Report of The Committee on Natural Gas Certificate and Authorization Regulations

This report of the Committee of Natural Gas Certificate and Authorization Regulations highlights the important natural gas pipeline certificate and authorization developments at the Federal Energy Regulatory Commission (Commission) and in the courts during the calendar year of 1985.

I. Major Clarification to Order Nos. *436* and *436-A*[1]

This summary outlines the major FERC clarifications to Order Nos. 436 and 436-A.[2] All of the clarifications have been issued in the proceeding styled *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Docket No. RM85-1-000. For purposes of identification, however, the clarifications discussed below adopt the Commission's practice of identifying the applicant who requested the clarification in the rulemaking docket.

A. *Summary of Clarifications*

The clarifications provide three broad exceptions to the provisions of Order No. 436. First, any transportation under Section 311 of the Natural Gas Policy Act of 1978 (NGPA)[3] that did not commence until after October 9, 1985 will subject the transporter to the non-discriminatory, open-access provisions of the new regulations *unless* the transportation had not commenced by that date because the facilities necessary to effectuate that transportation were under construction but not yet in service. Second, if transportation services were commenced under the regulations promulgated under Order No. 234-B,[4] such transportation services can continue beyond November 1, 1985 without subjecting the transporter to the open-access provisions, if such transportation services actually were qualified to have commenced under the regulations promulgated pursuant ot Order No. 319.[5] Third, delivery of receipt points not in use on October 9, 1985 may be used after that date, without subjecting the transporter

1. This summary is intended to supplement Griggs, *Restructuring the Natural Gas Industry: Order No. 436 and Other Regulatory Initiatives*, in this edition.

2. *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, 50 Fed. Reg. 42,408 (Oct. 18, 1985) [hereinafter cited as Order No. 436], *modified*, Order No. 436-A, 50 Fed. Reg. 52,217 (Dec. 12, 1985) [hereinafter cited as Order No. 436-A], *appeal pending sub nom.*, Associated Gas Distributors v. FERC, No. 85-1811 (D.C. Cir.).

3. 15 U.S.C. § 3371 (1982).

4. Order No. 234-B, Interstate Pipeline Blanket Certificate for Routine Transactions and Sales and Transportation by Interstate Pipelines, 48 Fed. Reg. 34,872 (1983), III FERC Stats. & Regs. (CCH) ¶ 30,476 (1983) (*codified at* 18 C.F.R. 157.209(e) (1983)). Order No. 234-B authorized transportation under a blanket certificate for any end-user including low-priority end-users, until July 1, 1985.

5. Order No. 319, Sales and Transportation by Interstate Pipelines and Distributors; Expansion of Categories of Activities Authorized Under Blanket Certificate, 48 Fed. Reg. § 34,875 (1983), III FERC Stats. & Regs. (CCH) ¶ 30,477 (1983), *as modified*, Order 319-A, 48 Fed. Reg. § 51,436 (1983), III FERC Stats. & Regs. (CCH) ¶ 30,512 (1983).

to the open-access provisions, if the underlying contract in existence on and before October 9, 1985, listed those points.

B. Specific Major Clarifications

1. *Northwest Pipeline Corp.*, 33 FERC (CCH) ¶ 61,137 (1985). The Commission clarified that if a pipeline files a "statement of notification" prior to November 1, 1985, notifying the Commission that it will comply with the nondiscriminatory access conditions set forth in the new regulations, the filing of such a statement will not be deemed as an election by the pipeline to become an open-access transporter subsequent to December 15, 1985.

2. *"Technical Corrections" to Order No. 436*, III FERC Stats. & Regs. (CCH) ¶ 30,665 (1985). The major correction provides that NGPA Section 311 transactions entered into on and between October 10, 1985 and November 1, 1985 will be treated as "new" NGPA section 311 transactions which will subject the transporter to the open-access provisions of Order No. 436.

3. *El Paso Natural Gas Co.*, 33 FERC (CCH) ¶ 61, 140 (1985). NGPA Section 311 transportation services which were being provided on October 9, 1985 pursuant to a written contract executed prior to that date may continue after November 1, 1985, if the contract so provides without subjecting the transporter to the open-access provisions of Order No. 436. In *Pacific Gas and Electric Co.*, 33 FERC (CCH) ¶ 61,155 (Oct. 31, 1985), the Commission further clarified, however, that if Section 311 service actually commenced prior to October 9, 1985 pursuant to a verbal agreement, such service could continue beyond November 1, 1985 without subjecting the transporter to the open-access provisions, if the parties to the transaction complied with all applicable reporting requirements. This transition rule is not applicable to service which commenced after October 9, 1985 pursuant to a verbal agreement entered into prior to October 9, 1985.

4. *Hadson Gas Systems Inc.*, 33 FERC (CCH) ¶ 61,142 (1985). Any subsequent changes to terms and conditions of transportation arrangements that existed on October 9, 1985 will be considered as an initiation of a new NGPA Section 311 transportation transaction under 18 C.F.R. § 284.102 as revised by Order No. 436. This holding was further clarified in *EnTrade Corp.*, 33 FERC (CCH) ¶ 61,411 (1985) wherein the Commission stated that "a change in the identity of the supplier is a change in a term or condition, as contemplated in the transitional provisions of Section 284.105, and would be considered an initiation of new service under Section 284.102."[6]

Hadson was reaffirmed in *Carbonaire Co.*, 34 FERC (CCH) ¶ 61,006 (1986). In its Request for Clarification or Waiver, Carbonaire stated that it had entered into a written contract with Transcontinental Gas Pipe Line Company (Transco) in July 1985 for interruptible transportation pursuant to Order No. 319. Carbonaire claimed that it had a verbal understanding with Transco whereby Transco would receive the volumes at an alternate receipt point in the event that the gas could not be transported on Transco's main line. Carbonaire claimed that Transco did not include the alternate delivery point in the July

6. *See also Panhandle Eastern Pipe Line Co.*, 33 FERC (CCH) ¶ 61,139 (1985).

1985 contract because of Transco's policy not to list receipt points that had been inactive for more than three weeks, and because Transco believed the contract could be amended at any time if capacity constraints made it necessary. On December 2, 1985, Transco ceased transporting the gas due to capacity constraints on its main line. Carbonaire stated, in its request, that the curtailment of its gas by Transco necessitated the purchase of alternative supplies "at a price so high as to render its operations noncompetitive" and that "it will have to shut down its plant if relief is not forthcoming." The Commission, citing *Hadson* and *Pacific Gas and Electric Co.*, 33 FERC (CCH) ¶ 61,155 (1985), refused to allow the addition of the alternate receipt point without invoking the non-discriminatory access provisions of Order No. 436 even though this receipt point had been explicitly listed in a prior contract. The Commission stated that:

> We recognize the hardship that Carbonaire may experience if Transco cannot transport gas under its existing contract, however, the grant of relief here would be to reverse our prior position on oral and modified contracts, which we believe best balances the interests of parties to transitional arrangements for transportation with the goals of Order No. 436.

34 FERC at 61,020.

5. *Midwest Solvents Co.*, 33 FERC (CCH) ¶ 61,157 (1985). The Commission, on its initial review of this request, held that if, prior to October 9, 1985, a pipeline has been transporting gas pursuant to the regulations providing for blanket transportation authority for low-priority end-users, Section 157.209(e) of the Commission's regulations (*i.e.* transportation pursuant to Order No. 234-B), that transportation could not continue under the transitional provisions of Order No. 436 beyond November 1, 1986 even if the transportation was, in actuality, for high a priority end-use. The Commission reversed this holding in its Order Granting Rehearing of this clarification[7] because the subject transportation was automatically authorized under 18 C.F.R. § 157.209(a)(1) without any filing requirement, with the commencement of service.[8]

6. *Carnation Co.*, 33 FERC (CCH) ¶ 61,152 (1985). Gas transported on October 9, 1985 under a special marketing program would not qualify for transportation during the transition period even if separate Order No. 319 authorization was in existence prior to October 9, 1985.

7. *Amstar Corp.*, 33 FERC (CCH) ¶ 61,156 (1985). Under a contract effective September 1, 1985, Amstar Corporation (Amstar) contracted with Texas Eastern to transport gas supplies Amstar had purchased from a producer. Texas Eastern, however, refused to transport the gas because it determined that the quality of the gas was unacceptable. Amstar then located another supplier and executed a second contract for those supplies on October 7, 1985. The gas made the subject of the second contract was actually tendered to

7. *Midwest Solvents Co.*, 33 FERC (CCH) ¶ 61,395 (1985).

8. *Accord Michigan Gas Utilities Co.*, 33 FERC (CCH) ¶ 61,181 (1985). *But see United States Steel*, Docket No. RM85-1 (Feb. 13, 1986). In a fact situation similar to that of *Midwest Solvents*, the Commission did not allow U.S. Steel to convert Section 157.209(e)(1) transportation to §157.209(a)(1) transportation because the underlying agreement indicated that the term of the transaction would continue in effect for only 120 days from the date of first deliveries, which term expired before October 9, 1985.

Texas Eastern for the account of Amstar on October 18, 1985 but Texas Eastern refused to transport these volumes because of the uncertainties surrounding the representation of Order No. 436 and the October 9, 1985 effective date. The Commission denied Amstar's request that the transitional regulations be waived so that the transportation could commence.

8. *Orange and Rockland Utilities, Inc.*, 33 FERC (CCH) ¶ 61,168 (1985). Orange and Rockland Utilities, Inc. (Orange and Rockland) and Transco entered into an agreement on July 29, 1985 whereby Orange and Rockland would bear the cost of constructing a 10,000 foot, 16-inch pipeline at a cost of $3,300,000. The facilities were not completed until October 11, 1985. The Commission held that the "extraordinary, unique circumstances presented" dictated that "this Section 311 NGPA transaction may continue under the transition provisions" of the new regulations even though the transportation began after October 9, 1985.[9]

9. *ANR Pipeline Co.*, 33 FERC (CCH) ¶ 61,180 (1985). The Commission accepted ANR's "statement of notification" only insofar as it declared that ANR intends to comply with the nondiscriminatory access conditions. The order rejected ANR's filing insofar as it stated that ANR will provide new service during the transition period pursuant *only* to a new Section 7(c) certificate.

10. *Tex-La Gas Co.*, 33 FERC (CCH) ¶ 61,206 (1985). United Gas Pipe Line Company commenced self-implementing transportation pursuant to NGPA Section 311 for Tex-La on July 19, 1985. The 30-day report for this transaction was due to be filed on August 18, 1985, but United did not file the report until August 23, 1985. United requested, through Tex-La, that this transaction be permitted to continue under the transition provisions of Order No. 436, even though the 30-day report had been filed late. The Commission held that the transaction could continue because it was in effect prior to October 9, 1985.[10]

11. *Natural Gas Pipeline Co. of America*, 33 FERC (CCH) ¶ 61,385 (1985). A receipt or delivery point existing in an agreement as of October 9, 1985, but not utilized prior to October 10, 1985, may be used after October 31, 1985 without subjecting the transporter to the nondiscriminatory access provisions of the new regulations as long as service under the agreement had commenced on or before October 9, 1985.[11]

12. *SarVic Gas Co.*, 34 FERC (CCH) ¶ 61,034 (1986). A receipt point specified in the contract but not used until after October 9, 1985 qualified under the transitional provisions. In addition, transportation to correct imbalances in deliveries made on or before October 9, 1985 may be made without subjecting the transporter to the non-discriminatory access provisions of the new regulations.

13. *Judel Glassware Co.*, 33 FERC (CCH) ¶ 61,386 (1985). This Order

9. *See also Transcontinental Gas Pipe Line Corp.*, 33 FERC (CCH) ¶ 61,185 (1985) and *Judel Glassware Co.*, 33 FERC (CCH) ¶ 61,386 (1985) (discussed *infra*).

10. *Accord United Gas Pipe Line Co.*, 33 FERC (CCH) ¶ 61,424 (1985). *But see National Fuel Gas Supply Corp.*, Docket No. RM85-1 (January 21, 1986) (wherein the Commission held that National would not be deemed eligible for the transitional provisions because, unlike United, National had not filed either the initial or extension reports required by the Commission's regulations prior to October 9, 1985).

11. *See also Sohio Petroleum Co.*, 33 FERC (CCH) ¶ 61,448 (1985).

pertains to sixteen distinct transactions whereby the applicants stated that they had entered into contracts prior to October 9, 1985 for the construction of facilities specifically to provide for transportation services to be performed pursuant to Section 311 of the NGPA. In these situations, the facilities had not been completed, and transportation had not commenced, on or before October 9, 1985. In fourteen of the sixteen transactions, the Commission agreed to waive the restrictions in the transitional provisions of Order 436 because the party demonstrated that there was "economic substance" to the transportation transaction prior to October 9, 1985. The Commission held:

> To demonstrate economic substance, the purchaser, seller, or end user must show that, in reliance on a transportation contract, it constructed significant facilities for delivery of gas prior to October 9, or expended substantial funds prior to October 9. This test will *not* be satisfied if the facilities were constructed, or the funds expended, *only* by the transporter itself, because a transporter has the option of utilizing the transportation authority of Order 436.

33 FERC at 61,750 (emphasis added). The maximum amount spent on the fourteen approved transactions was in excess of $27,000,000 (Creole) and the minimum was $40,000 (Power-Tex). Two of the transactions were not approved because construction and expenditure had not commenced prior to October 9, 1985 (Texas Gas Transmission and Feagan).[12]

14. *Columbia Gas Transmission Corp.*, 33 FERC (CCH) ¶ 61,398 (1985). Columbia cannot impose a requirement, as a condition of transportation, that its customer, Mountaineer Gas Company, pay contested demand charges under a separate sales contract before transportation service is provided. The Commission held, in this Order Denying Request for Clarification, that "refusing to provide transportation services under Section 284.223(g)(2) is not an appropriate means of resolving a dispute between the two parties concerning Columbia's sales tariff. That dispute should be resolved in [the appropriate form]." *Id.* at 61,766.

15. *Natural Gas Pipeline Co. of America*, FERC (CCH) ¶ 61,401 (1985). Natural argued that a NGPA Section 311 transaction which expired on November 21, 1985 should be allowed to continue subject to the transitional provisions because of a mutual understanding between it and the purchaser that the transaction could be extended beyond that date. The Commission held, however, that the necessary extension reports had not been filed prior to October 9, 1985 and, therefore, the transportation could not be continued as a "grandfathered" Section 311 transportation arrangement beyond the November 21, 1985 expiration date provided for in the contract.

16. *Midwestern Gas Transmission Co.*, 34 FERC (CCH) ¶ 61,007 (1986). Midwestern's transmission system is, in actuality, two distinct systems — the "Northern System" and the "Southern System." Because this pipeline structure predated the issuance of Order No. 436, "and could in no way be construed as an attempt to circumvent the purpose of the regulations", trans-

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12. The "economic substance" test has been applied in numerous subsequent clarifications. *See, e.g.*, *Caliche Pipe Line Co.*, 33 FERC (CCH) ¶ 61,425 (1985) (a total of $408,000 expended); *D. B. Baxter, Inc.*, 33 FERC (CCH) ¶ 61,468 (1985) ($25,000 expended to put a gathering line into acceptable working condition); *Seagull Energy Corp.*, 33 FERC (CCH) ¶ 61,469 (over $25,000,000 expended); *Conoco Inc.*, 34 FERC (CCH) ¶ 61,022 (1986) ($2,700,000 spent to repair a plant and return it to serviceable condition).

portation services pursuant to Order No. 436 on the Northern System would not subject transportation on the Southern System to the requirements of Order No. 436.

17. *Eastern Shore Natural Gas Co.*, 34 FERC (CCH) ¶ 61,009 (1986). Order No. 436 is inapplicable to emergency transportation performed by an interstate pipeline for another interstate pipeline pursuant to Subpart C of Part 157 of the Commission's regulations, and does not subject the interstate pipeline to the conditions in the regulations adopted by Order 436. The emergency transportation is covered by Section 7 of the Natural Gas Act (NGA)[13] and is independent of the transportation authorized by Order No. 436.

18. *ANR Pipeline Co.*, 34 FERC (CCH) ¶ 61,045 (1986). The transportation rates applicable to an Order No. 436 blanket certificate must be filed no later than May 31, 1986, with a proposed effective date of July 1, 1986. The language in Section 284.7(b)(2) of the Commission regulations does not mean that the rate must actually be in effect on July 1, 1986; the rates must merely be filed so that they have a proposed effective date of July 1, 1986.

19. *Pelto Oil Co.*, 34 FERC (CCH) ¶ 61,035 (1986). All transportation of gas on the Outer Continental Shelf is subject to the non-discriminatory access requirements of the Outer Continental Shelf Lands Act (OCSLA)[14] regardless of whether the gas is transported pursuant to the authority of Order No. 436 or individual NGA Section 7 certificates. The Commission declined to grant Pelto's request for clarification that "with respect to the transportation of OCS gas from the field to an onshore delivery point, the non-discriminatory access requirement of the OCSLA applies only to that segment of a pipeline's system on the OCS and to facilities necessary to effect delivery of the gas onshore."

II. Abandonments Under Section 7(b) of the NGA

One of the major developments affecting the natural gas industry in 1985 involved changes to the Commission's policy governing abandonments under Section 7(b) of the Natural Gas Act.

A. *Felmont Oil Corporation and Essex Offshore, Inc.*[15] In *Felmont*, the Commission set forth the criteria it now intends to follow in considering abandonment applications. Applicants Felmont and Essex sought Commission authorization, pursuant to the requirements of Section 7(b) of the Natural Gas Act (NGA), to abandon their obligation to sell Block 86 natural gas to Transcontinental Gas Pipeline Corp. (Transco) in view of the expiration of the underlying sales contracts and Transco's decreased purchases (which were substantially below the amount of gas available from this Block).

The gas from Block 86 is subject to ceiling prices established in Section 104 and 106(a) of the Natural Gas Policy Act of 1978 (NGPA).[16] The Applicants thus argued that bringing this low-cost gas to market rather than leaving it in the ground would lessen industry-wide distortions that arise when low-cost

13. 15 U.S.C. § 717f (1982).

14. 43 U.S.C. §§ 1301-1356 (1982).

15. 33 FERC (CCH) ¶ 61,333 (1985) (Opinion No. 245); *as clarified*, Docket No. CI84-10-000 mimeo (Feb. 28, 1986) (Opinion 245-A).

16. 15 U.S.C. §§ 3314 & 3316(a) (1982).

gas is withheld from the market and enable applicants to maximize their revenue through sales to other purchasers.

In opposition to this application, Transco argued that despite the current system-wide excess of gas, it continued to have a critical need for long-term reserves. Transco noted that its reserves-to-deliverability ratio was declining, and the loss of low-cost gas reserve would have an adverse impact both on itself and its customer. In addition, Transco objected to the general consideration of public convenience and necessity in requests for abandonment.

The presiding judge rejected the proposed abandonment as well as an offer of settlement submitted by the parties. Applying existing Commission precedent on abandonments, the judge concluded that the critical "public interest" factors to be addressed in an abandonment proceeding are the competing needs of the existing purchaser, and possible alternative purchasers, and the markets they serve.

On appeal, the Commission found that the enactment of the NGPA, especially the NGPA provisions on deregulation, evidenced Congress' intent to create a more unified national gas market and to rely increasingly on market forces in establishing prices and allocating supplies of natural gas. Accordingly, the commission found that a broader approach to abandonment is warranted. Under the new policy, Commission emphasis will shift from the identification of the interests of specific customers to a consideration of the public interest as a whole. Nonetheless, the party seeking abandonment must still demonstrate that the proposed abandonment would have beneficial effects on the market overall, and that those benefits outweigh any adverse effect to the purchaser to whom the gas is presently dedicated, or to that purchaser's customers. Where supplies of low-cost gas are not being taken by a pipeline, the Commission observed that abandonment would serve the public interest in marketing the gas. These increased purchases of low-cost gas, the Commission reasoned, will displace higher-cost supplies. Then, producers of high-cost gas will have a strong incentive to decrease their prices to preserve their market share. In adopting its new policy, the commission did not reject the prior abandonment policies *in toto*. Factor, such as environmental and economic consequences of abandonment, the parties' contract arrangements, and the parties' comparative needs, must still be weighed.

In applying this modified policy to the *Transco* case, the Commission approved a limited term abandonment, as proposed by the offer of settlement between the parties. Under this arrangement, Transco is required to submit to the Applicants at least thirty days in advance an estimate of volumes to be purchased during the succeeding six months. The estimates can be revised on a thirty-day basis within each six-month period. Any Block 86 gas that is not nominated in these estimates may be sold to other purchasers. However, Transco's firm customers will be allowed to bid for available volumes on a priority basis. The partial abandonment is authorized for a three-year period. Rehearing requests were denied.

B. *Pennzoil Producing o. and Pennzoil Gas Marketing Co.* Docket Nos. CI86-54-000 and CI86-57-000 (Order Permitting and Approving Limited-Term Abandonment and Issuing Limited-Term, Blanket Certificate) (March 5, 1986). Subsequent to *Felmont*, the Commission applied its new standard to an application for a partial abandonment. In *Pennzoil*, Pennzoil Producing Co. and Pennzoil Gas Marketing Co. (Pennzoil) requested blanket authorization for an unlimited term to partially abandon the sale of natural gas to United Gas Pipe Line Co. (United) because United had substantially reduced its takes of Pennzoil's production, averaging less than five percent of the total gas available. To mitigate the resulting adverse impact, Pennzoil credited United with take-or-pay relief, selling non-NGA gas on the spot market and through Pennzoil's special marketing program. Pennzoil also renegotiated various contracts with United. In support of its abandonment application, Pennzoil alleged that the increased cash flow resulting from additional sales would be used for additional exploration and production. In addition, Pennzoil claimed that it was being damaged by drainage and loss of reserves through the trapping of gas in partial water-drive reservoirs due to reduced production rates.

The Commission applied the *Felmont* standards and considered the benefits to all segments of the natural gas industry, including consumers. Since the shut-in gas was low-cost gas and release of this surplus would reduce United's take-or-pay obligations, partial abandonment was found to be consistent with the Commission's policy objectives. However, since Untied indicated it has only a two-year deliverability surplus, the Commission limited its abandonment authorization to two and one-half years. At the end of that period, the Commission will review the abandonment and assess whether it is still in the public convenience and necessity.

Finally, to allow Pennzoil to compete on an equal footing with non-jurisdictional purchasers, the Commission approved a blanket sales certificate so that Pennzoil can make spot or other sales to the interstate market. The certificate is conditioned so that the rates are the lesser of the contract price or the applicable maximum lawful price prescribed by the National Gas Policy Act.

C. *Limited Term Abandonments (LTAs)*. On October 29, 1985, the Commission issued its first order pertaining to Limited Term Abandonments (LTAs).[17] The LTAs are similar to the now defunct special marketing programs (SMPs) in that the LTAs permit the LTA certificate holder to make sales for resale in interstate commerce of natural gas for which the maximum lawful price is higher than the NGPA Section 109 price and to temporarily abandon such sales if: (1) the sales were previously certificated by the Commission; (2) the subject volumes are reserves contractually committed to a pipeline; (3) the volumes are released by the pipeline to the certificate holder; and (4) the releasing pipeline is absolved from take-or-pay liability for any volumes of gas sold under the LTAs.[18] All existing LTAs are scheduled to expire on March 31, 1986.

The purpose of the LTAs is to allow applicants to sell volumes of "higher-cost" gas to willing purchasers on a short-term, spot-market basis. The LTAs do not, however, provide transportation authority for the subject volumes. The

17. Tenneco Oil Company, *et al.*, 33 FERC (CCH) ¶ 61,134 (1985). This order authorized LTAs in 25 separate dockets. The applicants who were granted the LTAs are listed in Appendix A to the October 29 Order.

18. The Commission later clarified that its October 29, 1985 LTA Order included pre-granted abandonment of sales commenced pursuant to the LTAs. *Tenneco Oil Co.*, Docket No. CI85-633-001, *et al.* (Feb. 5, 1986) (Order Denying Rehearing and Granting Clarification).

LTAs were designed to avoid the discriminatory aspects of the SMPs as discussed in *MPC III*[19] because the LTAs do not provide the applicant or pipelines with transportation authority. Instead, transportation authority must be gained independent of the LTAs through the Commission's Order No. 436 proceedings[20] or through a certificate issued pursuant to Section 7 of the NGA.

Subsequent to the first "basket" LTA order issued on October 29, 1985, the Commission issued four more basket LTA orders in 1985.[21] These orders granted authority identical to that granted in the initial October 29, 1985 Order; *i.e.*, the applicant was given authority to begin and terminate sales of "higher-cost" gas released from pipelines through March 31, 1986. The subsequent orders did not grant transportation authority; but, pursuant to a request for clarification filed by Yankee Resources, Inc., the Commission clarified that LTA gas could be transported not only pursuant to Order No. 436, but also under Section 7 of the NGA or under "grandfathered" NGPA Section 311 transportation arrangements if the requirements for those transportation authorities were met.[22]

III. Court Decisions

A. *Maryland People's Counsel v. FERC.*[23] Perhaps the most significant legal decisions in 1985 were the so-called "*Maryland People's Counsel*" cases. These cases provided a major impetus to the regulatory changes brought about by Order 436. Each decision is discussed below.

In *MPC I*, the D.C. Circuit found that the "special marketing program" (SMP) authorized for Columbia Gas Transmission Corp. (Columbia) was arbitrary and capricious. Under this SMP, a pipeline and its producers agreed to amend the high-priced gas purchase contracts so as to permit producers to sell the committed gas to certain classes of customers at current market prices, and to credit the volume of such sales against the pipeline's purchase (take-or-pay) obligations. The Maryland People's Counsel (MPC) challenged the SMP as discriminatory against "captive customers," *e.g.*, those who do not have alternate fuel sources and thus could not qualify for an SMP purchase. MPC argued that the exclusion of captive customers from the SMP was discriminatory and that SMP sales to the qualified customers would have the ultimate effect of increasing the cost of gas to excluded, captive customers.

After finding that MPC had standing, the court found that the Commission did not set forth reasonale arguments to counter MPC's contentions. First the Commission's argument that the SMP limitation to certain customers would spread the pipline's fixed costs, thereby spreading the benefit to ineligi-

19. *See* discussion *infra.*

20. *See* note 2, *supra.*

21. The four subsequent "basket" LTA orders are reported at: *Amoco Production Co.*, 33 FERC (CCH) ¶ 61,173 (1985) (authorizing LTAs in five dockets); *Columbia Transmission Corp.*, 33 FERC (CCH) ¶ 61,233 (1985) (authorizing LTAs in two dockets); *Vesta Energy Co.*, 33 FERC ¶ 61,326 (CCH) (1985) (authorizing LTAs in nine dockets); and *Chevron USA*, Inc., 33 FERC (CCH) ¶ 61,455 (1985) (authorizing LTAs in four dockets).

22. *Amoco Production Co.*, 33 FERC (CCH) ¶ 61,454 (1985).

23. Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985) (*MPC I*) 761 F.2d 780 (D.C. Cir. 1985) (*MPC II*); 768 F.2d 450 (D.C. Cir. 1985) (MPC III).

ble customers as well, did not adeqately explain why SMPs without eligibility restrictions would not accomplish the same result. Second, the court also rejected as unsupported the Commission's argument that competition between pipelines for each other's "core" or market would not necessarily be in the public interest. Third, the court rejected the Commission's claim that MPC's concerns would be considerred in subsequent proceedings, noting that the Commission had not adressed MPC's concerns in any proceeding during the past year. Finally, the ourt held that the experimental nature of SMPs did not justify the arbitrariness of limiting the experiment without full consideration of relevant factors.

Since the challenged orders had expired, the court issued a certified copy of the opinion, and ordered the Commission and intervenors in other challenged proceedings to show cause why the successor SMP orders should not be vacated and remanded for reconsideration.

Thereafter, in *MPC III*, the court found the arguments raised by the Commission and intervenors in response to the show cause orders were basically the same as those raised in *MPC I*. The court observed that the Commission still had failed to explain why the benefits would not occur in the absence of eligibility restrictions. Although the Commission had adopted a "10% rule" to "reduce discrimination" by allowing captive consumers to nominate up to ten percent of their entitlement under the SMP, the Court found no basis for its choice of percentage. The court did not accept as persuasive the Commission's intention to avoid potential adverse effects of cost-shifting that may result from more substantial market restructuring. Finally, the court rejected the Commission's unsupported statement that less SMP gas may be moved if sold in a nondiscriminatory fashion. However, since the current SMP orders were scheduled to expire in October 31, 1985, the day that new rules effecting fundamental changes in the marketing of natural gas were scheduled to be promulgated, the court did not vacate these orders. Instead, the court remanded the orders to the Commission for proceedings consistent with its opinions.

In *MPC II*, a companion case to *MPC I*, the court reviewed FERC's "blanket certification program" which authorized interstate pipelines to transport gas at lower prices directly to "non-captive consumers" — large industrial end-users capable of switching to alternative fuels — without any obligation to provide the same service to "captive consumers" — a group that includes local distribution companies (LDCs) and their residential customers. As in *MPC I*, the Court found that the Agency's prime constituency — the consumers whom the Natural Gas Act was designed to protect against exploitation by natural gas companies. Again, the court held that the Commission had failed to evaluate the anticompetitive consequences of its action.

The court rejected FERC's contentions that the programs were "bacially neutral." Rather, the blanket certificate orders did, in fact, clear an area for discrimination against captive customers. Therefore, the court held that the Commission should have considered the anticompetitive effects of the program *before* the orders were promulgated, rather than later in a ratemaking proceeding or on a case-by-case basis as abuses arise. The court concluded that the alleged benefits of the program (increased fixed-cost recovery, better market signals to producers, and pressure on pipeline gas purchasers) could be achieved as well in a non-discriminatory program.

The Court initially vacated the challenged orders to the extent that they allowed transportation of direct-sale gas to fuel-switchable, non- "high-priority" end-users without requiring pipelines to furnish the same service to LDCs and captive consumers on non-discriminatory terms. Upon reconsideration, the court stayed its mandate until either the effective date of a final rule on the matter in the Commission's Docket No. RM85-1-000, or October 31, 1985, whichever occurred first.[24]

B. *Northern Natural Gas Company v. FERC*, No. 84-1516 (D.C. Cir. Dec. 31, 1985). In this proceeding, Northern Natural Gas Company (Northern) challenged two conditions attached by the Commission to a certificate of public convenience and necessity issued to Northern pursuant to Section 7 of the Natural Gas Act (NGA)[25] authorizing Natural to sell gas to customers possessing alternate fuel capacity under discounted rates. The first condition required Northern to credit all recoveries of fixed costs derived from sales to fuel-switchable end-users to its other captive customers. The second "required Northern, after its next rate case, to track its revenues and credit any net over-recovery of fixed-costs to non-discount customers." *Northern Natural, slip op.* at 2-3. The issues were whether the first condition was outside the scope of the Commission's authority under Seciton 7 of the NGA and whether the second was ripe for review.

Relying upon its decision in *Panhandle Eastern Pipe Line Co. v. FERC*, 613 F.2d 1120 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 889 (1980), the court vacated that portion of the Commission's order which required Northern to presently credit all recoveries of fixed costs derived from the discounted sales. The Court interpreted *Panhandle*, "as it was written, to proscribe the alteration, in a Section 7 proceeding, of 'rates previously approved by the Commission for customers not receiving *the services to be certificated*.' "[26] The Court noted that the impact of its holding in *Northern Natural* as well as in many other cases could have the effect of rejecting innovative certification proposals:

> It may be true that the consequence of this holding, in the present case and in many others, will be to compel the Commission to reject innovative certification proposals that benefit some customers while leaving others at least no worse off. But since that is *always* the effect of *Panhandle*, it is an argument for overruling the case rather than a guide to interpreting it . . . we decline to pare it down in a fashion that would only spawn further litigation articulating and refining ineffable distinctions.

Northern Natural, slip op. at 8 (emphasis in original). The Court went on to find that the second condition imposed by the Commission was not ripe for review by the court. *Id.* at 9.

IV. MISCELLANEOUS COMMISSION DECISIONS

A. *Panhandle Eastern Pipe Line Company.*[27] Applicant Panhandle Eastern

24. Maryland People's Counsel v. FERC, 768 F.2d 1354 (D.C. Cir. 1985).

25. 15 U.S.C. § 717f (1983).

26. *Northern Natural, slip op.* at 8 (quoting *Panhandle*, 613 F.2d at 1130 (emphasis added; footnote omitted).

27. 29 FERC (CCH) ¶ 61,338 (1984) (Order Issuing Certificate, Granting Late Filed Motions to

Pipe Line Company (Panhandle) requested authorization to add a new delivery point to Hayer-Albion Corp.; to reassign volumes of natural gas from an existing delivery point to the new delivery point; and, to construct and operate appurtenant facilities, pursuant to Section 7 of the Natural Gas Act. Southeastern Michigan Gas Co. (Southeastern) protested the application, arguing that it had the option to either transport for or sell to Hayes-Albion; that Panhandle was raiding its market; that the loss of potential revenue would adversely affect its customers; and that Hayes-Albion lacked the necessary approval for the construction of pipeline facilities.

Since 1944, Panhandle has sold natural gas to Hayes-Albion for use as process fuel in the manufactuure of malleable iron products for the automobile industry. Until the present time, Panhandle delivered the gas to Southeastern, and Southeastern transported it to Hayes-Albion. In addition, Southeastern sold gas to Hayes-Albion for heating its plant offices. In response to the 1976 natural gas shortages, Hayes-Albion contracted directly for local production wells, to serve its manufacturing process needs and built a pipeline from these wells to its plant. As a result, Hayes-Albion thereafter purchased only minimal amounts of gas from Panhandle. The transportation agreement between Hayes-Albion and Southeastern terminated in 1980, and was replaced with a stand-by sales agreement under which Hayes-Albion has made only minimal puchases. As the local supplies dwindled, Hayes-Albion elected to return to Panhandle as the primary source of gas for its manufacturing operations, while retaining Southeastern to supply its office heating and stand-by sales requirements.

In considering this application, the Commission acknowledged the policy preference for service by a local distributor.[28] However, the Commission noted that such preference was conditional, and would not apply if economic considerations precluded it. The cases cited by Southereastern in support of this policy were inapposite, according to the Commission. In those cases, local distributors were given preference because Panhandle was improperly attempting to supplement the distributors' sales. Contrary to these cases, Southeastern has not transported gas for Hayes-Albion's manufacturing process needs since 1976, except for the small volume under the stand-by agreement, and has not had a transportaiton agreement with Hayes-Albion since 1980. In as much as Hayes-Albion would continue to purchase gas from Southeastern for office heating and would continue the stand-by service, the Commission determined that Southeastern's interests would be adequately protected since there would not be any significant reductions in its current revenue or any loss of potential revenue upon which it may have reasonably placed its reliance.

The Commission rejected Southeastern's argument that Panhandle's gas supply deficiency caused Hayes-Albion to acquire its own sources of local production in 1976 and that the "unclean hands" principle should prevent Panhandle from benefiting from the resumption of deliveries on a direct supply basis. The Commission found that this difficiency was due to the general supply shortages of the 1970's, and should not prejudice Panhandle's present

Intervene and Denying Request for Formal Hearing), *as clarified*, 31 FERC (CCH) ¶ 61,333 (1985).

28. This policy was substantially changed by the "optional expedited certificates" program adopted by the Commission in Order No. 436. *See* note 2, *supra*.

application.

In contrast to Southeastern's interests, the Commission considered the substantial savings that Hayes-Albion would derive from the proposed direct deliveries, averaging at least $400 per day. In addition, Panhandle historically has been the seller of gas to Hayes-Albion, and the resumption of this relationship, the commission found, would not prejudice any interests of Southeastern.

After weighing all the factors, the Commission issued a certificate of public convenience and necessity authorizing Panhandle's constructin and operation of interonnecting facilities to transport gas directly to Hayes-Albion.

B. *Columbia Gas Transmission Corporation.* Two Commission decisions in 1985 clarified the scope of self-implementing authority under Section 311 of the Natural Gas Policy Act in cases where the 311 transportation moves gas displacing a so-called "core market" sale. Both decisions involved Columbia Gas Transmission Corporation (Columbia).

In the first case,[29] Columbia filed a complaint against Transcontinental Gas Pipe Line Corp. (Transco), urging the Commission to coduct an investigation into the construction and operation of certain interconnecting facilities to be used by Transco for the transportation of gas, persuant to Subpart B of Part 284 of the regulation Section 311 on behalf of Baltimore Gas & Electric Co. (BG&E).

Previously, BG&E had purchased all of its requirements from Columbia. In its complaint, Columbia argued that this arrangement would have an adverse impact on Columbia and its wholesale customers. Columbia further challenged the transportation arrangement on the grounds that allowing an interstate pipeline to connect with a local distribution company, constituted a "regulatory loophole" through which an unlimited core market could be displaced. Although the Commission had determined that Section 311(a) transactions generally do not require prior authorization, Columbia argued that review was necessary in this case to avoid core market displacement. Finally, Columbia argued that the Commission had broad authority to modify Part 284 regulations to condition the construction and operation of interconnection facilities.

The Commission rejected Columbia's arguments and agreed with Transco that the complaint should be dismissed. The Commission specifically found that the construction and operation of the interconnection facilities by Transco did not violate any rule, order, regulation, or statute.

In the second case,[30] Columbia filed a petition, requesting an expedited hearing and investigation into the use of the Butler Station by Texas Gas Transmission Corp. (Texas Gas) for the delivery of spot gas to Cincinnati Gas & Electric Co. (CG&E) pursuant to Subpart B of Part 284 of the regulations. Columbia again contended that its core market was being invaded and that its sales were being displaced, resulting in higher gas prices to Columbia's remaining customers. Columbia acknowledged that Texas Gas had authority to use

29. *Columbia Gas Transmission Corp. v. Transcontinental Gas Pipe Line Corp.*, 30 FERC (CCH) ¶ 61,298 (1985) (Order Dismissing Complaint).

30. *See Lawrence Gas Transmission Corp.*, 32 FERC (CCH) ¶ 61,158 (19859 (Order Denying Request for Investigation and Hearing).

the Butler Station to deliver gas to CG&E, without prior Commission approval, pursuant to Part 284 of the regulations implementing Section 311(a) of the NGPA. However, Columbia contended that the facts surrounding these Texas Gas/CG&E transactions demonstrated a need for the Commission to prevent the Part 284 regulations from being used to displace traditional core market sales, thereby causing cost shifts among customers. Columbia argued that under Section 7(e) of the NGA,[31] Section 311(a) of the NGPA, and Section 284.5 of the regulations, the Commission had the authority to require prior review in order to protect critical core markets.

The Commission rejected Columbia's arguments, finding that the transportation of spot gas in these transactions did not violate any rule, order, regulation, or statute. On the contrary, the Commission found that these deliveries were consistent with Section 284.102 of the Regulations, which authorizes any interstate pipeline to transport gas on behalf of any local distribution company with prior Commission approval, if the transportation does not exceed a two-year period and the local distribution company receives the gas for resale. Since these deliveries complied with the law and applicable regulations, Columbia's petitition was essentially reduced to a challenge to the propriety of the regulation itself, and therefore was dismissed.[32]

In a separate settlement agreement, Columbia agreed to not seek rehearing of the Commission's order dismissing its complaints in either case. *See* 31 FERC (CCH) ¶ 61,307 at 61,676 (1985).

C. *Fees Applicable to Natural Gas Pipeline.*[33] The Federal Energy Regulatory Commission has amended its regulations regarding the fees to be assessed for services and benefits provided by its staff under the Natural Gas Act and Natural Gas Policy Act. The Commission took the position that it is authorized to collect fees from identifiable recipients who derive a special benefit so that the agency will be selfsustaining to the extent possible. 31 U.S.C. 9701 (1982).[34]After receiving public comment, the Commission published the updated fee schedule and the basis for assessing particular fees in the *Federal Register.*[35]

Natural Gas Certificate and Authorization Regulations
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31. 15 U.S.C. § 717f(e) (1982).

32. The Commission also noted that the policy relating to these matters was being actively considered in RM85-1-000. *See* 50 Fed. Reg. 34,130 (1985), III FERC Stats. & Regs. (CCH) ¶ 32,408 (1985).

33. 18 C.F.R. Parts 2, 152, 154, 157, 284, 375, and 381, Docket Nos. RM79-63-000 and RM82-31-000, Order No. 433, 50 Fed. Reg. 40,332 (Sept. 30, 1985).

34. The Commission's action was upheld in Phillips Petroleum Co. v. FERC, No. 84-1846 (D.C. Cir., March 10, 1984).

35. *See* 50 Fed. Reg. 40,332-346 (Oct. 3, 1985) and 51 Fed. Reg. 4310 (Feb. 4, 1986).