STUDENT NOTES

A TEST FOR ABUSE UNDER NGPA SECTION 601(c)(2): *OFFICE OF CONSUMERS' COUNSEL v. FERC*

"Fraud, abuse, or similar grounds" are the findings which enable the Federal Energy Regulatory Commission to control prices pipeline companies pay for natural gas under section 601 of the Natural Gas Policy Act of 1978 (NGPA).[1] Only if a pipeline has engaged in business practices which fall under one or more of these terms may the Commission deny the pipeline's otherwise guaranteed right to pass through its gas acquisition costs[2] to its customers.

The need for industry development and expansion of natural gas supplies which existed when the NGPA was enacted rapidly changed. A period of precipitous increases in gas prices, during which pipelines entered into long term contracts for high cost gas supplies, was followed by a surplus, reducing demand. This left pipelines committed to purchase gas at costs far above the altered market levels.[3] As a result, "fraud and abuse" became the rallying cry of pipeline customers who sought to escape the burden imposed on them by pass-through of gas purchased at inflated prices. *Office of Consumers' Counsel v. FERC* emerged as the case arising from these circumstances that addressed the definition of "fraud, abuse, or similar grounds."[4] Protestors in *Consumers' Counsel* alleged that the business practices of Columbia Gas Transmission Corporation (Columbia) constituted abuse, and therefore that Columbia's request to pass through its natural gas purchase costs to its customers should be denied. The Court of Appeals for the District of Columbia Circuit took exception to the FERC's determination that Columbia had not acted abusively, finding that the Commission's test for abuse conflicted with the plain meaning of the statute.[5] It remanded the case to the Commission for a reformulation of the test for abuse, requiring the reformulated test to be applied to Columbia's pro-

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1. 15 U.S.C. § 3431 (1982).

2. Gas acquisition costs refer to purchases of gas under new contracts.

3. New, deregulated gas was relatively scarce immediately following enactment of the NGPA. Pipelines scrambled to purchase this gas which permitted producers to demand prices and contract terms favorable to themselves. The recession, milder winters, declining oil prices, and rising prices of old gas coupled with reduced sales left pipelines with the need to reduce prices paid for new, high-cost gas to remain economically viable. Ringleb, *The Natural Gas Regulatory Dilemma: A Market Solution, Another Compromise, or the Status Quo?*, 6 J. ENERGY L. & POL'Y 107, 121, 125 (1985).

4. *See* Office of Consumers' Counsel v. FERC, 783 F.2d 206, 223 (D.C. Cir. 1986). *See also* Interview with John Croom, Chairman and Chief Executive Officer, Columbia Gas Transmission Corp., *reprinted in* Gas Daily, Nov. 19, 1986.

5. *Consumers' Counsel*, 783 F.2d at 222.

tested actions.[6]

This Note will explore the statutory background of the case; the Commission's authority to interpret provisions of the Natural Gas Policy Act and its attempts to develop a working definition for "fraud, abuse, or similar grounds"; the reviewing court's opinion and ruling; and approaches that may be taken in applying the fraud and abuse test.

I. Development of the "Fraud, Abuse, or Similar Grounds" Test

The NGPA fulfilled its goal of alleviating gas shortages and stimulating the natural gas industry.[7] To secure adequate supplies to avoid the curtailments of the 1970s, pipelines committed themselves to purchase high-cost gas, often at inflexible contract terms which unduly favored producers.[8] Rising prices of regulated gas and shifting economic conditions resulted in a surplus of natural gas, making the once-attractive high-cost gas unmarketable.[9] By 1982, the Commission had received numerous protests that pipeline purchases, often of section 107 gas, were fraudulent or abusive.[10] The Commission was confronted with the necessity of defining the terms "fraud, abuse, or similar grounds" to determine whether pipeline gas acquisition costs should be denied passthrough under section 601(c)(2).

The FERC struggled with shaping a workable standard for "fraud, abuse, or similar grounds," the guaranteed passthrough exception, while balancing the competing requirements of a pipeline's duty to operate efficiently with the need to avoid indirect regulation.[11] A fundamental principle of pipeline regulation is that a pipeline must provide service at the lowest cost which will enable it to operate efficiently and adequately serve its customers.[12] The Commission is responsible for ensuring that pipeline business practices do not violate the Natural Gas Act (NGA) or Natural Gas Policy Act.[13] However, the legislative his-

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6. *Id.* at 223.

7. Ringleb, *supra* note 3, at 120.

8. *Consumers' Counsel*, 783 F.2d at 216 nn.17-20. For example, Columbia's contracts contained indefinite escalator clauses, which permitted producers to charge "up to 110% of No. 2 fuel oil" and allowed them to raise prices with no prescribed limits; favored nations clauses, which allowed producers to charge "the average of two or three highest prices paid by any pipeline in a large producing region"; unfavorable "market-out" clauses, which prevented Columbia from renegotiating its purchase price with producers in a timely fashion when high-cost gas became unmarketable; and high take-or-pay provisions which required Columbia to take or pay for a high percentage of high-cost gas. These clauses denied Columbia the flexibility to revise its purchase commitments when the market price of gas began to decline.

9. Ringleb, *supra* note 3, at 126.

10. Each of the following protests against passthrough of gas purchase costs was triggered by the pipeline's purchased gas adjustment (PGA) filing. *See, e.g.*, Michigan Wisconsin Pipe Line Co., 15 F.E.R.C. ¶ 61,108 (1981); Colorado Interstate Gas Co., 15 F.E.R.C. ¶ 61,055 (1981); Trunkline Gas Co., 14 F.E.R.C. ¶ 61,205 (1981); Transcontinental Gas Pipeline Corp., 14 F.E.R.C. ¶ 61,204 (1981) (included contention that certain purchases might fail to meet the "affiliated entities" test of section 601(b)(E) of the NGPA); Columbia Gas Transmission Corp., 14 F.E.R.C. ¶ 61,202 (1981) (initial protest leading to *Consumers' Counsel*).

11. *Consumers' Counsel*, 783 F.2d at 221.

12. *See, e.g.*, Atlantic Refining Co. v. Public Serv. Comm'n, 360 U.S. 378, 388 (1959); Texas Gas Transmission Corp., 36 F.E.R.C. ¶ 63,001 at 65,005 (1986); Columbia Gas Transmission Corp., 26 F.E.R.C. ¶ 61,034 at 61,100 (1984).

13. 15 U.S.C. §§ 717-717w (1982) and 15 U.S.C. §§ 3301-3432 (1982)

tory of the NGPA indicates that the Commission's enforcement power may not take the form of indirect or "back door" regulation by manipulating prices paid by pipelines to producers at the wellhead.[14]

The FERC developed the "fraud and abuse" standard in the process of adjudicating complaints against Columbia Gas Transmission Corporation[15] which led to *Office of Consumers' Counsel v. FERC*.[16] In its Clarifying Order issued April 30, 1981,[17] the Commission responded to the question of whether imprudence should be equated with abuse.[18] It reasoned that section 601 of the NGPA was intended to replace the prudence standard of determining just and reasonable rates contained in sections 4 and 5 of the NGA, where a finding of imprudence would authorize the Commission to deny passthrough of gas purchase costs.[19] It therefore determined that imprudence alone may not constitute abuse.[20] However, it declined to specify what actions or practices would constitute "fraud, abuse, or similar grounds," believing that prohibited behavior

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14. STAFF OF H.R. COMM. ON INTERSTATE AND FOREIGN COMMERCE AND S. COMM. ON ENERGY AND NATURAL RESOURCES, 95TH CONG., 2ND SESS., NATURAL GAS PRICING AGREEMENT ADOPTED BY THE CONFEREES ON H.R., 5289 at 19 (Comm. Print 1978) [hereinafter Committee Print]. "Back door" regulation had existed under the NGA by means of blanket certificate procedures issued by the Federal Power Commission to small producers to regulate their rates. This amounted to indirect regulation of producers by Commission review of pipeline purchase gas costs. The Supreme Court recognized the practice as acceptable in FPC v. Texaco, 417 U.S. 380 (1974). Thus, the concept of "back door" regulation of producer rates through review of purchase gas costs was "an available frame of reference for the statement by Congress that it intended to assure no 'back door' regulation of producers under the NGPA." Puckett, *The "Fraud, Abuse, or Similar Grounds" Exception Under Section 601(c)(2) of the NGPA*, 6 ENERGY L.J. 59, 60 n.9. (1985).

15. Allegations that Columbia had engaged in abusive acquisition practices that resulted in unjustifiably high payments for gas were addressed by the Commission in proceedings against Columbia at Columbia Gas Transmission Corp., 26 F.E.R.C. ¶ 61,334 (1984) [hereinafter Opinion No. 204-A]; Columbia Gas Transmission Corp., 26 F.E.R.C. ¶ 61,034 (1984) [hereinafter Opinion No. 204]; Columbia Gas Transmission Corp., 22 F.E.R.C. ¶ 63,093 (1982) [hereinafter Initial Decision]; Columbia Gas Transmission Corp., 15 F.E.R.C. ¶ 61,104 (1981) [hereinafter Clarifying Order]; Columbia Gas Transmission Corp., 14 F.E.R.C. ¶ 61,202 (1981). *See also* Columbia Gas Transmission Corp., 27 F.E.R.C. ¶ 61,475 (1984) (Statement of Comm'r Hughes to Opinion No. 204-A agreeing in part and dissenting in part) [hereinafter Statement of Comm'r Hughes].

16. *Consumers' Counsel*, 783 F.2d at 212. The Office of Consumers' Counsel, State of Ohio was one of eight entities protesting that Columbia's purchasing and pricing practices were abusive. They contended that the FERC's standard for abuse was incorrectly formulated and that it was misapplied in its finding that Columbia was not guilty of abuse. *See also* Initial Decision, *supra* note 15.

17. Clarifying Order, *supra* note 15, at 61,226.

18. *Id.*

19. 15 U.S.C. §§ 717c-717d (1982). Section 4 of the NGA permits rates to be charged through a cost-of-service filing (sometimes referred to as a full-scale section 4 review). Following such filing, if a pipeline's acquisition practices are determined to be "imprudent" the Commission may adjust the pipeline's rates as being unjust and unreasonable. This adjustment may be made despite a finding that the rates were originally just and reasonable absent imprudent actions by the pipeline. *See* Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954); Columbia Gas Dev. Corp. v. FERC, 651 F.2d 1146, 1148-49 (5th Cir. 1981). Under the NGA, rates will automatically be judged unjust and unreasonable upon a finding of imprudence. Panhandle Eastern Pipeline Co. v. FERC, 777 F.2d 739, 743 (D.C.Cir. 1985); *see also* Natural Gas Pipeline Co. of America v. FERC, 765 F.2d 1155 (D.C. Cir. 1985) (although a finding of imprudence will automatically render rates unjust and unreasonable under the NGA, imprudence is not the only means by which the Commission may find a pipeline's rates unjust and unreasonable).

20. Clarifying Order, *supra* note 15, at 61,227.

would be revealed through the hearings process.[21]

In response to the acceleration of complaints of "fraud and abuse" regarding pipeline purchases of section 107 deregulated natural gas, the Commission issued a nonbinding policy statement.[22] The policy statement was intended to expedite the hearings process by providing guidance to administrative law judges and by placing litigants on notice as to the standard which would be applied to their cases.[23] The FERC attempted to assign definitions to the words of the guaranteed passthrough exception beginning with an examination of "fraud." It found that fraud consists generally of a misrepresentation that is intended to deceive. This finding led to an investigation of the law of misrepresentation in tort.[24] The FERC declared that tort law provided a "useful analogy" from which to draw its definitions, and that it was consistent with the policies underlying the NGPA.[25] The FERC elected to restrict the definitions of "abuse" and "similar grounds" to the law of misrepresentation. Accordingly, it stated that "fraud" would be evidenced by fraudulent misrepresentation or concealment; "abuse" was to consist of negligent misrepresentation or misrepresentation made in disregard of duty; and "similar grounds" was conceived of as innocent misrepresentation.[26]

The administrative law judge (ALJ) who heard the complaints against Columbia took issue with the definition of abuse in the policy statement and determined that, in his opinion, it should be broadened to encompass inappropriate activities beyond imprudence and fraud.[27] He agreed with protestors that a standard limited to actual misrepresentation would fall outside the provisions of section 601(b), and noted that misrepresentation could result in prices paid which are not defined as "just and reasonable" under the section. Therefore section 601(c)(2), which guarantees automatic passthrough of prices deemed "just and reasonable" under section 601(b), could not be applied.[28] He con-

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21. *Id.* at 61,226.

22. Policy Statement, 18 C.F.R. § 2.300 (1985).

23. *Id.*

24. *Id.* The Commission began with the premise that fraud, in a general sense "consists of a misrepresentation that is intended to deceive" and concluded that its analysis should begin with an examination of the law of misrepresentation and the common law action of deceit. The Commission recognized that misrepresentation was more inclusive than deceit and elected to draw its definition for fraud from the law of misrepresentation.

25. *Id.*

26. *Id.* The Commission selected the torts standard of misrepresentation, stating that an investigation defined by misrepresentation would permit an inquiry into the amount paid for gas, but would preclude any inquiry into the prudence of purchase costs. It reasoned that the standard was consistent with legislative intent to provide a means of denying passthrough due to "fraud, abuse, or similar grounds" while protecting producers from "back door" regulation.

27. Initial Decision, *supra* note 15, at 65,331.

28. *Id.* at 65,330-31. The ALJ cited one protestor's examples of misrepresentation which would not be governed by section 601(c)(2). Section 601(b)(1)(A) states that payments which "[do] not exceed the applicable maximum lawful price" established under title I of the NGPA will be considered just and reasonable as will payments for gas with no "applicable maximum lawful price by reason of the elimination of price controls." Therefore, if due to misrepresentation the maximum lawful price is exceeded or regulated prices are paid for deregulated gas, these payments are not considered just and reasonable under section 601(b) and are ineligible for automatic passthrough. The ALJ emphasized the error of defining abuse as misrepresentation by noting that section 504(a) of the NGPA provides the means to police misrepresentation.

cluded that for section 601(c)(2) to function as Congress intended, the definition for abuse must be altered. The ALJ next examined the uses and meanings of the term "abuse" in contexts ranging from a legal dictionary to cases concerning monopoly power, and concluded that "[s]ince the legislative history indicates that 'abuse' was intended as something other than fraud and since misrepresentation is an element of fraud but not necessarily . . . abuse . . . the term 'abuse' may comprehend inappropriate activities, in addition to misrepresentation, that surpass imprudence."[29]

The Commission responded to the ALJ's criticism by creating a two-pronged test, with each prong to be satisfied, for identifying whether abuse had occurred within the meaning of section 601(c)(2). The first prong required a showing of "reckless disregard of duty."[30] The Commission, in Opinion No. 204, described reckless disregard as an "aggravated form of negligence" in disregarding a risk that was "so great as to make it highly probable that an adverse effect would follow from such action."[31] The second prong of the test contained the general requirement of "significant adverse effects on customers or consumers." It was intended to add further insurance against using section 601(c)(2) to indirectly regulate producers.[32]

Requests for a rehearing resulted in Opinion No. 204-A in which the Commission reaffirmed its adoption of the test for abuse formulated in Opinion No. 204.[33] One of the principal issues raised in the requests concerned the proper interpretation of the guaranteed passthrough exception. The parties challenged the two-pronged test for abuse, but made no objection to the Commission's interpretation of "fraud" or "similar grounds." Therefore, the Commission found no reason to change the definition of these terms from those of the policy statement.[34]

Challengers of the "abuse" test took the opposing positions that the standard was either broad or too narrow. Arguing that the two-pronged test was too broad, Columbia urged that the Commission should retain the policy statement definition.[35] A majority of the other parties contended that the adopted definition for abuse was too narrow because it failed to include the concept of imprudence.[36] The FERC rejected Columbia's argument stating that "[t]he dif-

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29. *Id.* at 65,333.

30. Opinion No. 204, *supra* note 12, at 61,100.

31. *Id.* The decision to define abuse as reckless disregard with its requirement of knowledge or almost certain knowledge of the harmful effects of an action represents a toughening of the abuse standard. In its policy statement definition, the Commission was unwilling to include willfulness or intent as an element of abuse, believing it would not conform to the purpose of the NGPA. Policy Statement, *supra* note 22.

32. *Id.*

33. Opinion No. 204-A, *supra* note 15.

34. *Id.* at 61,710.

35. *Id.*

36. *Id.* Other arguments against the two-pronged test were that "abuse" should be defined according to legal dictionaries or other case law which interpreted abuse through statutory and constitutional applications apart from the NGPA. The FERC rejected the use of dictionary definitions as examples of "possible ways" of defining the word which give no insight into the meaning Congress intended for "abuse." It also rejected the second argument because it felt only cases which interpreted transactions and regulatory goals resembling those under the NGPA would provide aid in determining Congressional intent. *Id.* at 61,711. The author independently examined other statutory applications of "abuse" in the regulatory context finding they provided no significant insight into a preferable definition for abuse.

ficulty with the policy statement definition is that, by confining fraud, abuse, or similar grounds to variations of misrepresentation, the policy statement effectively reads 'abuse' out of the statute." The definitions for "fraud" and "similar grounds" would encompass the meaning given abuse, a result which would be contrary to the traditional practice of giving importance to each word of a statute.[37]

In rejecting the contention that abuse should equate to imprudence, the FERC remained consistent with its earlier position that section 601 was designed to create a "different standard of review" for pipeline gas purchase costs. Therefore, to consider abuse equal to imprudence would destroy the distinction between section 601 and sections 4 and 5 of the NGA.[38] The Commission expanded its reasoning for selecting "reckless disregard" and "significant adverse effects" as elements which comprise "abuse." "Reckless disregard" was intended to distinguish abuse from imprudence and to create a clearer differentiation between the pipeline purchase review standards of the NGA and the NGPA. Believing that section 601(c)(2) was intended to guarantee passthrough of amounts paid for natural gas in all but exceptional circumstances, the Commission reasoned that abusive conduct must have a significant effect on the public.[39]

II. A Discussion of *Office of Consumers' Counsel v. FERC*

The Federal Energy Regulatory Commission's interpretation of abuse under section 601 was developed from the premise that Congress intended to limit the FERC's authority to regulate natural gas prices without undermining its enforcement powers.[40] Its two-pronged test gave rise to the major issues of *Consumers' Counsel*: (1) whether the FERC correctly interpreted the statutory language of the guaranteed passthrough exception in forming its definition of "abuse," and (2) whether the FERC properly applied the "abuse" standard to Columbia's gas acquisition practices in determining that passthrough of its costs should not be denied.

A. *The FERC's Application of the Guaranteed Passthrough Exception*

The FERC has the authority to define terms used in the Natural Gas Policy Act.[41] However, the court of appeals refused to validate the FERC's formulation of the requirement that significant adverse effects constituted an

37. *Id.*

38. *Id.* at 61,711. The Commission reasoned that if Congress had intended to apply the NGA standard of denying passthrough of purchase costs upon a showing of unjust and unreasonable conduct, it would have included these terms in section 601. *See also supra* note 19.

39. Opinion No. 204-A, *supra* note 15, at 61,712-13. However, the FERC had difficulty in explaining how the standard would be applied. It resorted to the circular reasoning that: (1) abuse must cause the purchase price to be excessive, and (2) if abuse is found the amount paid is by definition excessive.

40. Committee Print, *supra* note 14. The conferees state that "there is no intention to override the inherent enforcement power of FERC to police fraud, abuse, etc." However they are equally clear that section 601 is intended to prevent "back door" regulation of producers by the FERC.

41. Interstate Natural Gas Ass'n of America v. FERC, 716 F.2d 1, 10 (D.C. Cir. 1983). Traditionally, respect is given an agency's interpretation of statutes it is required to administer.

element of abuse. The court found that the requirement was more rigorous than could reasonably be interpreted from the language of the statute.[42]

Petitioners objected to the FERC's definition of abuse alleging, as they had in Opinion No. 204-A, that the standard was either too inclusive or so restrictive that it was difficult for the Commission to deny passthrough. They argued that abuse does not include the degree of culpability which accompanies the term "reckless" and that "reckless disregard" would allow costs to be passed through which were incurred negligently or with gross negligence.[43]

The specific business practices which gave rise to complaints of fraud and abuse were that Columbia had failed to consider the marketability of high cost section 107 gas in making its purchases; that it committed to an excessive supply of the gas; that its contract provisions, especially those which required it to take or pay for 85-90% of deliverable gas were unjustifiable;[44] and that it cut back its takes of less expensive gas in favor of taking high cost gas.[45] The FERC found that Columbia had not acted abusively because evidence did not show that the pipeline's customers had suffered significant adverse effects. However, it found that Columbia's gas acquisitions were imprudent,[46] and that while its take-or-pay contract provisions were reasonable when negotiated, their effects had become unjust and unreasonable, rendering their terms imprudent.[47] Gas acquisition violations were to be corrected by ordering Columbia to enter into an existing proposed settlement agreement. Take-or-pay provisions were to be remedied by Columbia taking "all reasonable action to mitigate their effects."[48]

Petitioners aligned with Columbia protested the Commission's determinations that the pipeline had acted with reckless disregard and imprudence, and disagreed with the Commission's prescribed remedies. Those who objected to the "abuse" standard as too restrictive due to the inclusion of "reckless disregard" asserted that the standard, even if proper, was incorrectly applied because the Commission determined Columbia had not acted abusively. These petitioners argued that the remedies for the pipeline's imprudent behavior were

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42. *Consumers' Counsel*, 783 F.2d at 218.

43. *Id.* at 219.

44. Take-or-pay provisions in gas purchase contracts require a purchaser to take a certain percentage of gas from a producer or pay for that same amount should it not require the gas. Take-or-pay requirements at 85% and above have been considered high. Puckett, *supra* note 14, at 70.

45. *Consumers' Counsel*, 783 F.2d at 224-36.

46. Opinion No. 204, *supra* note 12, at 61,112. The Commission based its reasoning on evidence that Columbia had failed to consider the effect of competition of alternate fuels, specifically No. 2 fuel oil, in making its gas acquisition plans.

47. *Id.* at 61,120. The Commission noted that a number of Columbia's customers could lose markets if their customers switched to alternate fuels and that ultimately consumers would unjustly bear the cost through higher rates.

48. *Consumers' Counsel*, 783 F.2d at 211. The Commission's admonition that Columbia take "all reasonable action" to remedy take-or-pay contract provisions has been criticized as ineffective and vague. It is therefore useless as a guideline for a pipeline seeking to avoid the take-or-pay problem in the future and for the Commission in attempting to enforce its directives. Puckett, *supra* note 14, at 66-67. The *Consumers' Counsel* court rejected the admonition that Columbia take "all reasonable action to correct take-or-pay contract provisions" as being "devoid of a remedy." It stated that the Commission is without power to decline to issue a remedy and that a remedy must be prescribed on remand. *Id.* at 236.

inadequate.[49]

B. *The* Consumers' Counsel *Court's Findings*

The court began its review of the disputed standard with the first prong, which required a finding of reckless disregard. To determine the prospects of defining reckless disregard as abuse, the court first examined the statutory language to determine whether Congress had set out the meaning of abuse.[50] Finding that Congress had not, the court weighed the parties' assertions with the totality of the statute and its legislative history to determine if the FERC had reasonably interpreted the statutory language.[51]

The court supported the Commission's conclusion that equating abuse with misrepresentation negated the purpose of including abuse in the statute. It agreed with the Commission that the legislative history of section 601 indicated that Congress intended to create a standard of review for pipeline gas purchase costs which was different from the "just and reasonable" standard of the sections 4 and 5 of the NGA. Therefore, a finding of imprudence, resulting in unjust and unreasonable rates which would disallow passthrough of purchase costs under the NGA was insufficient to deny passthrough under section 601.[52] Despite some reservations about the Commission's choice of the tort standard of "reckless disregard" to define abuse, the court viewed it as acceptable.[53]

However, the *Consumers' Counsel* court refused to accept the second half of the FERC's test. While it agreed with the FERC that a finding of abuse requires a showing of some effect, it found that the language of section 601(c)(2) specified an excessive payment as the effect sufficient to invoke denial of passthrough. The court therefore did not look beyond the words of the statute to justify the requirement that significant adverse effects be shown in addition to excessive payments, stating that "[r]equiring abuse to encompass a significant adverse effect—*i.e.*, over and above excessive payments—is flatly inconsistent with Congress' clear message on this precise issue, and therefore impermissible."[54] It also found that a heavier burden would be placed on those

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49. *Consumers' Counsel*, 783 F.2d at 211-12.

50. *Id.* at 218. The reviewing court has the ultimate authority to determine whether an administrative agency has correctly interpreted the language of the statute Congress has given it the authority to administer. If the meaning of the statutory language is clear, it must be followed by the agency and by the court. Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984).

51. *Id.* at 219-21. In evaluating conflicting opinions as to proper interpretation of the NGPA, the court will support FERC's interpretation if it is reasonable when considered "in light of the language, legislative history, purpose and structure of the NGPA." *Interstate Natural Gas Ass'n*, 716 F.2d at 10. *See* Superior Oil Co. v. FERC, 563 F.2d 191 (5th Cir. 1977). A reviewing court will examine an agency's actions to determine whether it was arbitrary or capricious. *See also* Peoples Gas Light & Coke Co. v. FERC, 742 F.2d 1109 (7th Cir. 1984). The reviewing court will evaluate the FERC's actions to establish whether it was within its authority and whether it has given reasoned consideration to relevant factors as it balances industry needs with public interests.

52. *Id.* The court pointed out that sections 601(b) and (c)(2) create a standard which is different from that of the NGA, and reasoned that "[h]aving just abrogated the traditional NGA 'just and reasonable' standard for gas acquisition costs, Congress could not have intended the FERC to deny passthrough of those costs pursuant to the same standard."

53. *Id.* at 221.

54. *Id.* at 222.

seeking a denial of passthrough, a burden it was unwilling to impose.[55]

In accordance with its conclusion that abuse must have the impact of an excessive payment, the court suggested a formula for determining such a payment: "we think a reasonable reading of excessive payment is the difference between what the pipeline actually paid for the gas and the lower amount it would have paid absent abusive or fraudulent conduct."[56] The appeals court required the FERC to formulate a standard for excessive payments to be applied in any protest against guaranteed passthrough. This requirement was to be applied on remand to the petitioner's complaints to determine if the FERC's decisions would be altered.[57]

III. AN ANALYSIS OF THE *Consumers' Counsel* COURT'S DECISION

In confirming the Commission's definition of abuse as "reckless disregard," the court accepted the principles of tort law as the basis for defining "fraud, abuse, or similar grounds." Therefore, it follows that these principles should be applied to determine the degree of harm which must be shown to deny passthrough of gas acquisition costs.[58]

The traditional elements of a negligence cause of action which govern "reckless disregard," the accepted portion of the Commission's test for abuse, require that "actual loss or damage resulting to the interests of another" must occur before negligence can be found.[59] This supports the *Consumers' Counsel* court's conclusion that abusive conduct must demonstrate an "effect" on a pipeline's customers. If actual damage or harm must be shown the question arises whether proof of "excessive payments" will suffice.[60] The court asserts that harm may be presumed upon a finding that gas purchase costs were excessive. It has stated that "[a]ny excessive payment for gas has a direct effect on customers and consumers because it is normally passed through, as guaranteed by the statute and reflected in the rates charged by the pipeline for gas."[61] Viewed

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55. *Id.* at 223.

56. *Id.*

57. *Id.* at 236.

58. Although it logically follows that a tort standard should define "abuse" as well as "fraud" or "similar grounds," the FERC rejected this logic in Opinion No. 204-A, as it defended its requirement that abuse must result in "significant adverse effects." It drew a distinction between a tort action and a proceeding under a federal statute. Opinion No. 204-A, *supra* note 15, at 61,712. *Compare* Statement of Comm'r Hughes *supra* note 15, at 61,904-05. The Commissioner criticized the FERC's reasoning, noting that in securities cases a common law action in tort is an accepted device to recover damages for a violation of either a federal statute of an administrative regulation. He concluded that tort concepts should be applicable.

59. W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON TORTS § 30 (5th ed. 1984).

60. In his statement, Commissioner Hughes attempted to determine what, if any, degree of harm must be shown to find abuse. He conducted an analysis of congressional regulatory provisions ranging from mail and securities regulation to utility and energy regulation. He drew the conclusion that regulatory schemes which provide specific standards of conduct for entities they govern require little or no showing of harm to trigger enforcement. Mere violation of a prescribed standard establishes a presumption that harm has resulted. However, schemes which are loosely defined and open to interpretation by their administrative agencies require an explicit showing of harm. Hughes determined that the NGPA is the latter type of regulatory vehicle and that therefore some degree of harm must be shown. Comm'r Hughes Statement, *supra* note 15, at 61,902-04.

61. *Consumers' Counsel*, 783 F.2d at 222 n.33.

in this way, a finding of "excessive payments" would satisfy both the requirement for damage in negligence and the express language of the statute.

An examination for excessive payments, as with all other elements of the guaranteed passthrough exception (fraud, abuse, or similar grounds), must be considered on a case-by-case basis.[62] The steps for applying the excessive payments test are constructed as follows: 1) an examination of acquisition costs a pipeline wishes to recover, often initiated by a purchased gas adjustment agreement; 2) a determination as to whether the rates or charges arose from reckless disregard of the pipeline's fundamental duty to provide service at the lowest reasonable rate consistent with maintenance of adequate service (the test for abuse); 3) if abuse is found to have affected purchase costs, a computation of the difference between actual payments and payments which would have been made absent abusive conduct (the excessive payments test); and 4) denial of passthrough under section 601(c)(2) of payments which have been identified as excessive under the test.[63] The following decision illustrates an application of the reckless disregard and excessive payments tests of the guaranteed passthrough exception.

On July 2, 1986, an administrative law judge adopted the court's instructions in his initial decision in Texas Gas Transmission Corporation (Texas Gas).[64] The decision arose from interveners' protests that Texas Gas' tariff filings indicated excessive acquisition costs,[65] and that its purchases constituted abusive conduct.[66] The ALJ found that Texas Gas had exhibited reckless disregard of its duty in entering into two contracts with Amoco to purchase high-cost gas reserves.[67] He next computed the difference in the contract payments with what Texas Gas should have paid as a prudent operator in light of known market conditions.[68] He determined that excessive payments were made and denied Texas Gas the ability to pass them on to its customers under the authority of section 601.[69] Although the ALJ did not require or search for "significant

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62. Due to the absence of congressionally mandated rules to prescribe "just and reasonable" pipeline costs under the NGPA and the NGA, the facts of each case must be examined by the Commission in order to establish a determination of the permissible standards. *See, e.g.*, Clarifying Order, *supra* note 15, at 61,228, and Comm'r Hughes' Statement, *supra* note 15, at 61,904.

63. This four step test, as envisioned by the author, was followed in substance by the administrative law judge in Texas Gas Transmission Corp., 36 F.E.R.C. ¶ 63,001 (1986).

64. *Id.*

65. *Id.* at 65,002.

66. *Id.*

67. *Id.* at 65,006-12. Texas Gas entered into the contracts in 1980, with the intent of assuring itself of a long-term, conveniently situated supply of gas. In so doing, it abandoned its initial plan to purchase short-term supplies while evaluating the regulatory effects of the newly enacted NGPA. The contracts contained no market-out provisions, a fact which at first made Texas Gas reluctant to commit, but rather a "FERC-out" provision to be triggered by a finding by the Commission of fraud or abuse under section 601(c)(2).

In 1981 Texas Gas ignored the predictions of a study it commissioned, which warned that deregulation would have a negative impact on pipelines committed to the purchase of high-cost gas. The pipeline not only increased its purchase commitments, but also failed to avail itself of an opportunity to escape from its contracts. The administrative law judge discussed the above facts and determined that it was impossible to conclude that Texas Gas had not acted in reckless disregard of its duty to operate prudently and efficiently.

68. *Id.* at 65,011.

69. *Id.* at 65,012.

adverse effects,"[70] he noted that they were clearly in evidence.[71] The ALJ's conclusion may confirm that a finding of such effects is superfluous to a finding of abuse, regardless of the questionable validity of the second prong of the FERC's test for abuse as a statutory construction.

IV. CONCLUSION

Office of Consumers' Counsel v. FERC remains the only case in which a court has taken issue with the Federal Energy Regulatory Commission's two-pronged interpretation of abuse under section 601(c)(2) of the Natural Gas Policy Act. Although it has yet to reformulate the abuse standard as ordered by the court, the Commission has not been prevented from enforcing the guaranteed passthrough exception. As is illustrated by *Texas Gas*, the Commission has found the court's suggested formula for evaluating the scope of payments combined with its test for reckless disregard sufficient to determine if a pipeline's business practices are abusive.

Despite inaction on redefining "abuse," the Commission has taken affirmative steps in the related area of take-or-pay liabilities. As *Consumers' Counsel* demonstrates, Columbia's high take-or-pay contractual obligations were among the principle bases of "fraud and abuse" allegations. Indeed, many of the natural gas industry's current troubles are blamed on take-or-pay problems.[72] On March 5, 1987, the Commission took affirmative steps to address these problems when it issued a proposed Statement of Policy. Under the plan, pipelines may buyout or buydown take-or-pay obligations so long as they are willing to equitably share the burden of accompanying costs on a 50-50 basis.[73]

The proposed policy statement may have the effect of reducing "fraud and abuse" actions. If it serves its intended purpose, take-or-pay inequities under existing contracts will be relieved and future take-or-pay costs will be reduced or eliminated. Also, if a pipeline agrees to absorb an equitable portion of its take-or-pay costs, the Commission will not investigate whether the costs were justified when they were incurred.[74]

Proposed take-or-pay remedies aside, the guaranteed passthrough exception of "fraud, abuse, or similar grounds" remains a valuable enforcement tool

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70. *Id.* at 65,011. The ALJ cited to *Consumers' Counsel* when he recognized that no significant adverse effect is required for a finding of abuse.

71. *Id.* The effects consisted of Texas Gas' customers being compelled to purchase gas at above-market prices. This resulted from the pipeline's reckless entry into contracts it had been warned were ill-advised and which lacked any provision under the "FERC-out" clause for Texas Gas to act independently to obtain relief for its customers. The ALJ found that while Texas Gas had not intentionally tried to harm its customers, it had acted only to protect its stockholders and investors.

72. Take-or-pay provisions are accused of spawning many of the problems currently plaguing the natural gas industry. As a result, there is an urgent need to address the difficulties they pose. Roland, *Take-or-Pay Provisions: Major Problems for the Natural Gas Industry*, 18 ST. MARY'S L.J. 251, 262-63 (1986). *See, e.g.*, Foster Natural Gas Report (Foster Associates) No. 1609 at 2 n.1 (Mar. 5, 1987) (severity of take-or-pay liabilities). According to the FERC, figures drawn from Form 10-K and 10-Q reports submitted by major pipelines to the SEC, reveal total potential liability increasing from $2.88 billion as of year end 1984 to $7.85 billion as of 9/30/86. The FERC noted it was unclear "whether those figures include take-or-pay obligations incurred by pipelines but not actually billed by producers."

73. Foster Natural Gas Report (Foster Associates) No. 1609 at 1-2 (Mar. 5, 1987).

74. *Id.* at 2.

for the Federal Energy Regulatory Commission. As its terms become better defined, it will enable pipelines to structure their business activities to avoid situations likely to result in charges of "fraud or abuse." Further development of the standard will benefit both the Commission and the natural gas industry as a whole.

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