Report of The Committee On Certificate and Authorization Regulations Under The Natural Gas Act

THIS REPORT SUMMARIZES major developments in the certification and regulation of jurisdictional pipeline companies and regulations covering independent producers of natural gas, pursuant to Section 7 of the Natural Gas Act, 15 U.S.C. § 717. Since the last Committee report of May 10, 1979, the Commission has taken a number of actions to implement the provisions of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. § 3301. Most of these actions have related to the establishment of wellhead pricing controls under Title I and incremental pricing thresholds under Title II of the Act. Several actions, however, affect the regulation of jurisdictional pipeline companies, such as Commission regulations governing transportation under Section 311 of the NGPA.

CHAPTER I: REGULATION OF JURISDICTIONAL PIPELINE COMPANIES UNDER THE NATURAL GAS ACT

A. *Certification of New Pipeline Projects.*

On October 12, 1979, the Commission approved the Pacific Alaska LNG Company Project (CP75-140 *et al.*,). This project is discussed in detail *infra*, Chapter III.

B. *Changes in Commission Policy Regarding Abandonment, Dedication and Diversion.*

On June 18, 1979, the United States Supreme Court ruled that a producer's certificated sale of natural gas includes a service obligation which may not be terminated without prior Commission approval under Section 7(b) of the Natural Gas Act. *United Gas Pipe Line Company* v. *McCombs,* 442 U.S. 529 (1979). In so holding, the Court reversed the Tenth Circuit Court of Appeals. *McCombs* v. *Federal Energy Regulatory Commission*, 570 F.2d 1376, 1382 (10th Cir. 1978). Relying on Section 7(b) and its decisions in *California* v. *Southland Royalty Co.*, 436 U.S. 519 (1970, and *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960) the Court held that a producer must obtain prior Commission approval for abandonment even where wells on a tract are depleted. 62 L.Ed. 2d at 66.

Shortly after the Supreme Court's *McCombs* decision, the Tenth Circuit again ruled upon the Commission's abandonment authority under Section 7(b) of the Natural Gas Act. In *Texas Oil & Gas Corp.* v. *Michigan Wisconsin Pipe Line Co.*, 601 F.2d 1144 (10th Cir. 1979), Shell Oil Company had drilled a successful gas well in 1962 on a tract of land in Oklahoma, delivering all gas produced in interstate commerce to Michigan Wisconsin Pipe Line Company until January 1969. In 1969, Shell applied for and obtained authority from the Oklahoma Corporation Commission to abandon the well. Shell did not apply, however, to the Commission for

authority to abandon its sale to Michigan Wisconsin. Subsequently, a successful gas production well was drilled on the tract by Texas Oil and Gas Corp., and Texas Oil commenced intrastate deliveries of natural gas to Delhi Gas Pipeline Corporation pursuant to a new gas purchase agreement. One month later, Texas Oil filed a complaint with the District Court requesting a declaratory judgment against the Commission and Michigan Wisconsin holding that the natural gas produced from such leases was not dedicated to interstate commerce.

The District Court granted summary judgment for plaintiffs Texas Oil, *et al.* On appeal, however, the Tenth Circuit reversed and remanded the case with instructions that the action be dismissed, in deference to the Commission's primary jurisdiction over the matter. The Tenth Circuit based its decision in large part on the Supreme Court's decision in *McCombs, supra,* that the certificated interstate service can be terminated only in accordance with Section 7(b) of the Natural Gas Act. 601 F.2d at 1146. On December 10, 1979, the United States Supreme Court denied plaintiff's petition for a writ of *certiorari* to review the Tenth Circuit decision. 444 U.S. 991 (1979).

Similarly, the Fifth Circuit determined on December 14, 1979 that the Commission has primary jurisdiction of the issue concerning abandonment where production of natural gas from the field covered by a certificate of public convenience and necessity had ceased 15 years earlier, the acreage having been *de facto* abandoned, and present leaseholders had no connection with the original certificate holders. *Texas Oil & Gas Corporation* v. *Valley Gas Transmission Company*, 608 F.2d 231 (5th Cir. 1979).

Thus, when the present leaseholders, Texas Oil & Gas Corporation, discovered natural gas on the land, Valley Gas Transmission Company, the buyer under the original certificate, asserted a right to the gas under the terms of the 1960 certificate. Texas Oil filed suit in the federal District Court to quiet title against Valley's claim, but the District Court determined that the Commission had primary jurisdiction over the matter. The Fifth Circuit affirmed the District Court decision.

While this appeal was pending, Valley initiated a proceeding before the Commission, asserting its rights under the 1960 certificate. The Commission issued its decision, holding that Texas Oil must repay Valley for all gas sold up to December 1, 1978. The Commission determined that, thereafter, gas produced from the land covered by the 1960 certificate came within the exception in the NGPA Section [15 U.S.C. § 3301(18)(B)(ii)]. On February 8, 1980, the Commission denied rehearing in the proceeding.

In *J. G. Stone, et al.*, Opinion No. 48 (July 27, 1979), the Commission held that a producer did not violate Section 7(b) of the Natural Gas Act by failing to request abandonment authorization when its sales to an interstate pipeline ceased because the producer consumed all of the gas produced pursuant to a reservation clause contained in its contract which in turn was incorporated in the certificate issued by the Commission. However, the leases remained dedicated to interstate commerce under the Natural Gas Act until at least December 1, 1978.

In addition, the Commission determined that the facilities owned by the interstate pipeline, which were connected to those of the producer, whether or not they may otherwise have been used for production or gathering, were used to effect a sale of gas in interstate commerce and that removal of facilities by the pipeline without abandonment authorization from the Commission was in violation of Section 7(b) of the Natural Gas Act.

On December 12, 1979, the Sixth Circuit upheld the Commission's declaratory order issued on January 27, 1977 that transportation through gathering lines and sales from these gathering lines are subject to the Commission's jurisdiction under Section 7 of the Natural Gas Act. *Public Service Commission of Kentucky* v. *Federal Energy Regulatory Commission*, No. 78-3100. In this case the Kentucky Commission ordered Kentucky West Virginia Gas Company, an interstate pipeline company, to furnish natural gas to local customers under Kentucky law arguing that this transportation of natural gas during the gathering line process is intrastate transportation and is part of the exempt production and gathering process under the Natural Gas Act. The Court ruled that the ultimate sale in other states of a substantial part of a producer's natural gas output involves federal jurisdiction over the entire volume of production; accordingly, transportation in interstate commerce begins at the wellhead.

C. *Budget-Type Certificates: Changes in Commission Policy Governing Short Form Certificate Applications.*

The enactment of the Natural Gas Policy Act of 1978 and continuing increases in the cost of constructing routine pipeline facilities necessitated a change in Commission regulations governing applications for budget-type certificates. [See 18 C.F.R. Section 157.7 (1979)]. Accordingly, in 1979 the Commission initiated a number of rulemaking proceedings to revise its regulations on budget-type certificates.

In Docket No. RM79-37 (order issued April 19, 1979), the Commission proposed to increase the yearly, overall budget-type certificate limit and to increase the single cost limit applicable to on-shore and off-shore projects. The Commission also proposed to amend its regulations by permitting budget-type certificates for the construction of pipeline facilities used to connect company-owned production.

Thereafter, on May 18, 1979, the Commission issued an interim rule to make clear that transportation pursuant to Section 311(b) and 312 of the NGPA also was eligible for budget-type certificate treatment. (Docket No. RM79-43).[1] Both types of transportation generally can be undertaken by an interstate pipeline with only minor changes to its existing pipeline facilities. The interim rule amended the regulations to allow construc-

[1]By Section 311(b) of the NGPA, the Commission may authorize an intrastate pipeline to sell natural gas from its system supply to an interstate pipeline or a local distribution served by an interstate pipeline. By Section 312, the Commission may authorize the assignment to an interstate pipeline of an intrastate pipeline's right to receive natural gas under a particular contract.

tion of such facilities under budget-type certificate authorization, thereby avoiding the need for a full-scale Section 7 certificate proceeding in these cases.

By its Order Nos. 56 and 56(a), issued on November 1, 1979 and January 2, 1980, the Commission consolidated Docket Nos. RM79-37 and RM79-43 and issued final regulations governing budget-type certificates.

The principal changes made by Order Nos. 56 and 56(a) relate to (1) the types of facilities which may qualify for a budget-type certificate; (2) the maximum total annual and single project limitations applicable to gas supply facilities; and (3) the filing and reporting requirements applicable to parties seeking budget-type certificates.

1. Types of Facilities Covered by Order Nos. 56 and 56(a).

The amended regulations authorize the Commission to issue budget-type certificates for "gas supply facilities", which include:

1. Facilities necessary to connect gas supplies purchased from a producer or other similar seller;
2. Facilities to connect a pipeline's production system, including production facilities of an affiliate of the applicant;
3. Facilities to connect gas acquired pursuant to Section 311 or 312 of the Natural Gas Policy Act; and
4. Facilities needed to transport or exchange natural gas.

Excluded from the definition of "gas supply facilities" are facilities built to acquire gas from another pipeline's system supply or from plants manufacturing synthetic gas or gasifying LNG. [See 157.7(b)(4)(ii)].

2. Maximum Total Annual and Single Project Cost Limitations Applicable to Gas Supply Facilities.

Only those facilities which meet maximum annual or single project cost limitations can qualify for a budget-type certificate. The revised regulations establish higher cost ceilings than previously existed. These are:

1. Maximum total cost. During any calendar year under the certificate, the total cost of gas supply facilities shall not exceed the lesser of three percent of the applicant's gas plant (i.e., account no. 101 of the Uniform System of Accounts) or $20,000,000.
2. Single project cost. *On-shore Projects:* Shall not exceed the lesser of twenty-five percent of the certificate holder's total calendar year dollar limit or $2.5 million; *Off-shore Projects:* Shall not exceed the lesser of $3.5 million or the certificate holder's calendar year dollar limit.

An exception is provided for certificate holders having a total calendar year dollar limit of $2 million or less. Here the single project cost limitation is $500,000.

These higher limitations apply only prospectively, i.e., to certificates granted after the effective date of the revised regulations. Significantly, the Commission in Order No. 56 directed its staff to review the dollar limitations on an annual basis and report to the Commission on the need for adjustment.

3. Filing and Reporting Requirements.

By Order Nos. 56 and 56(a) the Commission discontinued the yearly-filing requirement of the old regulations. As a result, budget-type certificates now will be granted for indefinite periods of time. Certificate holders are still required, however, to provide an annual completion report with the Commission. The report must be prepared on a calendar year basis. Section 157.7(b)(7)(i) of the revised regulations also provides that completion reports for budget-type certificates issued before December 1, 1979 shall be filed within sixty days of the certificate's expiration period.

D. *Extensions of Service to New Markets, Distribution Systems and Municipals.*

In 1979, the Commission issued only one decision of significance on the question of extension of service. *Town of Metcalfe, Mississippi* v. *Texas Gas Transmission Corporation*, Docket No. CP78-376, order issued April 9, 1979. On November 20, 1979, the Commission issued an order denying rehearing of its order authorizing an extension of service to the Town of Metcalfe, noting that it had not departed from the policy of denying Section 7(a) applications where the requested service would have an "ascertainable adverse effect" upon existing customers.

In another case, *Columbia Gas Transmission Corporation* v. *Southgate Development Corporation, cert. denied,* U.S. , 62 L.Ed. 2d 134 (1979), Columbia Gas Transmission, an interstate pipeline, had a right-of-way with covenant to provide gas service. The land owner sought service and, when service was refused, sued for breach of contract. Columbia defended on the ground that its Ohio distribution affiliate would be the one to provide service but could not due to a moratorium on new customers. Columbia also argued that the Ohio commission had exclusive jurisdiction since the obligation, if any, to serve had been passed to the distribution affiliate. On appeal, the Ohio court found the duty to provide service was Columbia's and it had breached its duty to attempt to secure the necessary authorization. The Court left the amount of damages for trial court consideration. In Columbia's petition for review to the Ohio Supreme Court, Columbia argued that an award of damages would conflict with the Commission's policy to base curtailments upon end use rather than contractual commitment. The Ohio Supreme Court, and subsequently the U.S. Supreme Court, refused to review the lower court decision.

CHAPTER II: CERTIFICATION OF THE GREAT PLAINS' COAL GASIFICATION PROJECT

By its Opinion No. 69, issued November 21, 1979, in *Great Plains Gasification Associates, et al.*, Docket Nos. CP78-391, *et al.*, rehearing denied Opinion No. 69-A, issued January 21, 1980, the Commission issued a certificate of public convenience and necessity authorizing Great Plains Gasification Associates ("Great Plains") to make sales for resale in interstate commerce of commingled natural gas and coal gas equivalent on a Btu

basis to the output of the proposed Great Plains Coal Gasification plant.* When constructed, the Great Plains' plant will be the world's first commercial-sized high Btu coal gasification facility. The capital cost of the project is estimated at approximately $1.2 billion.

The Commission noted that under the Natural Gas Act it has jurisdiction over the transportation and sale of the production from the gasification plant when that production has been commingled with natural gas moving in interstate transmission facilities (Op. 69, p. 12). The Commission likewise found that its jurisdiction over the transportation and sale of the commingled gas gives it corollary authority and responsibility to look into all factors bearing on the public interest, including Great Plains' non-jurisdictional gasification project facilities and Great Lakes Gas Transmission Company's proposed synthetic gas pipeline, citing *Henry* v. *FPC*, 513 F.2d at p. 405.

The Commission's decision to issue a certificate is based upon the finding that the project will evaluate the feasibility of converting the nation's abundant coal reserves into pipeline quality gas and, therefore, should be considered as an RD&D project (Op. 69, pp. 25-34). Having found that the project qualifies as RD&D investment, the Commission went on to find that special financing provisions are appropriate. Specifically, the Commission approved a tariff and financing plan which implements the following:

(1) A guarantee of the repayment of and interest on the debt in all circumstances and the repayment of and return on equity in most circumstances except where it can be shown that the management of the project or the expenditure of monies was imprudent or that the sponsors did not exercise prudent judgment as to the continuation of the construction of the project (Op. 69, pp. 62-65).

(2) Pipeline purchasers of gas from Great Plains are permitted to track the costs of such gas subject to supporting the overall cost of service justification for such tracking (Op. 69, p. 66; Op. 69-A, pp. 4-6).

(3) The gas purchased from Great Plains may be priced on a rolled-in basis (Op. 69, p. 67).

(4) The project sponsors are permitted to levy a surcharge during construction to recover interest and financing costs on debt, a return on equity and related taxes and similar carrying charges incurred by Great Plains under a coal purchase agreement. The Commission permitted this surcharge approach rather than the conventional AFUDC approach not only on the basis that this is a RD&D project requiring special financing provisions, but also because the Commission made provision for certain safeguards respecting (a) a project monitoring system; (b) the Commission's ability to terminate the project; and (c) the authority to determine whether equity recovery will be permitted in the event of abandonment or termination of the project (Op. 69, pp. 67-69).

*Commissioner Holden concurring in part and dissenting in part.

(5) The Commission reduced the project sponsors' claimed return on equity from 15 to 13 percent and required a periodic rate of return review commencing one year after the in-service date and then every three years thereafter (Op. 69, pp. 70-75).

The Commission refused to adopt Staff's position that an amount equal to the accumulated deferred investment tax credits should be removed from Great Plains' rate base, with a ratable portion of the credit to be restored over the life of the project. The Commission concluded that the sharing of the tax credit benefits proposed by Staff is not mandated under the Internal Revenue Code and that it is within the Commission's regulatory discretion as to whether or not those benefits should be shared (Op. 69, pp. 78-83).

The Commission also rejected the use of a consolidated tax rate in determining the income tax component of Great Plains' cost of service in accordance with Commission Opinion No. 47 in *Columbia Gas Transmission Company, et al.*, Docket Nos. RP75-105, *et al.*, issued July 2, 1979 (Op. 69, p. 84).

Finally, it should be noted that the Commission's approval of the Great Plains' project is conditioned on the project sponsors seeking any federal financial assistance which may be made available for this type of project and, if such assistance is granted, the project sponsors are required to file appropriate financing and tariff modifications for Commission approval (Op. 69, p. 114; Op. 69-A, p. 13).

CHAPTER III: CERTIFICATION OF LNG PROJECTS

On October 12, 1979, the Commission approved the Pacific Alaska LNG Project and terminal site at Point Conception, California. *Pacific Alaska LNG Company, et al.*, Docket Nos. CP75-140 *et al.* The Point Conception facilities are to be utilized for both the Alaska LNG as well as LNG to be imported from Indonesia. The Commission determined that it has exclusive jurisdiction to decide all natural gas issues in this proceeding since the Alaska LNG project, including the transportation of the gas to California, the construction and operation of the facilities, including the ships, and the sale to project sponsors in California all occur solely within the United States. Therefore, all issues in the case come under Section 7 of the Natural Gas Act and none come under Section 3, which involves consideration and approval by the Economic Regulatory Administration, Department of Energy.

In finding that there was a pressing need for the long-term supplies to be made available by the Alaska project, the Commission determined that no available alternatives existed. However, it rejected contentions that it must determine whether other alternative supplies will become available due to other projects since such a determination would be arbitrary.

The Commission also attached a number of conditions to the authorization. One required Pac Alaska to dedicate sufficient reserves, of a stated amount for each of two phases, to support certain deliveries for twelve years. In addition, the Commission required Pac Alaska's initial rates for sales

made pursuant to certificate to be based on the best estimate of the average of the first three years' project costs and LNG throughput. The Commission rejected, however, a proposed condition which would have prohibited the project sponsoring distribution companies from flowing through costs to consumers in the event of project failure before service commenced. The Commission found that such a condition would be an attempt to regulate nonjurisdictional utilities. The Commission also incorporated by reference provisions of the DOE/ERA Order authorizing the importation of gas from Indonesia to Point Conception (ERA Docket No. 77-001-LNG).

Earlier in the Pac Alaska proceeding, Southern California LNG Terminal Company (SCLNG) moved to consolidate its own application for an LNG terminal at Deer Canyon, California, with the ongoing proceedings involving applications to locate an LNG terminal at Point Conception. SCLNG has proposed that in spite of a lack of known future customers for its proposed terminal, its application should be granted, subject to later authorization of its future customers. The Commission denied SCLNG's motion, finding that the records in the Pac Alaska proceeding sufficiently consider alternative sites in order to permit a determination to be made of where the public interest lies. (Pac Alaska LNG *et al.*, Docket No. CP75-140 *et al.*, Order dated April 11, 1979.) Further, the *Ashbaker* doctrine, which provides for the consolidation of mutually exclusive applications, was not applicable since that case turned on "statutory procedural rights rather than on a public interest criterion". Moreover, the Commission noted the fact that it has established a cut-off date after which further hearings will not be considered. Thus, SCLNG came forward so late and with so little evidence, that it could not claim its statutory rights had been denied.

In a further development concerning an LNG facility application, the U.S. Court of Appeals for the District of Columbia Circuit denied a petition for review in *NGP-LNG, Inc.* v. *FERC*, No. 78-1936, judgment entered December 2, 1979. NGP-LNG, Inc. and Natural Gas Pipeline Co. of America had sought authority to construct and operate LNG terminal, storage and regasification facilities in San Patricio County, Texas. At the time of the filing, Natural was still in the process of negotiating for the supply of gas. Natural also requested that the proceeding be undertaken in two phases to divide the issues. In upholding the Commission's denial of the two-phase proposal and its rejection of the applications because they were unsupported by exhibits, the D.C. Circuit found that the Commission's procedures were not arbitrary. The Commission reasonably found that new circumstances posed by existing or approved LNG terminals require full specifications in exhibits supporting new applications.

CHAPTER IV: THE ALASKA NATURAL GAS TRANSPORTATION SYSTEM ("ANGTS")

A. *Determination of Incentive Rate of Return, Tariff and Related Issues for ANGTS.*

In Order No. 31, issued June 8, 1979, the Commission set the values for the incentive rate of return mechanism for ANGTS, established inflation ad-

justment and change in scope procedures, and decided the applicable tariff provisions. Order 31-B, issued September 6, 1979, clarifies and modifies Order 31.

The incentive rate of return is a mechanism designed to control cost overruns on the ANGTS by giving the sponsors of the system an incentive in the form of higher rates of return on equity to the extent the costs of ANGTS as built are equal to or are less than its base cost estimate adjusted for certain factors. To the extent that costs exceed the base cost estimate after adjustments, the rate of return will be reduced. Adoption of the incentive rate of return followed a long and complicated rulemaking by the Commission. The incentive rate of return was required by the President's 1977 Decision on ANGTS and the Canadian Government has agreed to impose a similar requirement on the project's Canadian segment.[1]

The incentive rate of return does not apply over the life of the project. Rather, the Commission opted to make a one-time adjustment to the rate base using discounted cash flow methodology so as to adjust the rate base in a manner that would reflect in present terms the value of the indicated incentive rate of return on equity over the life of the operation phase. Measurement of cost performance of the project will be determined by the cost performance ratio which is the difference between the projected cost and actual cost, the latter being determined at the start of operations and deflated to the same dollars as used in the projected capital cost figures. Projected costs in turn are the costs supplied to the Commission at the time of Section 7 certification, the estimate then adjusted for allowable changes in scope, design changes prior to final design and a finance charge. An inflation adjustment is applied to the cost of ANGTS as built to deflate the construction costs actually incurred to base year prices.

After certification by the Commission, in accordance with the President's *Decision*, the Federal Inspector will require a final design of ANGTS to be submitted to him and accepted by him.

The base cost figure for the IROR certified by the Commission will be adjusted upward by the Federal Inspector to correspond to the final design.

Changes in scope are permitted to increase the projected capital costs in only five cases: (1) wars, (2) disasters declared by the President, (3) major design changes compelled by changes in Federal or State law, or regulations applicable to natural gas pipelines subsequent to approval of the final design, (4) major changes in pipeline routing or capacity ordered by Federal or State governments, and (5) delay in the issuance of a permit subsequent to approval of final design which occurs through no fault of the sponsors and which causes significant cost increases.

The center point is the point of likely cost performance. In Order 31 the Commission proposed to use the March 1977 cost estimate as a point

---

[1]The order establishes an incentive rate of return for the Alaskan segment of 17.5 percent if the as built cost equals the expected cost after adjustment for inflation and certain other matters. For the Northern Border segment, the rate of return will be 15 percent at the center point. Once operation begins the project sponsors will earn a rate of return of 14 percent for Alaska and 13 percent for Northern Border.

of departure and allow a center point deriving from 130 percent of the base costs.

The Commission adopted a 6 month billing procedure and a billing commencement date which authorizes billing to commence when all pipeline segments are complete, tested and proved capable of operation following certification of that status by the Federal Inspector. Between completion of the system and actual transportation of gas, the rate to be charged is limited to a minimum bill equal to actual operation and maintenance expenses, current taxes, and amounts necessary for debt service. The Commission also required the tariff to include an interim rate schedule to cover an initial period of operation at less than design capacity.

On the question of reduced rate of return on equity in the event of service interruption, the Commission decided that there would be not only a reduction on return on equity but a disallowance of return on equity. This would occur only when the service interruption lasts more than 30 calendar days and only for that segment directly responsible for service interruption. All that would be suspended would be returns to and of equity, not debt service; and if the events were beyond the control of prudent management, the penalty to equity would not occur.

B. Production-Related Costs For Prudhoe Bay Unit Natural Gas.

In Order 45, issued August 24, 1979, the Commission adopted a rule, pursuant to Section 110 of the Natural Gas Policy Act, deciding who shall bear the costs of preparing natural gas from the Prudhoe Bay Unit in Alaska for transportation in the Alaska Natural Gas Transportation System (ANGTS). The Commission concluded that the responsibility for bearing these costs rested upon the producers of the gas except for a limited category of costs: the costs incurred in removing carbon dioxide from levels by volume of three percent to levels below three percent. The recovery of other conditioning costs under Section 110 was barred but the Commission left the door open for recovery of additional costs upon application for special relief under Section 502(c).

The Commission, after examining the unique circumstances of the ANGTS, determined that, on balance, production related costs for processing and conditioning should fall upon the producers or other first sellers who performed the functions necessary to make the gas transportable through ANGTS.

As to the pipeline sponsors' proposed one percent CO_2 standard, the Commission found a three percent standard common in industry practice and the removal of additional CO_2 was not required for entry of gas stream into the pipeline. It found the cost of CO_2 removal to 3 percent standard did not warrant an allowance under Section 110 but removal beneath a 3 percent standard did.

The Commission also adopted a policy statement that it would not permit purchasers of Prudhoe Bay unit gas to file tariff provisions that would include conditioning costs. The Commission said it would treat costs incurred by transporters-shippers to condition Prudhoe Bay unit gas as

not prudently incurred and it would deny any applications by jurisdictional companies for authority to construct, acquire and operate facilities to perform such conditioning unless they are financed by the producers or someone other than transporter-shippers of the gas.

In Order 31-A the Commission modified the incentive rate of return for ANGTS to adopt a policy with respect to conditioning of Prudhoe Bay gas consistent with Order 45.

In Order 45-A the Commission indicated that the time for judicial review of Order 45 would begin upon the effective date of Order 45, *not* August 24th, the date of issuance of the order itself. It also indicated that persons had the option of filing simultaneously petitions for rehearing and an application for adjustment pursuant to Section 502(c) but that it did not intend to preclude parties from filing a separate application for 502(c) relief in the future.

Subsequently, the Commission stayed Order 45 and 31-A indefinitely, in response to requests by the Secretary of Energy who cited ongoing discussions with producers regarding the financing of the ANGTS.

C. Size and Pressure.

On August 6, 1979, the Commission, in response to an application by Alaska Northwest National Gas Transportation Company ("Alaska Northwest"), issued an order approving the design specifications and initial system capacity of the Alaska segment of the Alaska Natural Gas Transportation System.

The Commission found that the President's *Decision* decided that the diameter of the pipeline in Alaska would be 48″ and created a "predisposition" in favor of a 1260 psig system. The Commission, however, found that the predisposition was a rebuttable one on appropriate showings that the amount of gas that could be expected to be available from the Prudhoe Bay field had increased so that a higher pressure system would be warranted because of its greater fuel efficiency at higher throughputs.

The State of Alaska and Earth Resources Company of Alaska both questioned the Commission's finding in favor of the 1260 psig line, expressing their concern about preserving the option of developing a world class petrochemical industry in Alaska using natural gas liquids from the Prudhoe Bay field. Responding to these concerns, the Commission found that a delay in determining the pressure could have serious and wide-ranging consequences in delaying the entire project, particularly in the ability of the project sponsors to finalize financing arrangements. However, in affirming its decision, the Commission said that the overriding consideration in determining the operating pressure was pipeline throughput capacity, and there was no evidence that the amount of gas was expected to increase.

Earth Resources and the State of Alaska joined by the North Slope Borough, the Fairbanks North Star Borough and the Kenai Peninsula Borough, petitioned the Commission to vacate the order, re-open the record and complete the investigation of Alaskan segment design specifications and related issues. By order issued October 15, 1979, the Commission

(with Commissioner Holden concurring) denied the petitions. As a point of clarification, however, the order noted that the Commission retained the power to approve a different operating pressure in the event that Alaska Northwest in its application for a final certificate of public convenience and necessity sought an alternative operating pressure.

Thereafter, the petitioners sought judicial review of the Commission's Orders, pursuant to Section 10 of the Alaska Natural Gas Transportation Act of 1976, (ANGTA), with the U.S. Court of Appeals for the District of Columbia Circuit. In an opinion issued January 3, 1980, the Court of Appeals dismissed the action, finding that the petitioners did not state any claims within its limited jurisdiction under ANGTS to review FERC Orders. *Earth Resources Co. of Alaska* v. *FERC*, No. 79-2191 (D.C. Cir. 1980).

D. Reorganization Plan for the Federal Inspector.

On April 2, 1979, the President submitted to Congress Reorganization Plan Number 1 of 1979 to create the Office of the Federal Inspector for the Alaska Natural Gas Transportation System and to establish the position of Federal Inspector. The Office of Federal Inspector was first described in the Alaska Natural Gas Transportation Act of 1976 as an office to provide for the monitoring of pipeline construction, to effect compliance with terms and conditions of the various authorizations, and to advise the President and Congress of progress on the pipeline. The plan transfers to the Federal Inspector the authority to supervise the enforcement of the terms and conditions of the permits and other authorizations for ANGTS and also provides that the Federal Inspector will coordinate Federal activities directly related to the pipeline project. Federal agencies maintain their authority to issue permits and related authorizations but responsibility for enforcement with respect to these permits and authorizations is transferred to the Federal Inspector. The transfer of agency enforcement authority is limited in scope to the agency's participation in ANGTS and in duration to the agency's participation in ANGTS and in duration to the period of construction and initial operation of ANGTS. The authorized officer of each involved permitting agency will be detailed to, and located within, the Office of the Federal Inspector. The Federal Inspector is required by the Plan to delegate to each agency authorized officer the authority to enforce the terms and conditions and stipulations of each grant, permit or other authorization issued by the Federal agency which appointed the authorized officer. In the exercise of his agency's enforcement function, the agency authorized officer shall be subject to supervision and direction of the Federal Inspector. The Federal Inspector is also responsible for coordinating the expeditious discharge of non-enforcement activities and coordinating the expeditious compliance by all Federal agencies with their permitting functions.

The Plan became effective on July 1, 1979, following hearings in the House and Senate and favorable Committee reports.

On June 8, 1979, the President nominated John H. Rhett as Federal Inspector and he was confirmed by the Senate on July 12, 1979. The Office

of Federal Inspector is now functioning.

After approval of the plan by Congress, the President signed an Executive Order creating an Executive Policy Board, with representatives from the key agencies, as an advisory body to enhance communication and coordination between the agencies and the Federal Inspector.

E. Federal Inspector Access to TAPS Documents.

By Order issued October 5, 1979, the Commission directed the production of certain documents relating to the interaction between the Department of Interior's Alaska Pipeline Office and the Aleyska Pipeline Service Company, including documents about the Alaskan Pipeline Office's regulation of oil pipeline construction and Aleyska's response thereto. The documents in question were produced by the Alaska pipeline office and supplied to Touche Ross and Company, a contractor of the Commission and formerly of the Interstate Commerce Commission. Aleyska and the other owners of TAPS objected to the disclosure of the documents without their approval. The Commission directed that after ten days advance notice to Aleyska and the TAPS owners the documents be made available to the Federal Inspector for the Alaska gas pipeline, either at the Commission's offices or at those of Touche Ross and Company. The documents were made available for examination but not copying or removal from the premises.

Chapter V: Storage

The Commission granted, on April 3, 1979, applications to develop and operate storage facilities in Bienville Parish Louisiana (CP78-266). The applications were filed by Bear Creek Storage Company, Southern Natural Gas Company and Tennessee Gas Pipeline Company. Under the terms of the Commission's approval, Bear Creek, which is jointly owned by Southern Natural and Tennessee, will acquire all field rights to the Pettit Reservoir for the purpose of developing storage facilities. Both Southern Natural and Tennessee have the right to withdraw gas at a specified average daily rate. This rate may be increased, however, if necessary to meet high priority requirements during period of peak demand.

The Commission also authorized Southern Natural and Tennessee to construct certain exchange facilities in conjunction with the storage service (CP78-267).

On September 14, 1979, the Commission affirmed without modification an initial decision (CP76-254) approving applications by Michigan Consolidated Gas Company to provide approximately 20 Bcf annual storage service to Northern Natural Gas Company, Natural Gas Pipeline Company of America and Northern Indiana Public Service Company over a 15 year period. Under the terms of the approval, each of the distributor customers will deliver its portion of the storage quantities to Michigan Wisconsin Pipe Line Company at the W. C. Taggart storage field for redelivery.

On June 21, 1979, the Commission conditionally granted applications to develop underground natural gas storage facilities in Allegany County,

New York, and to construct related pipeline transportation facilities. (See Opinion No. 42; application for rehearing and stay denied August 22, 1979, Opinion No. 42A). The applications were filed by National Fuel Gas Supply Corporation and National Gas Storage Corporation (CP76-492, *et al.*) and provide for up to 23.5 Bcf of storage service to 11 off-system distributor customers. The Commission also conditionally granted applications by Transcontinental Gas Pipe Line Corporation and Columbia Gas Transmission Corporation (CP77-518, CP77-519) to transport the storage gas to several of the 11 distributors.

In conditionally approving these applications, the Commission rejected a number of challenges raised by the Fair Environmental Deals for United People ("FEDUP"), which asserted environmental and procedural deficiencies in the proceedings. On October 22, 1979, FEDUP filed a petition for review of the Commission's action. That appeal now is pending in the Second Circuit Court of Appeals. See *Fair Environmental Deal for United People* v. *FERC*, No. 79-306.

Chapter VI: Rate Conditions Imposed in Certificate Proceedings

In addition to the various conditions imposed in certificate proceedings discussed elsewhere in this report, including the ANGTS and the Great Plains coal gasification project, the Commission continued to impose conditions on the issuance of most producer certificates. One of the conditions relates to the shifting of production related expenses to the pipeline purchaser. The certificates contain the condition that should a pipeline purchaser incur processing, dehydration, compression or other conditioning costs and seek to include such costs in its rates, it will also be required to prove that such costs were not provided for in the rate paid the producer. In addition, with the passage of the NGPA, the Commission has conditioned certificates on collection of the NGPA Section 104 rate, except where the interim collection procedure under Part 273 of the Commission's regulations has been complied with, or where a jurisdictional agency has made a final determination under Part 274. Finally, in issuing producer certificates the Commission continued, contrary to its Order No. 23, to waive specifically Section 154.93 of its regulations which makes inoperative any price escalation clause based upon the outcome of legislative action.

On February 6, 1979, the Fifth Circuit in *Transcontinental Gas Pipe Line Corp.* v. *FERC*, 589 F.2d 186 (1979) affirmed a Commission order authorizing Transco to extend its gathering system in southeast Louisiana. In granting such authority, the Commission had conditioned its approval upon the inclusion of offshore pipeline additions in Transco's cost of service at an average unit cost which uses not less than a 60% load factor. The Court refused to substitute its judgment for that of the Commission's on this condition.

In a decision concerning producer certificates, the Supreme Court in *FERC* v. *Shell Oil Co.*, No. 77-1652, on February 22, 1979, affirmed the Fifth Circuit's decision reversing and remanding Order No. 539-B which stated that producer certificates would thereafter be conditioned so that seller

must observe a "prudent operator" standard in the development and maintenance of the deliverability of dedicated reserves. The Fifth Circuit had found that the Commission order exceeded the Commission's jurisdiction because of the production and gathering exemption under Section 1(b) of the Natural Gas Act.

Chapter VII: Transportation Under Section 311 of the Natural Gas Policy Act of 1978

One of the Congressional objectives of the NGPA was to ease the regulatory roadblocks imposed by the Natural Gas Act ("NGA") to integration of the facilities of interstate and intrastate pipelines into a more efficient national transportation network. Under the NGA, transportation of natural gas by an interstate pipeline for another interstate pipeline or an intrastate pipeline required prior certification under Section 7(c) with all the attendant regulatory delays and burdens. Similarly, intrastate pipelines which might otherwise be willing to form an integral part of an interstate transportation service in order to accommodate interstate pipelines or local distribution companies were unwilling to subject themselves to all the burdens of NGA jurisdiction. Although the Commission had been experimenting with short-term transportation certificates containing pre-granted abandonment authority and relatively minimal reporting and other conditions, it was clear that there was a need to remove the NGA impediments to a more rational regulatory regime for interstate transportation. Section 311(a) of the NGPA provided that authority.

Section 311(a)(1) empowers the Commission to authorize any interstate pipeline to transport natural gas for any intrastate pipeline company or local distribution at rates meeting the just and reasonable standard of the NGA. Section 311(a)(2) confers similar authority for the Commission to authorize intrastate pipelines to provide transportation services for interstate pipelines and local distribution companies at rates which are "fair and equitable and may not exceed an amount which is reasonably comparable to the rates and charges which interstate pipelines would be permitted to charge for 'providing similar transportation service.'" The Commission was directed to promulgate regulations for determining a rate for intrastate pipeline transportation service that would "reasonably compensate such pipelines for costs associated with such service and provide an opportunity to earn a reasonable profit on such services."

The Commission issued interim regulations implementing Sections 311(a)(1) and (2) on December 1, 1978. As later revised and issued in final form by Order 46, Parts 284A, B, and C of 18 C.F.R., the regulations set up two mechanisms governing transportation by interstate and intrastate pipelines. The gas transported must be for the receiving entity's system supply for resale, not for individual end users. Transportation arrangements not exceeding two years' duration may be entered into without prior Commission approval. Proposals for service in excess of two years require an application and Commission approval. A pipeline initiating a short term transportation service must file a "summary report" within 48 hours after

commencing service. An "initial full report" must be filed within 30 days, (1) describing the transportation service, (2) explaining the basis for the rate being charged, and (3) (for interstate pipelines) stating that the transportation contract is conditioned upon the availability of capacity sufficient to provide the service without detriment to the pipeline's existing customers. Such service may be extended beyond two years by the filing of an "extension report" not less than 90 days prior to termination of the service which updates the data in the initial report. Unless disapproved by the Commission, an extension will be permitted for an additional two years. When the transportation service is ended, the pipeline must file a final report updating the date in the initial report and reporting the total and daily volumes of gas transported as well as the total revenues received and their disposition. All reports must be under oath and signed by a senior official of the company.

Where long-term transportation authority is sought, the required application must contain the same kind of information required for the short-term "initial fuel report" described above. While the application is being proposed, the Commission has encouraged the parties to initiate service on the short-term conditions.

Transportation rates charged by interstate pipelines must conform to any transportation rate schedules on file with the Commission for such service. If none is on file the pipeline may either construct a rate using the same methodology and costs used in designing its sales rates or use a rate from a rate schedule for a comparable transportation service. All revenues in excess of a one cent per Mcf allowance for out-of-pocket expenses are, with specific exceptions, to be credited to the pipeline's Purchased Gas Adjustment Account (No. 191).

An intrastate pipeline may elect either to base its rates on the methodology and costs used by an appropriate state regulatory agency in determining its rates for its various services or the rates from a rate schedule on file with such agency for comparable service. In the alternative, it may apply for Commission approval of such methodology or cost data as it may be able to support. In the latter case, the rates are subject to refund to the extent that the Commission may determine, after appropriate proceedings, that they exceed the standards of Section 311(a)(2). If the Commission fails to act within 150 days of receiving the application for approval, the filed rates shall be deemed to meet those standards.

The regulations make it clear that, consistent with Section 601(a) of the NGPA, none of the services provided under Section 311(a) will subject intrastate pipelines to NGA jurisdiction and that no certificate under Section 7(c) will be required for any facilities required solely to provide such services.

Only a relatively few Commission orders have been issued involving Section 311, and there have been no judicial decisions. In *ONG Western, Inc.* (Docket No. CP79-133, August 1, 1979), the Commission indicated that it will rely to the maximum extent possible on its authority under Section 311 rather than its certificate authority under Section 7 of the NGA. In its only rate decision under Section 311(a), the Commission order in *Black Warrior Pipeline, Inc.* (Docket No. CP79-295, August 31, 1979), ap-

proved an intrastate pipeline's long-term transportation rate on an independent review of the pipeline's methodology and costs. It stressed that the review methodology employed should not be viewed as a precedent for later cases. Several cases have involved the definition of "intrastate pipeline" for purposes of Section 311, each turning on its unique facts.

CHAPTER VIII: BLANKET CERTIFICATE AUTHORIZATION

A. Transportation by One Interstate Pipeline for Another.

On November 30, 1979 the Commission issued Order No. 60 in Docket No. RM79-74 which adds a new subpart G to the Commission's Regulations (18 CFR 284, 44 FR 68819). By this Order, the Commission adopted blanket certificate procedures to permit interstate pipelines to transport natural gas for delivery to other pipelines. Previously, the Commission under § 311(a)(1) of the Natural Gas Policy Act (NGPA) [Natural Gas Policy Act of 1978, 15 U.S.C. § 3371(a)(1)] had authorized pipelines to transport natural gas on behalf of intrastate pipelines and local distribution companies. However, transportation on behalf of an interstate pipeline is beyond the scope of § 311(a)(1). Furthermore, authorization implementing § 311 of the NGPA was implemented on a self-implementing basis.

A certificate is required under § 7(c) of the Natural Gas Act (NGA) to authorize interstate pipleines to transport natural gas on behalf of another interstate pipeline. Such certificate can be issued only after a case-by-case review. In an attempt to increase system supply available to interstate pipelines, as well as to reduce the regulatory burden associated with Section 7(c) applications, the Commission determined that a case-by-case review of each such transportation arrangement was inconsistent with the public interest. Therefore, the Commission established new subpart G which would allow the transporting interstate pipeline to apply for a one time blanket certificate which would authorize the transportation of natural gas by one interstate pipeline on behalf of another interstate pipeline. Such blanket authorization would be subject to the conditions established by § 311(a)(1) of the NGPA.

B. Transportation by a Natural Gas Act § 1(c) Company.

The Commission issued a rule permitting pipelines with facilities excluded from its jurisdiction pursuant to Section 1(c) of the NGA, the so-called "Hinshaw pipelines", to apply for a one-time blanket certificate authorization pursuant to Section 7(c) of the NGA. In Order No. 63, issued January 3, 1980, the Commission noted that this procedure will allow Hinshaw pipelines to carry out transactions of the kind permitted by Sections 311 and 312 of the NGPA. Thus, the Hinshaw pipelines will be able to transport and sell gas and also assign contractual rights to gas. Sections 311 and 312 allow such activities only for those meeting the NGPA definition of an intrastate pipeline, which excludes Hinshaw pipelines. In Order No. 63, the Commission found that Hinshaw pipelines are to be classified as local distributors in order that they will be subject to incremental pricing. Since the Commission determined this classification diminished the effectiveness of Sections 311 and 312, it found this rule was necessary. All volumes sold

pursuant to a blanket certificate acquired under this rule will be subject to incremental pricing to the same extent as if the sale has been authorized under Section 311.

CHAPTER IX: SPECIAL TRANSPORTATION CERTIFICATE ISSUES

A major purpose of the NGPA is to remove artificial restraints on the flow of natural gas between the intrastate and interstate markets. Sections 311 and 312 were enacted to further this objective by authorizing intrastate pipelines to transport, sell, or assign natural gas to the interstate market without becoming subject to the Commission's jurisdiction. Hinshaw pipelines are classified as local distribution companies in the NGPA and are thus ineligible to engage in these transactions. By Order No. 63, the Commission has provided that Hinshaw pipelines may apply for blanket certificate authority under Section 7(c) of the Natural Gas Act to engage in the same activities as intrastate pipelines under Sections 311 and 312 of the NGPA.

The authority conferred by such a certificate covers sales and transportation services which are within the Commission's jurisdiction under the Natural Gas Act. Self-implementing sales and transportation transactions under the certificate are limited in duration to two years. The terms and conditions attached to the certificate are essentially identical to those prescribed by the Commission for transactions carried out under Section 311 and 312 of the NGPA. Included among these is the requirement that all volumes sold or assigned pursuant to the certificate shall be subject to incremental pricing by the buyer or assignee in the same manner as required for transactions authorized under Sections 311(b) and 312.

Pending before the Commission is an important case which will determine the availability of long-term supplemental gas supplies for industrial consumers to offset the curtailment of Priority 2 and 3 process end uses. In the proceeding entitled *Natural Gas Pipeline Company of America, et al.*, Docket No. CP77-71, *et al.,* four interstate pipelines filed applications pursuant to Section 7(c) of the Natural Gas Act (NGA) seeking authorization to transport gas reserves for General Electric Company to three of its plants to offset high priority curtailment for a ten year period. The proceeding was viewed as a vehicle for establishing a precedent—whether and under what conditions the Commission would authorize long-term transportation arrangements for industries which purchased, developed or otherwise acquired gas supplies.

On March 1, 1979, Judge Lewnes issued the initial decision which granted certificates for the unexpired portion of the ten year term authorizing the transportation of Priority 2 and 3 uses to the extent the volumes do not exceed contract demand. The certificates were conditioned by Order No. 2 provisions and GE was required to file an annual report of the conservation measures implemented and gas saved.

The Commission has not yet ruled on exceptions to Judge Lewnes' decision. When it does, it is anticipated that the Commission will establish an end use transportation policy which encompasses transportation for the

life of the reserves. Key issues to be decided by the Commission include: (1) whether and to what extent the Commission will condition the certificate on subordination of such service to the pipeline's existing service during periods where the capacity of the pipeline is insufficient to accommodate both; (2) whether and to what extent the pipeline may be entitled to expropriate such gas to serve its own customers during periods of supply shortfall; and (3) whether the bulk sale of reserves in place may be prohibited by the NGPA.

It is noteworthy that the Commission has recently expanded the direct sale transportation program. By Order No. 52, issued October 5, 1979 in Docket No. RM80-1, the Commission established an interim rule removing the end-use limitation imposed by FPC Order No. 533 and Commission Order No. 2 which prohibited gas service for an industrial consumer's low priority requirements (Sections 2.79(e) and (f)), and allowed Order No. 533 customers to displace fuel oil. Certificates issued after October 5, 1979, or previously granted certificates which are amended will authorize a maximum daily volume which does not exceed the customer's high priority requirements or the sum of his normal entitlements plus fuel oil displacement volumes. The interstate pipeline was authorized to make a one time blanket filing to amend outstanding certificates.

On November 16, 1979, in Docket No. RM80-1 the Commission noticed a proposed statement of policy regarding the transportation of natural gas owned by a local distribution company from an outer continental shelf (OCS) lease to the service area of the local distribution company. The proposed rule addresses the description of the eligibility criteria, limitations and conditions which the Commission will attach to the transportation certificate. The Commission cited Section 7 of the NGA and 311 of the NGPA as the statutory authority for the proposed rule; however, it expressed its preference for relying upon Section 311 due to the flexibility afforded under the NGPA. In the notice, the Commission indicated its desire to place the distributors in a comparable position to that of other purchasers of gas.

CHAPTER X. PRODUCER COMPLIANCE AND ENFORCEMENT ISSUES

During the last year, the Office of Enforcement has been the primary arm of the Commission in investigating possible violations of the National Gas Act, the Natural Gas Policy Act, and the regulations thereunder. It also has been instrumental in recommending that the Commission take appropriate action—including the initiation of civil suits and the reference to the Department of Justice for criminal proceedings. Attorneys from the Office of Enforcement have represented the Commission in civil actions in federal district courts.

A. Rules and Proposed Rules Concerning Enforcement.

Order No. 8, issued June 14, 1978, in Docket No. RM78-15, promulgated Part 1b of the Commission's regulations relating to investigations. 18 CFR Part 1b (43 F.R. 27174). In response to comments received on that Order, the Commission issued a Notice of Proposed Rulemaking in that

docket on March 20, 1979, which would amend the presently-effective regulations under Part 1b. The regulations provide for Commission procedures for obtaining information during investigations, including use of compulsory process; delineate the rights of witnesses to obtain copies of transcripts and to submit statements of law or fact; and establish the criteria to be considered in determining what dispositive action to take following the investigation. As of the date of this report, no further orders have been issued in the docket.

Unlike the Natural Gas Act, the NPGA in Section 504(b)(6) authorizes the Commission assess civil penalties for knowing violations of the NGPA or rules or orders issued thereunder. On May 15, 1979, in Docket No. RM79-42, the Commission issued a Notice of Proposed Rulemaking which would establish procedures to govern the Commission's assessment of such civil penalties. The statute and proposed rules prescribe a maximum civil penalty of $5,000 for each violation, and each day of a continuing violation is deemed a separate violation. Procedurally, the rulemaking notice proposes that upon determination by the Commission that the imposition of civil penalties is appropriate, the Commission will issue a "Notice of Assessment" which identifies the alleged violator as respondent, set forth the alleged violation, and fixes the amount of penalty. The alleged violator has 30 days within which to respond, after which the Commission has 30 days to determine that no further action should be taken or to issue an assessment order. If a penalty is assessed and is not thereafter paid within 60 days, the Commission may seek affirmance and enforcement of the assessment in federal district court. No further orders have been issued in this docket.

B. Issues In Recent Enforcement Activities.

A producer's failure to comply with the various reporting requirements under the NGA, the NGPA, and the regulations thereunder, or a producer's erroneous reporting under such requirements may result in an enforcement action. Several such actions were taken by the Commission during the past year.

In *FERC v. Energy Reserves Group, Inc.*, D.D.C. Civil Action No. 78-2266, the Court approved a settlement agreement on March 2, 1979, under which Energy Reserves admitted that its failure to file Schedules 501 and 505 of FERC Form No. 108 for jurisdictional sales during 1976 and 1977 constituted a violation of the Natural Gas Act and the regulations. The settlement agreement was entered as a consent decree, resolving the injunctive action filed December 12, 1978, by the Commission. Similarly, one of the issues alleged by the Commission in its April 6, 1979 complaint in *FERC v. Triton Oil & Gas Corp.*, D.D.C. Civil Action No. 79-1004, involves the failure of Triton to file refund reports required by Opinion Nos. 598 and 598-A. The Commission also seeks to enjoin Triton from a continuing failure to make refunds, approximated to be $400,000, including interest, for sales in excess of the applicable area rate.

Allegedly erroneous producer filings under the NGPA have triggered

a Commission request for information from Belco Petroleum Corporation and an investigation of Texaco Inc. Parts 273 and 274 of the Commission's regulations require that sworn statements be filed as to natural gas eligibility for certain maximum lawful prices under the NGPA. By letter of November 26, 1979, to Belco, the Office of Enforcement discussed the required oath statement, noting that civil and criminal penalties can be levied for false statements in an oath statement. The Commission had earlier rejected a Belco filing for eligibility under Section 103 of the NGPA because the spud date of the relevant well was prior to February 19, 1979. The letter from the Office of Enforcement concluded that Belco had information enabling it to determine the well was ineligible under Section 103. The letter requested that Belco submit data to the Commission on the company's internal compliance procedures and management controls over NGPA well determination filings and on plans to prevent "errors" in the future.

On January 18, 1980, in Docket No. IN80-7 the Commission instituted a formal, private investigation to determine whether Texaco had violated the NGPA and the regulations with respect to Texaco's filings under Section 108 seeking stripper well status for two wells in the Permian Basin. The Order alleged that Texaco's jurisdictional agency applications were based only on partial production from one producing interval in each well rather than total production from each well as required under Section 271.804(a) of the regulations. The Commission asserted that Texaco's claim to eligibility may thus constitute violations of the NGPA and directed the Office of Enforcement to proceed with an investigation.

The *Mobil, Tenneco,* and *Atlantic Richfield* cases are indicative of the Commission's interest and concern in enforcing producers' certificate obligations. "Diversions" of gas away from an interstate purchaser may result in violations of Section 7(b) of the Natural Gas Act as well as violations of Section 4 of the NGA and Title I of the NGPA if the "diverted" gas is sold at a price higher than otherwise permitted under the NGA.

On June 22, 1979, the Commission filed a civil action against Mobil Oil Corporation seeking an injunction and restitution. *FERC v. Mobil Oil Corporation*, D.D.C. Civil Action No. 79-1638. The Commission asserted that in 1974, Mobil obtained Commission approval to delete certain acreage from a certificate authorizing sales of gas to Texas Eastern Transmission Corporation by making false and misleading representations in its application as to the company's future plans to drill the acreage to be deleted. Mobil thereafter sold gas from the deleted acreage in intrastate commerce. The Commission alleged that Mobil collected from the intrastate purchaser a price exceeding the maximum lawful price under the NGPA applicable to the gas "committed" to Texas Eastern and interstate commerce, and sought these "overcharges" as restitution to Texas Eastern. A settlement proposal is pending in the district court under which Mobil has agreed to pay $400,000 in refunds to Texas Eastern to be flowed through to interstate consumers.

Another issue in the Mobil case involves an alleged diversion of gas from interstate commerce. On November 6, 1979, the Commission amended

its original complaint, charging that Mobil had abandoned sales to Tenneco Inc. from producing fields in Texas without obtaining authorization under Section 7(b) of the NGA and had delivered the gas in intrastate commerce to Channel Industries Gas Company. This issue arises from the Commission's own investigation in Docket Nos. CI77-298 and IN79-3. Under the pending settlement in the district court, Mobil's liability in those Commission dockets would be resolved and Mobil would pay $18,100,000 in refunds to Tenneco's interstate customers. Mobil would also pay a civil fine of $500,000.

The proceedings in Docket No. CI77-298 were initiated in 1977 by a petition for declaratory order filed by Tenneco, Inc. Tenneco sought a ruling that all necessary filings under the Natural Gas Act had been made, and all authorizations obtained, in connection with the release of gas under contract to Tenneco for sale to Channel Industries. On January 29, 1979, the Commission suspended its administrative proceedings in Docket No. CI77-298 and instituted a formal, private investigation by the Office of Enforcement in Docket No. IN79-3. On June 13, 1979, the Commission issued Opinion No. 41, denying Tenneco's application for rehearing of its orders suspending the administrative proceedings and instituting an investigation. Tenneco sought Fifth Circuit review of the Commission's orders, *Tenneco, Inc.* v. *FERC*, No. 79-2910, and the case is pending upon the Commission's motion to dismiss the petition.

Related to the Commission's investigation in Docket No. IN79-3 are two criminal actions. On July 27, 1979, Tenneco Inc. and Tenneco Oil Company entered pleas of guilty and *nolo contendere* to five felony counts and one misdemeanor count asserting violations of the Natural Gas Act and were ordered to pay fines of $1,025,000. *United States v. Tenneco Inc. and Tenneco Oil Company*, D.D.C. Crim. No. 79-00362. One of the situations involved in the plea bargain involved sales to Tenneco and Channel Industries from the Southwest Pheasant Field that are also involved in the Commission's investigation in Docket Nos. CI77-298 and IN79-3. Tenneco pled *nolo contendere* to willfully and knowingly aiding and abetting an abandonment of an interstate sale to Tenneco without prior Commission approval and pled guilty to a charge of willfully and knowingly engaging in the unlawful exchange of gas with Channel. Two other matters covered by the plea agreement were the unauthorized exchange and transportation of interstate gas for delivery to Creole Gas Pipeline Corporation and the unauthorized construction and operation of jurisdictional facilities for the transportation of gas for Celanese Corporation.

The second criminal case involved a plea by Mobil on February 14, 1980, of *nolo contendere* to a one-count misdemeanor violation of Sections 157.30 of the Commission's Regulations involving abandonment of sales to Tenneco from the Southwest Pheasant Field from 1965 to 1977. *United States v. Mobil Oil Corporation*, D.D.C. Crim. No. 80-00076. Mobil was fined $500,000.

In *Atlantic Richfield Co., et al.*, FERC (Opinion No. 56) (August 3, 1979), reh. den., FERC (Opinion No. 56-A) (October 1, 1979), pet. for review

pending *sub nom Yegua—Stillwell Corporation v. FERC*, 5th Cir. No. 79-3723, the Commission affirmed an Initial Decision and held that various producers had abandoned sales of gas produced in Jim Wells County, Texas without prior Commission approval. Certain producers were directed to submit additional information as to gas production and deliveries under the subject leases to permit a formulation of appropriate remedies; other producers were ordered to repay diverted volumes to the interstate pipeline. The Commission determined that as to gas covered by Section 2(18)(iii) of the NGPA (the *Southland* exclusion), liability could be imposed only until December, 1978, prusuant to Section 601(a) of the NGPA. The Court proceedings were stayed by Order of December 6, 1979, pending settlement negotiations between the parties.

Another case involving alleged violations of certificate obligations involves Amoco Production Company's 1964 warranty contract with Florida Gas Transmission Corporation. On August 21, 1978, in Docket No. CP74-192, *et al.*, the Commission rejected a settlement agreement which would have resolved issues relating to Amoco's reduced deliveries under the contract. On the same day in Docket No. IN78-2, the Commission instituted a private, formal investigation as to whether Amoco and FGT had violated the Natural Gas Act as a result of the operation of an unfiled letter agreement altering the gas delivery provisions of the certificated contract. No civil action has been taken by the Office of Enforcement, although it was reported in late 1979 that the Commission referred evidence on the Amoco-FGT matter to the Department of Justice for possible criminal prosecution. To date, no further information has been released concerning Docket No. IN78-2 or the referral to the Attorney General.

In *Fair Environmental Deals for United People v. National Fuel Gas Supply Corporation*, Docket No. CP77-590, see discussion of storage issues, *supra*, Chapter V, now pending before the Commission on exceptions, an Administrative Law Judge on January 11, 1980, found that National Fuel Gas Supply Corporation willfully and knowingly violated the Natural Gas Act by failing to obtain authorization to construct jurisdictional facilities and that the company violated 18 U.S.C. § 1001 by willfully and knowingly submitting falsified information to the Commission. The Administrative Law Judge held that the violations of the Natural Gas Act "were deliberate and result-oriented," were undertaken with the prior willful and knowing authorization of the president of the company, and recommended referral to the Department of Justice. As to the violation of 18 U.S.C. § 1001, the Administrative Law Judge determined that there was no discretionary authority to determine whether such evidence should be transmitted to the Department of Justice and ordered such referral.

CHAPTER XI: REGULATION OF INDEPENDENT PRODUCERS UNDER Section 7 of the NATURAL GAS ACT

A. Scope of the Commission's Authority to Regulate and Treatment of Independent Producers.

The scope of the Commission's authority to regulate independent pro-

ducers under Section 7 of the Natural Gas Act was eliminated as to new sales by the provisions of Section 601 of the Natural Gas Policy Act, 15 U.S.C. § 3431. Section 601(a) of the NGPA provides that Section 7 of the Natural Gas Act will not apply to first sales by producers of gas which was not committed or dedicated to interstate commerce as of November 8, 1978, or to gas which was committed or dedicated on that date which is high cost gas, new natural gas or new onshore production well gas. Prices allowed by the NGPA are deemed just and reasonable for purposes of the Natural Gas Act, and the Commission is denied power to refuse or condition Natural Gas Act certificates upon the amount paid in first sales to producers which are allowable under the NGPA. These changes have eliminated the need for producers to seek the Commission's permission (as reflected in a certificate of public convenience and necessity) under Section 7 of the Natural Gas Act prior to commencing sales of natural gas for resale in interstate commerce.

While the need to seek certificates for new producer sales was eliminated by the NGPA, the Commission's authority over previously issued producer certificates was largely unaffected by the NGPA. Throughout the year, the Commission continued to attach conditions to producer certificate orders prohibiting passthrough by pipeline purchasers of costs associated with processing, dehydration, compression or other conditioning of gas unless proof is made that the costs were not compensated for in the applicable national ceiling rate. The conditions are made subject to whatever action is taken by the Commission on rehearing in Docket Nos. CI77-412, CP77-558, and CP77-577. Beginning with orders issued December 9, 1977 in *Phillips Petroleum Company,* Docket No. CI77-412 and December 30, 1977 in *United Gas Pipe Line Company*, Docket No. CP77-558 and *Michigan-Wisconsin Pipe Line Company*, Docket No. CP77-577, the Commission expressed concern with contractual provisions which require pipeline purchasers to bear costs for dehydration, conditioning and compression of gas without a concurrent reduction in the rate charged by producers for such gas. The Commission has now been considering the issues thus raised on rehearing for more than two years.

The final chapter in the Order No. 539-B controversy was written on February 22, 1979, when the United States Supreme Court issued an order stating "The judgment is affirmed by an equally divided Court." in *FERC v. Shell Oil Co.*, 440 U.S. 192, 99 S.Ct. 1273 (1979). The order affirmed *Shell Oil Co. v. FERC,* 566 F.2d 536 (5th Cir. 1978), which set aside FPC Order No. 539-B. Order 539-B had conditioned all producer certificates to incorporate the contractual obligations between the buyer and seller into the producers' certificate obligations and had required producers to observe the standard of a prudent operator to develop and maintain deliverability from dedicated reserves. The Fifth Circuit had found that the conditions thus imposed ran afoul of the production or gathering exclusion of Section 1(b) of the Natural Gas Act.

On February 20, 1979, an initial decision was issued in *El Paso Natural Gas Compnay, et al.*, Docket Nos. CP74-314, *et al.* The Law Judge found that a series of lease sale agreements which transferred ownership

of oil and gas leases and natural gas reserves underlying considerable acreage in the San Juan Basin to El Paso Natural Gas Company and its successor, Northwest Pipeline Corporation, were in fact sales of natural gas for resale in interstate commerce, subject to *Natural Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965) and its progeny. The matter is now pending on respondents' exceptions.

In *Florida Power & Light Co. v. FERC,* 598 F.2d 370 (5th Cir. 1979), certificate orders precluding the delivery of gas produced by Amoco Production Company under a 1965 warranty contract to Florida Power & Light Company for use as boiler fuel were affirmed. In 1965, the Commission had approved certain warranty contracts between Amoco's predecessor and Florida Gas Transmission Company and Florida Power & Light Company which promised delivery of stated amounts of gas without dedication from any particular source. Under a 1967 settlement approved by the Commission, Amoco's predecessor was allowed to deliver up to 92% of the FP&L warranty gas from federal off-shore sources for a period of ten years following initial deliveries. In the current proceeding, through several transportation and exchange agreements, Amoco sought to deliver gas from additional offshore sources to Florida Gas Tranmission Company for transportation to FP&L and sale under the 1965 warranty contract. The Commission granted certificates authorizing the proposed transportation and exchanges to enable delivery to Florida Gas Transmission Co., but conditioned the certificates to preclude delivery of the newly connected gas to FP&L for use as boiler fuel.

B. Service Obligations and Abandonments.

The Commission and the courts considered several cases in 1979 which raised the issue of the right of small, independent producers to abandon or alter service offered to interstate pipelines. As in the cases discussed in Chapter 1(B), *supra*, these cases affirm the obligation of a regulated producer to obtain Commission approval prior to abandonment of service.

In *Dore Corp. and Sullivan Wells Co.* v. *Federal Energy Regulatory Commission, et al.*, F.2d , Nos. 76-2428, 76-4093 (5th Cir. 1979), the Fifth Circuit affirmed the Commission's decision ordering petitioner companies to continue sales to interstate pipeline from properties upon which a 50 year lease had expired and gas production rights had reverted to the mineral interest owners. Petitioners, all of which were successors to large producers, had filed for small producer certificates in order to collect the higher small producer rates. The Commission held, and the court affirmed, however, that the petitioners were bound by rates charged by their large producer-predecessors.

In *Phillips* v. *Federal Energy Regulatory Commission*, 586 F.2d 465 (5th Cir. 1978), the Fifth Circuit vacated a Commission decision rejecting unilateral rate increases filed by nine small producers under Section 4 of the Natural Gas Act. The record showed that Shell Oil Company sold its portion of the gas from the Bryans Mill Field in Texas to Natural Gas Pipeline Company of America, Inc. pursuant to a contract on file with

the Commission. The small producers executed a marketing authorization with Shell authorizing Shell to sell their portion of gas from the same field to Natural Gas Pipeline under the same terms and conditions as Shell. Thereafter, Shell filed a supplemental application with the Commission for authority to market the small producers' gas. The Commission granted Shell's application. Some years later, in 1975, the small producers filed for blanket small producer certificates. The certificates were granted. Subsequently, the small producers entered into negotiations with Natural Gas Pipeline to obtain a higher rate for the gas sold by Shell, pursuant to the producers' marketing authorization with Shell. The negotiations were not successful, so the producers revoked Shell's marketing authorization and filed unilateral rate increases with the Commission. The Commission rejected the applications.

In vacating the Commission's action, the Court noted that there was no direct contractual relationship between the small producers and Natural Gas Pipeline. Further, the Court found that Natural Gas Pipeline was fully aware of the restrictions on Shell's authority to market the small producers' gas. In light of this, the Court held that the small producers' right to revoke Shell's marketing authorization took precedence over the fixed rate clause in Shell's contract with Natural Gas Pipeline.

In the last report of this Committee, the *Southland* case was discussed (*California* v. *Southland Royalty Co.*, 436 U.S. 519 (1978)). Subsequent to the Supreme Court's decision in that case, the Commission issued an order, dated December 13, 1978, requiring the companies to be certificated and to make appropriate rate filings. Prior to the Commission's order of December 13, 1978, however, some of the mineral interest owners filed a petition in the U.S. District Court for the Northern District of Texas seeking a declaratory order that there had been a "legislative abandonment" because of the passage of the NGPA, and, specifically, because of Section 218 of that Act. The case is pending.

In *Falcon Petroleum Co.* v. *FERC*, No. 79-3648 (5th Circuit) a petition was filed on November 1, 1979, for review of an August 8, 1979 Commission order (and October 6, 1979 order denying rehearing) which approved an offer of settlement resolving questions raised by an unauthorized abandonment of sales by Amoco Production Co., predecessor of Falcon Petroleum Co. (CI77-701), to Northern Natural Gas Co. from the Purdum Unit upon expiration of the lease in 1976. Falcon subsequently acquired mineral rights in the unit, deepened an existing well and discovered additional gas which was offered to the City of Perryton, Texas, rather than Northern. Falcon and the City of Perryton requested a declaratory order that the prior sales had been abandoned by Amoco. Northern protested, and the Commission instituted a show cause proceeding.

The settlement agreement approved by the Commission provided for resumption of sales to the interstate market in the same proportion as when Amoco was producing from the well.

In *Amarex, Inc.* v. *FERC*, 603 F.2d 127 (10th Cir. 1979) on July 17, 1979 the Court affirmed the Commission's Opinion No. 798 issued May 9,

1977 (and Opinion No. 798-A, issued July 1, 1977, modifying in part but otherwise denying rehearing) which directed Amarex, Inc. (CI76-346) to deliver its share of production from a newly discovered well in Beckham County, Oklahoma to Arkansas Louisiana Gas Co. (CP76-220) under the terms of a 1970 gas purchase contract. The well was completed on acreage covered by a 1967 lease which originally was dedicated to the 1970 contract but expired in 1972. A new lease executed in 1972 was not specifically included in the description of leases dedicated to the 1970 contract. Amarex contended that the gas involved was not dedicated to Arkla since the 1972 lease was not covered by the 1970 contract. The Commission held that expiration of the primary term of the 1967 lease did not operate to limit the duration of natural gas service under the 1970 gas purchase contract from that lease, and that Amarex's small producer certificate embraced all natural gas production from acreage ever identified as subject to the 1970 gas purchase contract.

Applying the principles of the Supreme Court's *Southland Royalty* decision, 436 U.S. 519 (1978), the Tenth Circuit concluded that (1) commencement of gas flow by Amarex to Arkla in November, 1971, constituted a dedication of all "fields" subject to the contract and authorized by the certificate, including gas reserves from the lease in question: (2) such flow, once commenced from a "field" subject to a certificate of unlimited duration, cannot be terminated without Commission authorization; and (3) expiration in 1972 of the 1967 lease did not affect the obligation of Amarex to continue the flow of gas from the "field" subject to the 1970 gas purchase contract. A concurrent opinion said that reference to "fields" in the majority opinion was too broad. On August 27, 1977, the Court denied petition for rehearing *en banc*. Application for certiorari was filed and was denied in February, 1980.

This report is respectfully submitted by the Chairman, Vice Chairman and members of the Committee* on Natural Gas Certificate and Authorization Regulations.

John Fleming Kelly, *Chairman*
John F. Harrington, *Vice Chairman*

Marilyn O. Adamson
W. Jonathan Airey
*Allan W. Anderson, Jr.
W. Bryce Arendt
John F. Bates
Christopher T. Boland
John R. Bonica
O. Grant Bruton
*Kim Martin Clark
Daniel F. Collins
*Bruce A. Connell
William P. Diener
*D. Jane Drennan
Gary Ewell
T. Brooke Farnsworth
*Earl L. Fisher

*Designates Committee members who contributed to this report.

Edward H. Gerstenfield
Brian R. Gish
*Larry D. Hall
*Roberta L. Halladay
John H. Holloman III
*Craig W. Hulvey
Bradford G. Keithley
Frank X. Kelly
*Robert H. Loeffler
*Susan A. Low
Michael J. Manning
*James D. McKinney, Jr.
Jerome Mrowca
*Jerome C. Muys
Stephen F. Noser
Daniel B. O'Brien
Kathleen O'Leary
Joseph M. Oliver, Jr.
Brian D. O'Neill
*Charles Laurence Pain
Robert W. Perdue
Paul H. Pieri
Donald W. Quander
*William A. Sackmann
Lance W. Schneier
*G. William Stafford
Lilyan G. Sibert
Walter M. Starke
*James L. Thorne
David B. Ward
R. Bruce Whitney
Frank P. Youngblood