of 1990 and more recent EPA rules, private enforcement suits under the CAA, including potential citizen suit actions related to alleged non-compliance by electric generation facilities, can be expected to increase.

II. OZONE TRANSPORT

A. Introduction

The EPA's recent initiatives to combat perceived air quality problems in the United States have been well documented. The most critical initiative from the perspective of electric generators, however, has probably gone relatively unnoticed. In November of 1997, the EPA proposed a requirement that twenty-two states revise their legal regimens for air quality compliance (state implementation plans (SIPs)) to combat the transport of ozone and ozone-precursors in the eastern United States where air quality problems have been most persistent (with the exception of California). The EPA's proposed action would find that the transport of ozone (known as smog) and ozone-precursors from certain states in the eastern two-thirds of the United States across state lines to downwind states (e.g., the Northeast) "significantly contributes" to nonattainment of the national ambient air quality standard for ozone.

Although styled in more general terms, the EPA proposal is aimed directly at the electric power generation industry, which will be affected in far greater proportion than other segments of U.S. industry. Nestled within the proposal is a key legal issue regarding the manner in which the cost of controls would be taken into account in establishing pollution reduction obligations. One proposed interpretation of CAA section 110(a)(2)(D) could bring under stringent regulation scores of older, fossil-fueled electric generating stations currently subject to relatively little regulation under the CAA. As discussed in greater detail below, the

3. Electric generating stations in the South and Midwest tend to be older and more likely to be
resolution of this issue will go far in determining how and on whom the re-
sulting cleanup burden ultimately will fall.

In addition, in early 1998 the EPA and a group of northeastern states
were negotiating a resolution of the states' petitions under CAA section
126, which sought EPA action to reduce emissions from midwestern utilities
believed to cause ozone compliance problems throughout the East. As
discussed below, the agreement reportedly will establish the EPA's proce-
dural response to the states' section 126 petitions in tandem with its previ-
ously mentioned administrative proposals under CAA section
110(a)(2)(D).

B. General Factual Background

Ground-level ozone, the main harmful ingredient in smog, is produced
by complex chemical reactions when its precursors, volatile organic com-
ounds (VOC) and nitrogen oxides (NO$_X$), react in the presence of sun-
light. Electric generation facilities emit NO$_X$ and, in many cases, more than
trace amounts of VOCs. Older, coal-fired generating facilities, many loca-
ted in the Midwest and South, are among the biggest contributors to the
nation's inventory of NO$_X$ emissions. The chemical reactions that create
ozone take place while the pollutants are being transported through the air
by the wind. The result is more severe ozone pollution many miles down-
wind from the source of the chemicals than at the source itself.

The science of ozone formation, transport, and accumulation is com-
plex and still evolving. Ozone is both produced and destroyed by a set of
chemical reactions involving NO$_X$, VOC and sunlight. Emissions of NO$_X$
and VOC are necessary for the formation of ozone in the lower atmos-
phere. In the complex cycle of chemical reactions, however, ozone con-
centrations in an area can actually be lowered by the reaction of nitric ox-
ide with ozone to form nitrogen dioxide; then, as the same air mass moves
downwind and the cycle continues, the nitrogen dioxide forms additional
ozone. The importance of this reaction depends on the relative concentra-
tions of NO$_X$, VOC and ozone, all of which change with time and location.
Sometimes NO$_X$ in the lower atmosphere is beneficial locally but then is
harmful downwind. Air quality modeling is used to predict exactly which
will be the case at any given geographic point.

Ground-level ozone may induce the following negative health effects:

- Increased respiratory symptoms, particularly in highly sens-
sitive individuals;
- Increased hospital admissions and emergency room visits;
- Decreased lung function;
- Inflammation of the lungs;

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fueled by coal. Indeed, many of the generating stations have not been subject either to the EPA's New
Source Performance Standards or to preconstruction review under the EPA's Prevention of Significant
older and more polluting sources often are referred to as "grandfathered."
• Long-term damage to the lungs.

In July 1997, the EPA promulgated a new national ambient air quality standard (NAAQS) for ozone to provide increased protection to the public from these potential health effects.  

Some studies also indicate that current ambient levels of ozone are responsible for damage to forests and ecosystems (including habitat for animal species). Ground-level ozone above background levels is also suspected of causing the loss of several hundred million dollars worth of agricultural crop yield each year. The EPA estimates that full compliance with the newly promulgated eight-hour ozone NAAQS will result annually in preventing about $500 million of crop yield loss.

C. General Legal And Regulatory Background

1. The Clean Air Act

For almost thirty years, Congress has focused major efforts on curbing tropospheric (ground level) ozone. It is fair to say that ozone control has been the centerpiece of the CAA. In 1970, Congress required that the EPA issue and periodically review and revise the NAAQS for ozone and other air pollutants. Congress also required the states to submit SIPs to attain those NAAQS, and Congress included a list of minimum requirements SIPs must meet. In 1977, Congress amended the CAA to provide additional time for areas to attain the ozone NAAQS and to impose specific SIP requirements for those nonattainment areas. These provisions first required the designation of areas as “attainment,” “nonattainment,” or “unclassifiable.” Congress also required that SIPs for ozone nonattainment areas include additional provisions set out in part D of title I of the CAA.

The 1977 amendments included two key provisions focused on interstate transport of air pollutants: (1) the predecessor to current CAA section 110(a)(2)(D), which requires SIPs for all areas to reduce emissions that would have certain adverse downwind effects; and (2) section 126, which authorizes a downwind state to petition the EPA to impose limits directly on upstream sources found to adversely affect that state.

Finally, in 1990, Congress amended the CAA to better address continued nonattainment of the one-hour ozone NAAQS. In its 1990 amendments, Congress required the states and the EPA to review and, if

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necessary, revise the designation of areas as attainment, nonattainment, and unclassifiable under the ozone NAAQS in effect at that time, which was the one-hour standard. Areas designated as nonattainment were generally divided into five classifications based on prevailing air quality conditions within each of the areas. Each classification carries specific requirements, including dates by which the ozone standard must be met.

On a scale of increasing severity of the air quality problem, these classifications are “marginal,” “moderate,” “serious,” “severe” and “extreme.”

It is at least arguable that the 1990 amendments to the CAA reflect a general awareness by Congress that ozone is a regional problem. As described above, ozone and its precursors may be transported long distances across state lines to combine with ozone and precursors downwind, thereby exacerbating the ozone problems downwind. Section 110(a)(2)(D) is the statutory key to the problem of ozone transport. This provision requires a SIP to have provisions preventing sources of air pollutants from contributing significantly to nonattainment problems or interfering with the maintenance of air quality standards in downwind states.

The CAA authorizes the EPA to review a SIP and determine when it is substantially inadequate to meet any CAA requirement, including the requirement to mitigate interstate transport of the type described in section 184 (concerning ozone transport in the Northeast) or section 176A (concerning interstate transport in general). When such a finding is made the EPA must require the state to submit, within a specified period, a SIP revision to correct the inadequacy.

The CAA further addresses interstate transportation of pollution in section 126. Subparagraph (b) of that provision authorizes each state (or political subdivision) to petition the EPA for a finding that emissions from “any major source or group of stationary sources” in an upwind state contribute significantly to nonattainment in the downwind state. If the EPA makes such a finding, it must impose limits on the affected source or group of sources.

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14. Section 110(a)(2)(D) provides, in relevant part, that each SIP must:
   contain adequate provisions — (i) prohibiting, consistent with the provisions of this subchapter, any source or other type of emissions activity within the State from emitting any air pollutant in amounts which will — (I) contribute significantly to nonattainment in, or interfere with maintenance by, any other State with respect to any such national primary or secondary ambient air quality standard ....
17. See Clean Air Act § 126(b), 42 U.S.C.A. § 7426(b) (West 1995).
18. See Clean Air Act § 126(c), 42 U.S.C.A. § 7426(c) (West 1995).
2. Recent Administrative Developments

a. SIP Modifications and Ozone Standards

States have not been able to modify their SIPs to meet the November 15, 1994 statutory deadline for demonstrating attainment of the ozone standard. Moreover, many states have failed to make other SIP submissions required under CAA section 182(c). A major reason for these failures has been that states were not able to address or control ozone pollution transported from the South and Midwest to the East. Accordingly, in 1995 the EPA created the Ozone Transport Assessment Group (OTAG), consisting of representatives of the thirty-seven eastern-most states. Shortly after the OTAG was created, the EPA indicated that it intended to issue a “SIP call” to require states to modify their SIPs to achieve the additional emission reductions necessary to address the ozone transport problem. In January 1997, the EPA published a Notice of Intent in that regard.20 Ultimately, the OTAG issued a very detailed set of recommended emission reductions which it believes are necessary to reduce ozone transport such that downwind areas will be able to attain the ozone NAAQS. These recommendations took direct aim at scores of major electric generating facilities.

In July 1997, the EPA issued its final action to revise the NAAQS for ozone.21 The one-hour standard was replaced by an eight-hour standard at a level of 0.08 parts per million (ppm). The eight-hour standard is based on the three-year average of the annual fourth-highest daily maximum eight-hour average ozone concentration measured at each monitor within an air quality management area. The EPA retained the applicability of the one-hour NAAQS for certain areas to ensure adequate health protection during the transition to full implementation of the eight-hour NAAQS.

At the August 7, 1997 Clean Air Act Advisory Committee meeting, the EPA announced the availability of a document that describes the multiple impacts of NOx emissions on public health and the environment.22 According to the EPA, “in addition to helping attain public health standards for ozone, decreases in emissions of NOx help reduce acid rain, greenhouse gases, nitrates in drinking water, stratospheric ozone depletion, excessive nitrogen loadings to aquatic and terrestrial ecosystems, and ambient concentrations of nitrogen dioxide, particulate matter, and toxics.”22

b. State Petitions Under CAA Section 126

There was more simultaneous administrative activity increasing the pressure on the EPA to achieve emissions reductions from upwind sources, most prominently electric generators. In the fall of 1997, the EPA received petitions from eight northeastern states under CAA section 126 identifying upwind sources of ozone precursors which the states claimed significantly contribute to downwind ozone nonattainment. A section 126 petition, according to the terms of CAA sections 126 (b) and (c), is limited to upwind major stationary sources of ozone precursors (e.g., electric power generators that burn coal) and may not consider other aspects of the emissions inventory, such as minor sources and mobile sources. Moreover, the granting of a section 126 petition would require the EPA itself to impose direct controls on sources, rather than issue a SIP call to the states to impose such controls.

D. The Proposed SIP Call and Electric Generators

1. Process for Requiring Submission of Section 110(a)(2)(D) SIP Revisions

As described above, SIPs for all areas must meet the requirements of CAA section 110(a)(2) which impose limits on sources that affect the ability of downwind areas to attain and maintain the NAAQS. Given the pressure that had built up by 1997 from the downwind states and the legal force of the section 126 petitions, the EPA’s proposed SIP call to the states to address section 110(a)(2)(D) noncompliance came as no surprise. The EPA has proposed that section 110(a)(2)(D) be applied in different ways with respect to each of the two ozone NAAQS, i.e., the one-hour NAAQS and the eight-hour NAAQS. The goal is to have the states responsible for ozone transport to develop SIPs by 1999 that require significant NOx reductions and to fully implement these plans before the summer of 2003.

a. The One-hour NAAQS

Each air quality management area is currently required to have a SIP in place to meet the one-hour ozone NAAQS. Moreover, the EPA has determined that where an area is designated nonattainment for the one-hour ozone NAAQS, that standard will continue to apply until it is determined that the area has air quality meeting the standard.23 Accordingly, each such area is under a current obligation to include provisions in its SIP that will enable the area to meet the requirements of section 110(a)(2)(D) for the one-hour ozone NAAQS.

This obligation to meet the one-hour standard applies even after the EPA determines that an upwind area has attained the one-hour standard (and the applicability of that standard thereby terminates for the upwind area). It is the EPA’s view that, regardless of the status of the one-hour

standard with respect to an *upwind* area's air quality, a *downwind* area may continue to have a nonattainment problem under the one-hour standard, and the upwind area's air emissions sources may continue to impact that downwind nonattainment problem. Under these circumstances, the upwind area is required to retain or adopt SIP provisions that meet the requirements of section 110(a)(2)(D).

The EPA proposes to determine that the SIPs for certain identified states are "substantially inadequate" to comply with the requirements of section 110(a)(2)(D) and to mitigate adequately the interstate ozone transport problem described in section 184. The EPA bases its proposal on the theory that ozone precursor emissions and transported ozone from those states contribute significantly to nonattainment downwind. Based on these findings, the EPA has proposed a call for SIP revisions to require the identified states to reduce emissions to mitigate their contribution.24

b. The Eight-hour NAAQS

Under the eight-hour ozone NAAQS, areas that have not been designated as attainment, nonattainment, or unclassifiable are not required to have SIPs in place. When those SIPs become due, they must meet the applicable requirements of section 110, which apply to all areas. The SIPs for areas designated nonattainment will also have to meet the additional requirements in subpart 1 of part D applicable to nonattainment areas. The EPA is proposing to require, under section 110(a)(1), that certain states must submit SIP revisions under the eight-hour ozone NAAQS to meet the requirements of section 110(a)(2)(D).25

2. The "Significant Contribution to Nonattainment" Issue

The threshold legal consideration under CAA section 110(a)(2)(D) is whether sources "contribute significantly" to "nonattainment in . . . any other State" with respect to the ozone NAAQS. A source cannot be legally subjected to the SIP call unless this test is met. The initial inquiry is to determine the geographic scope of "nonattainment" downwind. The EPA's proposed interpretation of this term is not limited to currently-designated nonattainment areas, but includes areas where air quality currently violates (and will likely continue to violate) the NAAQS for ozone. Although CAA section 110(a)(2)(D) does not refer to "nonattainment areas," it is a phrase that the EPA generally has interpreted to refer to areas that are designated nonattainment under CAA section 107 (section 107(d)(1)(A)(i)). The statutory provision includes only the term "nonattainment" and does not define that term.

After determining the scope of the downwind nonattainment problem, the EPA must next analyze whether the emissions from sources in the

25. *Id.* at 60,364-69.
upwind area "contribute significantly" to the nonattainment problem.26 The EPA analyzed all NO\textsubscript{x} emissions in specified upwind areas, made proposed determinations as to the significance of contributions based on the entire inventory of the area's NO\textsubscript{x} emissions, and proposes to call for SIP revisions that address overall levels of NO\textsubscript{x} emissions.27 Under the proposal, whether a contribution from sources in a particular upwind area is "significant" would depend on the overall air quality context. The EPA is proposing a "weight of evidence" test under which several factors are considered together, but none of them individually constitutes a bright-line determination.

The legal interpretation of section 110(a)(2)(D) becomes crucial at this point. While each of the two interpretations proposed by the EPA relies on an identical set of factors to make the determinations required under section 110(a)(2)(D), each relies on different factors in different parts of the analysis.

Under the first alternative interpretation, the weight of evidence test for determining "significant contribution" focuses on the following: (1) the amount of emissions and their ambient impact; (2) the level of emissions and emissions density in the particular upwind area; (3) the level of emissions in other upwind areas; (4) the amount of contribution to ozone in the downwind area from upwind areas; and (5) the distance between the upwind sources and the downwind nonattainment problem. Under this approach, when emissions and ambient impact reach a threshold level, as assessed by reference to the factors identified above, those emissions would be considered to "contribute significantly" to nonattainment. The EPA would then define the emission reductions required in order to adequately mitigate the "significant contributions." Critically, evaluation of the cost-effectiveness of available measures for reducing upwind emissions, relative to the cost effectiveness of available controls in downwind areas, enters into this determination only after the "significance" of the contribution is established.

Under the second alternative interpretation of section 110(a)(2)(D), the weight of evidence test for determining "significant contribution" includes all of the factors identified immediately above, including the factors that comprise the adequate mitigation test, i.e., relative cost-effectiveness. Thus, under this second interpretation, the cost effectiveness of controlling upwind emissions would be an important, though not necessarily controlling, factor in evaluating whether emissions meet the "significant contribution" test.


27. The EPA does not, in the proposed rulemaking, determine whether particular sectors of the NO\textsubscript{x} inventory "contribute significantly" and is not mandating controls on particular sectors of that inventory. That is up to the states.
3. The Legal Justifications for the Two Alternative Interpretations of Section 110(a)

The two alternative interpretations have significantly different legal justifications. The CAA, section 110(a)(2)(D), provides that the SIP for the upwind area must contain adequate provisions prohibiting sources “from emitting any air pollutant in amounts which will — (I) contribute significantly to nonattainment in, or interfere with maintenance by, any other State . . . .”

Under the first interpretation, the EPA may determine that a relatively larger inventory of emissions contributes significantly to nonattainment (or interferes with maintenance) in light of the fact that the costs of controlling those emissions are not considered in determining significant contribution. The EPA would then require adequate mitigation of the full set of emissions that contribute to nonattainment or interfere with maintenance.

Other statutory provisions support the idea that the CAA could be construed to require mitigation, in lieu of complete elimination, of emissions that contribute to air quality problems downwind. For example, section 110(k)(5) authorizes the EPA to promulgate a SIP call on a finding that a SIP is “substantially inadequate to attain or maintain the relevant NAAQS, to mitigate adequately the interstate pollutant transport described in section [176A] . . . or section [184] . . . , or to otherwise comply with any requirement of this chapter.” Section 176A describes interstate transport of air pollutants generally and section 184 describes ozone transport in the northeast region in particular, which constitutes part of the transport phenomenon at issue in the EPA proposal. Section 176A authorizes the creation of a transport region when emissions from one or more states contribute significantly to a NAAQS violation in another state and further authorizes a transport commission to assess strategies for mitigating the interstate pollution. These provisions, read together, could be taken to indicate that adequate mitigation of transport is an appropriate response to a SIP call. Arguably, this interpretation should hold when the EPA issues a SIP call based on section 110(a)(2)(D), and when the EPA mandates a SIP revision under section 110(a)(1), based on section 110(a)(2)(D).

The second legal interpretation, in contrast, focuses on the provisions of CAA section 110(a)(2)(D) stating that the SIP must “prohibit” any emission activity “amounts” that contribute significantly to downwind nonattainment or interfere with maintenance. The EPA has identified the states whose full set of NOx emissions contribute markedly to downwind problems. The term “prohibit” could be interpreted to require that the EPA, upon finding that a state’s full set of emissions “contribute significantly” to nonattainment, require the SIP to eliminate that full set of emis-

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sions. This construction, in theory, could mean that the EPA must require the state to shut down all of the emission-generating activities, including electric power plants. It seems highly doubtful Congress would have intended this result.

The EPA's second proposed interpretation rather neatly sidesteps this possible result by taking into account the relative cost effectiveness of the upwind and downwind controls in defining the "amounts" of emissions in each state that contribute significantly to the downwind problem. Once the EPA has set those "amounts" in light of its consideration of the cost factors, the SIPs for the affected states would then need to prohibit only those amounts.

4. The EPA's Recommended Emissions Reductions

For electric generators, the OTAG recommended that the range of NOx controls in the geographic area in which controls would apply fall between CAA-required controls (about a thirty percent reduction from 1990 levels) and the less stringent of either eighty-five percent reduction from the 1990 rate or 0.15 lb/MMBtu. The EPA's proposed utility emissions reduction budget component is significantly more stringent in two ways. First, it is based on the 0.15 lb/MMBtu emission rate without the eighty-five percent reduction option. (Thus, it is similar to the upper bound recommendation advanced by the OTAG, but excludes the eighty-five percent reduction option.) Second, the EPA's proposed utility emissions budget is based on a larger area from which emissions reductions will be extracted. (The OTAG plan involves only portions of designated states.)

E. State Petitions Under CAA Section 126

As previously noted, in the fall of 1997 eight northeastern states petitioned the EPA under CAA section 126, asking the EPA to require electric generation facilities and large industrial facilities in the Midwest to reduce NOx emissions by eighty-five percent. If the section 126 petitions, which alleged "significant contribution" by these facilities to downwind ozone nonattainment, were granted, the EPA itself would be required to impose direct controls on sources instead of imposing such controls through SIPs under section 110(a)(2)(D).

As of this writing, the EPA and the petitioning states are pursuing an agreement that would govern the EPA's procedural response to the petitions.60 Under this agreement the EPA reportedly would issue a final response to the section 126 petitions during the Spring of 1999, but would defer any remedy until the end of 1999. This delay would allow the midwestern states to impose the NOx reductions under their revised SIPs (pursuant to the outcome of the EPA's ongoing regulatory action under section 110(a)(2)(D), as discussed above), but the EPA would stand ready

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60. See, e.g., EPA/Northeast Near Deal to Coordinate Attack on Transported Ozone, INSIDE EPA, December 12, 1997, at 3-4.
to act immediately under section 126 in the event the states failed to act. In addition, the EPA has reportedly committed to the issuance of a generic proposal concerning the ozone transport problem by the fall of 1998, at which time the EPA hopes to have finalized its regulatory proposal under CAA section 110(a)(2)(D) concerning ozone-related revisions to SIPs.

III. CITIZEN SUITS

A. Introduction

Environmental citizen suits are a very significant aspect of federal environmental enforcement litigation in terms of both the frequency of these suits and the severity of the sanctions imposed. Significant expansion of this type of environmental litigation began in the early to mid-1980s and initially focused on the Clean Water Act (CWA). While the CWA continues to be a significant focus, citizen suit enforcement under other federal environmental statutes, such as the CAA, the Resource Conservation and Recovery Act (RCRA), and the Emergency Planning and Community Right-to-Know Act (EPCRA), is growing. The pattern followed by the environmental plaintiffs in these suits has often been to target a number of industrial facilities in a specific state or geographic region and file an essentially simultaneously very similar suits using a standard complaint, discovery papers and motions. A possible future focus of citizen suits under the CAA could relate to compliance by electrical utilities with the expanded ozone-related requirements under revised SIPs and operating permits discussed above.

There are several factors that provide the impetus for citizen suits. The first is the availability of civil penalty relief. The citizen suit provisions of federal environmental statutes generally authorize the imposition of civil penalties and injunctive relief. The CAA Amendments of 1990 added civil penalty relief to CAA citizen suits. These civil penalties can be very sizeable and have reached as much as $10 million in recent citizen suits.

Another factor is the strict liability standard that applies to these cases and the plaintiffs' ability to rely on self-monitoring reports as admissions of liability. In this regard, the 1990 CAA Amendments established the Title V operating permit program, which facilitates enforcement by centralizing all air pollution control requirements in a single integrated document, and imposed expanded monitoring and reporting obligations.

A third factor is the availability of attorneys' fees; citizen suit statutes typically provide for fee-shifting (the prevailing party must pay its adversary's litigation costs).

B. Prerequisites for Citizen Suits

In most cases, citizen enforcement under these statutes is narrower than government enforcement, because a citizen suit must be preceded by a period of mandatory notice (typically 60 days) before the suit can be commenced. Usually, the notice is required to be provided to the alleged
violator, the appropriate state enforcement agency and the EPA. If the
government undertakes diligent enforcement during that hiatus, the citizen
suit cannot be brought.

1. Notice Requirement

A considerable amount of litigation has been directed toward the ju-
risdictional nature of the notice requirement. For example, the Supreme
Court resolved a split in the circuits and held that the sixty-day notice re-
quirement in section 7002(b)(1) of the RCRA is a mandatory condition
precedent to commencing a citizen suit.\(^3\) Although the plaintiff had pro-
vided notice to the would-be defendant, the plaintiff had neglected to no-
tify either the EPA or the Oregon Department of Environmental Quality.
The plaintiff argued for a flexible construction of the notice provision
which would allow suits filed before appropriate notice had been given to
be saved by a sixty-day stay of district court proceedings. The Supreme
Court rejected that argument, reasoning that congressional policy "would
be frustrated if citizens could immediately bring suit without involving fed-
eral or state enforcement agencies."\(^3\)\(^5\)

In the wake of \textit{Hallstrom v. Tillamook}, many courts have addressed
the adequacy of the mandatory pre-suit notice in citizen suit cases. Al-
though these cases often turn on their own facts, a more flexible, plaintiff-
oriented standard has been set forth by the Third Circuit.\(^3\)\(^3\) In contrast, the
Ninth Circuit has imposed a more exacting standard in which the notice
must stand on its own and not require the affected state agency to make
extrapolations in order to determine the scope of the violations at issue.\(^3\)\(^4\)

2. Diligent Administrative Enforcement

A recurring theme in citizen suit litigation, particularly CWA citizen
suits, is whether there has been diligent state administrative enforcement
that precludes a citizen suit. Section 309(g)(6) of the CWA\(^3\)\(^5\) generally bars
citizen suits where there has been diligent administrative enforcement un-
der a state law that is comparable to the CWA provisions that govern ad-
inistrative enforcement by the EPA. Two lines of authority have devel-
oped under CWA section 309(g)(6) in determining whether state
administrative enforcement meets that "comparability" standard. The
Eighth Circuit has held that the comparability standard is satisfied where
the state's enforcement code considered as a whole, rather than merely the
provisions invoked in a particular enforcement action, contains administra-

\(^{32}\) \textit{Id.} at 29.
\(^{33}\) \textit{See Public Interest Research Group of New Jersey, Inc. v. Hercules, Inc.}, 50 F.3d 1239 (3rd
Cir. 1995) (notice of one aspect of an effluent violation, such as a violation of a concentration limit, is
deemed sufficient for the would-be defendant to identify other violations related to the same permit
parameter).
\(^{34}\) \textit{See Washington Trout v. McCain Foods, Inc.}, 45 F.3d 1351 (9th Cir. 1995).
tive penalty provisions similar to those in the CWA, has the same overall enforcement goals as the Act and provides interested citizens with a meaningful opportunity to participate at significant stages of the administrative enforcement process. The other line of authority is represented by the Ninth Circuit's more rigid approach: the specific statute that governed the state administrative enforcement proceeding (as opposed to other provisions of the state's enforcement code) must authorize imposition of administrative penalties and address each of the procedural requirements that govern administrative enforcement of the CWA by the EPA. The Supreme Court has denied petitions for writs of certiorari in both of these cases, thus allowing these somewhat contradictory approaches to interpretation of section 309(g)(6) to stand.


One of the most controversial issues in citizen suit litigation has been whether these suits can be brought for purely past violations, that is, violations that abated prior to the citizen suit. This issue has been extensively litigated under the CWA, including cases where, prior to initiation of the citizen suit, permit compliance has been achieved for many, if not all, permit parameters; unduly stringent permit limits had been superseded; or a discharge had terminated. The Supreme Court addressed the on-going violation issue in *Gwaltney of Smithfield, Ltd. v. Chesapeake Bay Foundation, Inc.* The Court ruled that a CWA section 505 citizen suit could not be brought for purely past violations. Subsequent decisions by other courts have ruled that this principle is to be applied on a parameter-by-parameter basis; an ongoing violation of one permit requirement does not authorize a citizen suit for previously abated violations of other permit requirements.

In this connection it should be noted that prior to 1990, the operative language of the CAA's citizen suit provision, section 304(a), had been identical to section 505(a) of the CWA, and objections to the effect of the *Gwaltney* decision were raised during congressional consideration of the CAA Amendments of 1990. The result was an amendment to CAA section 304(a). While the amended statute retains the former language authorizing suits where the facility in question is "alleged to be in violation" of CAA requirements, that provision is now coupled with language authorizing citizen suits against facilities alleged "to have violated" applicable standards "if there is evidence that the alleged violation has been repeated." Litigation over the precise meaning of that CAA amendment has found its way, albeit somewhat indirectly, to the Supreme Court.

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37. See Citizens for a Better Env't v. Union Oil Co. of Cal., 83 F.3d 1111 (9th Cir. 1996), cert. denied, 117 S. Ct. 789 (1997).
Steel Company v. Citizens for a Better Environment, involved the citizen suit provisions of section 326 of the Emergency Planning and Community Right-To-Know Act of 1986 (EPCRA). The Seventh Circuit had ruled that section 326 authorizes citizen suits for wholly past violations of EPCRA. In Steel Company, the Supreme Court vacated the Seventh Circuit's holding that section 326 of the EPCRA authorizes citizen suits for purely past violations of EPCRA. The Court concluded that since none of the relief sought by the citizen group would likely remedy its alleged injury in fact, the group lacked standing to bring the suit. The Court acknowledged that although prompt resolution of the merits of the EPCRA question is desirable, "it is not as important as observing the constitutional limits set upon courts in our system of separated powers."

D. Recent Decisions on Standing in Citizen Suit Litigation.

Under Article III of the Constitution a private plaintiff who seeks to enforce federal environmental laws (or, for that matter, other federal laws) must demonstrate that it has standing to sue. That requires the plaintiff to show that it has sustained, or will sustain, an injury that is caused by, or is fairly traceable to, the defendant's unlawful conduct and which will be redressed by the relief the plaintiff seeks. A full discussion of the policy and philosophical underpinnings of the constitutional requirement for standing is beyond the scope of this report. However, in the context of public law litigation, such as an environmental citizen suit, a principal purpose of the requirement for standing is to limit the business of the federal courts to adjudicating claims based on injury actually sustained by the plaintiff rather than allowing the courts to be used as a forum to ventilate generalized grievances shared by many in our society.

Standing to sue has been a "perennial" issue in environmental citizen suit litigation. Courts have generally held that the "injury in fact" and causation (or traceability) aspects of standing are satisfied in the CWA context where the defendant has had a non-complying discharge to a waterway in which the plaintiff, or its members, have a recreational, aesthetic, or property interest. Although almost always raised as a defense, challenging the plaintiffs' standing has rarely been successful for citizen suit defendants. Several recent cases, however, suggest a possible change in that trend. For example, the Fifth Circuit has recognized that there must be a reasonable geographic nexus between the offending discharge and the in-

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41. See Citizens for a Better Env't v. Steel Co., 90 F.3d 1237 (7th Cir. 1996).
42. Id.
43. 118 S.Ct. 1003, at 1020.
44. Id.
terests that the discharge was allegedly harming. As the court explained, "some 'waterways' covered by the CWA may be so large that plaintiffs should rightfully demonstrate a more specific geographic or other causative nexus in order to satisfy the 'fairly traceable' element of standing." 47

The geographic nexus issue that the court in Sierra Club v. Cedar Point discussed in dicta was squarely addressed in a subsequent Fifth Circuit case. 48 Friends of the Earth involved an oil refinery in Tyler, Texas, that discharged wastewater to the Black Fork Creek pursuant to an NPDES permit. Black Fork Creek flows into Prairie Creek, which then joins the Neches River, which in turn flows into Lake Palestine at a point that is 18 miles downstream from the refinery. The plaintiff's members claimed to have aesthetic and property interests in Lake Palestine that were injured as a result of Crown Central's alleged permit violations. Crown Central challenged the plaintiff's standing to sue and the Fifth Circuit agreed with Crown Central.

The court emphasized that the plaintiff had offered no competent evidence that the refinery discharges at issue had made their way to Lake Palestine or would otherwise affect Lake Palestine. As the court explained, the plaintiff chose instead to rely solely on the truism that water flows downstream, and on that basis proceeded to argue that any injury suffered downstream is "fairly traceable" to unlawful discharges upstream. The court noted that its ruling was narrow and did not impose an arbitrary mileage limit for CWA citizen suit plaintiffs. The court added that although "plaintiffs who use 'waterways' far downstream from the source of unlawful pollution may satisfy the 'fairly traceable' element [for Article III standing] by relying on alternative types of evidence" (such as water samples demonstrating pollutant migration), "we can no longer assume that an injury is fairly traceable to a defendant's conduct solely on the basis of the observation that water runs downstream." 49

A recent Third Circuit decision involving the CWA's citizen suit provisions is also on point. 50 That decision reversed an earlier district court ruling that the citizen suit plaintiffs had standing to sue. The Third Circuit's opinion emphasized that the same district court had also concluded, in a second phase of the litigation addressing civil penalties, that the defendant's non-complying discharges had caused no harm to the waterway at issue and may, in fact, have improved the waterway by adding essential nutrients. The Third Circuit also noted that the plaintiffs had not alleged in their complaint (or in affidavits submitted in connection with standing) any injury to the waterway at issue in the case.

47. 73 F.3d at 558 n.24.
49. Id. at 362.
On that basis the Third Circuit concluded that the plaintiffs lacked standing to sue and vacated the district court’s decision imposing $2.6 million in civil penalties and more than $500,000 in attorneys’ fees.

E. The Future of Citizen Suits.

Environmental citizen suits have become a significant portion of environmental enforcement litigation. While the frequency of these suits under individual environmental statutes will vary from time to time, it is expected that citizen suit litigation will increase under several statutes, a primary example being the CAA. One reason for this expected increase is the comprehensive operating permit program established by the 1990 CAA Amendments. Another reason is the availability of civil penalty relief, which was also added by the 1990 amendments. CAA citizen suit enforcement will also be assisted by the EPA’s “any credible evidence” rule and the flexibility provided by that rule (as well as in recent court decisions) with respect to the types of evidence that can be used to establish CAA non-compliance.

COMMITTEE ON THE ENVIRONMENT: 51
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51. The Committee thanks Scott M. DuBoff and John W. Heiderscheit III of the law firm of Wright & Talisman, P.C., who contributed to the preparation of this report.
REPORT OF THE COMMITTEE ON ETHICS

The American Bar Association Standing Committee on Ethics and Professional Responsibility (ABA Committee) has issued several formal opinions that are relevant to lawyers who work in the executive branch, the private lawyers who deal with them, or to both. These opinions address the conflict of interest rules governing former government lawyers, the ethical obligations of lawyers who serve as expert witnesses or expert consultants, and issues concerning ex parte communications with government agencies represented by counsel. While these opinions provide useful and important guidance to lawyers who encounter these problems, a lawyer should also consult the ethics rules and opinions in the jurisdiction(s) in which he or she practices. In addition, lawyers should consult relevant statutes and regulations, such as the conflict of interest rules that apply to former government lawyers and agency regulations governing ex parte communications.

I. ABA FORMAL OPINION 97-409: CONFLICTS OF INTEREST: SUCCESSIVE GOVERNMENT AND PRIVATE EMPLOYMENT (AUGUST 2, 1997)

This opinion addressed whether a lawyer formerly employed by a government claims administration agency can represent private claimants before her former agency in connection with the same general types of claims she handled while working for the agency. It also addressed whether the lawyer can bring suit against the agency on behalf of a private client challenging agency rules in whose development and implementation she was involved.

In order to resolve this question, the ABA Committee first had to determine which of the Model Rules of Professional Conduct govern the conflict of interest obligations of former government lawyers. Rule 1.9 (Conflict of Interest: Former Client) generally governs successive representations, while Rule 1.11 (Successive Government and Private

1. The Committee gratefully acknowledges the assistance of Jacqueline Gerson Cooper, Esq. of Sidley & Austin in the preparation of this report.
3. Id.
4. Model Rule 1.9, Conflict of Interest: Former Client, provides:
   (a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person’s interests are materially adverse to the interests of the former client unless the former client consents after consultation.
   (b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client
      (1) whose interests are materially adverse to that person; and
Employment) specifically governs the obligations of former government lawyers. The question whether Rule 1.9 or 1.11, or both, control the conflict of interest obligations of former government lawyers is critical, because the two rules are much different in scope. For example, the range of

(2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter, unless the former client consents after consultation.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

(1) use information relating to the representation to the disadvantage of the former client except as Rule 1.6 or Rule 3.3 would permit or require with respect to a client, or when the information has become generally known; or

(2) reveal information relating to the representation except as Rule 1.6 or Rule 3.3 would permit or require with respect to a client.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.9 (1996).

5. Model Rule 1.11, Successive Government and Private Employment, provides:

(a) Except as law may otherwise expressly permit, a lawyer shall not represent a private client in connection with a matter in which the lawyer participated personally and substantially as a public officer or employee, unless the appropriate government agency consents after consultation. No lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter unless:

(1) the disqualified lawyer is screened from any participation in the matter and is apportioned no part of the fee, therefrom; and

(2) written notice is promptly given to the appropriate government agency to enable it to ascertain compliance with the provisions of this rule.

(b) Except as law may otherwise expressly permit, a lawyer having information that the lawyer knows is confidential government information about a person acquired when the lawyer was a public officer or employee, may not represent a private client whose interests are adverse to that person in a matter in which the information could be used to the material disadvantage of that person. A firm with which that lawyer is associated may undertake or continue representation in the matter only if the disqualified lawyer is screened from any participation in the matter and is apportioned no part of the fee therefrom.

(c) Except as law may otherwise expressly permit, a lawyer serving as a public officer or employee shall not:

(1) participate in a matter in which the lawyer participated personally and substantially while in private practice or nongovernmental employment, unless under applicable law no one else is, or by lawful delegation may be, authorized to act in the lawyer's stead in the matter; or

(2) negotiate for private employment with any person who is involved as a party or as lawyer for a party in a matter in which the lawyer is participating personally and substantially, except that a lawyer serving as a law clerk to a judge, other adjudicative officer or arbitrator may negotiate for private employment as permitted by Rule 1.12(b) and subject to the conditions stated in Rule 1.12(b).

(d) As used in this Rule, the term "matter" includes:

(1) any judicial or other proceeding, application, request for a ruling or other determination, contract, claim, controversy, investigation, charge, accusation, arrest or other particular matter involving a specific party or parties, and

(2) any other matter covered by the conflict of interest rules of the appropriate government agency.

(e) As used in this Rule, the term "confidential government information" means information which has been obtained under governmental authority and which, at the time this rule is applied, the government is prohibited by law from disclosing to the public or has a legal privilege not to disclose, and which is not otherwise available to the public.

matters from which a lawyer would be disqualified under Rule 1.9 is much broader than the range of matters from which a lawyer would be disqualified under Rule 1.11. Rule 1.9(a) forbids a lawyer who formerly "represented" a client from undertaking an adverse representation in the same or a substantially related matter, while Rule 1.11 forbids a former government lawyer from undertaking an adverse representation only if the lawyer's prior involvement in the matter amounted to "personal and substantial participation." Rule 1.11(d) narrowly defines a "matter" to include decisions "involving a specific party or parties," while Rule 1.9 contains no such limitation, leading the ABA Committee to conclude that it applies to a broader range of situations than Rule 1.11. Finally, a significant difference between the two rules is that conflicts arising under Rule 1.9 are imputed to other lawyers in the former government lawyer's new firm, while conflicts arising under Rule 1.11 are not imputed, so long as the former government lawyer is properly screened.

The ABA Committee concluded, based on the fact that Rules 1.9 and 1.11 "overlap and sometimes conflict with one another," that they are not intended to apply in the same situation. Accordingly, it concluded that "Rule 1.11 occupies the field to the exclusion of Rule 1.9(a) and (b)," reasoning that "Rule 1.11 was plainly intended to define the conflict of interest obligations of former government lawyers, vis-a-vis their former government client as well as adverse third parties." The ABA Committee noted that this conclusion is consistent with the text of the rules, as well as the legislative history and commentary concerning them. It is also consistent with a principal purpose of Rule 1.11: to ensure that the conflict of interest rules do not impose a significant deterrent to public service and do not serve as an impediment to transfer of employment between the public and private sectors.

Even though the ABA Committee concluded that former government lawyers are not subject to the general conflict of interest provisions contained in parts (a) and (b) of Rule 1.9, it nevertheless concluded that they are subject to the provisions in 1.9(c) that prohibit a lawyer from using confidential information obtained during the representation of a former client to the disadvantage of that client. In reaching this conclusion, the ABA Committee noted that the confidential information provisions in Rule 1.9(c) have no analogy in Rule 1.11 and therefore do not conflict with it. In addition, the ABA Committee noted that Rule 1.11 does not contain any provision protecting the confidences of government clients and reasoned that it was unlikely the drafters of the Rules intended for the government to be unprotected in that regard.

The confidentiality provisions of Rule 1.9(c) effectively can preclude a former government lawyer from undertaking representations of private clients in certain circumstances. Specifically, the ABA Committee noted

7. Id.
that a former government lawyer's duty to protect the confidences of its former government client may "materially limit" the lawyer's ability to represent certain clients under Rule 1.7(b). In the face of a Rule 1.7(b) conflict, the representation cannot go forward unless the lawyer both "reasonably believe[s] the representation will not be adversely affected" and obtains the informed consent of the prospective client. The ABA Committee cautioned that it "believes it unlikely" that a lawyer could form a reasonable belief that the representation would suffer no adverse effect when a conflict arises under Rule 1.9(c), unless the former government client consented to waive the confidentiality barrier.

With respect to the facts at issue, the ABA Committee concluded that Rule 1.11 does not bar the former government lawyer from representing private claimants before her old agency, so long as the representations did not involve "particular matters" in which she had been involved. It also concluded that Rule 1.11 did not bar the lawyer from representing a private client in a challenge to agency rules, even where she had been involved in the rulemakings, because rulemakings are not "particular matters." The ABA Committee noted, however, that if zealous and competent representation of a private client required the former government lawyer to use or reveal nonpublic information acquired during her representation of the government to the government's disadvantage, then the representation should not be undertaken, unless the government waived its confidentiality protection.

This opinion will be highly significant to the large number of lawyers who move from the public sector to the private sector each year. By concluding that the conflict of interest obligations of former government lawyers are controlled by the narrowly tailored restrictions in Rule 1.11 rather than the more sweeping restrictions in Rule 1.9, the ABA Committee has reduced the sphere of potential conflicts that will confront a lawyer who decides to leave government service for private practice. This will ensure that the conflict of interest rules do not discourage such job transfers and thus do not serve as an impediment to lawyers entering government service in the first instance.

9. Model Rule 1.7(b) provides:

A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interest unless:

1. the lawyer reasonably believes the representation will not be adversely affected; and
2. the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7(b) (1996).


11. Id.
II. ABA Formal Opinion 97-407: Lawyer as Expert Witness or Expert Consultant (May 13, 1997)\textsuperscript{12}

This opinion addressed the ethical obligations of a lawyer who serves as an expert witness or a non-testifying expert consultant on behalf of a party who is another law firm's client. It is increasingly common for lawyers who are experts on legal subjects to serve in one or both of these roles, in administrative proceedings as well as litigation matters. The ABA Committee concluded that a lawyer who serves as an expert witness has ethical obligations that differ substantially from those of a lawyer who serves as an expert consultant. Specifically, a lawyer who serves solely as a testifying expert does not form a client-lawyer relationship with the party who retains him, and therefore is not subject to the Rules of Professional Conduct, while a lawyer who serves as an expert consultant does form such a relationship and is subject to the Rules.

In analyzing whether a lawyer serving as an expert witness forms a client-lawyer relationship with the party who retains him, the ABA Committee noted that a client-lawyer relationship generally comes into being as a result of the reasonable expectations of the client and a failure of the lawyer to dispel those expectations. With respect to a lawyer retained solely as a testifying expert, the ABA Committee concluded that the party who engages the expert cannot form a reasonable expectation of a client-lawyer relationship. This is because an expert witness, lawyer or otherwise, has a duty to provide the court with truthful and accurate information. Even though the expert testifies on behalf of a party, he is expected to be a neutral, objective witness and provide opinions adverse to the party if candor so dictates. In addition, clients cannot form a reasonable expectation of an attorney-client privilege because communications between the expert witness and the client are generally discoverable.

In contrast, a lawyer retained as a non-testifying expert consultant serves a much different role, leading the ABA to conclude that a client-lawyer relationship is formed. A consultant typically plays an active role in shaping legal strategy and identifying favorable facts, essentially serving as a partisan advocate. Indeed, the ABA Committee concluded that a lawyer consultant “acts like a lawyer” and essentially occupies the role of “co-counsel.” In addition, the communications between a non-testifying consultant and a client generally are not discoverable, giving rise to a reasonable expectation of confidentiality.

In order to avoid misunderstandings, the ABA Committee recommends that a lawyer serving as an expert witness obtain engagement letters from both the engaging law firm and the client that define the expert's limited role and make clear that no client-lawyer relationship is being formed. The ABA Committee acknowledged, however, that in actual practice it is common for the role of an expert witness to evolve into or overlap the role of an expert consultant. When this occurs, a client-lawyer

relationship exists and it is incumbent on the lawyer expert to assure that the client is fully informed of and expressly consents to the dual role, particularly since continuing to serve as a testifying witness might require the disclosure of confidences or affect the objectivity of the expert testimony. Accordingly, it may be necessary for a lawyer serving as an expert to update an initial engagement letter as the lawyer's role changes.

Although the ABA Committee concluded that a lawyer serving as an expert witness is not subject to the Rules as such because no client-lawyer relationship is formed, it noted that the lawyer's obligations under law apart from the Rules may give rise to limits under the Rules on the lawyer's ability to represent other clients. For example, the ABA Committee assumed for purposes of its opinion that the lawyer owes a duty of confidentiality to the party on whose behalf he is testifying. Such a duty to maintain confidences would limit the lawyer's ability to undertake concurrent representations adverse to the party on whose behalf he is testifying, because any concurrent representation would be subject to Rule 1.7(b).

In addition, even though a lawyer serving as an expert witness is not subject to the general conflict of interest rules concerning former clients and subsequent representations, subsequent representations also might be subject to Rule 1.7(b) based on duties of confidentiality imposed by other law.

This opinion provides a bright-line rule for lawyers who serve as expert witnesses and expert consultants: A lawyer enters into a relationship governed by the Rules when he is retained as an expert consultant, but does not enter into such a relationship when he is retained merely as an expert witness. Thus, a lawyer serving as an expert consultant is subject to the full panoply of conflicts rules, confidentiality obligations, and other duties set forth in the Rules. In contrast, a lawyer serving as an expert witness is not subject to the Rules per se with respect to that engagement, but may be limited by the Rules to the extent that the Rules incorporate other law.

III. ABA Formal Opinion 97-408: Communications with Government Agency Represented by Counsel (August 2, 1997)

This opinion addressed whether a lawyer who is representing a private party in a controversy with a government entity may communicate about the matter with responsible government officials without the prior consent of government counsel. This question might arise, for example, when a

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13. Id. In a footnote, the ABA Committee noted that some courts have deemed an expert witness to be an agent of the client while others have held that the relationship between an expert witness and client as confidential. Neither of these relationships, however, gives rise to an attorney-client privilege. Therefore, communications between an expert witness and client are ordinarily discoverable.

14. See supra note 9 for text of Rule 1.7(b).


lawyer is representing a private party in an administrative matter before a regulatory agency such as the Federal Energy Regulatory Commission (FERC), which is represented by a general counsel and staff attorneys, and the private party wants to contact individual commissioners or their staffs about the particular matter.

The ABA Committee framed the issue as whether and to what extent Rule 4.2, which forbids a lawyer from communicating with a person the lawyer knows to be represented by another lawyer without other lawyer’s consent, applies to a lawyer’s communications with government officials. This “no contact” rule is designed to protect represented persons from interference or overreaching by opposing counsel. The ABA Committee noted that the text of Rule 4.2 does not define the “person[s]” to whom it applies, but that the commentary to the rule indicates that it applies to represented organizations and government entities, as well as individuals. The commentary, for example, discusses controversies between government agencies and private parties. Accordingly, the ABA Committee concluded that Rule 4.2 is generally applicable to communications by lawyers with represented government entities.  

The ABA Committee acknowledged, however, that additional considerations arise with government entities because the federal Constitution guarantees citizens the right to petition the government for redress of their grievances. Thus, the “no contact” rule cannot be applied in such a way as to frustrate a citizen’s right to petition government decision-makers through a lawyer. The ABA Committee noted that it has limited jurisdiction to define the scope of the constitutional right to petition the government, but concluded that the appropriate way to reconcile the opposing considerations is to make unconsented contacts with government officials subject to two conditions. First, in order for an unconsented contact to fall within the right to petition, the government official contacted must have authority to take or recommend action in the controversy, and the purpose of the communication must be to address a policy issue, including settling the controversy. Second, even where a communication appears to fall within the right to petition, the lawyer for the private party must give government counsel advance notice of the intended communication so government counsel can advise their clients whether the communication should be entertained. In the case of proposed written communications, the lawyer for the private party should provide copies of the written material in advance to government counsel. These conditions, the ABA committee concluded, properly balance the right of citizens to seek direct access to government officials with the government’s need to protect itself from overreaching by lawyers for private parties.

17. Model Rule 4.2 provides: “In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized by law to do so.” MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.2 (1996).


19. Id.
The ABA opinion also cautions lawyers to consult other authority, such as applicable case law and regulations, that may impose different standards. Lawyers who practice before the FERC, for example, should consult the agency's rules regarding ex parte communications. These rules broadly proscribe a party or his counsel from undertaking off-the-record communications with members of the Commission, administrative law judges, or any other employee of the Commission "regarding any matter pending before the Commission in any contested on-the-record proceeding." The rules also enumerate specific exceptions, such as communications relating solely to procedural matters, communications "from any person when otherwise authorized by law," and communications "which the participants agree may be made on an ex parte basis."

COMMITTEE ON ETHICS
Eugene R. Elrod, Chair
Carl W. Ulrich, Vice Chair

George F. Bruder
James N. Horwood

I. INTRODUCTION

This Report summarizes the major energy cases in 1997, with a focus on cases at the appellate level. The majority of 1997 appellate cases analyzed below involve review of orders of the Federal Energy Regulatory Commission (FERC).

II. ADMINISTRATIVE LAW

A. Federal Pre-emption: Concerned Citizens of Cohocton Valley, Inc. v. New York State Department of Environmental Conservation

In Cohocton Valley, the Second Circuit affirmed the district court’s dismissal of the case filed by local environmental groups which attacked local agencies’ decisions for lack of jurisdiction on grounds of federal pre-emption. The matter at issue commenced when the FERC granted a NGA certificate to construct and operate a gas storage facility in New York. Upon issuance of the FERC certificate, the local regulators issued construction permits without addressing issues of compliance with the New York Environmental Quality Review Act (EQR Act). According to the agencies, the New York EQR Act was pre-empted by the NGA. The district court dismissed the federal suit because the federal pre-emption issue was not an element of the original claim but was only a defense. The NGA, the court concluded, did not so completely pre-empt state law so as to create federal question jurisdiction. On appeal the Second Circuit affirmed the district court, stressing the difference between “traditional pre-emption” and “complete pre-emption.” The court emphasized that, de-

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1. 127 F.3d 201 (2d Cir. 1997).

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spite the district court's dismissal for lack of "complete pre-emption," nothing barred the project participants from arguing in state court that the NGA pre-empted the New York EQR Act, as the local agency had already ruled.

B. Federal Pre-emption: In Re Cajun Electric Power Cooperative, Inc.

In the Cajun case, the court found that the Secretary of Agriculture, through the Rural Electrification Administration (REA, now the Rural Utilities Services), had exceeded his statutory authority by attempting to pre-empt rate orders issued by a state public utility commission (i.e., the Louisiana Public Service Commission (Louisiana PSC)). Cajun, a Louisiana electric cooperative, borrowed $1.6 billion from the REA to finance a nuclear power facility, pursuant to the Rural Electrification Act. Subsequently, the Louisiana PSC began an investigation into the prudence of Cajun's investments in the facility. Several years later, the Louisiana PSC approved the debt restructuring agreement (DRA) between Cajun and the REA related to the facility, but declined to guarantee recovery by Cajun of its debt payments under the DRA. In December, 1994, the Louisiana PSC found that Cajun's nuclear investments were imprudent and ordered a rate reduction. A few days later, the Secretary of Agriculture notified Cajun that the Louisiana PSC's rate order was pre-empted by federal law.

On review of the Secretary's order, the district court found in favor of the Louisiana PSC's authority. The Fifth Circuit affirmed. The court noted that the Rural Electrification Act neither expressly nor implicitly authorized the pre-emption powers that the Secretary claimed. The court further found that the purpose of the Act (to provide low-cost, reliable power) was contrary to approval of high rates to guarantee debt recovery. Finally, the court noted that the REA was more of a lending agency than a traditional public utility regulatory body.

C. Federal Pre-emption: McCartin McAuliffe Mechanical Contractor, Inc. v. Midwest Gas Storage, Inc.

In the MMMC case, the court held that the NGA did not pre-empt an Indiana state law granting a mechanic's lien to a contractor that provided construction services to a company that was constructing a gas storage facility subject to FERC jurisdiction under the NGA. While the gas storage company argued that a foreclosure sale under the state lien law would conflict with the NGA's requirement for FERC approval to abandon or transfer any NGA-regulated facilities, the court found this argument unconvincing and instead merely noted that any creditor seeking to foreclose would also have to comply with the FERC's regulations for FERC approval of any transfer. The court found that while federal regulations "may complicate" the foreclosure proceeding, the lien's foreclosure would

2. 109 F.3d 248 (5th Cir. 1997).
not conflict with the NGA regulations.

D. Federal Pre-emption: No Tanks Inc. v. Public Utilities Commission

In No Tanks, the Maine Supreme Court held that the NGA pre-empted a state law requiring approval from Maine’s Public Utilities Commission (Maine PUC) for an interstate pipeline company to provide storage and delivery of liquefied natural gas to an affiliated local distributor. The court noted that the FERC’s approval under the NGA was necessary for any such storage or transportation facilities, that the U.S. Department of Transportation had issued comprehensive safety regulations that would cover these facilities, and that the FERC’s regulations take environmental and safety issues into consideration. Although the FERC had not yet acted on the pipeline’s NGA certificate application, the court found that point insignificant in its decision.

E. Settlement/Evidence: Exxon Corp. v. FERC

In the Exxon case, the court affirmed in part and remanded in part the FERC’s orders which required an Administrative Law Judge (ALJ) to certify a contested settlement. Koch Gateway Pipeline Company (Koch) filed the settlement to resolve a pending rate case and the settlement was contested by some, but not all, parties. The ALJ refused to certify the settlement, stating that the FERC’s rules prohibited him from certifying a contested settlement if it left genuine issues of material fact unresolved and if the record contained insufficient evidence for the FERC to adjudicate these issues. Several parties filed an interlocutory appeal. The FERC ordered the ALJ to certify the settlement, and required Koch to provide additional evidence. Exxon was afforded the opportunity to file evidence, but declined to do so. The FERC subsequently approved the settlement. On rehearing, however, Exxon included certain new evidence. The FERC denied all requests for rehearing, and refused to consider Exxon’s new evidence.

While describing the FERC’s procedures as somewhat unusual, the court upheld the FERC’s orders, granting deference to the FERC’s determinations that the subject settlement rules only applied to the ALJ’s and not the FERC. The court further found that because Exxon was allowed to submit evidence and chose not to do so, it could not complain that it was unfairly harmed. The court also found that the FERC had no obligation to consider evidence brought before for it for the first time on rehearing, finding that Exxon had no right to “another bite at the apple.” However, the court remanded on one substantive issue that the FERC had failed to adequately address certain evidence which was refuted.

4. 697 A.2d 1313 (Me. 1997).
5. 114 F.3d 1252 (D.C. Cir. 1997).
F. Standing: City of Bushnell, Ill. v. FERC

In its one-paragraph opinion in *Bushnell*, the court abided by the rule that to seek judicial review of a FERC order under the NGA, the petitioner must have also participated in the FERC proceedings below. Because petitioners in this case (five Illinois municipalities) "did not participate," the court granted the FERC's motion to dismiss their petition for lack of jurisdiction. The petitioners' allegation that "the FERC acted in clear violation" of the NGA, the court noted, is not enough to bypass this bright-line rule.7

G. Standing/Late-filed Comments: Reytblatt v. United States Nuclear Regulatory Commission

In the *Reytblatt* decision, the court upheld challenges to the Nuclear Regulatory Commission's (NRC) rules on the reporting of containment leakage rate tests. The NRC rules at issue only required failed leakage rate tests to be filed publicly. Both Reytblatt and the Ohio Consumers for Responsible Energy (OCRE) filed comments which were considered by the NRC; however, the NRC ignored late-filed comments submitted by Reytblatt. As a preliminary matter, the court determined that both Reytblatt and OCRE met the requirements for standing to bring an appeal of the Final Rules. Both parties had suffered an injury in fact (reduced access to information) traceable to NRC's rules. Therefore, the parties' interests were within the zone of interests Congress intended to protect in enacting the controlling statutes (as public participants in the oversight of nuclear facilities). On the merits, the court found in favor of the NRC, finding that the NRC's responses to comments filed by Reytblatt were adequate (especially given what the court felt was the limited and invective nature of those comments). The court further held that the agency had no obligation to consider comments submitted after the end of the comment period.

III. ANTITRUST LAW

A. State Oil Co. v. Khan

In *Khan*, the U.S. Supreme Court reversed a 1968 decision finding that vertical maximum pricing constraints were *per se* illegal, instead determining that they were to be evaluated under the rule of reason standard. Kahn had entered into an agreement with State Oil to lease and operate a gas station owned by State Oil. Under the agreement, Kahn would purchase gasoline from State Oil at a price equal to State Oil's suggested retail price, minus a margin of 3.25 cents per gallon. While Kahn was not required to sell the gas at the suggested retail price, if it charged an amount

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7. Id.
8. 105 F.3d 715 (D.C. Cir. 1997).
more than this price, it was obliged to remit the excess to State Oil. Kahn could charge a price that was less than the suggested retail price, but this would reduce the 3.25 cents per gallon margin.

Kahn’s business failed and Kahn sued State Oil, alleging the maximum price scheme was an illegal pricing constraint. The district court found in favor of State Oil, holding that Khan had failed to show that a different pricing arrangement would have increased its sales, or that State Oil had market power or had affected competition in the relevant market. The court of appeals reversed, holding that under the Supreme Court’s ruling in Albrecht v. Herald Co., the pricing scheme was per se illegal.

The Supreme Court, in evaluating the continued validity of its Albrecht holding, stated that stare decisis, while of importance in establishing settled principles of law, is not an inexorable command. Finding that there was insufficient economic justification for the use of the per se rule, the Court determined that the rule of reason should apply (minimum vertical price constraints would remain illegal per se). The Court reasoned that unless the supplier is a monopsonist, it could not set the maximum price too low, or else it will drive its dealers to competing suppliers. The Court stated that maximum pricing schemes might be necessary to prevent a dealer from exploiting any monopoly power it may have, and may benefit consumers by leading to lower prices. In addition, a supplier might set a maximum price to prevent dealers who are willing to suffer decreased sales volumes in exchange for a higher profit from each unit sold, from setting prices at a level that reduce the volume of goods the dealer purchases from the supplier. The problems inherent in maximum pricing constraints, such as a loss of dealer flexibility or the fact that they may be a disguised form of minimum pricing, can be adequately dealt with through the application of a rule of reason analysis.

B. County of Stanislaus v. Pacific Gas & Electric Co.

In the Stanislaus case, a class action involving those who received service from Pacific Gas and Electric between 1988 and 1993, the Ninth Circuit affirmed the district court’s determination that the filed-rate doctrine bars federal antitrust market preclusion claims, federal antitrust price-fixing claims, and state antitrust price-fixing and market preclusion claims. Appellants argued that Canadian producers and Alberta & Southern Gas Company (A&S), a wholly-owned subsidiary of PG&E, conspired to sell Canadian gas to PG&E for a price above the market rate. A&S sold the gas to Pacific Gas Transmission Company (PGT), a wholly-owned subsidiary of PG&E that owns and operates the pipeline that carried the gas from the U.S.-Canadian border to California. PGT, in turn, sold the gas to PG&E. Appellants also claimed that PG&E and PGT prevented PG&E’s competitors from gaining access to PGT’s pipeline by “stuffing” the pipeline through excessive purchases of Canadian gas.

11. 114 F.3d 858 (9th Cir. 1997).
Regulatory Administration (ERA), the FERC and the California Public Utilities Commission (CPUC) approved the various transactions giving rise to this proceeding.

The Ninth Circuit found that the filed rate doctrine “has barred antitrust recovery by parties claiming injury from the payment of filed rates for goods or services.” The court stated that the doctrine prohibits the federal price fixing claim. In addition, the court asserted that the filed rate doctrine precludes the claim that PG&E and PGT prevented competitors from gaining access to PGT's pipeline. Noting that this was a matter of first impression, the court stated that such claim is, in effect, “a challenge to the quantity of gas that PG&E purchased from Canadian producers; because such quantities had received ERA approval and authorization, the claims cannot overcome the filed rate doctrine’s clear instruction that ERA-approved volumes are conclusively reasonable.” Finally, the court denied the state law claims, finding that the filed rate doctrine also bars those claims.


In the Schuylkill case, the Third Circuit affirmed the district court's dismissal of an antitrust claim filed by Schuylkill Energy Resources, Inc. (SER) against Pennsylvania Power & Light Company (PP&L). SER's claim alleged that PP&L's curtailment practices constituted illegal acts of monopolization and attempted monopolization. PP&L purchased power from SER, a qualifying cogeneration facility as defined under PURPA. Under the agreement, PP&L was entitled to curtail its purchases when required by a force majeure or system emergency. PP&L interpreted these provisions to include instances when demand fell below certain levels. SER claimed that PP&L had used the provisions to curtail purchases for economic reasons, rather than legitimate system emergencies.

SER's complaint in the district court was initially stayed pending a related proceeding before the Pennsylvania Public Utility Commission and eventually dismissed. The court of appeals affirmed this dismissal, finding that SER had not stated a claim for which relief could be granted. The court noted that the antitrust laws were intended to protect consumers and competition in the market in which the competition occurs. The court denied SER's claims that, by harming SER, PP&L's practices harmed competition; the court found that since SER was supplier rather than a competitor, no injury under these provisions arose. The court also rejected SER claims that PP&L's consumers were harmed by artificially high rates, holding that this issue was one for the Pennsylvania Public Utility Commission. As to SER's claims that consumers were harmed by the environmental impact of PP&L's actions, the Court held that this type of issue was beyond the scope of the antitrust laws.

12. Id. at 862 (citing Keogh v. Chicago Northwestern Ry. Co., 260 U.S. 156 (1922)).
13. 114 F.3d at 863-64.
14. 113 F.3d 405 (3d Cir. 1997).
D. Crossroads Cogeneration Corp. v. Orange and Rockland Utilities, Inc.\(^\text{15}\)

In the *Crossroads* case, the court dismissed claims brought by the owner of a qualifying cogeneration facility that Orange and Rockland Utilities, Inc. (O&R) had engaged in acts of monopolization and price discrimination. The court found that Crossroads Cogeneration Corp. (Crossroads) failed to state a claim that was actionable under the antitrust laws. In 1987, O&R entered into an agreement to purchase power from an energy supplier; the agreement was assigned to Crossroads in 1990. Both the original agreement and the assignment were approved by the New York Public Service Commission (NYPSC). Subsequently, Crossroads added a gas turbine to the facility and began to deliver and charge O&R for the output from this turbine. O&R filed a petition for a declaratory order from the NYPSC that it was not obliged to take or purchase power in excess of the amounts called for under the agreement. After the NYPSC granted O&R’s petition, Crossroads initiated the instant proceeding, asserting that O&R had engaged in acts of monopolization and attempted monopolization contrary to the Sherman Act and acts of price discrimination illegal under the Robinson-Patman Act.

The court dismissed the Sherman Act claims for failure to state an actionable claim, holding that Crossroads failed to plead a relevant market or to plead that O&R possessed or threatened to possess monopoly power in such market. In addition, the court found that because Crossroads was not a consumer or a competitor of O&R, its injuries were not of the type the antitrust laws were intended to redress. The Robinson-Patman Act price discrimination claims, which were based on O&R’s attempt to sell power at a discounted rates to one of Crossroad’s customers, were also dismissed; the court held that such a claim required two or more sales at differing rates resulting in an injury to competition, and no such sale or injury had occurred.

E. Snake River Valley Electric Ass’n v. PacifiCorp\(^\text{16}\)

In the *Snake River* case, the district court denied PacifiCorp’s motion to dismiss or stay antitrust claims relating to a refusal to provide service. Snake River Valley Electric Association (Snake River an association of non-profit electric cooperatives) sued, alleging that PacifiCorp’s failure to transmit power to it constituted a restraint of trade and an illegal form of exclusive dealing. Snake River sought to purchase power from PacifiCorp to sell to its members, or to purchase power elsewhere and have it transmitted by PacifiCorp; many of Snake River’s members also purchased power from PacifiCorp or its subsidiaries.

PacifiCorp moved to dismiss the claims arguing that its actions were immunized under the state action doctrine, or, in the alternative, should be stayed because the FERC or the Idaho Public Utilities Commission (Idaho...
PUC) had primary jurisdiction over such claims. The court denied PacifiCorp's motion for dismissal. The court found that although Idaho law discouraged cooperatives from competing for existing customers of an electric utility, PacifiCorp's actions were not immunized to the extent PacifiCorp prevented Snake River from serving its existing customers. As to the second prong of the state-action test, the court found that the state had failed to actively supervise the challenged activity. As to the denial of service on behalf of new customers, the court found that Idaho statutes allowed competition for new customers in some instances; thus there was no state policy immunizing actions by PacifiCorp that sought to prevent Snake River from serving new customers. The court also denied the request for stay, finding that no special expertise by an agency (such as the FERC or the Idaho PUC) was required in this instance.

IV. FEDERAL POWER ACT -- HYDROELECTRIC LICENSING (AND RELATED ENVIRONMENTAL ISSUES)

A. Farmington River Power Co. v. FERC17

In Farmington, the court vacated and remanded the FERC’s order, which required the operator of an unlicensed dam to pay the owners of upstream dams for headwater benefits. The court construed section 10(f) of the FPA to permit the FERC to assess the owner of an unlicensed dam for headwater benefits only for periods following actual notice to the owner of its potential liability for such charges. The court remanded to the FERC the question of when the dam operator had received the required notice. The court also ruled that the FERC violated section 27 of the FPA by charging the dam owner for water to which it had a vested right under state law.

B. State of Wisconsin v. FERC18

In the Wisconsin case, the court denied the petitions for review of two state agencies that challenged the FERC’s orders approving the transfer of the licenses for two hydroelectric projects. The state agencies contended that the FERC should have inquired further into the financial ability of the transferee to ensure the projects’ continued environmental compliance and to provide sufficient financial resources to cover the costs of decommissioning the dams.

The court held that the FERC was not required to hold an evidentiary hearing on the applications. It rejected the state agency’s argument that it was entitled to comment on the FERC staff’s proposed decision to approve the license transfer applications and review the documents on which the staff was relying before the staff issued an order to that effect. The court further held that the FERC’s decision to approve the license transfer

17. 103 F.3d 1002 (D.C. Cir. 1997).
18. 104 F.3d 462 (D.C. Cir. 1997).
was supported by substantial evidence, and it rejected the claim that the FERC should have inquired into the cost of future environmental compliance or decommissioning rather than deferring these issues until the relicensing of the project at the expiration of the existing license.

C. Rainsong Co. v. FERC

In Rainsong, the court upheld the FERC's interpretation that, when considering an application for a license for a hydropower project on a federal reservation, the FERC must make a threshold finding under section 4(e) of the FPA that the project "will not interfere or be inconsistent with the purpose for which such reservation was created or acquired" before the FERC discharges its further responsibility under section 4(e), "in deciding whether to issue any license," to give "equal consideration" to energy conservation, fish and wildlife, recreation, and environmental-quality concerns, as well as "power and development purposes." The court nonetheless remanded the FERC's orders denying the license application in this case because the FERC, rather than making its own finding that the project would be inconsistent with the purposes of the national forest at issue, relied instead on the Forest Plan issued by the Forest Service.

D. OMYA, Inc. v. FERC

In OMYA, the court rejected a hydroelectric project licensee's objections to the conditions the FERC imposed upon relicensing the project, including the requirement to file a recreation plan and to implement a historic preservation plan. The court's per curiam decision upholding the FERC's decision found that most of the licensee's arguments had not been preserved for appeal. The court also rejected the proposition that a Fifth Amendment takings claim was valid because the licensee's exclusive remedy is an action under the Tucker Act. The licensee had argued that the license conditions made the project uneconomic, and the FERC failed to give "equal consideration" to "the power and developmental purposes" of the dam as well as the recreational and historic purposes. The court held this argument was not yet ripe, but the licensee could raise this issue in further FERC proceedings once the costs of compliance with the license conditions were established.

E. State of North Carolina v. FERC

In North Carolina, the court upheld the FERC's amendment of a hydropower license to permit the City of Virginia Beach, Virginia, to build intake facilities within the project to withdraw water for transport to the city. The State of North Carolina contended that the FERC violated sec-

19. 106 F.3d 269 (9th Cir. 1997).
20. Id. at 272.
22. 112 F.3d 1175 (D.C. Cir. 1997).
tion 401(a)(1) of the Federal Water Pollution Control Act (the Clean Water Act) by issuing the license amendment without first requiring a water quality certification from North Carolina.

The court held that the FERC did not have to require that water quality certification be obtained from North Carolina before amending the project license to permit the City's project. The court adopted the FERC's view that the relevant activity permitted by the license amendment was the construction and operation of the City's water intake project, and that this activity required only a water quality certification from Virginia. The court also upheld the FERC's decision to amend the license to permit the City's water withdrawal project, including the finding that the Virginia Beach region needed the water to be withdrawn by the project.

Judge Wald dissented, disagreeing with the Court's conclusion that no water quality certification by North Carolina was required and concluding that the FERC's finding that Virginia Beach needed the water was arbitrary and capricious.

F. Keating v. FERC

In Keating, the court rejected a challenge to the FERC's denial of a hydroelectric license application for a project located in a national forest. Agreeing with the Ninth Circuit's decision in Rainsong, the court held that the FERC erred in deferring to the Forest Service's plan to determine whether the project would be inconsistent with the purposes for which the forest was created. Nonetheless, the court denied the petition for review, because the FERC's decision also rested on the alternative finding that complying with the Forest Service's section 4(e) license conditions would render the project uneconomic.

G. Southern California Edison Co. v. FERC

In Southern California Edison, the court rejected objections to other license conditions imposed under section 4(e) of the FPA, this time in the context of the relicensing of existing projects located on federal lands. The court upheld as reasonable the FERC's interpretation that section 4(e) of the FPA requires the FERC to include in such new licenses the conditions recommended by the federal agency administering the federal lands on which the project is located. The court also held that, in developing their mandatory license conditions pursuant to section 4(e), the federal land agencies are not confined to the purposes for which the federal reservation was originally acquired or created, but may look to the purposes for which the land is managed at the time of relicensing, including current environmental, wildlife, and recreational objectives.

23. 114 F.3d 1265 (D.C. Cir. 1997).
24. See Section IV.C. of this article for a discussion of Rainsong.
25. 116 F.3d 507 (D.C. Cir. 1997).
H. Skokomish Indian Tribe v. FERC

In Skokomish, the court denied an Indian tribe’s petition for review of FERC orders denying the tribe’s application for a preliminary permit to develop a hydroelectric project. The FERC held that the tribe’s proposal conflicted with a municipality’s pending relicensing application for an existing project in violation of FERC regulations. The court upheld the FERC’s interpretation of its regulations that the tribe’s proposal to use the same water that the municipality proposed to use conflicted with the municipality’s application.

I. American Rivers, Inc. v. FERC

In American Rivers, the court vacated and remanded orders in which the FERC issued licenses for hydroelectric projects without license conditions that a state had sought to impose pursuant to its water quality certification authority under section 401(a)(1) of the Clean Water Act. The FERC declined to include these license conditions because it determined they exceeded the state’s certification authority under section 401. The court held section 401 requires the FERC to incorporate all state-imposed water-quality certification license conditions and the legality of such license conditions can only be challenged by the licensee in a court of appropriate jurisdiction. The court distinguished the D.C. Circuit’s 1991 decision in Keating v. FERC, on which the FERC relied, concluding Keating addressed “the narrow question of the [FERC’s] authority to determine whether a valid section 401 certificate exists prior to issuing its license.”

The court also rejected the FERC’s arguments that the FPA preempts state law and the state-imposed license conditions in this case conflicted with requirements of the FPA.

V. Federal Power Act -- Electric Regulatory Law

In 1997, the U.S. Courts of Appeals issued no reported decisions involving judicial review of the FERC decisions issued under Part II of the FPA. In part, this development is due to an apparent willingness by the D.C. Circuit to dispose of more of the FERC’s appeals by unpublished orders. Moreover, the absence of reported decisions in 1997 is undoubtedly due in large part to the fact that the FERC, the public utilities it regulates under part II of the FPA, and the energy bar devoted most of their energies in late 1996 and 1997 to the implementation of the FERC’s regulations on open-access transmission in Order No. 888 and the open access same-
time information system and standards of conduct in Order No. 889. Petitions for review of these orders have been filed and may result in a decision during 1998.

The Ninth Circuit decided an interesting non-FERC case relating to electric rate issues and contracting in Association of Public Agency Customers, Inc. v. Bonneville Power Administration. In APAC, the court upheld a series of decisions by the Bonneville Power Administration (BPA) to enter into long-term transmission and sales agreements with one class of customers (direct services industries customers, or DSI's). In 1992, the BPA began renegotiating its contracts with the DSI customers. Over the next three years, the BPA issued a series of decisions and environmental impact statements, deciding to participate fully as a competitor in the market for power transmission, and entering into long-term transmission and sales agreements with the DSI customers. The BPA concluded that these agreements and its participation as a competitor in the transmission markets best balanced its mandate to market and provide power to the region, while still meeting its environmental concerns. Under the transmission contracts, the BPA would transmit non-federal power on behalf of the DSI customers.

Petitioners in APAC (a group of trade associations and public and energy policy organizations) challenged the BPA's decisions, claiming the BPA exceeded its statutory authority by agreeing to transmit non-federal power. The court found that the BPA's organic statutes were silent on the issue. The court further found, in light of the BPA's broad-based authority and obligation to act in its best business interests, the BPA had not exceeded its statutory authority. The court accepted as reasonable the BPA's determination that the contracts would generate sufficient revenues so that there would be no stranded costs associated with these services.

VI. INTERSTATE COMMERCE ACT -- OIL PIPELINES

A. Amerada Hess Pipeline Corp. v. FERC

In Amerada Hess, the court affirmed the FERC's ruling that the Trans Alaska Pipeline System (TAPS) carriers may not recover the costs of litigating and settling civil suits arising out of the Exxon Valdez oil spill in their tariff rates. The FERC held that these litigation and settlement costs were "extraordinary expenses," not "operating expenses," under the

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33. 126 F.3d 1158 (9th Cir. 1997) (hereinafter APAC).

34. 117 F.3d 596 (D.C. Cir. 1997).
FERC's Uniform System of Accounts (USOA) and that a settlement agreement between the carriers and the State of Alaska prohibited the carriers from recovering extraordinary expenses in their tariffs. The court held the FERC's interpretation of the USOA was entitled to considerable deference and the FERC reasonably treated the litigation and settlement costs as extraordinary expenses under the USOA. The court also accorded deference to the FERC's interpretation of the TAPS settlement agreement to prohibit recovery of extraordinary expenses. Although the carriers had proffered extrinsic evidence supporting their contrary interpretation, the court upheld the FERC's determination that the extrinsic evidence was not probative of the parties' mutual intent when they negotiated the settlement agreement.

VII. NATURAL GAS ACT -- PIPELINE RATE REGULATION

A. Natural Gas Clearinghouse v. FERC

In Natural Gas Clearinghouse (NGC), the court affirmed the FERC's approval of Koch's tariff provision allowing shippers to choose between paying Koch in cash for fuel usage or in-kind. NGC argued Koch's "fuel-gas option" was actually an attempt by the pipeline to sell natural gas in violation of Order No. 636. The court rejected this argument, finding that energy used for transportation is an aspect of the transportation service. The court also found the FERC was reasonable in concluding that NGC's concerns about cross-subsidization were unfounded.

B. Exxon Corp. v. FERC

In Exxon, as discussed above, with the exception of one provision, the court affirmed the FERC's approval of a partially contested settlement between Koch and its customers. On the non-procedural issues, the court noted Koch's interruptible transportation service (ITS) rate increased for Type I service (transportation from one to one hundred miles), although the rates for all greater distances decreased. The court found that the increase in short-haul rates would result in subsidization of long-haul shippers by short-haul shippers. In addition, the court deferred to the FERC's approval of Koch's use of demand data from the entire twelve-month test period, rather than requiring Koch to limit its demand analysis to the last two months of the test period. Although Koch's firm transportation demands did increase during the last two months of the test period, the court agreed with the FERC that the increase was not necessarily predictive of future demand.

35. 108 F.3d 397 (D.C. Cir. 1997).
36. 114 F.3d 1252 (D.C. Cir. 1997).
C. Williston Basin Interstate Pipeline Co. v. FERC

In Williston, the court affirmed the FERC's order requiring Williston to sell certain stored gas at cost rather than market price. Williston had stored the gas when it performed a merchant function, before the enactment of Order No. 636. Noting that the FERC had been reluctant to require pipelines to bear losses related to surplus gas supplies resulting from Order No. 636, the court asserted that symmetry required disallowing pipelines to benefit economically from surplus gas sold due to restructuring. In addition, the court found that the Commission's decision was consistent with its general cost allocation scheme under Order No. 636.

D. Michigan Gas Co. v. FERC

The court in Michigan Gas affirmed the FERC's orders authorizing ANR Pipeline Company (ANR) to construct a new delivery point, i.e., a point which allowed the customer to bypass Michigan Gas Company's (MiGas) local distribution system. The Board of Public Works of the City of Holland, Michigan (BPW) contracted with ANR and Consumers Power, another LDC, to obtain natural gas as a replacement for oil used for ignition purposes at one of its coal-fired stations. The BPW proposed to construct the pipeline to connect to ANR's system, and ANR proposed to construct the delivery tap. The FERC granted the requested authority over MiGas's argument that the cost of the ANR connection would be greater than the cost of connecting BPW's pipeline to MiGas and would create "wastefully duplicative facilities." The court found that MiGas presented no evidence that any redressable injury would be caused by the construction of the ANR delivery tap and that all of MiGas's arguments were related to the construction of the BPW pipeline. Hence, the court concluded that reversing the FERC order allowing the construction of ANR's delivery tap would not remedy the alleged harm that MiGas described and, therefore, that the petition for review should be denied.

E. JMC Power Projects v. FERC

The court in JMC affirmed the FERC's regulations requiring natural gas companies which file new rate schedules to also file "[a] motion, in case of minimal suspension, to place the proposed rates into effect at the end of the suspension period; or, a specific statement that the pipeline reserves its right to file a later motion to place the proposed rates into effect at the end of the suspension period." JMC argued that section 4(e) of the NGA required such a motion to be filed only in cases of rate increases, not increases.

37. 115 F.3d 1042 (D.C. Cir. 1997).
38. 115 F.3d 1266 (6th Cir. 1997).
39. Id. at 1269.
41. Id. at *2.
rate decreases. However, the court agreed with the FERC's interpretation that a motion must be filed with any type of rate change, because the FERC may suspend any change in rates or services.

F. Williams Natural Gas Co. v. FERC

In Williams, the court affirmed the FERC's interpretation of Williams' 1992 settlement with its customers concerning how Williams would recover amounts over the first fifty million dollars in gas supply realignment costs and costs related to restructuring under Order No. 636. Williams argued that it was entitled to recover the costs from historic customers by means of direct billing. The FERC found that the language in the settlement was ambiguous, and allocated the costs in question among Williams' current customers according to a formula established by Order No. 636, under which such costs are charged ten percent to the pipeline's current interruptible shippers through a volumetric surcharge and the remainder to current firm transportation customers through a reservation charge.

The court agreed with the FERC's decision that the settlement's language was ambiguous, and deferred to the FERC's resolution of the ambiguity. The court also noted the FERC had issued an order on remand of Order No. 636 determining the allocation of costs to its customers depended on the circumstances and not a generic ten percent. The court stated that the amounts at issue in the proceeding would be resolved in the Order No. 636 remand proceeding.

G. Union Pacific Fuels. Inc. v. FERC

In Union Pacific, the court upheld the FERC's orders requiring an interstate pipeline to change its rate structure from "modified fixed/variable" (MFV) to "straight fixed/variable" (SFV), even as to shippers which had previously obtained long-term contracts with the pipeline company that provided for MFV rates. While this change shifted economic risks from the pipeline to the shippers, the court affirmed the FERC's finding that that was acceptable given the larger policy considerations. The court noted that each shipper's contract contained a standard Memphis clause specifying that the contract's rates were subject to the FERC's regulation and, thus, to change in FERC rate regulation. Noting that this change followed Order No. 636's policy decision to require SFV rates in order to prevent price distortions among competing pipelines, the court emphasized the FERC's duty and ability to make and, at times, change policies. The court concluded that one person may benefit from a change in policy to the detriment of others (inherent in most policy decisions) but that was not enough to hold that the FERC's order was arbitrary and capricious.

42. No. 96-1280, 1997 WL 244256 (D.C. Cir. Apr. 30, 1997).
43. 129 F.3d 157 (D.C. Cir. 1997).
H. **Northern Border Pipeline Co. v. FERC**

In *Northern Border*, the court upheld a FERC ruling in an accounting proceeding that an interstate pipeline which had purchased a pipeline segment from another pipeline at its original construction costs must take into account the accumulated depreciation before the sale in computing its rate base. The court noted that the FERC was following its "bedrock principal" of original cost accounting, pursuant to which a purchaser of a pipeline facility must generally book the facility at its original cost less accumulated depreciation unless it can prove that an excess amount paid "accrued to" the benefit of the pipeline's ratepayers. The court emphasized that the pipeline company was free to seek to prove such accrued benefit in a separate NGA section 4 rate proceeding or NGA section 7 certificate proceeding, where the ratepayers could participate and make their view known. The court upheld the FERC's decision not to consider such accrued benefit claims in accounting proceedings, which are generally conducted between the pipeline company and the FERC's accounting division without any intervenors.

I. **Pennsylvania Office of Consumer Advocate v. FERC**

In *Pennsylvania OCA*, the court upheld the FERC's decision approving Carnegie Natural Gas Company's (Carnegie) tariff provisions permitting the pipeline to retain revenues from its assessment of imbalance and OFO penalties. Appellants challenged the FERC's approval, arguing that it should have required Carnegie to credit the revenues to customers who were not responsible for such imbalances or OFOs; otherwise, the tariff provided the company with an incentive to assess penalties and resulted in windfall profit above its cost of service. The court upheld the FERC's orders because Carnegie did not collect penalty revenues in 1996, the FERC pledged to monitor the level of penalty revenues, and the FERC established accounting practices to help track the revenues. The court reserved the issue on future penalty revenues for another day.

VIII. **NATURAL GAS ACT (NON-PIPELINE RATE REGULATION) AND NATURAL GAS POLICY ACT**

A. **WRT Energy Corp. v. FERC**

In the *WRT* case, the court upheld the FERC's reversal of the Louisiana Office of Conservation's determination that gas producers' wells that previously produced gas cap gas, until fit with new technology for removing gas from the brine in the aquifer, did not qualify for NGPA purposes as high-cost natural gas under section 107 of the NGPA.

44. 129 F.3d 1315 (D.C. Cir. 1997).
45. 131 F.3d 182 (D.C. Cir. 1997), corrected by, 134 F.3d 422 (D.C. Cir. 1998).
46. 107 F.3d 314 (5th Cir. 1997).
B. Rocky Mountain Natural Gas Co. v. FERC

In Rocky Mountain, the court remanded the FERC's orders for a second time, responding to the FERC's approval of retroactive abandonment of Grynberg's interstate dedication of gas from six wells. At issue in the case was a 1968 contract between Grynberg and Mountain Fuel Company which provided that Grynberg sell gas from certain acreage to Mountain Fuel, and the FERC certificate covering that sale. Gas from one well on that acreage was sold to Mountain Fuel. Subsequently additional wells from surrounding acreage was committed to Rocky Mountain, an intrastate pipeline. Rocky Mountain later decided that the gas had been dedicated to interstate commerce, reducing its payments to Grynberg based on the FERC's ceiling price for interstate gas. On the first appeal, the Court vacated the FERC's order, holding that the FERC had not properly interpreted the 1968 contract as a whole to determine the issue of dedication. On remand, the FERC upheld its original contract interpretation, but allowed retroactive abandonment because no interstate purchaser was harmed regardless of whether Grynberg acted with knowledge (or presumed knowledge) of the scope of interstate dedication.

On the second appeal, the court held that the FERC's failure to analyze Grynberg's knowledge of the scope of dedication was not consistent with its precedent in Mitchell Energy Corp. The court again remanded the matter for FERC to explain its decision further.

C. Pacific Gas & Electric Co. v. FERC

The court in Pacific Gas affirmed the FERC's order allowing El Paso Natural Gas Company (El Paso) to abandon certain facilities, finding those facilities to be non-jurisdictional gathering facilities when "spundown" to El Paso Field Services Co. (Field Services), a wholly-owned subsidiary of El Paso. Appellants argued that allowing Field Services to operate El Paso's gathering facilities without regulatory oversight or significant competition would lead to unreasonably high gas prices. In addition, Appellants cited Northern Natural Gas Co. v. FERC in support of its argument that the FERC may regulate gathering facilities owned by affiliates of natural gas companies. The court found that Conoco, Inc. v. FERC controlled the issue, although it noted that the creation of an affiliated gathering company changed a heavily regulated service into a service outside the FERC's jurisdiction. Finally, although it found curious the FERC's suggestion that it does not have the power to examine whether abandonment of facilities to a nonjurisdictional entity would be in the public interest, the court concluded that the FERC had adequately considered and protected against possible antitrust problems that could result from El

47. 114 F.3d 297 (D.C. Cir. 1997).
49. 106 F.3d 1190 (5th Cir. 1997).
50. 929 F.2d 1261 (8th Cir. 1991).
Paso's abandonment.

D. Sea Robin Pipeline Co. v. FERC

In Sea Robin, the court vacated the FERC's finding that Sea Robin Pipeline Company's (Sea Robin) gathering facilities were jurisdictional as transmission facilities. The FERC had found that Sea Robin's extensive offshore facilities did not perform a gathering function under its primary function test. The court found that despite the FERC's stated policy (i.e., that the test involves balancing of factors and a sliding scale as to size and diameter), it appeared that the FERC treated Sea Robin's large size as a single-factor, bright-line test. The court noted that the FERC excluded at least four factors from the primary function test on the basis that they were not informative for offshore pipelines. The result, according to the court, was a size litmus test. The court further criticized the FERC's emphasis on business purpose, ownership, and prior certification as running afoul of Congress' choice to define the FERC jurisdiction by physical characteristics. The court stated that these factors must be secondary to physical criteria; however, the court was careful not to dictate that a different result was necessary on remand, stating that the FERC could reformulate its primary function test.

IX. PUBLIC UTILIty REGULATORY POLICIES ACT

A. Niagara Mohawk Power Corp. v. FERC

In the Niagara Mohawk case, the court dismissed petitions for review of the FERC declaratory orders holding that state statutes requiring a utility to purchase electricity from a qualifying facility (QF) at a rate higher than the utility's "avoided cost" are pre-empted by section 210 of PURPA. The FERC issued an order generally recognizing that state statutes are pre-empted by section 210 to the extent that they require a utility to purchase electricity at rates higher than the utility's avoided cost. However, the FERC stated that in this case it would not apply its general pre-emption analysis to invalidate existing QF-utility contracts that had already been approved under state law and were not the subject of challenges on pre-emption grounds. Parties sought review of both the pre-emption holding and the failure to apply that holding to existing contracts.

The court dismissed the petitions for lack of jurisdiction. Relying on its analysis of the enforcement scheme of section 210 of PURPA in Industrial Cogenerators v. FERC, the court held that the FERC's declaratory order had no legally binding effect and did nothing more than set forth the position that the FERC would take in an enforcement action before a federal district court. The court held that its pre-enforcement review of the

52. 127 F.3d 365 (5th Cir. 1997), pet. for reh'g and suggestion for reh'g en banc pending.
53. 117 F.3d 1485 (D.C. Cir. 1997).
54. 47 F.3d 1231 (D.C. Cir. 1995).
FERC's declaratory orders would interfere with this statutory enforcement scheme, because the court would necessarily have to determine whether the state had properly implemented PURPA.

B. New York State Electric & Gas Corp. v. FERC

In the NYSEG case, the court followed its Niagara Mohawk analysis that was decided the same day. In its orders on review, the FERC ruled that the rate a utility pays to purchase power under two long-term QF contracts complied with section 210 of PURPA because the rate was equal to the utility's estimated avoided costs at the time the utility entered into the contract. Before the court, the utility sought to distinguish Industrial Co-generators on the ground that: (i) it had petitioned the FERC to modify the QF contract rates under section 206(a) of the FPA; (ii) it had not commenced an enforcement action in district court and would not need to do so if the FERC granted it relief; and (iii) it had asked the FERC to revise or waive its PURPA regulations to require modifications of the rates under its QF contracts.

The court concluded it was irrelevant that the utility had not yet commenced an action in the district court. It also declined to review the FERC's denial of relief under the FPA or its refusal to modify its PURPA regulations. The court held that reviewing either question would necessarily decide matters that should be decided in the first instance by the district court under the PURPA enforcement scheme.

X. ENERGY TAXES

A. General Motors Corp. v. Tracy

In General Motors, the U.S. Supreme Court upheld Ohio sales and use taxes applying to natural gas purchases from all sellers that do not fit Ohio's definition of a "natural gas company." Ohio's local distribution companies (LDCs) fit within the definition, but pursuant to the Ohio Supreme Court's decision on review at the United States Supreme Court, producers and independent marketers generally do not. Therefore, under the Ohio law, only Ohio LDCs were protected from these taxes. General Motors, which purchased almost all the gas for its plants from out-of-state marketers, was subject to tax through its marketers and challenged the tax scheme as violative of the Commerce and Equal Protection clauses of the United States Constitution.

The Supreme Court upheld Ohio's taxes on the ground that Ohio LDCs and producers and independent marketers are not similarly situated for purposes of constitutional analysis because they serve different markets. The Court found that the LDC's bundled product serves the core

55. 117 F.3d 1473 (D.C. Cir. 1997).
56. 47 F.3d 1231 (D.C. Cir. 1995).
and residential market, and that the core market would not be better served by interstate sellers. The residential market, according to the Court, would not thrive if Ohio removed the tax disparity. Without the tax differential, competition between LDCs and marketers for the non-core market, a market without a need for bundled protection, would likely increase. The Court emphasized the need to protect the captive core market and, therefore, decided to treat marketers and LDCs differently for Commerce Clause analysis. The Court similarly rejected General Motor’s Equal Protection argument, finding that the challenge was hypothetical because Ohio might apply the taxes to out-of-state LDCs.

B. Nielson-True Partnership v. Commissioner of Internal Revenue

In Nielson-True, the Tax Court agreed with the Internal Revenue Service’s (IRS’s) disallowance of a section 29 “non-conventional fuels” tax credit. This tax credit related to revenues from gas produced from a tight formation under NGPA section 107 (at least for tax periods prior to the date the Natural Gas Wellhead Decontrol Act of 1989 went into effect) where no such formal determination was made by the FERC or a designated jurisdictional state agency under NGPA section 503. After reviewing the history of the NGPA’s provisions on tight formation incentive pricing and the related tax credits, the court agreed with the IRS that it was not enough for the gas to meet the NGPA’s definition of a tight formation (in effect prior to deregulation). Because the taxpayer had failed to obtain a tight formation determination for the well’s production from the state agency or the FERC, the court upheld the IRS’s disallowance of the tax credit.

XI. LIST OF CASES DISCUSSED

(In alphabetical order under each topic.)

ADMINISTRATIVE LAW

Exxon Corp., et al v. FERC, 114 F.3d 1252 (D.C. Cir. 1997).
In re Cajun Electric Power Cooperative, Inc., 109 F.3d 248 (5th Cir. 1997).
No Tanks Inc. v. Public Utilities Commission, 697 A.2d 1313 (Me. 1997).

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ANTITRUST LAW

County of Stanislaus v. Pacific Gas and Elec. Co., 114 F.3d 858 (9th Cir. 1997).

FEDERAL POWER ACT -- HYDROELECTRIC LICENSING

American Rivers, Inc. v. FERC, 129 F.3d 99 (2d Cir. 1997).
Farmington River Power Co. v. FERC, 103 F.3d 1002 (D.C. Cir. 1997).
Keating v. FERC, 114 F.3d 1265 (D.C. Cir. 1997).
OMYA, Inc. v. FERC, 111 F.3d 179 (D.C. Cir. 1997).
Rainsong Co. v. FERC, 106 F.3d 269 (9th Cir. 1997).
Skokomish Indian Tribe v. FERC, 121 F.3d 1303 (9th Cir. 1997).
Southern California Edison Co. v. FERC, 116 F.3d 507 (D.C. Cir. 1997).
State of North Carolina v. FERC, 112 F.3d 1175 (D.C. Cir. 1997).
State of Wisconsin v. FERC, 104 F.3d 462 (D.C. Cir. 1997).

INTERSTATE COMMERCE ACT -- OIL PIPELINES

Amerada Hess Pipeline Corp., et al. v. Bonneville Power Admin., 126 F.3d 1158 (9th Cir. 1997).

NATURAL GAS ACT -- PIPELINE RATE REGULATION

Exxon Corp., et al. v. FERC, 114 F.3d 1252 (D.C. Cir. 1997).
Michigan Gas Co. v. FERC, 115 F.3d 1266 (6th Cir. 1997).
Natural Gas Clearinghouse v. FERC, 108 F.3d 397 (D.C. Cir. 1997).
Northern Border Pipeline Co. v. FERC, 129 F.3d 1315 (D.C. Cir. 1997).
Williston Basin Interstate Pipeline Co. v. FERC, 115 F.3d 1042 (D.C. Cir. 1997).

NATURAL GAS ACT (NON-PIPELINE RATE REGULATION) AND NATURAL GAS POLICY ACT

Pacific Gas & Electric Co., et al. v. FERC, 106 F.3d 1190 (5th Cir. 1997).
Rocky Mountain Natural Gas Co. v. FERC, 114 F.3d 297 (D.C. Cir. 1997).
Sea Robin Pipeline Co. v. FERC, 127 F.3d 365 (5th Cir. 1997).
WRT Energy Corp. v. FERC, 107 F.3d 314 (5th Cir. 1997).

PUBLIC UTILITIES REGULATORY POLICIES ACT
New York State Electric & Gas Corp. v. FERC, 117 F.3d 1473 (D.C. Cir. 1997).
Niagara Mohawk Power Corp. v. FERC, 117 F.3d 1485 (D.C. Cir. 1997).

ENERGY TAXES
General Motors Corp. v. Tracy, 117 S. Ct. 811 (1997).

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