Report of The Committee On Natural Gas Rates And Accounting Regulations

I. Court Determinations

A. Agricultural Priority

On July 29, 1981, the U.S. Court of Appeals for the D.C. Circuit issued its decision on the consolidated appeals filed by several industrial consumer groups and others, from the permanent and interim curtailment rules issued by the U.S. Department of Agriculture ("USDA"), the Federal Energy Regulatory Commission ("FERC") and the Economic Regulatory Commission ("ERA"). *Process Gas Consumers Group v. United States Department of Agriculture,* 661 F.2d 1322 (D.C. CIr. 1981), rehearing *en banc* granted, November 13, 1981. The case involved the 1979 rules promulgated by the USDA, FERC and ERA to implement Section 401 of the Natural Gas Policy Act of 1978 ("NGPA"), requiring protection of essential agricultural users from curtailments of natural gas deliveries by interstate pipelines, except to the extent necessary to meet the requirements of higher priority users.

In general, the court's decision affirmed the regulations, although it reversed and remanded the regulations in two respects. First, the court rejected the ERA's rule that plant protection is available only if an industrial facility is shut down. Second, a majority of the original panel rejected the FERC's decision to apply fixed base periods to high priority users and ruled that the issue should be remanded to the Commission for further consideration. The latter ruling was subsequently vacated by an order issued by the full court, which agreed, *en banc,* to rehear two issues decided by the original panel. The court's disposition of other issues was as follows.

The court rejected objections by agricultural users that the NGPA's curtailment priorities must be applied to capacity curtailments as well as to supply curtailments. In this regard, the Court accepted the FERC's argument that capacity curtailments are infrequent, pose more complex issues, and, therefore, should be left for case-by-case consideration.

The court rejected agricultural users' contentions that the NGPA's agricultural curtailment priority must be followed through to the burner tip, thereby overriding state curtailment authority. In this connection, the court ruled that the NGPA, as finally passed, omitted language in a prior House bill refering to distributor curtailments. Had Congress desired to mandate a system for policing the priorities of deliveries by local distributors, the court stated, it would have used language similar to that found in the House bill.

Overriding the challenges of several full requirements customers, the court affirmed the FERC's partial requirements formula for allocating end user requirements among multiple pipeline customers.

The court upheld the FERC's detemination to require that interstate pipelines serve the essential agricultural use volumes certified by the USDA, provided that such volumes do not exceed limits imposed by contracts or certificate.

The court rejected the agricultural users' challenges to the FERC's decision to restrict agricultural requirements to volumetric limitations imposed by contracts and certificates of public convenience and necessity. As noted by the court, acceptance of the agricultural users' arguments would enable them to receive more gas during shortage than during ordinary periods of operation, a "paradoxical result" which the court found to be unsupported.

Disagreeing with industrial consumers' arguments that the FERC should have undertaken a substantive review of the USDA certification, using fixed base period restrictions, the court found that "FERC reasonably concluded that its function was simply to implement the USDA certification" without giving it a substantive review.

A majority of the court accepted arguments by two distributors that, in view of the use of current requirements for the agricultural priority, it would be discriminatory to impose fixed base periods on the "high priority" categories. The court then stated that "[i]t would turn the statutory scheme of priorities up side down to allow growth in a lower priority while discouraging it in the primary (high-priority) sector of the economy." Here, Judge Patricia Wald dissented, stating that there is no legislative mandate requiring the FERC to implement, without change, the Secretary of Agriculture's certification of agricultural users' gas needs.

Further, the Court rejected the request of a pharmaceutical manufacturer for classification as a high priority user based on the alleged social importance pharmaceutical and medical products.

The court disagreed with the argument advanced by several industrial consumer groups that an alternate fuel test should be imposed upon large commercial users in the high-priority category. The court stated that if Congress had intended an alternate fuel test for the high-priority category, it would have done so explicitly.

Rejecting objections raised by certain distributors, the court held that nothing in the NGPA required FERC or DOE to require all pipelines to classify storage injections in any particular curtailment plan. The court agreed with FERC that a complete examination of the storage gas issue is not required by the NGPA.

The court remanded the ERA's treatment of plant protection gas. The court recognized that there may be instances in which gas may be used to protect life, health or physical property, even while an industrial facility continues to operate.

Finally, the court affirmed FERC Order No. 27, rejecting one agricultural user's argument that the Commission should have allowed agricultural users access to off-shore gas. The court also upheld the FERC's decision to prescribe a five-year term for self-help transactions.

On November 13, 1981, the full court granted rehearing *en banc* and vacated those portions of the opinion that are the subject of the rehearing. The portions vacated included (1) the determination of what percentage of high priority customers' needs must be filled by a pipeline that had been one of several suppliers to a customer and (2) the finding that the FERC lacked authority to order pipelines to use fixed base periods for high-priority or essential agriculturaluses in view of the Secretary of Agriculture's certification of 100 percent of agricultural users' current requirements as "essential agricultural uses."

B. *Commission's Burden of Proof in Changing Allocation Methodology*

The burden facing the FERC in justifying a methodology it proposes in a case was the subject of the United States Supreme Court's denial, on October 15, 1981, of petitions for writs of certiorari to review a District of Columbia Circuit Court ruling overturning FERC Order No. 59. *Federal Energy Regulatory Commission v. Public Service of the State of New York et al.*, S.Ct. No. 80-1937, *cert. denied,* 50 U.S.L.W. 3250, (October 5, 1981).

As reported by the Committee in its last annual report, the Circuit Court held that the FERC lacked the authority to order a new cost allocation method in a rate case in which the filing pipeline did not seek to change its existing allocation method without first finding that the existing method was "unjust, unreasonable, unduly discriminatory, or preferential" under Section 5(a) of the Natural Gas Act. *See* 2 Energy L.J. 172 (1981).

Justices Brennan, White and Blackmun voted to grant certiorari. Justice White did not participate in the Court's action.

C. *Constitutionality of PURPA*

On June 15, 1981, the Supreme Court agreed to entertain a joint appeal filed by the Federal Energy Regulatory Commission and the Secretary of Energy, involving a federal court decision which held certain provisions of the Public Utility Regulatory Policies Act of 1978 ("PURPA") unconstitutional.

The lower court decision was issued by District Court Judge Harold Cox on February 19, 1981, in *Mississippi v. FERC,* S.D. Miss. No. J79-0212 (February 19, 1981), *prob. juris. noted,* 49 U.S.L.W. 3930 (June 15, 1981). Judge Cox held that titles I, III and Section 210 of PURPA unconstitutionally usurped the regulatory power and authority of the State of Mississippi over the intrastate activities such as policies of public utilities operating in the state. The court stated, "[t]here is literally nothing to be found anywhere in the Commerce Clause which would authorize or justify the United States in replacing the Public Service Commission . . ." and in starting the regulation of telephones, natural gas and other such utilities as the Public Service Commission has done extensively on evidence and in furtherance of the local public interest. The court concluded that PURPA is therefore a clear usurpation of power and authority which the United States simply does not have under the Commerce Clause.

D. *Constitutionality of Louisiana First Use Tax*

On May 26, 1981, the United States Supreme Court issued an opinion in *Maryland v. Louisiana,* 49 U.S.L.W. 4562 (1981), finding the Louisiana First Use Tax unconstitutional.

Enacted by the Louisiana Legislature in July 1978, the First Use Tax was imposed on certain "first uses" of natural gas brought into Louisiana which was not previously subjected to taxation by another state or the United States. At the rate of 7 cents/Mcf, the burden of the tax fell primarily upon natural gas entering Louisiana from the Outer Continental Shelf.

Responding to an original action brought by eight states, the Court ruled that section 1303(c) of the First Use Tax Act violated the Supremacy Clause by intruding upon FERC's authority under the Natural Gas Act to determine the allocation of costs for gas sold in interstate commerce. Further, the Court ruled that the entire First Use Tax is unconstitutional under the Commerce Clause of the United States constitution since it discriminated against purchases of gas moving through Louisiana in interstate commerce.

The Court's opinion was delivered by Justice White, who was joined by Justices Brennan, Stewart, Marshall, Blackman and Stevens. Chief Justice Burger concurred, but cautioned the Court to be alert to any effort to expand the use of its original jurisdiction. Justice Rehnquist dissented arguing that the court should not have exercised original jurisdiction in this case. Justice Powell took no part in consideration or decision of the case.

On July 15, 1981, the Supreme Court issued a judgment in *Maryland v. Louisiana*, 49 U.S.L.W. 4709 (1981), which enjoined Louisiana from further collection of the Louisiana First Use Tax and directed Louisiana to refund to the pipeline taxpayers within 30 days of the judgment all revenues collected pursuant to the First Use Tax, together with all interest earned thereon. At the request of the plaintiff states and the plaintiff intervenors, the Court further provided that the First Use Tax revenues which have been invested by Louisiana in interest bearing securities are to be refunded by Louisiana as each security matures, to avoid any interest penalty associated with premature termination of these securities. This staggered refund procedure will increase refunds to consumers by at least $17 million.

E. *FERC Allocation of Cost of Emergency Gas to Low Curtailment Priority Users through PGA Clause*

In *United Gas Pipe Line Company v. Federal Energy Regulatory Commission*, 649 F.2d 1110 (5th Cir. 1981), the court affirmed the Commission's allocation through the PGA clause of the cost of emergency gas to customers with lower curtailment priorities in order to concentrate on those customers the effects of natural gas curtailments. The court held that the Commission properly prohibited the use of rolled-in pricing to recover the emergency gas costs since there was no direct benefit to all customer classes; that the Commission adequately explained the basis for its decision as encouraging low priority customers to find substitute fuels and make more efficient use of the gas they do receive, and that United was not unfairly singled out among all other pipelines. In so holding, the court noted the Commission's finding that it has historically favored the rolled-in approach for cost allocation, but stated that the Commission was entitled to change its policy.

F. FERC Approval of GRI R&D Budget

On August 24, 1981, the D.C. Circuit Court of Appeals upheld the Federal Energy Regulatory Commission's ("FERC") authority to approve the Gas Research Institute's ("GRI") budget, *Public Utilities Commission of the State of Colorado v. Federal Energy Regulatory Commission,* ____ F.2d ____, D.C. Cir. No. 80-1117 (August 24, 1981).

The GRI case involved Colorado's appeal of Opinion No. 64, in which FERC approved GRI's 1980 research and development ("R&D") budget. GRI obtains funds through a "funding unit" formula, which, under the 1980 budget, costs the average gas-consuming household about 60 cents per year. GRI's 1980 budget totalled $55.4 million. In its challenge of the Commission's order, Colorado contended that: (1) FERC could not approve an application by GRI because GRI is not a natural gas company, and (2) even if FERC could act on GRI's application, FERC acted unlawfully in approving a surcharge since some of GRI's R&D projects fall outside the Commission's natural gas authority.

In approving GRI's 1980 budget, FERC relied on a section of its regulations that gives it authority over R&D organizations. Challenging this assertion of jurisdiction, Colorado argued that FERC did not have jurisdiction under the Natural Gas Act because GRI is not a natural gas company, and the FERC's regulations could not confer such authority.

Rejecting this argument, the court found it "to be unduly restrictive and to exalt form over substance." The court further observed that Section 4 of the Natural Gas Act gives the Commission authority over all rates charged by a natural gas company, and 29 interstate pipeline companies belonging to GRI are natural gas companies subject to FERC's regulation. Rather than approving R&D budgets submitted by the individual pipelines, FERC acted once through its approval of GRI's budget, which the court concluded to be "a rare instance of a government agency trying to cut red tape."

The court also affirmed FERC's position that its R&D regulations gave it authority over GRI's expenditures, which it asserted in response to Colorado's reliance upon the *Great Plains* decision, *Office of Consumers' Counsel v. Federal Energy Regulatory Commission,* 655 F.2d 1132, D.C. Cir. (1980), for the proposition that at least some of the objects of GRI's R&D — manufacture of synthetic gas, demonstration of electric power plants, and development of solar energy — were not jurisdictional. Distinguishing the GRI budget approval from the *Great Plains* case, the court held that the budget approval is in a rate proceeding under Section 4 of the Natural Gas Act, not a certificate proceeding under Section 7, and that the "FERC's discretion and authority under the two sections were not necessarily coextensive."

The court also observed that in this case FERC was not seeking to regulate the construction or operation of any project and in further contrast to *Great Plains:*

> "GRI is not putting all of its eggs in one basket by devoting all of its resources to one risky venture . . . it has steered a course of moderation which includes areas of natural gas research, synthetic gas, gas efficiency, etc."

The court also noted that the Supreme Court on numerous occasions has held that FERC may take into consideration nonjurisdictional items when setting jurisdictional rates. Finally, the court pointed out that the *Great Plains* project was not likely to benefit the ratepayer, unlike GRI's activities. As the court summed it,

> "there is a difference between FERC's becoming an active participant in the building, financing and operation of a large scale commercial synthetic fuel operation which had little possibility of benefit to the ratepayer, and the various areas of research to be carried out here."

G. *Filed Rate Doctrine*

On July 2, 1981, the United States Supreme Court issued an opinion in *Arkansas Louisiana Gas Co. v. Hall*, 49 U.S.L.W. 4947 (1981), finding that the filed rate doctrine embodied in the Natural Gas Act prohibits a state court from awarding damages in a breach of contract action, where the seller's rates were subject to Federal Energy Regulatory Commission jurisdiction.

The case involved a breach of contract suit arising from a contract entered into in 1952 between a group of small producers and Arkansas Louisiana Gas Company ("Arkla"). Under the contract the producers agreed to sell Arkla natural gas from a certain gas field in Louisiana pursuant to a fixed price schedule and a favored nations clause, which provided that if Arkla purchased gas from another party in the same field at a higher rate than it was paying the producers, the producers would be entitled to the higher price for their sales to Arkla.

In 1954, the producers filed the contract with the Federal Power Commission and were issued a certificate of public convenience and necessity authorizing the sale of gas at the specified contract rates. In 1961, Arkla purchased certain leases in the same gas field from the United States and began producing gas on its leasehold. In 1974, the producers filed a state court action in Louisiana contending that Arkla's lease payments to the United States had triggered the favored nations clause.

The Louisiana trial court held that the filed rate doctrine, which prohibits a federally regulated seller of natural gas from charging rates higher than those filed with the Commission pursuant to the Natural Gas Act, precluded an award for damages for the period prior to 1972 (the time during which the producers were subject to the Commission's jurisdiction). The intermediate appellate court in Louisiana affirmed the trial court, but the Louisiana Supreme Court reversed, holding that the producers were entitled to damages for the period between 1961 and 1972 notwithstanding the filed rate doctrine.

In a 5-3 decision, the U.S. Supreme Court held that the Natural Gas Act bars a regulated seller of natural gas from collecting a rate other than the one filed with the FERC and prevents the Commission itself from imposing a rate increase for gas already sold. Next, the Court pointed out that Congress has granted exclusive authority over rate regulation to the Commission and, in so doing, withheld the authority to grant retroactive rate increases or to permit collection of a rate other than that on file. In this regard, the Court observed that it would be inconsistent with this Congressional purpose to permit a state court to do through a breach of contract action what the FERC may not do. Further, the Court explained that under the filed rate doctrine, when there is a conflict between the filed rate and the contract rate, the filed rate prevails. Thus, the Court concluded that permitting the state court to award what amounts to a retroactive right to collect a rate in excess of the filed rate "only accentuates the danger of conflict," and no appeal to equitable principles can justify such usurpation of federal authority.

The majority opinion was by Justice Marshall, joined by Chief Justice Burger and Justices Brennan, White and Blackmun. Justice Stevens, joined by Justice Rehnquist, dissented, expressing the view that the state court damage award to redress the breach of contract did not violate federal policies and was not preempted by federal law. Justice Powell also dissented, expressing agreement with Justice Steven's separate opinion and emphasizing that the judgment of the Louisiana Supreme Court should be affirmed, given that court's finding that Arkla was responsible for the producer's failure to file an increased rate. Justice Stewart did not participate in consideration of the case.

H. *First Sale Status Under NGPA of Gas Produced by Pipelines and Distribution Companies*

On December 23, 1981, in *Mid-Louisiana Gas Company v. FERC,* 664 F.2d 530 (5th Cir. 1981), the United States Court of Appeals for the Fifth Circuit held that Congress clearly intended for any production attributable to an "interstate pipeline, intrastate pipeline or local distribution company, or any affiliate thereof" is to be accorded first sale status under the Natural Gas Policy Act of 1978, and Congress further contemplated that the intracorporate transfer of pipeline production to the pipeline would be treated as a first sale. Further, in vacating Order Nos. 58 and 98, the court ruled that the FERC lacked authority to set prices for interstate pipeline production under the Natural Gas Act ("NGA").

In Order No. 58, the Commission determined that if a pipeline commingled gas produced by it with gas produced by other entities, the pipeline was not entitled to NGPA prices for the gas it produced. The order was premised on the view that the sale referred to by 15 U.S.C. §3301(21)(B) was a transfer by the pipeline to its customers and that such a transfer was not a "first sale" unless the gas transferred was exclusively attributable to the pipeline's own production.

Because sales by pipelines are normally comprised of commingled gas, FERC acknowledged that its regulation denied NGPA prices to virtually all pipeline produced gas and that FERC would retain jurisdiction under the NGA to set the price of such gas. The Commission justified its regulation because it intruded the least into state regulation and because it was less difficult to administer.

In Order No. 98, the FERC, acting under the NGA authority it had recognized in Order No. 58, established prices for intrastate pipeline sales which come from mixed volumes of pipeline and independent producer gas. The Commission allowed pipelines whose production had previously been priced according to area or national rates to sell gas at NGPA prices, but refused to extend NGPA prices to pipelines whose production had been priced on a cost-of-service.

Examining the language of 15 U.S.C. §3301(21)(B) that pipeline sales are not first sales unless attributable to the pipeline's own production, the Court noted that Order No. 58 would render the "unless" clause of subsection (B) a nullity by over-stressing the provision that pipeline sales are not first sales. The Court declared that nothing in the language of the NGPA suggests any intent to deny NGPA pricing to natural gas just because it is produced by a pipeline. Thus, the Court determined that the "unless" clause can only have meaning if it is interpreted as granting "first sale" status to gas which is attributable to pipeline production.

The Court further rejected the FERC claims that its interpretation of first sale is consistent with both the purposes of the NGPA and the state's traditional jurisdiction over retail sales reasoning that two of the overriding purposes of the NGPA were to eliminate the dual interstate and intrastate market for natural gas and to provide higher prices to encourage production. In achieving the goal of increasing natural gas production, the Court asserted that pipeline producers deserve the price encouragement of NGPA no less than other producers. Further, while the FERC's approach would retain control of interstate pipeline production under the NGA, it would also leave intact state regulation of intrastate pipeline and local distribution company production. This would leave a substantial vestige of the dual market structure that Congress sought to eliminate.

Next, referencing other provisions in the statute, legislative history and a NGPA Conference Committee report, the Court found additional support for its ruling that Congress intended to accord pipeline production first sale status.

Finally, responding to the Commission's concerns that applying NGPA prices to sales to customers downline would supplant the states' traditional jurisdiction over retail sales by interstate pipelines, intrastate pipelines and local distribution companies, the Court ruled that attachment of NGPA prices to the intracorporate transfer would leave intact the states' jurisdiction over retail rates, and the only change would be that the cost of the gas to the pipeline or distribution company would be the NGPA price. Furthermore, the Court stated that application of NGPA prices to intracorporate transfers would not disturb the Commission's traditional method of establishing prices for downline pipeline sales. NGPA prices would merely establish the "cost" of the pipeline's own production to the pipeline and that this cost would then be factored in as a component of the pipeline's overall costs, precisely as the FERC has done under the cost of service method.

I. Gas Contract Interpretation Procedures Under Order No. 23

On August 21, 1981, the U.S. Court of Appeals for the Fifth Circuit issued its decision in *Pennzoil Company* v. *Federal Energy Regulatory Commission,* 645 F.2d 360 (5th Cir. 1981). The case involved FERC Order No. 23 which provided that the Natural Gas Policy Act of 1978 was no bar to area rate clause escalation to NGPA ceiling prices, and which established procedures whereby parties could contest the contractual sufficiency of specific area rate clauses. Denying requests for rehearing, the Court generally affirmed Order No. 23 and related orders, but to a minor degree set aside and modified the Commission orders.

The Court agreed with the FERC that the NGPA neither precludes nor requires area rate clauses to escalate interstate contract prices to the maximum NGPA price. Praising the actions of the Commission, the Court observed that the FERC, faced with a "monumental task not forseen by Congress", adopted a "reasonable approach" for resolving the problem of contractual authority provided by area rate clauses. The Court then concluded that the FERC orders did not violate the NGPA or the Natural Gas Act and for the most part were "not arbitrary, capricious, an abuse of discretion, irrational or unreasonable."

The Court's decision reversed and modified the Agency's determinations in only two minor respects. First, the Court rejected FERC's position that is is obliged to consider protests directed to contracts covering categories of gas which will be removed from jurisdiction under the NGA by a jurisdictional agency determination of eligibility pursuant to Sections 102, 103 or 107 until such time as the jurisdictional agency determination becomes final. The Court labelled this a "waste of legal resources" and ruled that the Commission should consequently stay protests regarding Section 102, 103 and 107 gas pending completion of the jurisdictional agency well determination process. Second, the Fifth Circuit held that which state's contract law applies is properly within federal-common law, and the interstate nature of the choice of law makes the choice essentially federal in character. The court, however, determined that it is reasonable to put the burden on the parties to inform FERC if the state law that should apply is any different from the general principles that FERC uses.

J. Payment of Compound Interest on Refunds at an Average Prime Rate for Each Calendar Quarter

Order Nos. 47, 47-A, and 47-B, requiring natural gas companies to pay compound interest at an average prime rate for each calendar quarter on the portion of increased rates found not justified, were affirmed in an appeal filed by numerous producers and pipelines. In *United Gas Pipe Line Company* v. *Federal Energy Regulatory Commission,* 657 F.2d 790 (5th Cir. 1981), the court rejected the idea that there is a statutory right to seek higher rates and pointed out that interest runs only on charges found not justified. It further rejected any analogy to commercial loans and described the Commissions actions as rectifying the consequences of unlawful behavior in which the Commission becomes a stakeholder in determining who owns the stakes.

K. Rate of Treatment of Consolidated Income Tax Savings

In *City of Charlottesville, Va.* v. *FERC,* 661 F.2d 945 (D.C. Cir. 1981), the court reviewed the Commission's treatment of consolidated income taxes in Opinion Nos. 47 and 47-A, issued in proceedings on rate increases proposed by Columbia Gas Transmission Corporation and Columbia Gulf Transmission Company. The majority (District Judge Aubrey Robinson and Judge Wald) remanded the case for the Commission's failure to adequately specify evidence on which the rate order was premised. As to the practice whereby the parent borrows money at high interest rates and lends it to subsidiaries at low rates resulting in a balance sheet loss, the court held that there is no principled basis for giving Columbia, and denying ratepayers, benefits of the resulting tax savings. The Court further held that an evaluation of petitioner's claim requires an examination of the interaction between the tax calculation and other portions of the ratemaking formula not briefed to the court, and the Commission lacked factual support for its conclusion that Columbia should be allowed the benefit of consolidated tax savings as an incentive to exploration and development. Thus the ALJ found that only a portion of the tax savings were routed to exploration and development subsidiaries with the remainder used for general corporate purposes, and the Commission cited no evidence that tax savings "trickle down" from the parent to exploration and development affiliates.

Judge Wald concurred emphasizing that after seven years, it would seem reasonable not merely to say that "gas is short", but to utilize evidence that the specific tax treatment given is having the effect desired. Also, Judge Wald questioned the use of predictive economic models rather than actual costs in rate cases without monitoring whether the model's assumptions work in practice.

Judge McKinnon dissented, contending that the Commission had sufficient basis for permitting the pipeline to retain the benefit of consolidated tax savings attributable to losses of its affiliated exploration and development companies. Thus a utility should be considered on its own merits and not those of its affiliates; and it was sufficient to find that the pipeline had affiliates engaged in exploration for new energy supplies, the affiliates incurred losses during the relevant period, and the losses contributed to the pipelines' consolidated tax savings.

L. *Well Determination and Allied Procedures*

Various orders of the FERC implementing interim and final Commission regulations governing the well determination process, collection of sales revenues and the applicability of certain NGPA pricing categories were affirmed by the Fifth Circuit in *ECEE, Inc. v. FERC,* 645 F.2d 339 (5th Cir. 1981). The court held that Section 503(c)(3) of NGPA does not give jurisdictional agencies authority to decide what evidence must be submitted, but merely provides the new and separate procedures will not be imposed on the agencies. Also Section 503(c)(3) prescribes both the form and content of the filings and vests broad discretion in the FERC to prescribe what is to be in the record on review. In addition, the requirement that the FERC shall reverse the determination evidence in acoordance with the traditional definition assures that the FERC will not "second guess" the agency. Furthermore, the required search by the applicant of its records is expressly limited to relevant and reasonably available records. This is an exercise of FERC's authority under NGPA §501(a) to issue necessary or appropriate rules and orders. Other facets of the rules approved by the court include the procedures for toiling the commencement of the preliminary review period and for treating confidential information. The court additionally approved procedures for review of jurisdictional agency deteminations including the standing to protest, and the evidence to be submitted by protesters. Still other areas that the court favorably considered were the opportunity to respond to protests, the finality of the jurisdictional agency determination, the refund obligation and the treatment of specific well categories. In summary, the court held that the NGPA's complexity is another example of why federal courts show great deference to an administrative agency's interpretation of its own statute and it is satisfied that the FERC lived up to its obligation.

II. COMMISSION CASES

A. Allocation of Costs Between Transportation of Natural Gas and Handling of Liquids and Liquefiable Hydrocarbons

On March 4, 1981, the FERC issued an order on rehearing in *Trunkline Gas Company et al.*, Docket Nos. CP78-340 *et al.*, (14 FERC 61,222), which amended certificates granted to pipelines for transportation of offshore natural gas by requiring cost allocations between the transportation of natural gas and the transportation of liquid and liquefiable hydrocarbons. In the order, the Commission reaffirmed its policy of protecting customers of jurisdictional pipelines from sharing the cost of transporting liquids and liquefiable hydrocarbons.

The Commission explained that the issue of cost allocation arises in at least two distinct factual settings. One involves the construction and operation of pipeline facilities connecting a gas well to a separation facility or processing plant where liquids and liquefiable hydrocarbons (to which the producer retains title) are separated from the natural gas stream. In this case, if the pipeline transports the producer's liquids or liquefiable hydrocarbons without allocating costs to that service, the pipeline's customers will bear the entire cost of constructing and operating the pipeline even though the presence of the hydrocarbons decreases pipeline efficiency and requires greater capacity to transport the entire stream.

A more complex situation arises where a pipeline which purchases gas from a producer and retains title to the liquids and liquefiable hydrocarbons, contracts with another pipeline to transport both the natural gas and the hydrocarbons in a combined stream to a processing plant. If the transporting pipeline charges an existing rate to the shipper pipeline, then only the cost of transporting natural gas will be recovered, and the costs of transporting liquids and liquefiable hydrocarbons will be borne either by the transporting pipeline's shareholders or by the producers through payment of charges to the transporting pipeline. Where the transporting pipeline proposes an initial rate rather than an existing rate, however, then an allocation of transportation costs between natural gas and other hydrocarbons will allow the shipper pipeline to pass through the respective costs to the two separate beneficiaries of the service.

In each case, the Commission stated that a certificate condition is necessary to ensure that the rates charged to the natural gas customers do not improperly subsidize the beneficiaries of the liquid and liquefiable hydrocarbon transportation. The Commission explained that such a shifting of costs from a producer to the purchasing interstate pipeline has been viewed under the Natural Gas Act as having the practical effect of increasing the price of the producer's sale above the contract price. *Atlantic Refining Company* v. *Public Service Commission of New York,* 360 U.S. 378, 383-84, 393 (1959). The Commission added that the same concern for cost shifting continues under Title I of the Natural Gas Policy Act of 1978. Further, the Commission observed that in Opinion No. 90, it determined that the prudence of incurring production-related costs which have been shifted from the producer to the pipeline would be subject to review in the purchasing pipeline's next rate proceeding. Here, the Commission stated that it viewed the assumption of producer-owned liquids and liquefiable hydrocarbon transportation costs by the purchasing pipeline to be part and parcel of the same problem.

Outlining new procedures in this area, the Commission stated that it will refer cost apportionment issues arising in pipeline certificate proceedings to resolution in the pipeline's rate proceeding where proposed facilities have been submitted for inclusion in the cost of service of the transporting pipeline as part of its general rate proceeding. The Commission further stated that it will consider the cost apportionment issue in individual certificate proceedings when circumstances prevent referring the issue to a general rate case.

Finally, the Commission noted that adjudication of cost allocation issues on a case-by-case basis can be avoided if pipelines make appropriate cost allocations when initially contracting for transportation services. In that regard, the Commission stated that it expects that pipelines will properly apportion costs to transportation and handling of liquids and liquefiable hydrocarbons when negotiating future transportation arrangements.

B. Budget Approval of GRI Five Year R&D Plan

On September 28, 1981, the FERC, in *Gas Research Institute,* Docket No. RP81-72-000, Opinion No. 131, granted an application by the Gas Research Institute (GRI) for advance approval of its 1982 gas research and development (R&D) program and a related 1982-1986 five-year R&D Plan. Of the proposed $99.8 million 1982 budget submitted to the FERC for approval, approximately $91.5 million would constitute a funding unit surcharge (of 7.2 mills per Mcf) on the sale and transportation by GRI members of 12,743 Bcf of natural gas to distributors for resale, to non-member pipelines of GRI and to ultimate consumers. Also, the total proposed budget contemplates approximately $8.3 million in revenues from patent licenses, interest income, contract settlements, sales of research equipment, and unexpected funds collected pursuant to prior approved programs.

In approving the overall program and plan, the Commission rejected many of the recommendations outlined in the staff's critical report of the GRI

1982 budget. Declining to review the technical structure of each project, the Commission stated: "we have consistently stated that we view our function with respect to GRI's annual applications as that of a reviewing body, not that of an active participant in the formulation of the details of GRI's programs." Further, in response to the staff's principal complaint that the near-term commercial aspects of GRI's program and GRI's emphasis on promotional activities were departures from the established scope of GRI's activities, the Commission ruled that: (1) GRI's proposals in this area are a rational development in the evolution of its program; (2) it never intended to preclude commercialization activities by GRI; and (3) GRI's budget proposals do not have to conform with the administration's inclination to withdraw government research funds from near-term projects. Finally, the Commission held the revised funding service requirement to be both just and reasonable and collectable by GRI's jurisdictional customers.

C. *Criteria for Commitment and Dedication Under Section 104 and Section 109(a)(2) of the NGPA*

After allowing Tenneco Exploration to withdraw two certificate applications under the optional procedure of 18 CFR § 2.75, the Commission fixed a maximum lawful price as prescribed in § 104 of the NGPA rather than § 109(a)(2) as sought by Tenneco Exploration. On appeal, the FERC's holding was set aside in part and remanded, the court distinguishing whether there had been sales in interstate commerce on November 8, 1978, the criterion for commitment and dedication under the NGA, or whether a contract was entered into after November 8, 1978 and was dedicated under the NGPA. *Tenneco Exploration Ltd.* v. *FERC,* 649 F.2d 376 (5th Cir. 1981). If dedicated under the NGA, Section 104 of the NGPA would have been appropriate, while Section 109(a)(2) would be appropriate if the sale were pursuant to the NGPA. The court's rationale was that there was no need to encourage gas already subject to the NGA, as there was by entering into a contract under the NGPA.

D. *Financing and Rate Conditions Imposed on Certificate Authorization*

1. Background

Opinions 125 and 125-A, issued July 28 and October 2, 1981, in *Ozark Gas Transmission System,* (Docket No. CP78-532), involved an application filed by Ozark Gas Transmission System ("Ozark"), requesting authority pursuant to Section 7(c) of the Natural Gas Act to: (1) construct and operate a natural gas pipeline extending from Oklahoma to Arkansas, and (2) transport natural gas in interstate commerce through the proposed pipeline facilities for Tennessee Gas Pipeline Company ("Tennessee") and Columbia Gas Transmission Corporation ("Columbia").

The Ozark system would consist of about 265 miles of 20-inch pipeline and about 180 miles of smaller diameter lateral pipelines, together with related facilities. Such facilities would have a design capacity of 170,000 Mcf per day. The facilities would enable Ozark to receive, transport and deliver gas obtained from the Arkoma Basin.

Tennessee and Columbia would each have the use of 50% of the initial pipeline capacity subject to a capacity option by Oklahoma Natural, which would be allowed to elect, within two years after the pipeline commenced commercial operation, to use up to 25% of the capacity not then used or committed to Columbia or Tennessee.

The pipeline would be built at an estimated cost of $118.5 million. Thirty percent of the system's cost would be financed with equity contributions from Ozark's partners. The remaining seventy percent would be financed with long-term debt. The project sponsors proposed project financing (*i.e.*, securing the project debt with stream of income generated by the project).

Arkansas Louisiana Gas Company ("Arkla"), vigorously opposed the application.

2. Initial Decision

On September 12, 1980, Administrative Law Judge Burton S. Kolko issued his decision approving the application filed by Ozark, subject to stated financing and rate conditions.

Judge Kolko addressed Ozark's proposal for project financing based on a 70/30 debt-equity structure. The law judge approved a two-part rate containing a demand charge or minimum bill, designed to recover operating and maintenance expenses, full depreciation, operating taxes, exclusive of income taxes, and interest on long-term debt, and a commodity charge, designed to recover the remaining fixed costs consisting of return on equity and income taxes.

Finally, Judge Kolko provided for a triennial recomputation of Ozark's cost of service in order to avoid an overrecovery of investment after the first three years of operation.

3. Opinion No. 125

On July 28, 1981, the Commission issued its Opinion No. 125, in Docket No. CP78-532, affirming the decision of the law judge with several modifications.

First, the Commission concluded that while Ozark had made only a marginal case for project financing, that there existed factors that nevertheless allowed it to find that project financing of this pipeline is in the public interest. Here, however, the Commission issued a warning that future requests for approval of project financing will undergo careful scrutiny.

Second, the Commission approved the two-part rate containing a demand charge (minimum bill) and a commodity charge. Concluding that the demand charge approved by the law judge would not achieve the goal of recovering full debt service, the Commission modified the demand charge to provide for the recovery of the actual debt interest paid by Ozark.

The Commission also modified the law judge's recommendation regarding triennial review of Ozark's rates. In this regard, the Commission decided to view the initial rates as interim rates which it found in the public convenience and necessity. However, since this is a new pipeline with no operating history, the Commission directed Ozark to provide a basis on which to evaluate future rates no later than two years after the beginning of service. At the end of this period, the company must submit a cost and revenue study to support either the continuation of existing rates or a change in them.

4. Opinion No. 125-A

On October 2, 1981, the FERC issued Opinion No. 125-A denying applications by Arkla, the New York Public Service Commission and the People's Counsel of Maryland for rehearing of Opinion No. 125. In denying rehearing, the Commission further amplified its position on project financing.

Addressing Arkla's contention that the Commission erred in permitting the minimum bill provision to facilitate project financing, the Commission noted that "nothing in the statute or cases requires the Commission to favor 'conventional' over 'project' financing." The Commission explained that project financing accomplishes two primary ends. First, it constitutes a pre-abandonment finding that the project represents a prudent investment thus assuring lenders that their loans will be recoverable from ratepayers. Second, project financing is a mechanism for off-balance sheet financing, "and therein lies the real risk to consumers. Since the consumer pays for gas it does not receive in cases where the Commission allows amortization of the cost of a failed project which was conventionally financed, its position is indistinguishable from the case of project financing except that the finding of prudence was made before, not after, abandonment of the project. It is the finding of prudence that is essential to the allowance of off-balance sheet financing. Such financing should not be permitted *unless* the Commission can find in advance, as it has done here, that the project is prudent." The Commission added that its discussion of project financing in Opinion No. 125 was intended to describe a list of policy considerations it considered before permitting project financing in this case, "and should serve to warn that off-balance sheet financing will not be cavalierly approved in the future. While this Commis-acknowledges that this set of considerations constitutes a policy change from the past, policy consideration applicable to future cases will be considered on a case-by-case approach until a reasonably permanent standard is developed."

Additionally, the Commission discussed Ozark's request for confirmation that the minimum bill tariff condition, approved as an integal part of project financing will never be subject to review in a future rate proceeding. The Commission responded that while the minimum bill condition will not automatically be subject to review in a future Section 4 proceeding, it does not have authority to insulate this condition from a challenge raised pursuant to Section 5. However, the Commission would have to sustain a very high burden of proof.

Finally, the Commission was not persuaded that further hearings were needed in this proceeding.

E. *Waiver of Law Package Allowing Advance Billing of Natural Gas Ratepayers*

In December 1981, President Reagan approved legislation (S.J. Res. 115) to expedite the construction and operation of the Alaskan Natural Gas Transportation System ("ANGTS"). See *Alaska Natural Gas Transportation System,* (Docket No. CP78-123 et al.). This included a waiver of law package that is expected to remove legal barriers to private financing of ANGTS, the cost of which is currently projected to require—after inflation, interest costs, and the inclusion of a gas-conditioning plant—up to a $35-$48 billion investment. The plan contained three controversial provisions: (1) advance billing of natural gas ratepayers; (2) equity participation by the producers; and (3) inclusion of the gas-conditioning plant in the ANGTS costs.

Under the waiver, ANGTS would be divided into three "segments": the Alaskan pipeline, the Canadian pipeline, and the gas conditioning plant, and ratepayers would be subject to advance billing whenever one or more of the segments is completed—even if gas is not yet flowing. In effect, ratepayers would guarantee that the project debt would be repaid in the event of project delay or non-completion. The waiver removes doubts as to the legality of such a pre-billing arrangement arising from President Carter's 1977 decision when the project was initially approved, and the NGA.

Second, the waivers package permits producers to own a minority equity interest and participate in management of ANGTS. The Justice Department must find, however, that such participation will not violate the antitrust laws, restrict access to the transportation system by non-producer shippers or restrict expansion capacity. The 1977 decision by President Carter had ruled out such participation by the producers.

Finally, President Carter's decision and subsequent FERC decisions envisioned that the producers, not the pipeline, would build a conditioning plant on Alaska's North Slope to prepare the gas for transportation to the lower 48 states. Such a plant would not be subject to FERC jurisdiction. The administration's waivers package permits the plant to be treated as a part of the overall pipeline project subject to FERC jurisdiction. Costs of the plant would then be part of the overall pipeline construction costs for which natural gas ratepayers would be liable in the event of non-completion or interruption of service. The plant is estimated to cost between $3 to $6 billion.

F. *LIFO Treatment of Stored Gas*

By order issued January 16, 1981, in *Consolidated Gas Supply Corporation,* Docket Nos. RFP79-22 and RP78-52, the Commission affirmed the Administrative Law Judge's August 15, 1980 decision approving a LIFO (last in, first out) tretment for natural gas in storage, and by order issued March 19, 1980 it denied rehearing with respect to the January 16 order. The ALJ's decision recognizes that customers are affected by the treatment intwo ways, the charges passed on to customers under the Purchased Gas Adjustment and the return and related income taxes on the storage inventory which is included in the rate base as working capital. Hence during periods of rising prices the result is higher charges for sales of gas withdrawn froms torage and lower charges to customers to cover inventory costs.

The ALJ's decision, as affirmed by the Commission, was largely based on the conclusion that the proposed accounting treatment was proper and although there is no hard and fast rule that accounting must control ratemaking, any deviation should be the exception rather than the rule.

G. *Rate and Financing Conditions on Certificate Authorization and Conditions for Allocation of Costs Between Transportation of Gas and Handling of Liquids and Liquefiable Hydrocarbons*

On March 17, 1981, the Commission issued an order in *Pacific Offshore Pipeline Company*, Docket No. CP74-35, amending an authorization to Pacific Offshore Pipeline Company (POPCO) to transport gas from the offshore production facilities of Exxon Corporation (Exxon); to sell such gas for resale to Pacific Lighting Service Company within California; and to construct, test, operate and own gas treatment facilities. The Commission conditioned its authorization, however, to reflect 70% debt and 30% equity, 12.80% on equity, 3.33% depreciation. Other conditions were designed to assure that Exxon would not divert the gas stream to another plant or to take title to extracted products without Commission approval and in accordance with the cost allocation provisions of Commission Order No. 94, issued July 25, 1980 in Docket No. RM80-47.

In its order, the Commission concluded that the proposed project will generate benefits to warrant its approval, including the development of additional gas supplies in the immediate vicinity, that should result in a high level of usage of the proposed facilities. However, the Commission expressed major concerns with certain elements of the agreement between POPCO and Exxon.

Here, the Commission took issue with the financial and rate structure of the arrangement between POPCO and Exxon, and provisions wherein POPCO could incur all costs of transporting and treating the gas, but Exxon may, at any time, take title to the by-products and may even divert the total gas stream to another plant. Rejecting this structure, the Commission stated that it would not be in the public interest to approve the application without conditions.

The Commission exlained that it had no objections to the project in the context of POPCO constructing, owning, and operating the proposed pipeline and gas treating plant and appurtenant facilities, where the revenues from the products removed from the gas stream (including liquids, liquefiable hydrocarbons, and non-hydrocarbon constituents) accrue to POPCO's cost of service. However, the Commission raised strong objections to Exxon's option to take title to the extracted products in the absence of apportioning costs to production, transportation and handling of liquids, liquefiable hydrocarbons, and non-hydrocarbon constituents.

Accordingly, the Commission conditioned POPCO's certificate to require that (1) Exxon not exercise its option to divert the gas stream involved in this project to another plant, without specific prior approval by the Commission; (2) Exxon not exercise its option to take title to the extracted products without prior approval of the Commission; and (3) if Exxon exercises its option to take title to the extracted products, the Commission will require the application of its (Exxon's) outstanding policies related to "production-related costs" and apportionment of costs to the transportation and handling of liquids, liquefiable hydrocarbons, and non-hydrocarbons in accord with Order No. 94, "Regulations Implementing Section 110 of the Natural Gas Policy Act of 1978 and Establishing Policy under the Natural Gas Act," Docket No. RM80-47 (Issued July 25, 1980).

III. RULEMAKING ACTIONS

A. Amended Stripper Well Regulations Pursuant to Section 108 of NGPA

On November 16, 1981, the FERC issued three orders in rulemaking proceedings relating to stripper wells covered by Section 108 of the NGPA. *Final Rules Amending Stripper Well Regulations* (Docket Nos. RM81-6, RM81-25, and RM79-73), Order Nos. 186, 187, and 188

1. Order No. 186

The NGPA defines a stripper well as one that produces at its maximum efficient rate of flow, no more than an average of 60 Mcf of nonassociated natural gas per production day during the preceding 90-day production period. If a well's production exceeds this limit, the well will be disqualified as a stripper well unless the overproduction is shown to be caused by application of a "recognized enhanced recovery technique" (*see* § 271,803) or seasonal fluctuations (see § 271.804(d)). If such circumstances cause the overproduction, the well will continue to qualify as a stripper well.

When a well overproduces, however, § 271.805 of the Commission's regulations require that the operator and purchaser give notice of the disqualification to the Commission and appropriate jurisdictional agency within 90 days after the end of the production period (90 days or, in the case of a seasonally affected well, 12 months) in which the overproduction occurs. Under § 271.805(d), however, the operator of such a well could continue to collect the stripper well price (subject to refund) after the disqualification notice was served, if, within 30 days, the operator filed with the jurisdictional agency a petition for a determination that the increased production is the result of one of the above-describved circumstances, or if the operator filed a motion contesting the notice of disqualification filed by the purchaser. If timely action was not taken by the operator to oppose the notice of disqualification, the well was disqualified and ceased to be eligible for the section 108 price as of the last day of the disqualifying period.

On November 25, 1980, the Commission issued an interim rule amending §271.805 (45 FR 80273, December 4, 1980). Under the interim rule, a motion or petition filed within the 30-day period would permit the operator to continue to collect the section 108 price after the last day of the disqualifying period. However, failure to file timely would not permanently deprive the operator of the right to collect this price. It would merely terminate the operator's right to collect the section 108 price from the last day of the disqualifying period until the date the motion or petition is later filed.

On November 16, 1981, the Commission issued Order No. 186 in Docket No. RM81-6, which essentially adopts the interim rule as the final rule with a slight modification.

The Commission agreed with the suggestion of a commenter that the 30-day period for filing be extended to 60 days in order to provide small producers sufficient time, in view of their manpower constraints, to prepare and file the motion or petition. Further, the Commission attempted to eliminate confusion as to the date an operator's motion or petition must be filed in the event the notice of disqualification is filed late, by requiring that the operator file the motion or petition within 150 days after the last day of the disqualifying period.

2. Order No. 187

Section 271.805 requires the operator and purchaser to file notices of disqualification when a stripper well exceeds the natural gas production limitation. If the purchaser files a notice of disqualification and the operator does not agree, the operator can protest the notice by filing a motion contesting the notice of disqualification in accordance with §271.805(b)(1)(i) of the regulations.

The regulations currently do not prescribe the filing requirements for the operator's motion to contest or the procedures for considering and acting upon the motion. On April 3, 1981, the Commission issued a Notice of Proposed Rulemaking for the purpose of amending the regulations to eliminate this procedural deficiency by proposing filing requirements and protest procedures for public comment (46 FR 21192, April 9, 1981).

On November 16, 1981, the Commission issued Order No. 187 in Docket No. RM81-25, which sets forth the final rule establishing procedures and filing requirements for protests for operators of notices to disqualify stripper wells from the section 108 pricing category. The final rule incorporates the procedures outlined in the rulemaking notice.

The final rule would amend §274.206 to provide filing requirements for a motion contesting a notice of disqualification and would be required to provide a statement summarizing the reasons why the well should not be disqualified, accompanied by any supporting documentary evidence.

The final rule would further amend §271.806 to provide that a jurisdictional agency shall treat a motion contesting a notice of disqualification as it would treat an application for initial determination. The jurisdictional agency would make a determination on the motion and, within 15 days of the date of determination, would give written notice to the Commission in accordance with §274.104.

The procedures for Commission review of jurisdictional agency determination on a motion contesting a notice of disqualification would be the same as those governing review of well category determinations under §275.202. Thus, under the amendments, the Commission would have 45 days after receipt of the determination to act on the jurisdictional agency determination; if no action were taken by the Commission within the 45-day period, the jurisdictional agency determination would become final.

Finally, the operator would be allowed to continue to collect the Section 108 price subject to refund during the pendency of the protest proceeding.

3. Order No. 188

On November 16, 1981, the Commission issued Order No. 188 in Docket RM79-73, which adopted as a final rule, an interim rule which defines the term "produced" as that term is used in the definition of "production days" in section 108(b)(3) of the Natural Gas Policy Act (*see* 44 FR 66783, November 21, 1979). Natural gas is "produced", within the meaning of Section 108(b)(3) of the NGPA on (1) any day during which there is a measurable production of natural gas from a well, and (2) any day during which a well is open to the line even if it is unable to produce measurable quantities of natural gas. The rule provides a basis for wells that are either shut-in or open valve and are incapable of producing or that are producing on an irregular basis to qualify for stripper well status.

The final rule adopted the interim rule without change. In its summary of public comments, the Commission dismissed a recommendation by one commenter to expand the definition of "production day" to include days when a well is shut-in due to actions by a pipeline. The Commission also rejected a recommendation by another commenter to exclude days in which an operator increases line pressure to enable a well to meet the production limitations for a stripper well. While acknowledging the possibility that manipulation of line pressures might circumvent the intent of §108, the Commission stated that it had no reason to believe that such activity is prevalent and requires any Commission action at this time.

B. Clarified Regulations on New, Onshore Production Wells Pursuant to Section 103 of NGPA

On May 28, 1981, in the wake of apparent producer confusion over section 103 eligibility under the Natural Gas Policy Act, the Commission issued Order No. 149, *Final Rule Clarifying Regulations Regarding New, Onshore Production Wells,* Docket No. RM81-31, amending §271.303 of its regulations to clarify the definition of "new, onshore production well."

The Commission explained that it had become aware — through adjustment filings and informal contacts with Staff — that some producers did not understand that qualification under section 103 applies only to production from particular proration units. In light of such confusion, the Commission clarified the definition of a "new, onshore production well" in §271.303 by expressly providing that a determination that a well qualifies under section 103 applies only to gas produced from the proration unit (or units) on which the determination was based.

The Commission explained that its order would be effective retroactively to December 21, 1978, since it made no substantive change, and the change it did make was necessary only for proper implementation of the regulations.

Addressing past misinterpretations, the Commission also provided that a requirement of refunds would be inequitable in most instances and that producers would be permitted to collect the section 103 price for the period they were unaware of the proper interpretation of the definition of "new, onshore production well" provided their contracts do not prevent such collection.

In the absence of probative evidence to the contrary, the Commission further explained, it will presume that a producer relied on a misinterpretation of the regulations until such time as the producer files a section 103 application for more than one proration unit in the same wellbore or for sales from any proration unit in any well which had previously obtained a section 103 determination for a different proration unit, or made refunds after becoming aware of the need to obtain another section 103 determination.

Finally, the Commission stated that neither refunds nor retroactive collections will be permitted in cases where producers were aware of the filing requirement and simply made a late filing.

C. *Definition of Agricultural Use In Incremental Pricing Regulations*

Title II of the NGPA requires the Commission, within certain guidelines, to institute and administer an incremental pricing program. The program is designed to pass through, by surcharge, a portion of the increases in the wellhead prices of natural gas allowed under Title I of the NGPA to certain industrial facilities that use natural gas as a boiler fuel.

Pursuant to section 206(b)(1) of the NGPA, however, incremental pricing does not apply to any "agricultural use" of natural gas. Section 206(b)(3) defines "agricultural use" to encompass both use in agricultural production and as process fuel or feedstock in the production of products related to agriculture.

The statutory term "agricultural use" has been defined in Section 282.202(a)(1) of Part 282 of the Commission's regulations [18 CFR Part 282] through Commission action in several rulemaking dockets. The term is defined by a list of industrial products and processes including references to Standard Industrial Classification Codes (SIC codes) where applicable.

By a Notice issued June 5, 1979 in Docket No. RM79-14, the Commission proposed a definition of "agricultural use" which listed certain uses of natural gas that were certified by the Secretary of Agriculture as "essential agricultural uses" pursuant to section 401 of the NGPA. In the final rule (Order No. 49, issued September 28, 1979), the Commission expanded the list to include the processing and finishing of natural fiber by the textile industry, and, on releasing of the final rule, added wood processing (Order No. 49-A issued December 27, 1979).

In Order No. 189 issued on November 16, 1981, in Docket No. RM81-17, the Commission added the following products and processes to the growing list: (1) production of gelatin; (2) production of glue; (3) processing of tankage into nitrogenous fertilizer; (4) production of carboxymethyl cellulose from wood pulp and processed cotton liners; (5) processing of wood into resins, turpentine, rosin and pine oil; (6) manufacture of metal crowns and closures that are part of the food container in its final form; (7) production of monosodium glutamate; and (8) production of foodgrade salt for human consumption. Items (1) through (5) above were categorized as natural fiber processing, item (6) as food qualify maintenance, and items (7) and (8) as food processing.

Further, the Commission rejected requests to categorize the following as agricultural uses: (1) dyeing and finishing of man-made fibers; (2) processing of agricultural products and by-products into fatty chemicals used in foods, textile and pharmaceutical products; (3) production of tall oil, rosin, resins, turpentine and fatty acids; (4) production of feed-grade salt; and (5) processing of guar beans.

E. *Refund of Louisiana First Use Tax*

1. Interim Rules

On July 17 and 22, 1981, the Commission adopted interim rules establishing special refund procedures for use by interstate "primary" pipelines and "secondary" pipelines in flowing through refunds of Louisiana First Use Tax revenues together with all interest earned on those revenues. *See Refund Procedures For Interstate Pipeline Flowthrough of Louisiana First Use Tax,* Docket Nos. RM78-23 and RM81-37. Refunds are required by the Supreme Court's judgment, issued on June 15, 1981 in *Maryland, et al. v. Louisiana,* 49 U.S.L.W. 4709 (1981), wherein the Court enjoined the state of Louisiana's First Use Tax on natural gas and directed Louisiana to refund all revenues collected pursuant to the Tax, together with all interest earned on those revenues upon the maturity date of each security in which the revenues and interest have been invested.

The interim rule, applicable to 20 "primary" pipelines (RM78-23) which paid the First Use Tax directly to the State of Louisiana, required the pipelines to refund to their customers the initial refund received from Louisiana within 30 days of disbursement and to refund any subsequent amounts received within 25 days of disbursement. If a pipeline fails to make the initial refund within 15 days or subsequent refunds within 10 days of disbursement, they must pay interest computed in accordance with §154.67(d) of the Commission's regulations (based on a three-month average of the prime interest rate).

The interim rule for the primary pipelines relied heavily on a proposed stipulation tendered to the Commission's Office of the Solicitor by fifteen of the twenty pipelines to resolve litigation in the Fifth Circuit (*Tennessee Gas Pipeline Co. et al. v. FERC,* Docket No. 78-3816 *et al.*). The taxpaying pipelines questioned, *inter alia,* the legality of the FERC rule which required them to refund all taken revenues, plus interest at six percent, within 60 days of a final and nonappealable court decision holding the First Use tax statute unconstitutional -- regardless of whether the state of Louisiana had refunded any tax collections to the taxpaying pipelines within that 60-day period.

The interim rule for "secondary" pipelines (RM81-37), which receive First Use Tax refund monies from another pipeline, required these pipelines to make refunds within 30 days of receipt. If refunds are not made within 15 days of receipt, the pipelines are required to pay interest in accordance with §154.67(d) of the Commission's rules.

In adopting slightly different rules for secondary pipelines, the Commission reasoned that secondary pipelines should be given an additional five days beyond the 10 days accorded to primary pipelines to flow through refunds without incurring interest liability because of greater administrative burdens in processing the amounts involved. The Commission also stressed the need to adopt special uniform refund procedures and noted that absent such procedures, pipelines would refund the tax funds in accordance with their existing tariff provisions which generally provide that refunds should be made either through a credit to Account 191 or through a lump sum refund procedure for refunds prior to January 1, 1980. These tariff refund provisions, the Commission explained, may not be adequate to assure that the refunds promptly flow back to those customers that have incurred the cost of the tax, since lump sum refunds are based on various methods for allocating the refunds which are often the result of settlement agreements and may allocate refunds among customers differently from the method funds were collected when the First Use Tax was in effect. Requiring refunds to be credited to Account 191 is also likely to allocate the refunds among customers in a manner different from the method they were collected simply because of changes in sales patterns over time.

Additionally, tariff refund provisions may not allow for prompt refunds, since provisions which require crediting of the refund to Account 191 may take as long as six to eight months. Tariff provisions which require lump sum refund procedures may also delay flow through of First Use Tax funds to the ultimate consumer, since under most lump sum refund procedures, pipelines have a minimum of at least 30 days from the date of receipt or until some refund threshold level is reached to make refunds.

Finally, there are significant variations in the interest requirements of the tariff refund provisions.

For all the above reasons, the Commission concluded that the public interest warranted adoption of a special uniform refund procedure, although Commissioner Hughes dissented on the basis that a period of interest free use of refund monies was allowed to the pipeline companies.

2. Final Rule

On November 20, 1981, the FERC issued Order No. 194, in RM78-23 and RM81-37, which clarified, and adopted as final, the interim regulations prescribed in July 1981. Specifically, the Commission made clear that primary pipelines may both determine the jurisdictional portion of First Use Tax refunds and allocate that jurisdictional portion on the basis of the amounts paid as reflected in the books and records of the pipeline. In addition, the Commission made clear its intent to require that pipelines apportion refunds among jurisdictional customers on the same basis that was used to allocate First Use Tax costs when incurred.

E. *Revision of Form 2, Natural Gas Company Annual Report*

As part of the Commission's ongoing effort to eliminate the reporting of information which is not needed for decisional purposes in the Commission's regulatory process, the Commission in its Order No. 121 revised Form No. 2, the Annual Report for Natural Gas Companies, to reduce the number of schedules and data elements contained in the form, to establish or alter threshold reporting levels in certain schedules, and to change reporting schedules in several schedules. This was stated to result in a 19 percent reduction in the Commission-imposed reporting burden related to Form No. 2.

F. *Tax Normalization of Items Reflecting Timing Differences*

1. Final Rule

On May 6, 1981, the Commission issued a final rule in Docket No. RM80-42, *Regulation Implementing Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses and Revenues for Ratemaking and Income Tax Purposes,* which amended Part 2 of its regulations to require public utilities making rate filings under the Federal Power Act or interstate pipelines making rate filings under the Natural Gas Act to use tax normalization for miscellaneous timing differences in computing the income tax component of its cost of service. This included all timing difference transactions except those addressed in prior Commission orders. The rule also codified the existing Commission practice of adjusting rate base for accumulated deferred income taxes. Finally, the rule required a rate applicant to make provision in the income tax component of its cost of service for any excess or deficiency in the deferred tax accounts due to tax rate changes and timing difference transactions in ratemaking that had previously been given flow through treatment.

The Federal Power Commission had on various occasions considered the issue of normalization where timing differences exist, Order No. 530-B, Docket Nos. R-424 and R-446, issued July 6, 1976,b eing the last such generic normalization proceeding before the FPC. That proceeding, which *inter alia,* addressed the ratemaking implications of normalization and modified the provisions of the Uniform System of Accounts in order to establish accounting procedures necessary to achieve tax normalization, was remanded as part of the February 16, 1979 remand of the Order No. 530 series of Orders by the United States Court of Appeals for the District of Columbia Circuit in *Public Systems et al. v. FERC,* 606 F.2d 973 (D.C. Cir. 1979). The court there found that the Commission had failed to "assess the consequences of its action for the industry," and to "indicate 'fully and carefully' the purposes behind the order."

Although the regulation is relatively broad in scope, certain items are expressly excluded from consideration. These include timing differences which relate to: (1) differences that result from the use of the accelerated depreciation and class Life Asset Depreciation Range (ADR) tax provisions of the Internal Revenue Code of 1954; (2) differences that result from the use of accelerated amortization provisions on certified defense and pollution control facilities; (3) differences that result from recognition of extraordinary property losses as a current expense for income tax purposes but as a deferred and amortized expense for ratemaking purposes; (4) differences that arise from recognition of research, development, and demonstration expenditures as a current expense for income tax purposes but as a deferred and amortized expense for ratemaking purposes; (5) differences that result from different reporting for income tax purposes and ratemaking purposes of deferred gains or losses from disposition of utility plant; (6) differences that result from the use of the Asset Guideline Class "Repair Allowance" provision of the Internal Revenue Code of 1954; and (7) differences that result from recognition of purchased gas costs as a current expense for income tax purposes but as a deferred expense for book purposes.

By defining the term "timing differences" in the final rule to exclude those differences which exist, at least in part, because income tax law and the Commission place different dollar values on a transaction (or one does not recognize the transaction), the Commission has also excluded from the tax normalization rule those transactions for which there are "permanent differences."

In evaluating the relative merits of the normalization and flow through policies, the Commission concluded that while both policies result in rates that are cost-based, the normalization policy more equitably balances the interests of present and future ratepayers by matching the interperiod allocation of tax benefits to the interperiod recovery of expenses.

The rule was stayed on July 2, 1981, pending final Commission action on applications to rehear the rule.

Subsequent to the issuance of both the final tax normalization rule and the Commission's order staying that rule, the Congress enacted the Economic Recovery Tax Act of 1981, Pub.L. No. 97-34 (August 13, 1981). On October 5, 1981, some participants in the rulemaking requested that the Commission institute extensive proceedings for re-examination of all aspects of its final rule in light of the new law. On November 30, 1981, the Commission issued a notice requesting comments by December 21, 1981 on the narrow question of whether the new tax law requires amendments of the final rule.

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