

*Report of The Committee  
On  
Rate and Accounting Regulations*

**I. RULEMAKING DECISIONS**

**A. *Producer Matters***

1. Order No. 40, Docket No. RM79-8—Final Rule; 15 Year Minimum Duration for New Contracts for Some Sales of Certain Outer Continental Shelf (“OCS”) Gas.

Order No. 40 was issued by the Federal Energy Regulatory Commission (“Commission”) on August 2, 1979. This order promulgates Section 277.101 of the regulations and implements Section 315(a)(3) of the NGPA concerning the minimum duration of certain new contracts for the first sale of high cost natural gas or new natural gas produced from any reservoir on the OCS. The regulation defines a “new contract” as one which is executed on or after December 1, 1978. Any such new contract for the first sale of high cost gas or new gas produced from an OCS reservoir must be of a duration of at least 15 years or, if less, for the commercially producible life of the reservoir.

2. Order No. 45, and related developments; Docket No. RM79-19—Regulations and Statement of Policy; Treatment of Certain Production Related Costs for Natural Gas to be Sold and Transported through the Alaska Natural Gas Transportation System (“ANGTS”).

Order No. 45 establishes responsibility for the costs of conditioning natural gas produced from the Prudhoe Bay Unit in Alaska for transportation through the Alaska Natural Gas Transportation Systems (“ANGTS”). The Commission concluded that the producers of Prudhoe Bay natural gas will enjoy “significant benefits” from the sale of such gas and, therefore, should bear responsibility for the majority of the production-related costs for processing and conditioning the gas in order to render it transportable through the ANGTS. The Commission will, however, permit first sellers of gas produced for the ANGTS to make application for recovery, under Section 110 of the Natural Gas Policy Act of 1978 (“NGPA”) of costs incurred in removing carbon dioxide from levels of three percent by volume to levels below three percent by volume.

Order 45 also limited the recovery of production-related costs incurred by transporters and shippers of Prudhoe Bay gas to the costs of carbon dioxide removal below three percent.

The provisions of Order 45 limiting Section 110 recovery have been stayed by the Commission pending the outcome of negotiations involving the Department of Energy, the Prudhoe Bay producers, and the pipeline sponsors of ANGTS.

3. Order No. 23, *et seq.*; Docket No. RM79-22—Amendment and Clarification of Interim Regulations Under the NGPA and Regulations Under the Natural Gas Act (“NGA”).

The Commission adopted final regulations in this docket regarding the issue of contractual authorization in interstate and intrastate gas purchase contracts to collect NGPA prices under Section 101(b)(9) of the NGPA.

#### *Order No. 23*

In Order No. 23, the Commission expressed its view regarding contractual authorization required to collect NGPA maximum lawful prices and to provide guidance as to how it would discharge its responsibility under the NGA and the NGPA. The Commission reviewed its prior positions as to area rate clauses and stated that, in the absence of specific contract language to the contrary, it generally will “interpose no objection” to an interpretation by the parties of an area rate clause in an interstate contract which would authorize the collection of NGPA prices, and that area rate clauses would appear to have been triggered at least with respect to the rates under Sections 104 and 106(a) of the NGPA. The Commission also concluded that any contractual provision which, by its terms, specifically permits collection of NGPA prices authorizes collection of such prices. The Commission provided for protests of contractual authority under interstate contracts by parties to the contracts and by third parties; however, it advised third parties that in the event a protest is made in the face of agreement among the parties to the contract as to the interpretation, considerable weight will be given to the interpretation ascribed to the contract by the parties. The Commission left open the procedures it would use to dispose of protests, the evidentiary standard that might be imposed, and the standard of review that may be employed by the Commission in deciding these issues (See discussion of Order No. 23-B). The Commission concluded that, in the event of a challenge to authorization, it is not necessary for the Commission to specifically suspend and require that the amounts in dispute be collected subject to refund because the producer will be required to refund with interest if it is determined by a final, nonappealable order that contractual authority to collect the NGPA prices is lacking. Because of its view regarding the operation of existing indefinite price escalator clauses, the Commission did not consider the authority of the parties to existing contracts to amend their terms. This was left to a subsequent interpretative order (see discussion of Order No. 23-A).

Order No. 23 provides that indefinite price escalator clauses in existing intrastate contracts may permit price escalation, according to the terms of the contract, up to the highest applicable NGPA price. Questions of interpretation of intrastate contracts will be left, in the first instance, to the parties, with disagreements left to state courts to resolve.

On May 2, 1979, the Commission issued a *Notice of Inquiry* in Docket No. RM79-22, requesting suggestions on the proper forum in which to deal

with challenges of contractual authority and the most expeditious method of dealing with such challenges.

On May 11, 1979, the Commission issued its *Order on Rehearing of Order No. 23*. At that time, the Commission, *inter alia*, expanded and clarified its position as to two substantive issues: the scope of the Commission's duty to examine contractual authority to collect NGPA prices, and the applicable rules of law to be applied in the Commission's examination.

The Commission stated that its statutory responsibility to determine whether contractual authorization exists for the collection of NGPA rates was established by the Supreme Court under the *Mobile-Sierra* doctrine (*United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956)), and that this doctrine only applies to gas that also is subject to the NGA. The Commission also noted that Sections 105 and 106(b) prices governing intrastate sales are based on contractual provisions but that the Commission, because the gas is not subject to its NGA jurisdiction, is not the proper forum to adjudicate contractual disputes. The Commission stated that, as to gas not covered by the NGA, the Commission's involvement in determining contractual authority will be limited to its enforcement responsibility imposed by Title V of the NGPA.

The Commission clarified its rejection of the "plain meaning rule" in interpreting contracts and its statement that "great weight" will be given to the intent of the parties holding that where it must rule on the proper interpretation of a contract clause, reference will be made not only to the "four corners" of the contract, but also to the circumstances surrounding its execution.

#### *Order No. 23-A*

On June 12, 1979, the Commission issued Order No. 23-A as an interpretative rule and concluding that both interstate and intrastate contracts may be amended to provide authorization for the payment of the highest applicable NGPA price and for interim collection of such prices.

The Commission noted that most comments on the amendment issue were directed to the question of pipeline collection of prices paid pursuant to amendments from their customers. The Commission recognized that it could not deny collection of NGPA prices unless it determined that the amount paid was excessive due to "fraud, abuse, or similar grounds" and that general guidance as to the grounds for such a determination would be desirable; however, the Commission concluded such guidance must be developed in individual cases. This position was maintained in the *Order on Rehearing of Order No. 23-A* issued August 13, 1979.

#### *Order No. 23-B*

On June 21, 1979, the Commission issued Order No. 23-B, establishing protest procedures. Under such procedures, the jurisdictional pipeline pur-

chaser is required, within sixty days of a producer rate filing, to make an evidentiary submission consisting of the text of the contractual provisions as well as any other evidence which the pipeline believes may constitute contractual authority to escalate prices under the NGPA. Protests are to be filed within 60 days of the producer rate filing by the pipeline purchaser and within 120 days by any third party. Each protest is required to include the text of the contractual provisions which the protester believes is inconsistent with a conclusion that the contract authorizes the collection of NGPA prices. Additionally, the protest may include any other evidence relied upon by the protester to support its position of lack of contractual authority.

In those circumstances where the producer and pipeline interpret the contract to give the producer contractual authority to collect NGPA prices, the Commission will not allow the parties' interpretation to be dispositive where that interpretation does not appear to be reasonable in light of the language of the contract and the conduct of the parties. In such circumstances, the burden of going forward with evidence of lack of contractual authority will be placed on the third-party protester. Unless the third-party protester can show the language of the contract is inconsistent with the parties' interpretation or can include evidence sufficient to show lack of contractual authorization, there is no basis for finding that the parties' conclusion is unreasonable, and the protest should be summarily dismissed. If the protest is not summarily dismissed, it will be set for hearing with the burden of persuasion on the parties to the contract to establish their position by a preponderance of the evidence.

On August 6, 1979, the Commission issued an *Order on Rehearing of Order No. 23-B*, where it considered further the distribution of the burden of proof as described in Order Nos. 23 and 23-B. When a pipeline and producer assert that a contract authorizes the collection of an NGPA price, a presumption arises that (1) the parties to the contract should know what their intent was when they executed the contract, and (2) those parties are truthful. This presumption may be rebutted by a third-party protester, by coming forward with enough evidence to show there is not contractual authority to collect the NGPA price, such that a reasonable man could infer that contractual authority does not exist. If the third-party protester's burden of production is satisfied, a hearing will be held.

The Commission again addressed the issue of the scope of its jurisdiction to interpret contracts. The Commission stated that as to gas over which it had jurisdiction pursuant to NGPA Section 601(a)(1)(B), it would, upon a protest, interpret the contract, but its interpretation would only govern those deliveries made before the determination becomes final.

4. Docket No. RM79-67—Special Relief Under Section 104, 106 and 109 of the NGPA; Notice of Proposed Rulemaking, Proposed Final Rule.

The Commission is considering proposed regulations which would establish procedures to provide special relief for natural gas producers which can

demonstrate that their costs of producing additional gas supplies warrant prices in excess of the NGPA price ceilings. Special relief would be available in two situations: first, where there is no planned investment and the operation and maintenance costs of continued production from an existing well cannot be recovered if gas from the well is sold at the applicable NGPA price; and second, where additional planned investment is necessary before a producer can continue production from a well or begin the development of a reservoir, which would not be incurred if the gas were held to the applicable NGPA price.

In the case of a well for which there is no planned investment, a special relief rate would be permitted at which the producer could recover its "out-of-pocket" expenses, including recurring operating and maintenance expenses, regulatory expenses and a 5 percent incentive after allowance for Federal income taxes. In the case of a "planned investment project", a special relief rate would include a component under which the producer would earn a 15 percent return on investment incurred in completing the project, using a discounted cash flow analysis, and a component under which the producer would recover all project operating expenses, plus an allowance for regulatory expenses. The 15 percent return would not be permitted on any investment incurred prior to the filing date of any pending special relief or "optional procedure" application, or on any investment incurred prior to the filing date of any future special relief application. No allowance for depreciation, depletion, amortization, income taxes or return could be included in a producer's operating expenses.

A number of producers have filed comments on the draft proposed regulations criticizing their failure to permit the recovery of and a return on all investments in a project, including those made prior to the date of applying for special relief. Comments have also argued that the 15 percent return on investment is inadequate in the case of such marginal projects.

5. Order No. 42 *et seq.*; Docket No. RM79-68—Final Regulations Implementing Section 102 of the NGPA.

Order 42, issued August 14, 1979, sets forth Final Regulations implementing Section 102 of the NGPA and applies to natural gas produced from (1) a new OCS lease, (2) a new onshore well, (3) a new onshore reservoir, and (4) a new reservoir on an old OCS lease. The regulations contain special rules relating to several tests required to be met in order for a well to qualify for the Section 102 maximum lawful price. These special rules concern (1) the vertical measurement of 1,000 feet between completion locations, (2) the determination of whether a reservoir was "capable of producing in paying quantities", (3) determining whether a reservoir is "commercially producible", (4) determining whether "suitable facilities" existed for the production and delivery of natural gas on April 20, 1977, and (5) determining whether "production of natural gas in commercial quantities" has occurred.

Order 42-A was issued on November 29, 1978, granting in part rehearing

of Order 42. Order 42-A amends the definition of the term "commercially producible" as used in Section 102(d) of the NGPA. Under the new definition a reservoir is deemed commercially producible if a well completed therein can reasonably be expected to produce gas in quantities sufficient to yield revenues in excess of operating costs. Operating costs include those out-of-pocket cash expenses necessary to operate and maintain a well.

Order 42-A also amended the provisions of the regulations which define the phrase "could have been produced in commercial quantities" for purposes of the behind-the-pipe exclusion. The new provisions apply both a physical capability test and an economic test in determining whether a reservoir is disqualified by virtue of the fact that gas from that reservoir could have been produced in commercial quantities from an old well prior to April 20, 1977.

On January 28, 1980 rehearing of Order 42-A was denied.

6. Order No. 43 *et seq.*; Docket No. RM79-72—Final Regulations Implementing Section 103 of the NGPA.

Order No. 43, issued August 20, 1979, sets forth Final Regulations implementing Section 103 of the NGPA and applies to natural gas produced from a new onshore production well. These are wells (1) the surface drilling of which began on or after February 19, 1977, (2) which satisfy Federal or State well-spacing requirements, and (3) which are not within certain proration units. The regulations promulgated under Order No. 43 contained a special rule applicable to a second well on an existing proration unit. This rule required that a jurisdictional agency make a determination, prior to the drilling of a second well on an existing proration unit, that such second well is necessary for the effective and efficient drainage of a portion of the reservoir covered by the proration unit which could not be effectively drained by any existing well within the proration unit.

Order No. 43 also required that where a finding is made that both an existing well and a new well are required to effectively and efficiently drain the reservoir and a State authority sets allowables or production levels for the proration unit, the jurisdictional agency must also set separate allowables or production levels for both the new well and the existing well. Part 274 of the regulations, which sets forth filing requirements for jurisdictional agency determinations, was also amended to reflect this special rule.

Order 43-A, issued November 16, 1979, granted, in part, rehearing of Order No. 43. On rehearing the Commission determined that a jurisdictional agency could make the finding that a second well on a proration unit is necessary for effective and efficient drainage *after* the well has been drilled as long as the agency can reasonably conclude that, as of the time of the commencement of surface drilling, the well was necessary.

Order 43-A also created a rebuttable presumption that a well which was plugged and abandoned prior to January 1, 1970, and has not produced

natural gas on or after that date, has not produced and is not capable of producing gas in commercial quantities and therefore is not an existing well.

The amended regulations also provide that a jurisdictional agency can designate or recognize an NGPA proration unit in two ways. The agency can redefine the boundaries of a previously existing unit prior to the drilling of a new well or, if it finds that a second well is necessary to drain a portion of an existing unit, the agency is making a *de facto* designation of that portion of the unit as an NGPA proration unit for purposes of Section 103.

The requirement that separate allowables be set for both the new and old well on a proration unit was deleted from the regulations and an alternate proposal on this topic is being considered in Docket No. RM80-12.

7. Order No. 44 *et seq.*; Docket No. RM79-73—Final Regulations Implementing Section 108 of the NGPA.

Order No. 44, issued August 22, 1979, sets forth final regulations implementing Section 108 of the NGPA and applies to first sales of natural gas produced from stripper wells. Order No. 44 provides definitions of several key terms for the purpose of Section 108. The terms defined are (1) “recognized enhanced recovery techniques;” (2) “nonassociated natural gas;” (3) “90 day production period;” and (4) “production day.” Also set forth are special rules concerning (1) rate of production, (2) averaging of production, (3) applications for determinations, and (4) seasonally affected wells. Section 271.805 applies to continued qualification of a well where the production rate exceeds 60 Mcf per day for any 90 day production period or where a seasonally affected well produces at an average rate in excess of 60 Mcf per day for any 12 month period.

On November 9, 1979, the Commission issued Order No. 44-A which granted, in part, rehearing of Order No. 44. In this Order, the Commission clarified the effective date on which the jurisdictional agency may no longer apply the deferral procedures of Section 271.804(d)(3)(ii) of the interim regulations and must apply the revised deferral procedures of Section 271.807 of the final regulations. The revised procedure was made available to all jurisdictional agency applications filed on or after September 21, 1979.

Contemporaneously with Order No. 44-A, the Commission issued an interim interpretive regulation defining the term “produced” as it is used in portions of Section 108 and also clarifying the terms “production day” and “90 day production period.”

8. Order No. 58; Docket No. RM80-7—Final Rule Governing the Maximum Lawful Price for Pipeline, Distributor or Affiliate Production.

On November 14, 1979, the Commission issued Order No. 58, which Order amended Section 270.203 of the Commission’s Regulations by defining which sales of volumes produced by pipelines or distributors (and affiliates thereof) do and do not qualify for “first sale” status under Section 2(21)(B) of the NGPA. As amended, Section 270.203(a) states that a pipeline’s or a

distributor's sale of its own produced gas is a first sale only if the sale is comprised exclusively of volumes from wells owned by the pipeline or distributor. Section 270.203(b) provides that even if a sale by a pipeline or a distributor otherwise qualifies as a first sale it will not be treated as such if the price at which the gas is sold is regulated by a state agency or pursuant to the NGA. Under Section 270.203(c), however, all sales of volumes produced by affiliates of pipelines or distributors are given first sale status if the affiliate is not itself a pipeline or a distributor.

On January 9, 1980 the FERC granted rehearing of Order No. 58 solely to obtain further time to consider applications for rehearing.

9. Order No. 65; Docket No. RM80-15—Final Regulations Implementing Filing Requirements of the NGPA.

The Commission has issued final regulations which set forth the filing requirements for applicants seeking well category determinations from jurisdictional agencies for natural gas qualifying under Sections 102, 103, 107 and 108 of the NGPA. Subpart B of Part 274 of the Commission's regulations requires applicants to file with the jurisdictional agency FERC Form No. 121, together with statements of eligibility and diligence under oath and any leases, maps, plats, surveys, reports, data, logs, tests or other geological or production information, as required for each category of gas, which support the requested well category determination. The applicant must also state that it has delivered or mailed a copy of the FERC Form No. 121 to the purchaser.

10. Order No. 64; Docket No. RM80-19—Final Regulations Implementing Sections 104 and 106(a) of the NGPA.

On January 3, 1980, the Commission issued Order No. 64 which promulgated final regulations implementing Sections 104 and 106(a) of the NGPA. The regulations specify the pricing of first sales of natural gas committed or dedicated to interstate commerce on November 8, 1978 for which a just and reasonable rate under the NGA was in effect. The final regulations are identical in pertinent part to the interim regulations originally issued by the Commission on December 1, 1978.

With respect to flowing gas under Section 104 of the NGPA, the regulations specify that the maximum lawful price is equal to the higher of (1) the just and reasonable rates established for each vintage of gas as of April 20, 1977 plus the monthly annual inflation adjustment since that date or (2) any higher just and reasonable rate established by the Commission after April 20, 1977 and before the date of enactment of NGPA (November 9, 1978). The regulations also specify that any just and reasonable rate established prior to April 20, 1977, under some form of special rate relief, shall constitute the maximum lawful price if it is higher than the inflation adjusted rate otherwise applicable to a particular vintage.

With respect to gas committed or dedicated to interstate commerce and



sold under rollover contracts pursuant to Section 106(a) of NGPA, the regulations specify that the applicable maximum lawful price is the higher of the just and reasonable rate established by the Commission and applicable on the date the rollover occurred (adjusted by the monthly equivalent of the annual inflation adjustment factor for the months following the rollover), or 54 cents per MMBtu as of April, 1977 adjusted monthly thereafter by the applicable inflation factor.

The Commission declined to adopt any modification to the interim regulations implementing Sections 104 and 106(a) as suggested by many parties during the comment period. The significant portions of the final regulations adopted by the Commission can be summarized as follows:

- 1) The regulations reaffirm the Commission's view that the minimum rate for natural gas may be adjusted by the monthly inflation factor since April, 1977.
- 2) With respect to gas certificated under the optional procedure, the regulations adhere to the Commission's determination not to allow monthly inflation adjustments to the established just and reasonable rates because of the seller's election under the optional procedure to waive all rights to seek further rate increases.
- 3) Concerning small producer gas, Order No. 64 sets forth the Commission's decision to retain a 70.2 cent per MMBtu price determined under Section 106(c) for rollover contract sales as of December 1, 1978 plus annual escalations of 1.3 cents in accordance with the escalation provisions of Opinion Nos. 770 and 742.
- 4) Order No. 64 rejects a recommendation to define "small producers" by reference to both interstate and intrastate sales.
- 5) The Commission declined to eliminate a 1 cent distinction between the ceiling prescribed by Section 106(a) of the NGPA for committed or dedicated gas sold under large producer rollover contracts (60.3 cents as of December, 1978, determined by applying the monthly inflation adjustment factor to the April, 1977 rate of 54 cents per MMBtu), and the ceiling applicable to committed or dedicated gas in large producer replacement contracts (59.3 cents as of December, 1978 determined by applying the monthly inflation adjustment factor to the 53 cent just and reasonable rate of April 20, 1977).
- 6) The final regulations also contain a special rule requiring an 83 cent per MMBtu carrying charge determined for any sale of post-1974 gas for which the seller accepted advance payments after November 5, 1976 and was permitted to include such payments in its rates.

11. Order No. 68; Docket No. RM80-14—Final Regulations Implementing Sections 105 and 106(b) of the NGPA.

Order No. 68, issued January 18, 1980, sets forth final regulations imple-

menting sections 105 and 106(b) of the NGPA. Section 105 applies to natural gas sold under existing intrastate contracts and successors to existing intrastate contracts. Section 106(b) applies to gas sold under intrastate rollover contracts.

Order No. 68 sets forth a definition and special rules for so-called percent-of-proceeds sales. These provisions are added to Section 270.202 of the Commission's Regulations.

Under Section 105, the Commission made the determination that the term "contract price," as it is used to determine whether a contract qualifies under Sections 105(b)(1) or 105(b)(2), includes all proceeds paid or payable to the seller, even if specifically earmarked for reimbursement of State severance taxes or production-related costs. Section 271.505 sets out provisions for permissible contract modifications under Section 105.

Also regarding Section 105, the definition of "successor to an existing intrastate contract" has been amended in order to clarify the fact that successors to existing intrastate contracts may include interstate contracts.

In the regulations implementing section 106, paragraph (b) of section 271.602 has been corrected to include a reference to State or Indian royalty interests as well as production interests.

Also, on January 18, 1980, the Commission issued a Notice of Proposed Rulemaking in Docket No. RM80-21. The Notice proposes amendments to the Commission's Regulations under Section 110 of the NGPA which would provide for the treatment of State severance taxes imposed on gas subject to Section 105(b)(1).

#### *B. Accounting Regulations*

1. Order No. 62; Docket No. RM80-4—Order Amending Title of Account 670 of the Uniform System of Accounts for Pipeline Companies and Related Provisions and Forms.

By Order No. 62 issued December 6, 1979, Account 670 and the accompanying instruction 1-12 were corrected to accurately depict the content of the account. In an annual report to the FERC, oil pipeline companies are required to include all income taxes: Federal, state, local and foreign, on income arising from continuing operations. The annual reports must be prepared in accordance with the specifications of 49 CFR § 1204 (1978), the Uniform System of Accounts for Pipeline Companies. Pursuant to Section 402(b) of the DOE Organization Act, the administration of Section 1204 was transferred from the Interstate Commerce Commission ("ICC") to the Commission; however, the part has yet to be recodified under CFR Title 18.

Under the ICC, Account 670 was used for crediting income taxes on ordinary income. In 1974, the account was revised and it became the reporting device for taxes arising from continuing operations. Order No. 62 amends instruction 1-12 to reflect the revision which was never incorporated in the instruction.

### C. *Rates and Refunds*

1. Order No. 47 *et seq.*; Docket No. RM79-22—Final Rule on Rate of Interest on Amounts Held Subject to Refund.

On September 10, 1979 the Commission issued Order No. 47, which Order amended Sections 35.19a, 154.67 and 154.102 of the Commission's regulations to require that refund amounts held by electric utilities, natural gas pipelines and independent producers from and after October 1, 1979 shall bear interest at an average of the prime rate for each calendar quarter. Order No. 47 defined such average prime rate to be the arithmetic mean of the prime rate values published in the *Federal Reserve Bulletin* for the fourth, third and second months preceding the first month of the calendar quarter. Order No. 47 further required that such interest be compounded quarterly and that Section 154.38(d)(4)(iv)(c) of the regulations be revised to require that carrying charges on Account 191 (deferred purchased gas costs) balances be computed at the average prime rate and also compounded quarterly.

Order No. 47-A, issued November 8, 1979, denied numerous producer and pipeline applications for rehearing and clarified that post-September, 1979 compounding is to apply to all interest, regardless of whether accumulated before or after October 1, 1979.

Order No. 47-B, issued December 26, 1979, further clarified Order Nos. 47 and 47-A by providing that if the *Federal Reserve Bulletin* is not timely available then data from the Federal Reserve's Statistical Release G.13 may be used.

Numerous petitions for judicial review of Order No. 47, *et seq.* have been filed by producers and pipelines. It now appears that such appeals will be heard before the Fifth Circuit and that a primary argument will be the unfairness of requiring a prime rate of interest on refunds when the refunding entity (due to current federal income tax payments on amounts later to be refunded) has the beneficial use of only half the amount on which interest is to be computed.

### D. *Pricing Provisions of the NGPA*

1. Order No. 49 *et seq.*; Docket No. RM79-14—Final Rule on Regulations Implementing the Incremental Pricing Provisions of the NGPA.

In Order No. 49, the Commission implemented Section 201 of the NGPA which required interstate pipelines and local distribution companies to pass through certain portions of their natural gas acquisition costs (as defined in Section 203 of the NGPA) to non-exempt large volume industrial boiler fuel users. In addition, Order 49 established a procedure for obtaining exemptions under Section 206 of the NGPA for small volume boiler fuel users (*i.e.*, those users who were in existence on November 9, 1978 and did not use more than an average of 300 Mcf per day during any calendar month of 1977), agricul-

tural users, electric utilities, qualifying co-generation facilities, and schools, hospitals or similar institutions. The basic mechanism adopted for implementing incremental pricing at the pipeline level utilizes the pipeline's existing purchased gas adjustment ("PGA") clause and is called the "reduced PGA approach." This mechanism permits pipelines to estimate in advance their total gas acquisition costs and the portion of those costs which would ultimately be absorbed by non-exempt industrial users through incremental pricing surcharges. The estimated surcharge recovery is subtracted from the estimated total gas acquisition costs to derive a reduced gas acquisition cost estimate for recovery through the pipeline's PGA clause. Monthly reconciliations are then made on the basis of the actual surcharge absorption capability calculated for each non-exempt industrial facility and local distribution company on the interstate pipeline system and the total incremental gas acquisition costs incurred by the pipeline during that month. Any resulting unrecovered incremental acquisition cost may be recovered in the pipeline's following PGA period since the unrecovered balance is credited to Account 191, unrecovered purchase gas costs.

2. Orders 50 and 51 *et seq.*; Docket No. RM79-21—Rules Implementing Alternative Fuel Price Ceilings on Incremental Pricing Under the NGPA.

In Order No. 50, the Commission established a three-tier system for determining the alternate fuel ceiling for non-exempt industrial boiler fuel users subject to incremental pricing. Pursuant to this Order a non-exempt industrial boiler fuel facility is deemed to use No. 2 fuel oil as an alternate to natural gas unless the user can certify that it has the capability to burn No. 6 high sulphur fuel oil, No. 6 low sulphur fuel oil or No. 5 fuel oil. A non-exempt industrial boiler fuel facility which certifies that it has the capability to burn No. 5 fuel oil is deemed for purposes of the determination of the alternate fuel price ceiling to burn No. 6 low sulphur fuel oil. Order No. 51 (a companion order to Order No. 50) was transmitted to Congress for its review pursuant to Section 206(d) of the NGPA and became effective on December 1, 1979. It holds the three-tier price ceiling provisions of Rule 50 in abeyance until November 1, 1980 by establishing a single price ceiling of No. 6 high sulphur fuel oil. In addition, Order 51 defines incremental pricing regions to account for varying prices of No. 6 oil throughout the country and sets forth the procedure by which non-exempt users file alternate fuel affidavits.

## RATEMAKING DECISIONS

### A. *Advance Payments*

In Opinion No. 769 (issued July 9, 1976) the Commission determined that advances not expended by producers within 30 days of inclusion of such advances in the pipeline's rate base would not be afforded rate base treatment. Since that time the Commission has attempted to apply this timing standard retroactively to advances made pursuant to Order No. 465 (issued

December 29, 1972) and Order No. 499 (issued December 28, 1973). Several court decisions were rendered this year on these Commission actions.

On January 5, 1979, the Seventh Circuit reversed and remanded a Commission order in *Natural Gas Pipeline Co. of America v. FERC*, 590 F.2d 664 (7th Cir. 1979) on the basis that application of the 30-day rule to Order No. 499 advances was retroactive modification of that order. On June 20, 1979, the D.C. Circuit remanded the Commission's denial of rate base treatment of Order Nos. 465 and 499 advance payments by Tennessee Gas Pipeline Co., Transcontinental Gas Pipe Line Co., and Michigan Wisconsin Pipe Line Co. in *Tennessee Gas Pipeline Co. v. FERC*, 606 F.2d 1094 (D.C. Cir. 1979). Relying on the "used and useful" tenet, the court said that the pipelines have the burden of affirmatively showing the benefits of front-end advances. On the other hand, the court found that strict application of the 30-day rule was unwarranted. On June 22, 1979, the Fifth Circuit, in *United Gas Pipe Line Co. v. FERC*, 597 F.2d 581 (5th Cir. 1979) reversed the Commission's application of the 30-day rule to Order 465 advances and remanded with regard to Order 499 advances. The Supreme Court has denied certiorari of the D.C. Circuit and Fifth Circuit decisions in *Tennessee Gas Pipeline Co. v. FERC*, No. 79-962 and *FERC v. United Gas Pipe Line Co.*, No. 79-1055, 48 U.S.L.W. 3567 (March 4, 1980).

*Interest Reimbursements:* Relying on the Fifth Circuit's decision in *United*, Judge Harfeld issued an Initial Decision on September 26, 1979, in *United Gas Pipe Line Co. (RP74-20, et al)* approving cost of service treatment for United's front-end reimbursement of interest paid by producers on loans used for exploration and development. Staff's application of the 30-day rule was rejected.

*Impact of NGPA:* The Commission is currently grappling with the possibility that producers could be receiving a price in excess of the maximum lawful ceilings due to the interest-free nature of advance payments. Possible courses of action being considered by the Commission include total prohibition of advances under the NGPA or limiting the prices producers can receive to 50% of NGPA price until the advance plus interest (at prime or above) has been repaid.

#### B. Cost Classification, Cost Allocation, and Rate Design

During the past year, the Commission's movement from the *Seaboard* to the *United* formula for cost classification, allocation and rate design encountered its first major setback. On May 17, 1979, the D.C. Circuit remanded to the Commission for further proceedings its Opinion Nos. 792 and 792-A (issued April 11, 1977 and June 7, 1977, respectively, in *Texas Gas Transmission Corporation*, Docket No. RP75-19), wherein the Commission had directed Texas Gas to shift from the *Seaboard* to the *United* formula for cost classification, allocation and rate design. The Court concluded that the Commission had failed to provide a reasoned explanation for the abandonment of the *Seaboard* formula. In particular, the Court found

the Commission's mere reliance on its previous decision approving the *United* formula for *United Gas Pipeline Company, i.e., Consolidated Gas Supply Corporation v. FPC*, 520 F.2d 1176 (D.C. Cir. 1975), to be inadequate since there was no discussion of the significant factual differences between the *United* and Texas Gas pipelines. *Columbia Gas Transmission Corporation, et al. v. FERC*, Nos. 77-1627, *et al.* The remanded proceeding is now before the Commission awaiting further action.

Prior to issuance of the *Columbia* decision, the Commission issued on February 16, 1979, its Opinion No. 21-A in *Texas Eastern Transmission Corporation*, Docket No. RP74-41. In the Opinion, the Commission upheld its previous decision in Opinion No. 21 (issued August 9, 1979) that the *United* formula, rather than the *Seaboard* formula, is appropriate for cost classification on Texas Eastern's system; however, the Commission reversed its previous decision to allocate transmission costs to Texas Eastern's Zone A by using a zone gate method, while allocating transmission costs to its Zones B, C, and D on the basis of Dth-miles. The Commission noted that this particular allocation procedure resulted in rates for Zone A being higher than rates for similar services in Zone B, which was 335 miles further downstream of Texas Eastern's area of gas supply. Upon reconsideration, the Commission directed Texas Eastern to allocate Zone A transmission costs to each zone on a pro-rata dekatherm basis, with remaining transmission costs, exclusive of those originating in Zone A, being allocated on a Dth-mile basis. Petitions for review of Opinion Nos. 21 and 21-A were filed with the United States Court of Appeals for the District of Columbia Circuit. On October 31, 1979, the Court granted a motion for remand of that portion of the record dealing solely with the question of whether the *United* or the *Seaboard* formula is appropriate for classifying costs on Texas Eastern's system. *Texas Gas Transmission Corporation v. FERC, et al.*, Nos. 79-1385, *et al.*

In other developments, the Commission approved the conversion of Transwestern Pipeline Company's tariff from a volumetric to a dekatherm basis and, in connection therewith, directed the company to allocate its transmission and purchase gas costs on a similar dekatherm basis. The Commission concluded that costs should be allocated on the basis of heat value in order to eliminate any rate differences and undue discrimination resulting from a volumetric allocation. Opinion No. 43, *Transwestern Pipeline Company*, Docket No. RP75-74, June 25, 1979. In Opinion No. 51, *Great Lakes Gas Transmission Company*, Docket No. RP75-94, July 30, 1979, the Commission reaffirmed its previous position that, absent some countervailing consideration or policy, the distance of haul is to be regarded as the primary determinant of the cost of providing service on a pipeline system. To this end, the Commission upheld a Presiding Judge's Initial Decision which required a zoned, Mcf-mile allocation of transmission costs on Great Lakes' system. In a similar vein, the Commission in Opinion No. 59, *Transcontinental Gas Pipeline Corporation*, Docket Nos. RP76-136, *et al.*, August 6, 1979, directed Transco to allocate its transmission costs to

zones by the Mcf-mile method. In so doing, the Commission reversed an Initial Decision which recommended continuation of historical rate differentials in effect on Transco's system since 1962.

#### C. *Research Development and Demonstration*

Opinion No. 69, issued November 21, 1979 approved the sale of natural gas produced from coal at the proposed Great Plains coal gasification demonstration project in Mercer County, North Dakota. The plant will be built by Great Plains Gasification Associates, a consortium of five interstate pipeline companies at an estimated cost of \$1.2 billion. The Commission, in Opinion No. 69, reduced the initial rate of return on equity for the project from the proposed 15 percent to 13 percent.

The Commission approved a request that the cost of the synthetic natural gas be "rolled-in" with the cost of the pipeline companies' other supplies. The applicants have estimated that the SNG could range in price from \$5.56 to \$8.62 per Mcf.

The Commission found the project eligible for treatment as an RD&D project, therefore the project will not be required to use the standard financing and tariff arrangements for a conventional pipeline project. RD&D projects are permitted to recover expenses on a current basis, to amortize large, non-recurring costs over a five year period and to normalize taxes. The Commission indicated that it would not necessarily find future coal gasification projects or supplemental gas supply projects to be appropriate for RD&D treatment.

In lowering the proposed rate of return on equity the Commission also voted to require periodic review of the rate of return to be granted to Great Plains. The Commission denied the applicants request for a minimum level of return on equity of \$10 million per year to be used in the later years of the project.

On January 21, 1980, the Commission issued Opinion No. 69-A which denied applications for rehearing, reconsideration or modification of Opinion No. 69. The Commission's opinions have been appealed by, among others, General Motors Corporation.

#### D. *Pipeline Rates*

1. Opinion No. 47. Opinion Determining Proper Cost of Service Treatment of Tax Liability Arising from the Filing of Consolidated Income Tax Return. Columbia Gulf Transmission Co., Columbia Gas Transmission Corp., Docket No. RP75-106, July 2, 1979.

Opinion No. 47 dealt with a cost of service allowance for ratemaking purposes claimed by Columbia Gulf Transmission Co. and Columbia Gas Transmission Corp. for federal income tax expense. Each pipeline had claimed an income tax expense determined by the application of the statutory 48% tax rate to its respective taxable income for the adjusted test period,

separately determined. The pipelines, however, had joined with other affiliates and their parent, to file a consolidated income tax return which reduced the net tax liability for the combined system.

In his 1977 Initial Decision, the presiding ALJ had determined that the income tax allowance claimed by each pipeline was excessive and ordered refunds. Opinion No. 47 reversed the ALJ's findings, holding that each pipeline should be treated on a "stand-alone" basis as though each filed a separate income tax return, for purposes of computing tax components of cost of service. The Commission therefore found the resulting rates to be just and reasonable.

## 2. Rate Treatment for Unsuccessful Gas Supply Projects

On June 20, 1979, in *Tennessee Gas Pipeline Co. v. FERC*, 606 F.2d 1094, the D.C. Circuit affirmed the Commission's application of the "used and useful" principle in denying rate base treatment and amortization over a period of time to certain unsuccessful gas supply projects (Opinion Nos. 801 and 801-A). The Court found that the Commission's policy was a proper exercise of discretion. On October 16, 1979, the Court denied a petition for rehearing by Transco in which Transco pointed to the inconsistent rate treatment being afforded gas and electric utilities by the Commission.

The Commission now has before it, on exceptions, an Initial Decision in *Tennessee Gas Pipe Line Company*, Docket No. RP75-13, *et al.* where the issue of the propriety of the Commission mandating a "used and useful" standard to be used for recovery of unsuccessful gas supply projects (Opinion No. 801-A, and *Northern Natural Gas Co.*, Opinion No. 14-A, issued September 14, 1978), and, at the same time, continuing to use the "prudent investment" standard for rate treatment of unsuccessful supply projects in electric cases (*New England Power Co.*, Opinion No. 49, issued July 19, 1979 and *Southern California Edison Co.*, Opinion No. 62, issued August 22, 1979). The Commission is faced with the use of different standards for unsuccessful supply projects under similar statutory frameworks.

Exceptions have also been filed to the Initial Decision in *Natural Gas Pipeline Company of America*, Docket No. RP78-78, where Judge Ellis rejected the "used and useful" standard, and allowed recovery of costs by applying the "prudent investment" standard to an unsuccessful coal gasification and LNG project. Amortization of Gas Arctic cost was disallowed, without prejudice, and Judge Ellis recommended consideration of such amortization in a proceeding considering all Gas Arctic precertificate costs.

On March 3, 1980, an Initial Decision was issued in *Natural Gas Pipeline Company of America*, Docket No. RP77-98 and RP78-78, approving Natural's use of its own method of accomplishing tax normalization. Natural was not required to adopt the tax normalization method proposed by Staff, which was initially applied in the settlement of *South Georgia Natural Gas Company*, Docket No. RP77-32.



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