

*Report of The Committee  
On Natural Gas Certificate  
And Authorization Regulations*

I. REGULATION OF JURISDICTIONAL PIPELINE COMPANIES UNDER THE NATURAL GAS ACT

A. Commission Policy Regarding Certification and Abandonment

1. Transportation Authorization Regulations.

(a) *Order No. 319*, 24 FERC ¶ 61,100 (July 20, 1983). Order No. 319 implements Phase II of the Commission's blanket certificate program at 18 C.F.R. Part 157. The order extends the program to include interstate pipeline transportation of direct sale natural gas to high priority end users. Supplies eligible for such transportation include gas owned and developed by a high priority end user and gas purchased by an end user from a producer, an intrastate pipeline, or the local supply of a local distribution company. Such transportation is automatically authorized for a term of up to five years and for the lesser of ten years or the life of the reserves for reserves owned and developed by a high priority end user. Arrangements for a longer term are subject to notice and protest procedures.

Revenues received for transportation to high priority end users may be treated in either of two ways. The pipeline may (1) include representative levels of short term transportation service in the test period data used to determine its base rates and retain all transportation revenues attributable to such services; or (2) credit all revenues to Account 191 in excess of 1 cent per MMBtu. Order No. 319 also provides for an Additional Incentive Charge (AIC) of up to 5 cents per MMBtu which pipelines choosing the revenue crediting treatment may collect and retain for end user transportation, subject to agreement by the end user. The AIC is permitted for an experimental period ending January 31, 1985 and is limited to 5 cents per transaction, regardless of the number of transporting pipelines participating.

Order No. 319 extended the blanket certificate authorization to cover transportation of gas for system supply on behalf of a local distribution company, interstate pipeline or intrastate pipeline, subject to notice and protest procedures. Such transportation is not limited as to term and is not eligible for the 5 cent AIC. Additionally, Order No. 319 permits unlimited, successive two-year extensions of self-implementing transactions under NGPA section 311(a); authorizes self-implementing intrastate pipeline transportation incidental to interstate pipeline transportation of end user gas under a blanket certificate; extends the Order No. 63 program to local distribution companies; and includes qualifying off-system sales between interstate pipelines under the blanket certificate program, subject to notice and protest procedures.

(b) *Order No. 234-B*, 24 FERC ¶ 61,099 (July 20, 1983). Order No. 234-B extends the interstate pipeline blanket certificate program to cover transportation to all end users, including industrial and boiler fuel users, for an experimental period ending June 30, 1985. Transportation to an industrial or boiler fuel end user for 120 days or less would be self-implementing while longer arrangements would be subject to notice and protest procedures. Longer arrangements may, however, commence on a self-implementing basis, pending the notice and protest procedures.

(c) *Order No. 319-A*, 25 FERC ¶ 61,194 (November 3, 1983). Order No. 319-A amended section 157.209 of the Commission's regulations regarding eligible sellers under the blanket certificate transportation program. Eligibility is extended to any seller in a first sale other than an interstate pipeline selling its own pipeline production. The order clarified the Order No. 319 regulations to provide that proven reserves in place purchased by an end user do not qualify for blanket

certificate transportation as "gas owned and developed" by a high priority end user. Order No. 319-A also continues the exclusion of "committed or dedicated" gas from eligibility for blanket certificate transportation.

## 2. Statement of Policy on Offsystem Sales, 23 FERC ¶ 61,140 (April 25, 1983).

The Commission issued its Statement of Policy to provide guidance for the disposition of pending or future cases which propose certification of offsystem sales. The Commission stated that the offsystem sales policy should accomplish four objectives: (1) permit pipelines with excess gas supplies to sell to pipelines and local distribution companies experiencing a physical gas shortage; (2) permit pipelines with excess gas to sell to pipelines, local distribution companies and end users who would otherwise purchase more expensive gas; (3) ameliorate take-or-pay problems; and (4) accomplish these objectives without unduly burdening the selling pipeline's traditional customers and without simply transferring problems of the interstate pipelines to the intrastate market.

With regard to price, the Commission concluded that, where a sale is between two interstate pipelines, the sale should be priced at the higher of the selling pipeline's system average load factor rate or its average NGPA section 102 gas acquisition cost. Where the purchaser is not another interstate pipeline, the selling pipeline would be free to negotiate a higher price. Regarding revenues, a pipeline may (1) establish a representative level of sales or revenues in its general rate case; or (2) credit to Account 191 all revenues from offsystem sales in excess of one cent per MMBtu (or demonstrated actual out-of-pocket costs if higher than one cent).

A selling pipeline, to be eligible to make an offsystem sale, must demonstrate a sufficient surplus such that service to existing customers will not be impaired and must also show at least potential take-or-pay liability. The buyer's need for gas will not be an issue beyond a demonstrated willingness to purchase in the form of an executed contract. There must, however, be specific identification of the buyer.

The Statement of Policy does not impose restrictions on the end use of offsystem sale gas. The Commission continues its policy of authorizing offsystem sales on a "best-efforts" basis with a requirement that such sales be interrupted prior to interruption of on-system customers. The Commission also continues to authorize offsystem sales for one year, without prejudice to the seller seeking an extension.

The Policy Statement delegated to OPR the authority to issue certificates authorizing offsystem sales when the application is uncontested and consistent with the terms of the Policy Statement.

## 3. Certification of Pipeline Incentive Sales and Marketing Programs.

In order to mitigate the problems of market loss and take-or-pay liability facing interstate pipelines, the Commission certificated a number of incentive sales and marketing programs proposed by various pipelines during the year.

(a) *Transcontinental Gas Pipeline Corp.* On April 28, 1983, 23 FERC ¶ 61,199, the Commission approved a settlement of Transco's general rate case which established two special marketing programs. The Incentive Sales Program (ISP) permitted the voluntary release by Transco of gas from its traditional pipeline suppliers for sale on a spot market basis. Under the ISP, Transco, as agent, arranges gas supplies to be purchased by eligible customers at a posted price and transports such gas to market. The posted price is set by Transco monthly at a level which permits customers to compete with alternative fuels. The Contract Carriage Program (CCP) provides for transportation by Transco of gas purchased directly by Transco's customers from its

producer suppliers. Transco was subsequently granted the necessary section 7 authority to include its jurisdictional producer — suppliers in the CCP. The ISP and CCP programs were initially approved through October 1983.

On November 10, 1983, 25 FERC ¶ 61,219, the Commission authorized the extension of the ISP and CCP through March 31, 1984 and modified the conditions applicable to the programs. No gas released for sale under the programs may be sold unless the weighted average price of the gas prior to release is equal to or exceeds Transco's weighted average cost of gas (WACOG). All gas sold or transported under the programs was required to be sold or transported in the same proportion of pricing categories under which it was released. No gas may be released by Transco unless the producer-supplier agrees to absolve Transco of any take-or-pay liability for such volumes. Any gas sold under the programs to distributors or end users served by any pipeline was required to be limited to new requirements not previously served by gas or to requirements which are being or would be served by alternative fuels, direct sale gas, gas from other industrial sales programs, gas sold at discount rates, offsystem sale gas or propane or synthetic gas. No gas may be sold under the programs from reserves not contractually committed to Transco or Transco Gas Supply Company on or before November 10, 1983. Transco was further required to credit volumes sold or transported to a distribution company traditionally served by Transco, or one of Transco's distributor customers, against the distribution company's minimum bill obligation to Transco.

On January 16, 1984, 26 FERC ¶ 61,000, the Commission issued its order on rehearing of the November 10 order. The requirement that gas must be sold or transported in the same proportion of pricing categories under which it was released was deleted by the order on rehearing. The types of loads for which ISP/CCP gas may compete was expanded to include requirements being served under interruptible sales service schedules. The scope of the program was expanded to permit any pipeline or distributor to release gas into the ISP or CCP, subject to Transco's discretion to transport gas from its own producers before gas from off-system producers.

(b) *Columbia Gas Transmission Corp.* By orders issued November 10, 25 FERC ¶ 61,220, December 20, 1983, 25 FERC ¶ 61,000, and January 16, 1984, 26 FERC ¶ 61,000, the Commission authorized a Special Marketing Program (SMP) for Columbia's system. Columbia originally proposed to release Exxon Corporation, its largest supplier, from its sales obligation for NGPA sections 102(c) and 103 gas to the extent Columbia was unable to take such gas. The Commission expanded the program to make all of Columbia's producers and pipeline suppliers eligible to participate. The Commission authorized Columbia to transport released gas to its direct and indirect customers. The weighted average cost of gas released by Columbia must equal or exceed Columbia's WACOG for its system supply. No gas may be sold under the SMP unless the maximum lawful price for such gas is greater than the NGPA section 109 price. Moreover, no gas may be sold from reserves not previously contractually committed to any pipeline or distributor on or before November 10, 1983. Sales under the SMP may compete for new loads or for requirements which are being, or would otherwise be, served by alternative fuels, producer direct sales, gas made available under industrial sales programs or similar programs, gas sold by pipelines under special discount rates or in offsystem sales, propane or synthetic natural gas, or interruptible sales service.

(c) *Tennessee Gas Pipeline Company.* By order dated December 20, 1983, 25 FERC ¶ 61,000, the Commission conditionally approved the Temporary Emergency Marketing Program (TEMPRO) proposed by Tennessee. The experimental program, which will expire on October 31, 1984, permits Tennessee to release

certain supplies and to act as agent arranging sales to eligible buyers from producers at a posted price. Again, the Commission imposed numerous conditions on the program. The rates charged by producers for gas released under TEMPRO shall not exceed the lesser of the pre-release contract price or the NGPA ceiling price. No gas released for sale under TEMPRO may be sold unless the weighted average cost of all released gas is equal to or exceeds Tennessee's system WACOG. Producers must absolve Tennessee of any take-or-pay liability for volumes of gas sold under TEMPRO. Further, only gas from reserves contractually committed to Tennessee on or before December 20, 1983 may be sold under TEMPRO.

With respect to eligible markets, only direct and indirect sales customers of Tennessee or new loads located in the service area of such direct or indirect customers may purchase TEMPRO gas. Sales to distributors or end users which are served by Tennessee as well as another pipeline may compete only for new loads or requirements which would otherwise be served by alternative fuels, producer direct sales arrangements, gas sold under ISPs or similar programs, gas sold by pipelines under special discount rates or in offsystem sales, or propane or synthetic natural gas. Specific rates designed to recover the fully allocated cost of transportation are provided for Tennessee's transportation of TEMPRO gas. In addition, Tennessee or any of its interstate pipeline customers which transports TEMPRO gas for a distribution company must treat the transported volumes as volumes satisfying the minimum commodity bill provision of such distribution company.

#### 4. Jurisdictional Transportation v. Exempt Gathering Activities.

The Commission issued several orders in 1983 which provide some guidance on the application of the Natural Gas Act section 1(b) jurisdictional exemption for "facilities used for . . . the production or gathering of natural gas." the determination of whether particular facilities are exempt from the Commission's certificate and authorization jurisdiction as "gathering" facilities has always turned on a fact-specific consideration of the facilities in question. While the Commission has not enunciated a definitive distinction between transportation and gathering, it has historically applied a series of tests to distinguish between such services: the "behind the plant" test, *Phillips Petroleum Company*, 10 FPC 246 (1961), *rev'd on other grounds sub nom. Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954); the "central point" test, *Barnes Transportation Company, Inc.*, 18 FPC 369 (1957); and the "primary function" test, *Ben Bolt Gathering Co.*, 26 FPC 825 (1961), *aff'd sub nom. Ben Bolt Gathering Co. v. FPC*, 323 F.2d 610 (5th Cir. 1963). The current applicability of these tests is addressed in the following orders:

(a) *Farmland Industries, Inc.*, 23 FERC ¶ 61,063 (April 11, 1983). The Commission disclaimed jurisdiction over certain facilities in the Velrex Eldorado Field Area of Texas. The facilities consisted of a system which gathered gas from several wells in the area and delivered the gas into an 18-mile, six-inch diameter pipeline operated by Farmland. Farmland's pipeline, which had previously been certificated under the NGA, ended at a processing plant. The gas was processed and delivered at the tailgate of the plant to an interstate pipeline.

The Commission indicated that the regulatory context of its section 1(b) determinations has been fundamentally changed by the NGPA. The Natural Gas Act "producer-pipeline" dichotomy is no longer applied and the Commission recognizes the non-jurisdictional status of third-party gatherers who neither sell gas for resale in interstate commerce nor engage in jurisdictional transportation. The Commission stated that it considers a number of factors in analyzing the section 1(b) gathering test:

Although a variety of labels has been applied to these factors, the ultimate test is whether the primary function of the facility can be classified as transportation or gathering. Several indicia of this test include: 1) the diameter and length of the facility, 2) the location of compressors and processing plants, 3) the extension of the facility beyond the central point in the field, 4) the location of wells along all or part of the facility, and 5) the geographical configuration of the system. 23 FERC at 61,143.

In support of its disclaimer of jurisdiction, the Commission noted that: (1) Farmland's entire system is located behind a processing plant, (2) the system is only 18 miles long and uses six-inch diameter pipe, and (3) the system is not operated at pipeline transmission pressures.

(b) *J-W Gathering Company*, 23 FERC ¶ 61,007 (April 4, 1983). The Commission also disclaimed jurisdiction over J-W's proposed "comite System" in Louisiana. The system was to consist of 6.5 miles of 4½-inch lateral lines to connect four existing wells to a central line running to a processing plant in the field. J-W would also construct 15.4 miles of 12¾-inch pipeline from the tailgate of the plant to a proposed interconnection with Transcontinental Gas Pipeline Company. J-W was seeking NGPA section 311(a)(2) authorization for the portion of the facility from the tailgate of the plant to the interconnection with Transco. In order to come within section 311(a)(2) the facility is required to be classified as an intrastate pipeline under section 2(16) of the NGPA.

The Commission, however, found that based upon a review of the geographical configuration and primary function of the Comite System, the entire facility qualifies as gathering facilities which are exempted from the Commission's jurisdiction. Here, J-W would move only the gas which J-W itself gathers, unlike facilities in other cases which were held to be engaged in transportation because they move only gas which was gathered by others. 23 FERC at 61,021.

While concurring in the result in *J-W Gathering*, Commissioner Richard filed a separate statement expressing uncertainty as to whether J-W's facilities are properly classified as gathering facilities under the primary function test. Commissioner Richard cited the indicia of gathering set forth in the *Farmland* decision and stated that "[t]he application of this test to J-W's proposed system indicates that the 15 mile portion of it, almost 3 times the size of [the] pipeline segment linking the wells, could be transportation." *Id.* at 61,023.

(c) *Shell Oil Company and Chaparro Gathering Company*, 24 FERC ¶ 61,371 (September 21, 1983). In *Shell Oil Company*, the Commission addressed the transportation of jurisdictional natural gas through a non-jurisdictional gathering facility. Shell transported gas through the facility of Chaparro, its wholly-owned subsidiary, from several points in the field to a processing plant. All of the gas transported through the line was sold within the state at the tailgate of the processing plant. All gas sold in interstate commerce at the outlet of the plant was transported to the plant in a separate line owned by a third party. Due to a shut-down by the third party, Shell proposed to transport some "interstate" gas through the Chaparro facility, but only if the Commission determined that such action would not subject the Chaparro line to NGA section 1(b) jurisdiction. Applying the behind the plant and primary function tests, the Commission found the Chaparro facility to be a non-jurisdictional gathering facility, thus, implicitly holding that the transportation of jurisdictional gas does not impair a gathering exemption.

B. *Abandonment Matters.*

1. *Florida Gas Transmission Company*, Opinion No. 144-A, 24 FERC ¶ 61,005 (July 7, 1983).

The Commission denied rehearing of Opinion No. 144, 20 FERC ¶ 61,298 (1982) which had granted the application of Florida Gas Transmission to abandon 889 miles of 24-inch natural gas pipeline between Baton Rouge, Louisiana and Port Everglades, Florida and to transfer the pipeline facilities to its affiliate, Transgulf Pipeline Company, for conversion to transportation of light petroleum products. Maritime Intervenor and Florida Cities had sought rehearing and Maritime Intervenor had petitioned to reopen the record for additional evidence on the fair market value of the facilities to be transferred.

The Commission affirmed the inclusion of a \$44 million tax component in the transfer price and reiterated that the tax benefits associated with new investment in new facilities should properly accrue to FGT and not its ratepayers, for two reasons. First, for ratemaking purposes, no recognition will be given to the cost of the new facilities computing FGT's rates. Such rates will be computed as if the new facilities did not exist. Because no depreciation expense associated with the new facilities will be recognized or borne by FGT's ratepayers, there is no basis for allocating the tax benefits associated with the new facilities to FGT's ratepayers. Second, FGT proposed an accounting and rate treatment which benefits its customers by allocating gain from the sale of the facilities to the customers. Moreover, the Commission stated that FGT's inclusion of a tax component in the transfer price would be proper if the proposed sale were to a non-affiliated company and there is no basis for a different conclusion because FGT and Transgulf are affiliated.

Florida Cities had requested that the Commission require FGT to pass through the cost-of-service effect of the \$7,000,000 reduction in rate base resulting from Opinion No. 144. The Commission noted that FGT's direct sales to Florida Cities are not subject to Natural Gas Act jurisdiction and, thus, the Commission cannot set rates for such sales. Accordingly, the Commission lacks authority to condition FGT's authorizations in order to accomplish indirectly what it cannot do directly.

## II. REGULATION OF INDEPENDENT PRODUCERS UNDER THE NATURAL GAS ACT

A. *Scope of the Commission's Authority Under the Natural Gas Act*

1. *El Paso Natural Gas Company v. Sun Oil Company*, 708 F.2d 1011 (5th Cir. 1983).

The United States Court of Appeals for the Fifth Circuit reversed a Commission decision, 12 FERC ¶ 61,297 (1980), wherein the Commission had determined that it had jurisdiction, under the Natural Gas Act, over lease-sale agreements transferring rights to certain gas bearing lands in New Mexico and Colorado. The Fifth Circuit affirmed the decision of the U.S. District Court for the Western District of Texas that, where the reserves underlying the leaseholds were not substantially developed at the time the lease-sales were executed, because of lack of imminent ability to produce in commercial quantities, such lease-sales were not sales of natural gas in interstate commerce within the meaning of the Natural Gas Act and were, therefore, beyond theregulatory jurisdiction of the Commission.

The court held that lease-sale agreements must be evaluated for jurisdiction under the NGA as of the date of execution. In determining whether the lease sales were sales of gas in interstate commerce, the court found that three criteria must be

satisfied: (1) the economic effect of the transfer must be similar to that of a conventional sale, (2) the subject of the transaction must be both "proven and substantially developed" reserves, and (3) the transfer of reserves must be for the purpose of interstate transmission and resale. Based on its finding that the transfer was not a jurisdictional sale, the court determined that payments to owners of overriding royalty interests in the leases were beyond the Commission's jurisdiction.

*B. Special Producer Sales Program Certificate*

1. *Tenneco Oil Company*, 25 FERC ¶ 61,234 (November 10, 1983) and 26 FERC ¶ 61,030 (January 16, 1984).

The Commission has authorized, on a blanket basis, an experimental, spot market sales program referred to as "Tenneflex." The program is authorized through October 31, 1984. Tenneflex is designed to permit Tenneco to sell certain surplus gas from the Outer Continental Shelf (OCS) to eligible purchasers.

The Commission attached numerous conditions to its certificate authorization of Tenneflex. Gas sold under the program must have been contractually committed to a pipeline or distribution company purchaser on or before November 10, 1983 and must be released by such purchaser. The rates which Tenneco may charge for Tenneflex gas may be no higher than the lesser of the pre-release contract price or the applicable NGPA ceiling price. No gas may be sold under Tenneflex unless the maximum lawful price applicable to such gas exceeds the NGPA section 109 price. In addition, no gas may be sold under Tenneflex unless the weighted average cost of the gas prior to release exceeds the releasing pipeline's system WACOG. All Tenneflex gas must be sold and transported according to the applicable contract price, with the most expensive released gas being sold and transported first.

In an attempt to protect the "core market" of pipelines from allegedly unfair competition from sales of Tenneflex gas, the Commission limited the markets in which such gas may be sold to new loads, not previously served by natural gas, and requirements which are being, or would be served by alternative fuels, producer direct sales arrangements, gas sold under ISPs or similar arrangements, gas sold by pipelines under special discount rates or in offsystem sales, propane or synthetic natural gas, or interruptible sales service. A pipeline may waive such market restrictions to permit Tenneflex gas to compete for that pipeline's core markets.

Tenneco may not sell released gas under Tenneflex unless it absolves the releasing pipeline of take-or-pay liability for any volumes released and sold. Additionally, where one or more pipelines transport Tenneflex gas for a pipeline or distribution company, or an end user served by a distribution company, each transporting pipeline must credit volumes transported as though they were purchased by the next transporting pipeline or distribution company for purposes of satisfying any minimum commodity bill provision. The transporting pipelines are required to apply as a credit to the minimum commodity bill all variable costs associated with the volumes transported.

*C. Optional Procedure Certificates*

1. *Pennzoil Producing Co.*, 22 FERC ¶ 61,107 (January 28, 1983).

The Commission approved a proposed Stipulation and Agreement (Stipulation) which would settle numerous issues arising under applications of Pennzoil, Pennzoil Louisiana and Texas Offshore, Inc. (PLATO), and Pennzoil Oil and Gas,

Inc. (POGI) for optional procedure certificates for new producer sales of natural gas as provided for at 18 C.F.R. § 2.75. The applications at issue were filed in 1972, 1973, 1974, 1977 and 1978.

*The 1972, 1973 and 1974 Applications* — On March 9, 1979, Pennzoil requested waiver of Section 2.75 in order to charge the applicable NGPA section 102 or 104 rate (together with annual inflation adjustments) for wells drilled after November 1, 1982 on certain old optional procedure OCS blocks, *i.e.*, the OCS blocks at issue in the 1972, 1973 and 1974 applications. Pursuant to the Stipulation, Pennzoil reduced its waiver request to cover only applicable Section 104 rates (together with added annual inflation adjustments).

*The 1977 and 1978 Applications* — On December 1, 1978, the Commission in *Appalachian Exploration and Development, Inc.*, 5 FERC ¶ 61,198 (1978) (*Appalachian*), issued an order which limited the rates in all pending optional procedure applications to the applicable NGPA level. Thus, the proposed rates for the 1977 and 1978 PLATO and POGI applications, which were higher than applicable NGPA levels, have not been collected. PLATO and POGI, in their requests for rehearing of *Appalachian*, asserted that they would collect as much as \$765 million above the applicable NGPA rates if *Appalachian* were vacated.

With regard to the 1977 and 1978 applications, the primary provisions of the Stipulation result in: (1) a rate reduction from (as much as) \$765 million above NGPA prices to \$21.75 million above NGPA prices, which final amount will be considered to be a prudent expense by the purchasers; (2) Commission issuance of NGA section 7(c) certificates authorizing certain sales at issue in these dockets; (3) revision of certain contracts to include "deregulation" and "economic out" clauses and modification of certain existing "take-or-pay" clauses; (4) final resolution of issues raised by the 1977 and 1978 applications including withdrawal of the 1977 and 1978 optional procedure applications; and (5) PLATO and POGI will refrain from seeking judicial review of the *Appalachian* order.

The Commission approved the Stipulation without modification stating that the settlement is just and reasonable, in the public interest, and provides benefits to ratepayers with respect to both past and future periods. In concluding, the Commission stated that approval of the Stipulation would "avoid lengthy, costly administrative and judicial proceedings involving past and future periods," 22 FERC at 61,159, and that the Commission's approval of the Stipulation "shall not constitute approval of or precedent regarding any principle or issue in these proceedings." *Id.*

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