THE EMERGING FEDERAL ROLE IN GAS DISTRIBUTION COMPANY AND END-USER REGULATION

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A MAJOR REALLOCATION of regulatory authority has occurred in the natural gas industry in the last ten years, one that promises to have a profound impact upon local gas distribution companies[1] and gas end-users.[2] During the 1960's the federal energy infrastructure's attempts to regulate, directly or indirectly, the policies of local distribution companies were very limited. Moreover, gas end-users served at the retail distributor level were free of any direct federal controls and the indirect controls were minimal. For many gas end-users, gas was merely one of a number of alternative fuels available to meet energy requirements. The impact of the natural gas shortages of the 1970's, however, engendered a growing role of indirect regulation of distributors and end-users by the Federal Power Commission ("FPC").[3] Today, the National Energy Act of 1978 ("NEA")[4] and other energy-related legislation give the federal energy establishment a direct and powerful role in distributor and end-user regulation. This federal role can be expected to grow yet larger in the 1980's, exacerbating the present tension between federal and state regulation. This trend eventually may create a truly national energy policy, but in so doing it also may result in energy actions which are far less responsive to local and regional conditions. Whether the emerging federal role will redound to the nation's benefit remains to be seen; all that is clear today is that a radical transformation is taking place.

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[1]A local gas distribution company is a company, not subject to the jurisdiction of the Natural Gas Act ("NGA"), which purchases gas at wholesale and then sells that gas, plus any it produces itself, at retail to end-users. *See* NGA § 1, 15 U.S.C. § 717 (1976).

[2]For the purposes of this article, an end-user is a purchaser of gas who uses that gas for its own purposes and does not resell the gas.

[3]The Federal Energy Regulatory Commission ("FERC") succeeded to most of the authority of the Federal Power Commission ("FPC") under the Department of Energy Organization Act (hereinafter "DOE Act"). 42 U.S.C.A. §§ 7171-7177 (Supp. 1978).

[4]The National Energy Act of 1978 (NEA) consists of five separate pieces of legislation: the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3350 (1978) (hereinafter "NGPA"); the Powerplant and Industrial Fuel Use Act of 1978, Pub. L. No. 95-620, 92 Stat. 3289 (1978) (hereinafter "FUA"); the National Energy Conservation Policy Act, Pub. L. No. 95-619, 92 Stat. 3206 (1978) (hereinafter "NECPA"); the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (1978) (hereinafter "PURPA"); and the Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174 (1978).

I. The Historical Background

Federal regulation of natural gas was inaugurated in 1938 with the passage of the Natural Gas Act ("NGA").[5] The NGA represented a limited exercise of the Congressional power to regulate interstate commerce.[6] As originally interpreted, the NGA was applied only to transportation and the rates of sales for resale by interstate pipelines.

The FPC's asserted jurisdiction escalated twice in the next twenty years, first in 1947 when the Supreme Court held that the FPC could regulate the prices charged interstate pipelines for gas produced by affiliated producers[7] and second in 1954 when the Court held that the FPC had jurisdiction over and must regulate the rates charged by producers who sell gas in interstate commerce for resale.[8] The scope of federal regulation, however, was narrowed somewhat in 1954 with the passage of the Hinshaw amendment, which confirmed that the activities of intrastate gas distribution companies subject to state regulation were free from FPC jurisdiction and which removed from FPC jurisdiction certain pipelines, subject to state regulation, which transported natural gas received at or within the borders of a single state for resale in that state.[9]

Despite the movement of the FPC into interstate producer regulation, the division of authority between the FPC and state regulatory agencies remained clear. The FPC regulated only interstate pipelines and producers who sold gas in interstate commerce for resale or transported gas in interstate commerce.[10] State regulators controlled producers who sold gas ex-

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[5]15 U.S. C. § 717 *et. seq.* (1976).

[6]The NGA asserted jurisdiction only over wholesale sales and transportation in interstate commerce. Congress could have asserted jurisdiction over transactions affecting interstate commerce. *E.g., Wickard v. Filburn*, 317 U.S. 111 (1942); *Heart of Atlanta Motel v. United States*, 379 U.S. 241 (1964). Instead, Congress "did not envisage federal regulation of the entire natural-gas field to the limit of constitutional power." *F.P.C. v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 502 (1949).

[7]*Interstate Natural Gas Co. v. F.P.C.*, 331 U.S. 682 (1947).

[8]*Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

[9]15 U.S.C. § 717(c) (1976). The Hinshaw amendment provides:

"The provisions of this chapter shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. The matters exempted from the provisions of this chapter by this subsection are declared to be matters primarily of local concern and subject to regulation by the several States. A certification from such State commission to the Federal Power Commission that such State commission has regulatory jurisdiction over rates and service of such person and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction."

Section 1(b) of the NGA has always provided for the non-jurisdictional status of local distributions. Section 1(b) provides, in part:

> "[t]he provisions of this [Act] . . . shall not apply . . . to the local distribution of natural gas or to the facilities used for such distribution." 15 U.S.C. § 717(b) (1976).

The House of Representatives actually considered this reservation of power unnecessary:

> "That part of the negative declaration stating that the act shall not apply to 'the local distribution of natural gas' is surplusage by reason of the fact that distribution is made only to consumers in connection with sales, and since no jurisdiction is given to the Commission to regulate sales to consumers the Commission would have no authority over distribution, whether or not local in character."

H.R. Rep. No. 709, 75th Cong., 1st Sess. 3 (1937). The Supreme Court has consistently recognized this express exemption. *E.g., F.P.C. v. Panhandle Eastern Pipe Line Co., supra*, 337 U.S. at 504.

[10]The Supreme Court held in *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507 (1947) that FPC jurisdiction extended to three things and three things only: "(1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale." 332 U.S. at 516. This enumeration excludes the sale at retail by anyone; it also excludes wholesales in intrastate commerce.

clusively to intrastate end-users, intrastate pipelines, and local distribution companies (or often eschewed control except for the collection of severance taxes). At that time, federal control with respect to both distributors and end-users was minimal. When it occurred, it occurred indirectly in the context of proceedings before the FPC where pipelines were requesting authorization to (i) transport gas in interstate commerce for a direct sale to an end-user,[11] (ii) transport gas owned by end-users,[12] (iii) increase contractual sales to existing distributors[13] or (iv) expand or construct interstate pipelines.[14] Under these circumstances, the FPC considered, among other factors, the end-use of the gas by distributors or end-users, whether the requested authorizations would result in preemption of pipeline capacity to the detriment of existing pipeline customers, and the price for the transportation service or gas which was the subject of the proceeding.[15] As a result of these considerations the FPC did in some cases deny pipeline authorizations and therefore pipelines were unable to provide the requested service to their distributor or direct end-user customers. Except for this type of very broad indirect control, local distributors and end-users were essentially free from federal regulation. With respect to local distributors, state public utility commissions exercised pervasive control—setting rates and rate structures, attachment priorities and other policies.[16] End-users purchasing directly from a pipeline faced federal control only with respect to the initial pipeline authorization to transport the gas and construct the necessary facilities to serve that end-user. Otherwise, for such end-users and all end-users

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[11]*Panhandle Eastern Pipeline Co. v. F.P.C.*, 232 F.2d 467 (3rd Cir.), *cert. denied* 352 U.S. 891 (1956) (where the 3rd Circuit affirmed the FPC's refusal to permit an interstate pipeline to make direct sales to industrial customers when such sales would interfere with service to the pipeline's existing customers); *American Louisiana Pipe Line Co.*, 30 F.P.C. 698 (1963), *aff'd sub nom., Central Illinois Public Serv. Comm. v. F.P.C.*, 338 F.2d 682 (7th Cir. 1964) (where the FPC conditioned authorization by a pipeline for transportation service involving a direct sale so as to assure that the sale would be interruptible and not preempt capacity needed to meet firm demands of the pipeline's jurisdictional distribution customers); *Northern Natural Gas Co.*, 33 F.P.C. 501 (1965) (where despite the objection of certain distribution companies, the FPC approved the issuance of a certificate for an additional direct sale by an interstate pipeline).

[12]*Trans-Continental Gas Pipe Line Corp.*, 21 F.P.C. 138 (1959), *rev'd* 271 F.2d 942 (3rd Cir. 1959), *rev'd sub nom. Consolidated Edison Co. v. F.P.C.*, 365 U.S. 1 (1961) (where the Supreme Court affirmed the FPC's denial of transportation authority for gas purchased by a New York City public utility company directly from producers in Texas for use as boiler fuel); *El Paso Natural Gas Co.*, 47 F.P.C. 896 (1972), *aff'd sub nom. Arizona Public Service Co. v. F.P.C.*, 483 F.2d 1275 (D.C. Cir. 1973), 490 F.2d 783 (D.C. Cir. 1974) (where the FPC denied a pipeline's request for an authorization to transport natural gas owned by a public utility from Texas to Arizona for use as boiler fuel).

[13]*Arkansas-Louisiana Gas Co.*, 27 F.P.C. 697 (1962), *rehearing denied*, 27 F.P.C. 1257 (1962), *rev'd in part, aff'd in part sub nom. Granite City Steel Company v. F.P.C.*, 320 F.2d 711 (D.C. Cir. 1963) (where the D.C. Circuit reversed the FPC decision and required that a request by a pipeline to increase sales to existing distributors be denied because of the adverse impact which such service would have on the pipelines's existing industrial customers); *Natural Gas Pipeline Company of America*, 33 F.P.C. 543 (1965) (where the FPC determined that a pipeline's expansion would not prejudice the competitive position of coal retailers).

[14]*Natural Gas Pipeline Company of America*, 34 F.P.C. 771 (1965) (where the FPC denied permission for the construction of a new pipeline from Oklahoma to the St. Louis market area); *Midwestern Gas Transmission Company*, 22 F.P.C. 775 (1959) (where the FPC certificated facilities with 22,790 Mcf unallocated capacity); *Trans-Continental Gas Pipe Line Corp.*, 22 F.P.C. 836 (1959) (where the FPC authorized construction resulting in 17,000 Mcf of unallocated capacity). *See also Trans-Continental Gas Pipe Line Corp.*, 27 F.P.C. 858 (1962) (where the FPC authorized 8,603 Mcf of unallocated capacity); *Southern Natural Gas Company*, 31 F.P.C. 789 (1964); and *Texas Eastern Transmission Corp.*, 28 F.P.C. 1035 (1962).

[15]*See F.P.C. v. Trans-Continental Pipe Line Corp., supra.*

[16]The NGA does not give the FPC the authority to interfere with regulation by the States of local utility service. *Public Util. Comm'n v. United Fuel Gas Co.*, 317 U.S. 456 (1943); *F.P.C. v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 27-28 (1961). Indeed, the NGA was intended expressly to fill the areas which the Federal Constitution forbade the states to regulate; no supplanting of state power was intended. *See, e.g., F.P.C. v. Panhandle Eastern Pipe Line Co., supra*, 337 U.S. at 502-505.

served by distributors, the choice of gas (where available) over any other energy source was by and large a matter for internal decision. While the FPC arguably had the potential to affect local distributors and end-users indirectly,[17] that potential remained largely unrealized in the gas-abundant, low-priced market of the 1950's and 1960's.

The potential was not diminished, however, by the fact that it remained unrealized. Beginning in the 1960's, a force began to operate that ten years later would first induce the FPC to exercise increased regulation of distributors and later cause Congress to alter the natural gas market fundamentally. That force was the development of a natural gas shortage that culminated in serious curtailments during the winter of 1976-77.

The development of this gas shortage was signalled by one factor and aggravated by a second. First, the looming shortage manifested itself initially only as a statistical quirk—despite relatively stable production of gas committed to the interstate market, the nationwide reserve-to-production ratio was in a period of significant decline.[18] As natural gas production and use increased, the period over which interstate gas would be available steadily

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[17]The ability of the FPC to do indirectly what it lacks the jurisdiction to do directly has been a subject of great controversy and much legal learning. The NGA was enacted partially in response to abuses that resulted from the states' inability to regulate the flow of gas in interstate commerce. The NGA remedied this by asserting federal jurisdiction over those areas beyond state jurisdiction. This interstitial nature of federal regulation is a key factor in the limitations that have been placed upon the FPC and the FERC.

The FPC cannot use its powers to achieve indirectly what it cannot achieve directly. For example, except under very limited circumstances, the FPC cannot require an interstate pipeline to construct facilities or provide service to new customers. In *Central West Utility Co. v. F.P.C.*, 247 F.2d 306 (3d Cir. 1957), an interstate pipeline applied for a certificate to construct new facilities, but the FPC was asked to condition its approval upon the construction of other facilities. The FPC concluded in language the court adopted:

> "In the instant case, it is true that the requirement would be imposed by a condition [to a certificate to construct and operate pipeline facilities] . . . However, despite the method employed, the effect remains the same—the company would be compelled to enlarge its facilities, contrary to the express declaration . . . that to require such is 'beyond the power of the Commission.' To impose such a requirement would put us in the position of doing indirectly what we are forbidden to do directly. Familiar rules of law and our own regard for a proper observance of the limitations which Congress and the courts have placed upon our authority both restrain us from pursuing such a course.
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> "These same reasons require us to reject the proposition that an order requiring the enlargement of facilities by way of a condition to a certificate authorization would be a permitted exercise of power, since a condition would be 'voluntary', not 'mandatory' . . . [A] 'choice' between the grant of a certificate on condition that the company enlarge certain other transportation facilities, on pain of denial of the certificate authorization if the company refuses to accede to the condition, cannot fairly be called 'voluntary.' "

247 F.2d at 310-311.

Subsequent cases have upheld this result, *e.g., Mobil Oil Corp. v. F.P.C.*, 483 F.2d 1238 (D.C. Cir. 1973).

While the FPC cannot use this type of indirect power, it can consider the results its activities will produce if policies contrary to the ones it espouses are followed. *See infra*, text at note 43.

A third type of indirect authority must be discussed. The FPC has the authority to take certain steps even though such steps place significant pressure on non-jurisdictional entities, like local distributors, to follow suit. Thus, the FPC is perfectly free to adopt a rolling base period in its curtailment plans, even though that places great pressure on distributors to upgrade their load. The FPC can establish curtailment priorities even if that puts pressure on the states to adopt similar priority ratings. The FPC can set interstate pipeline rates in a way that rewards distributors with a high proportion of residential users even though it cannot force distributors to upgrade their load. In other words, there are significant pressures the FPC can bring to bear to foster results it cannot achieve directly as long as it does not cross explicit jurisdictional prohibitions.

[18]The reserve-to-production ratio is the amount of proved reserves divided by annual production. This ratio declined significantly between 1946 and 1971—from 32.6 to 12.6. 1972 FPC ANN. REP. 38, 1970 FPC ANN. REP. 51. Until 1968, the annual additions to proven reserves exceeded annual production; in 1968, excluding the Alaskan gas reserves, proven reserves began a steady decline. American Petroleum Institute, RESERVES OF CRUDE OIL, NATURAL GAS LIQUIDS, AND NATURAL GAS IN THE UNITED STATES AND CANADA AND UNITED STATE PRODUCTIVE CAPACITY AS OF DECEMBER 31, 1972, Vol. 27 (1973).

declined. Second, newly developed reserves were increasingly reserved to the intrastate markets, where gas commanded a higher price than that allowed by the FPC-regulated rates. As the nation's supply of future marketable gas declined, an increasing proportion of it was kept out of the interstate market. The natural gas market was legally and practically separated—two completely different markets for one product, one with an FPC-fixed price cap that discouraged new dedications, the other with a flexible price system that encouraged production.[19]

The statistical manifestations of the gas shortage became concrete in the early 1970's, when several of the interstate pipelines began experiencing increasing difficulty obtaining sufficient natural gas to fulfill their contractual supply commitments. By 1977, the problem had reached crisis proportions with the shortfall reaching twenty-five percent of all interstate pipelines' contract demand.[20] Individual interstate pipelines' curtailments reached even more staggering proportions.[21]

In response to this crisis, the FPC required interstate pipelines in the early 1970's to formulate curtailment plans which would govern the allocation of insufficient supplies of gas to the competing demands of contract-purchasers.[22] These plans produced the most significant impact of FPC regulation on distributors and end-users to that date. End-users who purchased gas directly from interstate pipelines suffered direct and immediate impacts.[23] Even though the FPC's pipeline curtailment plans and priorites could not be directly imposed upon end-users served by distributors,[24] they had serious effect. As a general rule, the FPC's curtailment plans did not operate to reduce supplies to distributors on a *pro rata* basis below contract volumes;[25] instead, a hierarchy of gas uses was developed to determine

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[19]The FPC set gas rates through various means during its history. While these methods are unimportant for the purposes of this paper, the divergence in prices caused by FPC regulation is important. Between 1969 and 1976, interstate prices for new gas rose from 19.8 cents per thousand cubic feet (Mcf) to $1.42 per Mcf. In contrast, between 1969 and 1977, intrastate prices for new gas rose from 18 cents per Mcf to $2.39 per Mcf. S. Rep. No. 95-436, 95th Cong., 1st Sess. 8 (1977).

[20]Federal Power Commission, *Requirements, Curtailments and Deliveries of Interstate Pipeline Companies* (June 1977).

[21]For example, on the Transcontinental Gas Pipe Line Corp. system, curtailment levels reached 44% in 1976-77, up from 7.41% in 1972-1973. *State of North Carolina v. FERC*, 584 F.2d 1003, 1008 (D.C. Cir. 1978).

[22]In April, 1971, the FPC issued Order No. 431, which required every jurisdictional pipeline to report whether it expected to curtail deliveries to customers. Pipelines expecting curtailments were required to file a tariff specifying how supplies of gas would be allocated. *Policy With Respect to Establishment of Measures to be Taken for the Protection of as Reliable and Adequate Service as Present Natural Gas Supplies and Capacities Will Permit*, Order No. 431, 45 F.P.C. 570 (1971).

[23]The Supreme Court held that direct purchasers could be curtailed under the Commission's transportation authority, even though it had previously denied the power of the FPC to control direct purchase rates. *F.P.C. v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972).

[24]The regulation of rates and services charged by local utilities is left to the states. *See* note 9. The FPC recognized this when it promulgated its end-use priority plan (*infra*, note 26), stating "Our decision is made with full knowledge that certain sales to ultimate customers are beyond our jurisdiction." *Utilization of Conservation of Natural Resources—Natural Gas Act*, Order No. 467, 49 F.P.C. 85, 87 (1973). *See* note 9. Because the Commission's curtailment power is based upon its transportation authority under section 1(b) of the NGA, which also excludes regulation of local distributors, the FPC has not attached end-use conditions to curtailment plans. For a full description, *see* note 26. *Also see, Panhandle Eastern Pipe Line Co.*, Opinion No. 754, *mimeo.* at 31-33 (February 27, 1976).

[25]The major exception to this general rule was the curtailment plan of Natural Gas Pipeline Company of America, which curtailed Natural's nine largest distribution customers on a *pro rata* basis. *Natural Gas Pipeline Company of America*, 46 F.P.C. 1262 (1971). This basic structure survived several modifications and a formal complaint. *See, General Motors Corp. v. FERC*, No. 77-1859 (D.C. Cir. October 24, 1979).

entitlement, with all of the demand for the highest priority end-users required to be fulfilled before any gas was allocated to users situated in the next level in the hierarchy.[26]

Under an end-use plan, the interstate pipeline would compile an end-use profile of the users supplied by its customers. It would then allocate the gas it expected to have by end-use, filling all of the needs of the highest-priority users before supplying any gas to a lower priority end-user. For example, assume that a pipeline with contract demand for 200 units of gas, divided equally between two distributors, A and B, had actual supplies of only 150 units, and that distributor A's end-use profile indicated that it needed 80 units for priority 1 users and 20 units for priority 3 users, while distributor B's profile was 50 units for priority 1 users and 50 units for priority 2 users. Under an end-use curtailment plan, A would receive 80 units of gas while B received 70 units. These figures contrast to the 75 units each would receive if the curtailment was shared on a *pro rata* basis.

While the Commission adopted this so-called end-use curtailment plan at the wholesale and direct purchaser level, it could not impose its hierarchy on end-users served indirectly by interstate pipelines through a state-regulated distributor.[27] Once a distributor received an allocation of gas based on its consumers' end-use profile, it was free to allocate the gas among its end-users as it and its state regulator saw fit after taking state and local conditions into consideration.

The distributor might adopt a *pro rata* rather than an end-use plan. Thus, in the example above, distributor A received 80 units of gas because of its priority 1 requirements, but nothing in federal law stopped it from allocating this gas under a *pro rata* system, pursuant to which it might allocate

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[26]In response to Order No. 431, *supra*, note 22, several pipelines filed curtailment plans. Some based delivery priorities on contract entitlement, others on end-use. In response, the Commission issued Order No. 467, which stated it was Commission policy to require end-use curtailments, in accord with a listing of nine categories it provided. Order No. 467, *supra*. This order was clarified or amended twice, Order No. 467-A, 49 F.P.C. 217 (1973); Order No. 467-B, 49 F.P.C. 583 (1973).

The nine priorities were:

(1) Residential, small commercial (less than 50 Mcf on a peak day).
(2) Large commercial requirements (50 Mcf or more on a peak day), firm industrial requirements for plant protection, feedstock and process needs, and pipeline customer storage injection requirements.
(3) All industrial requirements not specified in (2), (4), (5), (7), (8), or (9).
(4) Firm industrial requirements for boiler fuel use at less than 3,000 Mcf per day, but more than 1,500 per day, where alternate fuel capabilities can meet such requirements.
(5) Firm industrial requirements for large volume (3,000 Mcf or more per day) boiler fuel use where alternate fuel capabilities can meet such requirements.
(6) Interruptible requirements of more than 300 Mcf per day, but less than 1,500 Mcf per day, where alternate fuel capabilities can meet such requirements.
(7) Interruptible requirements of more than 3,000 Mcf per day, but less than 10,000 Mcf per day, where alternate fuel capabilities can meet such requirements.
(8) Interruptible requirements of more than 3,000 Mcf per day, but less than 10,000 Mcf per day where alternate fuel capabilities can meet such requirements.
(9) Interruptible requirements of more than 10,000 Mcf per day, where alternate fuel capabilities can meet such requirements.

18 C.F.R. § 2.78 (1978) (superseded).

While these priorities were not slavishly adhered to, the basic structure was observed in most curtailment plans.

A key feature of this end-use plan was the absolute priority that a higher priority use had over a lower priority use. Order 467 mandated "full curtailment of the lower priority category volumes to be accomplished before curtailment of any higher priority volumes is commenced." Order 467, *supra*, 49 F.P.C. at 87.

[27]*Supra*, note 24.

64 units to its priority 1 users and 16 units to its priority 3 users. In that case, it would be serving some priority 3 users while distributor B was unable to meet all of its priority 2 requirements. This federally perceived "problem" would worsen if distributor A also had 20 units of its own self-help gas,[28] not subject at all to FPC jurisdiction. The inability of the FPC to carry its curtailment priorities through to the burner-tip resulted in asserted inequities—during the periods of deepest curtailments, some distributors met all of their customers' needs for gas while others were cutting off gas deliveries to relatively high priority users.

After the adoption at the federal level of the theory of end-use curtailment, there remained the question of how to apply it. In practice, the answer to that question depended on the temporal profile of an interstate pipeline's customers to which the end-use concept was to be applied. The choice was between a "fixed base period"[29] and a "rolling base period".[30] Opponents of a rolling base period argued that the rational response to a curtailment plan with a rolling base period was to add new residential loads, thereby increasing its top priority load and, hence, the amount of gas available to the distributor. That, in turn, freed the distributor's non-FPC regulated gas for sale to its other customers. On the other hand, the use of a fixed-base period encouraged an end to the use of interstate pipeline gas for new customers, as each distributor's share of its supplying pipeline's gas remained fixed despite any growth that might occur on the distributor's system.

Thus, despite the FPC's lack of direct authority over distributor service to end-users, the curtailment plans of interstate pipeline suppliers had a direct effect on the policies adopted by local distributors and state regulators. First, the adoption of a fixed or rolling base period did affect the ability of a distributor to serve new end-users. Second, the state regulators' responses to the adoption of a federal end-use scheme varied greatly. For example, in Illinois, the Illinois Commerce Commission approved a curtailment plan for Central Illinois Light Company which combined both end-use and *pro rata* aspects. With respect to other distributors, however, the Illinois Commission merely instituted an extensive investigation of supplies and demand and issued a general rule requiring distributors to file a curtailment plan two years before they projected curtailment. As a result of a basically favorable supply picture resulting from self-help activities, few curtailment plans were ever filed. Moreover, because of the recent improvement in interstate

[28]Self-help gas includes intrastate gas, synthetic natural gas, propane air mixtures and other non-interstate pipeline supplies.

[29]Under a fixed base period plan, the end-use profile of the pipeline's customers is fixed by the actual end-uses served during an historical time period. Subsequently, this fixed base period is not updated to reflect either the addition or termination of end-users.

[30]A rolling base period plan is one in which the end-use profile of the pipeline is updated as to the volume used by each class of end-user. In this way, curtailment is based upon a recent "snapshot" of the pipeline's actual customer load.

pipeline supplies all proceedings in the general curtailment docket have been suspended.[31]

The gas curtailments and the crises they caused provided a major impetus to the passage of the five components of the National Energy Act, which fundamentally altered gas regulation and irrevocably committed the "federal energy establishment" to the regulation of local energy practice. However, before the passage of the National Energy Act, the FPC and the Federal Energy Administration ("FEA") already had attempted to utilize other indirect means of regulating the end-use and price of gas to the end-user.

As a result in part of the FPC's urging in Order No. 431,[32] one of the interstate pipeline responses to curtailment was the increased utilization and development of storage both for the pipeline itself and for its distributor customers. Both pipelines and distributors used storage to mitigate the impact of curtailment upon high priority users whose demands peak during the winter heating season. Storage permitted them to curtail low priority end-users during the summer months in order to increase storage injections and therefore the availability of additional gas during the winter months. In those cases where pipelines sought to develop additional storage capacity for this purpose, existing end-users argued that the FPC should condition any authorizations so that storage service would only be available to distributors who were not adding new customers.

While the FPC rejected such a condition because of "implementation problems" and "countervailing policy considerations",[33] it did take other steps which had an immediate impact on the distributors' ability to serve end-users. As noted earlier, the Commission indirectly restricted distributor load growth by requiring fixed base periods in many pipeline curtailment cases.[34] It also furthered this policy of indirectly restricting distributor load growth by (i) establishing volumetric limitations fixing the amount of gas that a pipeline could sell to its distribution customers on an annual or

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[31]The Central Illinois Light Company curtailment plan consisting of eight curtailment steps was approved by the Illinois Commerce Commission (Ill.C.C.) on December 28, 1977. Order, *Central Illinois Light Company Proposal to Establish a Gas Curtailment Plan*, Docket No. 77-0123 (December 28, 1977). The Ill.C.C. proceedings "to determine the criteria that should be established for curtailment of service to existing non-interruptible customers during periods of insufficient supply" were originally initiated by that body on January 30, 1974. Order, *Illinois Commerce Commission on Its Own Motion: Investigative Proceeding to Determine the Criteria for the Curtailment of Service to Existing Gas Consumers During Periods of Insufficient Supply*, Docket No. 58818 (January 30, 1974). After extensive hearings, the Ill.C.C. adopted curtailment guidelines for all Illinois gas distribution utilities on August 21, 1975. Those guidelines were modified on rehearing by order dated March 4, 1976. The guidelines combined both *pro rata* and end-use criteria for curtailment and varied considerably from the Federal Power Commission's Order No. 467-B and modifications thereof. *Id.* (August 21, 1975, March 4, 1976). On February 15, 1978, the Circuit Court for the Seventh Judicial Circuit, Sangamon County, Illinois remanded to the Ill.C.C. its August 21, 1975 and March 4, 1976 orders with instructions that the Ill.C.C. clarify its orders as to whether the intent of said orders is a statement of general policy concerning curtailment guidelines or a determination that is final and binding. *General Motors v. Illinois Commerce Commission*, Docket No. 285-76, Circuit Court for Seventh Judicial Circuit, Sangamon County, Illinois (February 15, 1978). However, as a result of the generally improved gas supply situation, the Ill.C.C. on January 30, 1980 suspended all activities in Docket No. 58818 "pending reopening of the proceeding should new gas curtailments be anticipated two years hence." Notice, Docket No. 58818, *supra* (January 30, 1980).

[32]In Order No. 431, the FPC declared that "During the storage injection season all natural gas pipelines subject to the jurisdiction of the Commission should make every reasonable effort to fill all storage fields supplied by such pipelines to a capacity sufficient to meet the anticipated heating season demands." Order No. 431, *supra*, 45 F.P.C. 570, 571 (1971).

[33]*Michigan Wisconsin Pipeline Co.*, Opinion No. 810, *mimeo.* at 18-20 (July 7, 1977).

[34]*E.g., id,* at 19.

other time period basis[35] and (ii) limiting pipelines' attempts to increase their contract demand[36] or peak day entitlements to distributors.[37]

As further reaction to gas curtailments and its view that low priority industrial end-users should be discouraged from using natural gas, the FPC required pipelines to place a larger portion of their fixed costs in the commodity or unit charges to their customers.[38] While it recognized that it lacked authority over distributor rates to industrial end-users, the FPC's goal was to discourage distributors from selling gas to industrial users and to stimulate their "awareness of the extent of the gas supply shortage and encourage efforts to prepare for the possibility of partial or total curtailment."[39] Because distributor rates to industrials (particularly interruptible industrials) often were tied to the pipeline commodity charge to the distributor, the practical result of this FPC action was the emergence of federal rate design.

The FEA's attempt to regulate the use and price of natural gas arose in response to the construction by distributors of synthetic natural gas ("SNG") plants, which could transform various liquid hydrocarbons into pipeline quality synthetic natural gas. While the construction and operation of such plants by distributors were free from FPC jurisdiction,[40] under the Emergency Petroleum Allocation Act of 1973 ("EPAA"),[41] petroleum and liquid hydrocarbons were subject to allocation and price controls under regulations promulgated by the-then FEA.[42] FEA regulations required companies desiring liquid hydrocarbons for use in SNG plants to apply to the FEA for authority to use feedstock for the SNG plant. The FEA seized the opportunity presented by these applications to attempt to condition feedstock allocations on limitations on load growth and incremental pricing of the SNG. Over significant protests, the courts denied the power of the FEA to use its conditioning power to impose policies indirectly that it could not dictate directly,[43] but said that the FEA could consider these factors in determining whether it was consistent with the goals of EPAA to grant such applications.

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[35] *Tennessee Gas Pipeline Co.*, Opinion No. 712, 52 F.P.C. 1459 (1974), and Opinion No. 712-A, 53 F.P.C. 187 (1975).

[36] *Northern Natural Gas Co.*, Opinion No. 773, *mimeo.* (August 13, 1976).

[37] Opinion No. 810, *supra*, *mimeo.* at 21-26.

[38] Historically, pipelines designed their charges to distributors on the basis of a demand component and a commodity component. The demand component represented fixed charges and the commodity component variable charges. Under the FPC's longstanding policy (*Atlantic Seaboard Corp.*, 11 F.P.C. 43 (1952); *Northern Natural Gas Co.*, 11 F.P.C. 123 (1952), *aff'd*, 206 F.2d 690 (8th Cir. 1953), *cert. den.*, 346 U.S. 922 (1954)), 50% of the fixed costs were assigned to be recovered by the demand component and 50% included in the commodity component. In 1973, the FPC rejected this historical rate design by requiring that 75% rather than 50% of the fixed costs be recovered through the commodity component. *United Gas Pipe Line Co.*, Opinion No. 671, 50 F.P.C. 1348 (1973), *reh. denied*, Opinion No. 671-A, 51 F.P.C. 1014 (1974), *aff'd sub nom. Consolidated Gas Supply Corp. v. F.P.C.*, 520 F.2d 1176 (1975). *But cf. Columbia Gas Transmission Corp. v. FERC*, No. 77-1627 (D.C. Cir. May 17, 1979).

[39] *Natural Gas Pipe Line Co.*, Opinion No. 782, *mimeo.* at 12 (November 9, 1976), *reh. denied*, Opinion No. 782-A, *mimeo.* (January 6, 1977).

[40] *Henry v. F.P.C.*, 513 F.2d 395 (D.C. Cir. 1975), held that the FPC has no regulatory authority under the NGA over the production or sale of SNG. However if SNG is commingled in the natural gas and transported and sold in interstate commerce, the FPC can assert jurisdiction over the commingled stream.

[41] 15 U.S.C. § 75 *et seq.* (1976).

[42] The procedures for allocating SNG feedstock were found at 10 C.F.R. § 211.29 (1978).

[43] *Consumers Power Company v. Federal Energy Administration*, 413 F. Supp. 1007 (E.D. Mich. 1976), 413 F. Supp. 1024 (E.D. Mich. 1976).

Thus, by the time the National Energy Act was enacted, the Federal Energy Regulatory Commission ("FERC"), the successor to the FPC, the Department of Energy ("DOE") and its component agency, the Economic Regulatory Administration ("ERA"), the successor to the FEA, had developed indirect tools that greatly heightened the federal impact upon gas distributor service to end-users. However, energy policy was still fragmented; the FERC's and ERA's tools were too limited to develop and impose a nationally consistent energy policy. Perceiving a need for such a policy, President Carter submitted to the Congress the package that eventually became the National Energy Act.

II. The National Energy Act

The National Energy Act, taken as a whole, extends federal jurisdiction to the intrastate market, thereby unifying the previously separate gas markets, mandates certain uniform curtailment priorities for interstate pipelines, establishes incremental pricing of gas by distributors at the end-user level, places present and future limits on the use of gas by certain end-users regardless of the source of their gas, and begins a potentially far-reaching reappraisal and restructuring of gas rates for all end-users.

Prior to the passage of the NGPA, two completely different markets existed for the first sales of natural gas—the intrastate and interstate markets. The interstate market had rigid price ceilings, while the intrastate market generally was unregulated. As might be expected, new sources of gas tended to be reserved for the intrastate market where a higher price could be charged.[44] Furthermore, because gas once dedicated to the interstate market could not regain its intrastate and deregulated status,[45] intrastate producers were loath to serve interstate purchasers except in times of emergency and then only with assurances that they would not be subject to FPC jurisdiction.[46]

The NGPA places a gradually rising cap on prices for new interstate natural gas and other categories of gas, but it also places a ceiling on intrastate gas prices.[47] New production of gas, previously uncommitted under

[44]*See* note 19.

[45]Once gas is dedicated to the interstate market, it must remain dedicated unless and until the FPC grants permission to abandon the interstate sale. The expiration of a sales contract alone cannot undo the dedication. NGA § 7(b), 15 U.S.C. §§ 717 (b),(c),(e) (1976); *United Gas Pipeline Co. v. McCombs*, __U.S.__, 99 S. Ct. 2461 (1979).

[46]In order to allow quick response to gas crises, the FPC created several programs under which gas could be sold without prior certification and without dedicating the gas to interstate commerce. 18 C.F.R. §§ 2.68, 157.22, 157.29.

[47]Title I of the NGPA fundamentally alters the FPC method of setting rates and the jurisdictional consequences of making sales in interstate commerce. Under the NGA, the FPC was required to set a "just and reasonable" price for gas. The FPC set such prices first on a company-by-company basis, then by gas producing areas, and finally by setting national rates. Under Title I of the NPGA, different categories of gas are defined. For each category of gas, there is a corresponding base price to which an escalator, equal to at least the rate of inflation, is applied. Gas dedicated to interstate commerce before November 9, 1978 can qualify for these higher prices, but escalated prices can be charged only if the sales contract so allows. Intrastate gas prices also are controlled, irrespective of contract provisions, under a formula which eventually equalizes them with new natural gas, subject to contract limitations. The Commission's ratemaking powers, therefore, have been reduced to two: the granting of special relief for gas included in lower, pre-NGPA price categories and the setting of incentive rates for certain categories of expensive-to-produce gas.

Gas which was not dedicated to interstate commerce before November 9, 1978 and certain categories of dedicated gas are subject to neither the certification nor the abandonment provisions of the Natural Gas Act. Interstate transportation and pipeline charges remain subject to NGA jurisdiction.

any contract, receives the same price regardless of the market. Thus, the NGPA removes the price advantage of the intrastate market, and at the same time stimulates production by providing for rising prices for old gas and, eventually, deregulated prices for most gas not committed to interstate commerce on the date of the NGPA's passage.

The NGPA also removes the jurisdictional consequences of certain sales of intrastate gas to an interstate pipeline or other purchaser. It provides a variety of mechanisms through which intrastate pipelines can sell their excess gas and by which purchasers of intrastate gas can obtain transportation for that gas.[48] These transactions are largely self-executing, thereby removing the obstacle of regulatory lag. Because they also are viewed as isolated events, thereby limiting FERC's jurisdictional claims, these mechanisms provide the means by which components of the gas industry can move gas to where it is needed absent the necessity of prior FERC approval. The result, as was anticipated, is a new measure of flexibility, the tapping of the relatively over-supplied intrastate market by the interstate market and the loss of the distinctive status of the intrastate market.

In addition, the NEA has impacted on five primary areas of gas service—curtailment and self-help policy, incremental pricing, gas availability to end-users (and hence distributor load management), rate design, and the protection of "consumer" interests. In each of these areas except curtailment policy, new policies and priorities have been imposed directly upon distributors and their sales to end-users.

The cumulative impact of those changes, many of which have not yet been fully implemented, has injected the federal government into the regulation of the availability and price of gas to end-users to a degree never experienced in the past.

A. Curtailment

The NGPA initiated a restructuring of the curtailment process which has yet to run its course. While federally mandated curtailment of end-users has not occurred yet (except in the case of direct purchasers from interstate pipelines), there are significant pressures in that direction. The NGPA, as passed by the House of Representatives, would have extended federal curtail-

[48]Subtitle B of Title III of the NGPA established several mechanisms through which surplus gas can be transported quickly and efficiently. Interstate pipelines are authorized to transport gas on behalf of intrastate pipelines and local distributors, and intrastate pipelines are authorized to transport gas on behalf of interstate pipelines and local distributors. NGPA § 311(a), 15 U.S.C. § 3371(a) (Supp. 1978). Intrastate pipelines are authorized to sell their surplus gas to interstate pipelines and distributors without subjecting themselves to both FERC regulation (except in the rates and conditions of the particular transaction). NGPA § 311(b), 15 U.S.C.A. § 3371(b) (Supp. 1978). An intrastate pipeline also may assign its contractual rights to purchase natural gas at the first sale. NGPA § 312, 15 U.S.C.A. § 3372(b) (Supp. 1978). While some questions still remain unresolved, the effect of these provisions is to enable sales and transportation of intrastate gas in interstate commerce without creating FERC jurisdiction over the seller or the transporter.

These transactions are governed by 18 C.F.R. Part 284. (The Code of Federal Regulations has not yet been updated to contain all the regulations promulgated pursuant to the NEA. All of the regulations cited can be found in the Prentice-Hall publication, *Energy Controls*.) The complexities of this program are beyond the scope of this paper. What is important is that the NGPA enables the interstate market and local distributors to tap into surplus supplies of interstate gas which previously were rigidly withdrawn from any contact with interstate commerce. These new sources of gas have begun to play an important part in the national gas supply picture.

ment priorities to the burner-tip, thereby requiring distributors to curtail their customers on an end-use basis and mandating that all high-priority users served indirectly receive gas before any low-priority user receives gas, even if that gas comes from a distributor's own supplies. This provision, however, was dropped in conference and the NGPA curtailment priorities therefore apply only to interstate pipeline deliveries to distributors.[49]

Despite this Congressional history, in a controversial move the ERA requested comments on its existing authority to impose curtailments at the burner-tip.[50] Shortly thereafter, the FERC requested comments on a proposal that would tie a non-high priority user's curtailment to the price it nominated as its alternative fuel price for incremental pricing.[51] The great majority of comments submitted opposed the proposals for policy and jurisdictional reasons, and no assertion of such jurisdiction is expected. However, the lack of burner-tip curtailment authority has been decried by the Chairman of the FERC, and the issue remains alive.[52]

The mere possibility of burner-tip curtailment throws great uncertainty on distributor operations and end-user reliance upon gas for all but the highest priority users. It also raises grave questions as to the desirability and ultimate effectiveness of self-help and conservation measures.[53] One growing fear of distributors is that the federal move toward burner-tip regulation will be forwarded by the *State of North Carolina*[54] decision and will result in the loss of less expensive pipeline gas by distributors who can offset possible curtailments with higher-priced self-help gas. Lower priority end-users fear that they will be allotted this high priced gas so that residential and other high-priority users can escape escalating gas costs.[55]

In the *State of North Carolina* case, the United States Court of Appeals for the D.C. Circuit rejected a curtailment plan based on a fixed base period, and indicated that the Commission's curtailment policies were inconsistent and inadequately supported. The court was particularly distressed that curtailment plans often affected customers served by the same

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[49]*See* discussion, S. Rep. No. 95-1126, 95th Cong., 2nd Sess. 111-112 (1978).

[50]This request was contained in a rulemaking in which ERA requested comments on an entire range of curtailment issues. ERA wished to determine what, if any, changes in present curtailment priorities were required in light of Title IV of the NGPA. *Review of Natural Gas Curtailment Priorities and Certain Other Related Gas Issues Under the Natural Gas Act and the Natural Gas Policy Act*, ERA Docket No. ERA-R-79-10, 44 Fed. Reg. 16954 (1979).

[51]Notice of Inquiry, *Regulations Implementing the Second Stage Incremental Pricing Provisions of the Natural Gas Policy Act of 1978*, FERC Docket No. RM-79-56, 44 Fed. Reg. 38857 (1978).

[52]This lack of authority is clearly statutory. Very few commenters doubt that a statute conferring such authority would be constitutionally valid. This type of regulation is common today—note the petroleum pricing regulations which govern the prices at which retailers of petroleum products, including those who make sales only in intrastate commerce, are subject to federal price and allocation controls. *See also* note 6.

[53]The utility of self-help measures has been threatened by the essential agricultural users attribution rules. *Infra*, note 61. The concerns about conservation measures have been answered in part; section 605(a) of PURPA provides that in the event the base period data used to compute allocations in time of curtailment is updated, and decrease in high-priority use caused by conservation measures will not be reflected in the updated base period, even if the "conserved" gas is reallocated to a low priority user. PURPA § 605 (a), 15 U.S.C.A. § 717x(a) (Supp. 1978).

[54]*State of North Carolina v. FERC*, 584 F.2d 1003, 1008 (D.C. Cir. 1978).

[55]In the House version of the NGPA, incremental pricing reserved lower-cost pipeline gas to high-priority users while other users were allocated, for rate purposes, all the higher-priced gas. While this form of incremental pricing was not adopted, fear of it colors many end-users' and distributors' plans. The concern, particularly for industrial end-users, is that the previous financing of high-cost supplemental gas will result in mandated dependence on that gas. The irony is that distributors who took no self-help steps at all may be rewarded by being given first claim to the less expensive old pipeline gas.

interstate pipeline quite differently, noting particularly that some distributors were meeting all of their contract demands while others were curtailing all customers below the residential and small commercial user priority.

If the impact of pipeline curtailment plans on distributors is to be the ultimate test, even under existing law, for their validity, then some form of burner-tip curtailment must be envisaged by the court. Some distributors have avoided the full impact of curtailments through self-help gas, customer attrition, and the use of storage. If, however, the availability of gas through these self-help measures must be weighed by the FERC in developing a curtailment plan, a facsimile of burner-tip curtailment can be achieved. For example, if FERC curtailment plans are based on actual total distributor supplies, a distributor would lose pipeline gas to the extent it has self-help gas, and the Commission would achieve *de facto* burner-tip curtailment power. Whether or not the *North Carolina* case compels that result is not clear.

A curtailment plan that considers self-help supplies obviously places a premium on having a high proportion of high-priority users. If a rolling base period is used, distributors may have an incentive to discourage conservation by such users, for, as high-priority use drops, less expensive pipeline gas is allocated to other distributors, while a greater reliance is placed upon higher-cost, self-help supplies.[56]

Regardless of the ultimate resolution of this issue, two trends in federal curtailment policy resulting from the NGPA are already evident. First, the NGPA moves away from individual plans for curtailing interstate pipelines and toward the application of fixed priorities to end-user profiles. Second, it turns from an "end-use standard" to a combination of end-use and "end-product" standards.

The move toward fixed-priorities is a marked departure from past practice. While it is true that the FPC established a general policy favoring the adoption of a particular end-use priority scheme, the very order establishing that scheme emphasized that the individual plans should be designed to meet the particular circumstances facing each system.[57] The FPC accepted, and the courts affirmed, large variations from the Orders 467 *et al.* priorities, including the aggregation of different priority levels,[58] and, in two cases, a *pro rata* plan.[59]

The NGPA changes this. Pipeline curtailment plans simply will not be handled as flexibly as in the past. The FERC has issued orders requiring the revising of curtailment plans;[60] not only do these orders require rigid ad-

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[56]For an example, *see* the agricultural user attribution rule, *infra*, note 61.

[57]Thus, Order No. 467, *supra*, was a policy and not a firm rule. *Pacific Gas and Electric Co. v. F.P.C.*, 506 F.2d 33 (D.C. Cir. 1974). The courts accepted this view and indeed held that curtailment plans had to be responsive to local conditions. *State of Louisiana v. F.P.C.*, 503 F.2d 844, 872 (5th Cir. 1974); *Consolidated Edison Co. of New York, Inc. v. F.P.C.*, 511 F.2d 372, 381 (D.C. Cir. 1974).

[58]Thus, several curtailment plans used fewer than the nine-steps Order No. 467 outlined. *E.g., State of Louisiana v. F.P.C., supra*, 503 F.2d at 848-50.

[59]*Supra*, note 20. *Inland Gas Co.*, Docket No. RP76-3, "Order Granting Extension and Modification of Interim Curtailment Plan," *mimeo.* (December 27, 1978).

[60]The orders have been codified at 18 C.F.R. Part 281 and the agricultural priority rules and currently are the subject of litigation in *The Process Gas Consumers Group v. F.E.R.C.*, Docket No. 79-1449 *et al.*, (D.C. Cir. filed May 2, 1979).

herence to the NGPA priorities, but they have been implemented so as to require distributors to account for their self-help supplies in determining whether the needs of essential agricultural users would be met.[61] To use one extreme example, the two pipelines using *pro rata* plans have been required to rework their plans in order to implement the priorities of Title IV.[62] This more rigid adherence to fixed priorities and the inclusion of self-help supplies in determining end-user needs is a sharp and unprecedented break with past practice—if extended to all priority uses, this principle could result in massive reallocations of pipeline supplies.

It should be noted, however, that because the NGPA requires adherence to its curtailment priorities only to the "maximum extent practicable"[63] and because the FERC can grant adjustments to avoid extreme hardships,[64] the FERC has permitted some variations from the literal requirements of Title IV of the NGPA.[65]

As noted above, an equally important trend is the NGPA's establishment of a new standard for determining curtailment priorities—certain priorities are based upon end-products rather than end-uses. The impact upon certain end-users has been dramatic. With the switch from an end-use to an end-product priority scheme, previously low-priority users have moved up into higher priority categories. An example best illustrates the meaning of this change. Under the end-use test, gas used as boiler fuel by hospitals was given a priority based solely on its use in a boiler. Therefore, hospitals' gas use was treated exactly the same as any other gas burned by a commercial user. Under the NGPA, the end-product (here, health services) determines priority, and hospital gas is ranked in the highest priority, whether or not it is destined to be used as boiler fuel, as feedstock or process gas, or for plant protection.[66] Similarly, the importance of agricultural products is recognized, so essential agricultural uses receive the second highest priority even if the gas is destined to be burned in a boiler, a use traditionally disfavored by the Commission.

Under Title IV of the NGPA, the highest priority includes residential

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[61]The source of this concern is the attribution rules, found at 18 C.F.R. § 281.209. Under these rules, if an essential agricultural user which is entitled to 150 Mcf of gas per day is supplied by a distributor which obtains two-thirds of its gas from interstate pipelines, and one third from self-help supplies, then only two-thirds of the user's entitlement, or 100 Mcf, receives priority 2 treatment in the pipeline curtailment plan. If curtailment does occur, the distributor therefore would receive less gas than if it had no self-help gas. Because the "saved" gas would be supplied to another distributor with less than or no self-help gas, self-help gas becomes an expensive detriment during curtailment.

[62]*Natural Gas Pipeline Co. of America and Inland Gas Co.*, Docket Nos. TC79-128, TC79-129, "Order Directing Natural Gas Pipeline Company of America and Inland Gas Company, Inc. to File Tariff Sheets in Conformance with Section 401 of the Natural Gas Policy Act," *mimeo.* (May 2, 1979), *reh. denied, mimeo.* (August 24, 1979).

[63]NGPA § 401(a)(2), 15 U.S.C.A. § 3391(a)(2) (Supp. 1978).

[64]NGPA § 502(c), 15 U.S.C.A. § 3412(c) (Supp. 1978).

[65]The FERC has indicated its willingness to approve curtailment plans that deviate from the literal priorities of section 401. Thus, the FERC has approved a plan which places industrial and commercial requirements up to 199 Mcf per day ahead of essential agricultural requirements (*Northern National Gas Co.*, Docket Nos. RP74-102, RP76-52, *mimeo.* (November 30, 1979)), and one which places essential agricultural use of more than 300 Mcf per day below any others, essential process or feedstock use (*Montana-Dakota Utilities Co.*, Docket No. RP76-91, *mimeo.* (November 30, 1979)). The FERC also has granted adjustments excusing literal compliance with the regulations. *See, e.g., Arkansas Louisiana Gas Co.*, "Order of the Director Office of Pipeline and Producer Regulation Granting Adjustment," *mimeo.* (January 25, 1980).

[66]*Contrast* the treatment of hospitals in *Cities Service Gas Company*, Opinion 805, *mimeo.* (June 14, 1977) and Opinion 805-A, *mimeo.* (August 2, 1977) (hospitals treated as large commercial users) *with* the settlement agreement filed by Cities Service on February 25, 1980 (hospitals placed in Priority 1).

requirements, small commercial requirements, requirements of schools, hospitals, and similar institutions, and requirements necessary to protect health, safety, and property.[67] The second highest curtailment priority is granted to essential agricultural users for which alternate fuels are either uneconomical or unavailable.[68] The third highest curtailment priority is reserved for essential industrial process and feedstock users;[69] all other uses (which include other industrial boiler fuel use and electric power generation) are left to be ultimately ranked by DOE.[70]

Curtailment also is indirectly affected by FUA.[71] As discussed in section B below, FUA has the potential to force large users of natural gas to the use of other fuels, thereby decreasing the demand for available quantities of gas. While lessened demand suggests a correspondingly decreased chance of curtailment, the difficulties of administering a curtailment plan also may increase, for there would be fewer lower-priority users to bear curtailment before it reached the higher-priority users.[72] Thus, FUA may lessen the likelihood of curtailment by reducing demand but may sharpen the impacts that will hit if curtailment does occur.

Future FERC and DOE actions may have even greater effects upon existing end-users through the redesign of pipeline curtailment plans. DOE has the authority to set curtailment priorities, although the authority must be exercised consistently with Title IV of the NGPA. On the other hand, the FERC has the authority to establish and enforce curtailment plans.[73] Further, under section 404 of the DOE Act, the FERC has an effective veto over DOE proposals concerning curtailment priorities.[74] This jurisdictional division contains the potential for enormous controversy and confusion. As long as the two agencies are in fundamental agreement, this structure will present no insurmountable obstacles.[75] However, any disagreements

[67]NGPA § 401 (a), (f), 15 U.S.C.A. § 3391(a), (f) (Supp. 1978).

[68]NGPA § 401, 15 U.S.C.A. § 3391 (Supp. 1978). Pursuant to section 401(c) of the NGPA, the Secretary of Agriculture certified to the Secretary of Energy and the FERC the quantities of gas needed in order to meet the requirements of full food and fiber production, and ERA has adopted regulations establishing curtailment priorities. 10 C.F.R. Part 580. The FERC also has adopted a curtailment rule which implements Title IV of the NGPA. 18 C.F.R. Part 281.

[69]The ERA has not yet adopted a rule which defines essential industrial process and feedstock users. NGPA § 402, 15 U.S.C.A. § 3392 (Supp. 1978).

[70]Under the DOE Act, ERA has the authority to establish curtailment priorities. DOE Act, §§ 301(b), 402(a)(1)(E), 42 U.S.C.A. §§ 7151, 7191 (Supp. 1978); DOE Delegation Order No. 0204-4, 42 Fed. Reg. 60726 (1977).

[71]Obviously, the greatest effect of FUA will be on the industrial end-user. However, discussion of this major effect of FUA is reserved for a later section.

[72]Curtailment is easier to administer when definite priorities exist. The problems of curtailment are heightened tremendously when all the users share a common priority. While aggregate volumes can be reduced on a *pro rata* basis, determining which residences will lose gas service either entirely or for certain hours is obviously a highly charged issue.

[73]Under section 403(b) of the NGPA, the FERC is called upon to implement the curtailment priorities which DOE establishes. *See* note 70. The definitional barrier between implementation and establishment of priorities is nowhere documented.

[74]Section 404 of the DOE Act allows the FERC, in its discretion, to consider any DOE rule, regulation, or policy which DOE prescribes as part of the power delegated to it by section 301 of the DOE Act. The FERC then can veto the rule entirely or require that changes be made in the rule if DOE proposes to make the rule final.

[75]One example of differences between the two agencies was their diverging opinions on load growth. As noted above (*see* text at notes 34-37), the FERC has frowned upon load growth when gas was in short supply. On the other hand, the National Energy Plan II encouraged load growth (Chapter IV, p. 26) and in January, 1979, then-Secretary of Energy Schlesinger sent a letter to all state public utility commissions, advocating residential load growth as a response to oil problems. No real conflict followed, but the example suggests future difficulties which could arise.

could escalate into jurisdictional controversy that would leave pipelines and distributors floundering for guidance.

In sum, there is a discernible movement toward federal regulation of distributor service in periods of curtailment. Title IV already has lessened FERC flexibility to respond to local conditions by mandating a more rigid set of priorities for gas use—areas of the country which are heavily dependent on gas for jobs may bear a disproportionate share of the costs of any curtailment. The FERC and DOE have attempted to discover the limits of their present authority and have sought additional authority. Under FUA, a direct federal role in end-user access to gas through distributor load management already has developed; a similar curtailment role may not be far behind.

B. End-Use Regulation, Load Management and the NEA

End-use regulation and load management, the determination of which classes of gas customers to serve and under what circumstances, primarily have been a subject of local regulation.[76] Except for interstate pipeline direct sales to end-users and pipeline expansion cases,[77] access to gas service was set by the local regulatory body. The decision at the distribution level of whether to upgrade load (by adding new high-priority customers or by curtailing interruptible or low-priority users) also was determined by the local regulator. The desirability or undersirability of any particular use of gas was subject to the sole discretion of the state regulators, even during periods of curtailment.

FUA and PURPA radically alter this picture. Together, they give the federal government the ability to say when and whether certain end-users may receive gas service. At this point, a distinction must be drawn between curtailment policy and load management. Curtailment policy determines the order in which classes of gas users lose access to gas in the event available gas supplies are not sufficient to meet contract demand. While the logic that leads to the assignment of a low curtailment priority to a particular use of gas would indicate that such use is of low utility, curtailment policy makes only relative judgments.[78] In the face of continuing ample supplies of gas, curtailment priorities are of theoretical importance only and deprive no user of gas.

In contradistinction, load management policies establish priorities of gas use and seek to enforce them even during periods of a relative abundance of gas. One limited form of load management, load growth policy, concerns itself only with the addition of new customers—new hookups might be allowed only for users in high-priority categories. Another limited form turns upon rate considerations, trying to balance different users because of their

[76]The terms of service by a local distributor under the NGA were subject only to state regulation. *Supra*, note 16.

[77]*See* notes 11 through 16 *supra* and accompanying text.

[78]Curtailment priorities are of theoretical concern when gas supplies are ample. Low-priority users do not lose gas service permanently, but only during the curtailment. After normal gas service resumes, low-priority users are free to burn gas again.

ability to balance seasonal loads. For example, a distributor and its regulator may seek industrial users with year-round gas demands to counterbalance highly seasonal residential users, thereby limiting the relative importance of the demand component of pipeline rates.[79] Yet another limited form of load management, interruptible sales, permits a distributor to serve industrial users on a when-and-if-gas-is-available basis, thereby also counterbalancing the highly seasonal requirements of weather sensitive residential users.

The final, most drastic form of load management seeks to upgrade load by forcing "lower" priority users of gas to other fuels while keeping constant or increasing the number of higher priority users on the system. This form of load management has been extremely rare, but PURPA and FUA now mandate this principle.[80] Furthermore, certain of the decisions on load upgrading are to be made by federal agencies and not the state regulatory bodies.

Section 303(a) of PURPA provides an example of the federal government's first direct intrusion into the area of when service may be terminated to end-users served by distributors. Pursuant to that section, the states are required to consider adopting federal standards governing the termination of gas service.[81] The federal standards would prohibit terminating gas service if it would be dangerous to the health of a consumer who is unable to pay for the service. While the states are free to reject the standards, they must report annually on their implementation of them. Furthermore, if a state regulatory body previously lacked the power to promulgate such rules, PURPA is explicitly designed to fill that gap.[82]

Likewise, section 402 of FUA provides an excellent, albeit minor, illustration of the federal government's new power to prohibit the use of gas altogether for a specified use.[83] Section 402 effectively prevents an end-user from using gas for outdoor lighting. Section 402(a) prohibits any local distribution company or any industrial user of gas supplied by a natural gas pipeline from installing any outdoor lighting fixture using natural gas. Section 402(b) requires the Secretary of Energy to promulgate a rule prohibiting local distribution companies from supplying gas for use in existing outdoor lighting. The section has varying effective dates for different users,

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[79]Most interstate pipeline rates are based upon a commodity charge (for actual volumes of gas used) and a demand charge (for the claim to a percentage of the delivery system's physical capacity on a peak day). A distributor with only residential customers, in effect, would have to "rent" pipeline capacity all-year, despite its highly seasonal demand for gas. If the distributor also serves year-round customers, they can be charged some of this rent. *Cf.* note 38.

[80]As described *infra*, FUA seeks to limit gas use just by electric power plants and major fuel burning installations. PURPA protects residential users from termination of gas service and provides incentives for industrial users to switch to other fuels. PURPA's rate policies also discourage industrial gas use.

[81]PURPA §§ 303, 304, 15 U.S.C.A. §§ 3203, 3204 (Supp. 1978).

[82]PURPA § 303, 15 U.S.C.A. § 3205 (Supp. 1978). As the conferees stated in language applicable to section 303:

> "The intent here is that where a State regulatory commission or nonregulated utility finds insufficient authority pursuant to otherwise applicable State law, under which it may adopt a standard established in section 113, then these three purposes of the title provide such authority. In effect the three purposes expand the discretion of the State regulatory commission or nonregulated utility to adopt the standards of section 113. However, the conferees also intend that three purposes do not override State law."

H.R. Rep. No. 95-1750, 95th Cong., 2nd Sess. 75 (1978). This provision, in the absence of contrary state law, therefore expands the power of state regulatory agencies.

[83]FUA § 402, 42 U.S.C.A. § 8372 (Supp. 1978).

allows for certain exemptions and the delegation of the regulation of outdoor lighting to state regulatory authorities.[84] Despite the exemptions and the possibility of delegation, the principle behind section 402 is stark—particular end-users are prohibited by the federal government from using gas for a particular purpose.[85]

While this application is minor, the change in the source of regulatory authority is major. Throughout the deepest curtailments of the mid-1970's, federal authorities were not able to prohibit the use of gas by any class of user, despite the magnitude of the crisis those curtailments produced. In contrast, even with the increase in gas supplies since passage of the NGPA, the federal government has the authority to ban absolutely certain uses of gas.

A departure of such magnitude from past jurisdictional divisions obviously was not brought about merely to ban the use of natural gas on residential front porches. FUA has the potential to force major movements from natural gas to other fuels. While FUA grants the Secretary of Energy considerable authority to enforce or waive its provisions, legislation now being finalized by the Administration would mandate the load upgrading which the exemptions to FUA could forestall.[86]

By establishing a system of fuel preferences, FUA can prevent all use of gas by certain new large industrial and utility boilers.[87] Furthermore, the use of gas by existing large industrial and utility boilers can be stopped despite the expense that conversion to other fuels may cause.[88] If FUA is fully utilized, the large end-user will not be able to make its fuel decisions itself. Traditional economic criteria will be replaced by federal directive.

FUA contains two sets of fuel preferences that are to be applied to

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[84]New use of gas for outdoor lighting was banned the date the rule was issued. If gas was used for lighting by a residence or a municipality prior to the passage of FUA, gas can still be used through January 1, 1982. Industrial and commercial users were given 180 days in which to terminate gas use. FUA § 402(b), 42 U.S.C.A. § 8372(b) (Supp. 1978). Exemptions can be granted for memorial lights or lights of historical significance, for safety or health reasons, and for certain commercial lighting. The regulations are found at 10 C.F.R. Part 516.

[85]Congress has now asserted jurisdiction over matters merely affecting interstate commerce, thereby undoing the jurisdictional division it thought wise at the passage of the NGA.

[86]Thus, a progression exists. ESECA (Energy Supply and Environmental Coordination Act, Pub. L. No. 93-319, 88 Stat. 246 (1974)) placed the burden on the government to demonstrate that a user could use an alternate fuel. Under FUA, DOE chooses to which existing gas user to issue a prohibition order and the user must demonstrate that an exemption is applicable; new facilities are prohibited from using gas unless they can demonstrate qualification for an exemption. The proposed legislation lists 107 existing electric powerplants which will be required to switch to the use of coal. DOE discretion to postpone issuing a prohibition order is removed. All of the exemptions of FUA will be available, but that initial step of prohibition will be mandated. "Specifications for Legislation to Reduce Use of Oil and Gas in the Electric Utility Sector," The White House (March 6, 1980).

[87]Title II of FUA prohibits future MFBI's (*see* note 91, *infra*) or electric powerplants from using natural gas or petroleum. FUA §§ 201-202, 42 U.S.C.A. §§ 8311-8312 (Supp. 1978). If the user carries a burden of proof, it may be granted a temporary or a permanent exemption from the prohibition. Temporary or permanent exemptions may be granted due to the lack of an alternate fuel supply, site limitations or environmental considerations. FUA §§ 311-314, 42 U.S.C.A. §§ 8321-8324 (Supp. 1978). A temporary exemption also may be granted if the future use of synthetic fuel or coal can be proven or if the public interest so requires. *Infra* note 98. Permanent exemptions can be granted for the use of fuel mixtures containing oil or natural gas, for emergency or peakload powerplants, for product or process requirements and several other criteria. These exemptions are fleshed out by detailed statutory provisions and regulations, the full description of which is beyond the scope of this article. The regulations are found in Parts 504 and 506 of the regulations. 10 C.F.R. Parts 504, 505.

[88]Title III of FUA allows DOE to require an existing facility to switch to an alternative fuel. 42 U.S.C.A. §§ 8341-8354 (Supp. 1978).

power plants and large industrial boiler and other industrial combustion uses of gas. First, FUA's prohibitions will foster the use of alternative fuels over both oil and gas.[89] Second, if a choice is between oil and gas, FUA discourages the use of gas; a switch from oil to gas is banned for electric power plants.[90]

FUA applies those fuel preferences with respect to several classes of fuel users. New electric power plants and new large industrial boiler users are prohibited from using oil or gas as their primary energy source absent the grant of a formal exemption by DOE.[91] The Secretary of Energy is also allowed to identify, generically or individually, large industrial non-boiler installations which are to be prohibited from using either oil or gas as their primary energy source.[92] Existing power plants are prohibited from using any gas after January 1, 1990, and can use gas until then only if they burned gas during 1977. If gas was used in 1977, the level of gas use cannot exceed the average used in 1974-1976. Furthermore, if certain conditions are met, the use of either oil or gas can be prohibited before 1990 in existing electric power plants and major fuel burning installations, both boiler and non-boiler.[93] The prohibition is achieved through the issuance of prohibition orders by DOE.

An existing facility can be required to switch to an alternative fuel if it has or once had the technical ability to use an alternative fuel, if it can use an alternative fuel without substantial physical modification or reduction in capacity, and if such use is economically feasible. The scope that DOE has given these criteria in its regulations is subject to change; if DOE wishes to foster more fuel-switching, it can, through a rulemaking, vastly expand the number of end-users it can prohibit from using gas.[94]

As one example, an electric power plant or major fuel burning installation may be prohibited from using oil or gas if the use of an alternate fuel

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[89]As a general rule, new powerplants and large industrial installations (*see* note 91) are automatically prohibited from using oil or gas, FUA §§ 201, 202, 42 U.S.C.A. §§ 8311, 8312 (Supp. 1978), while existing powerplants and MFBI's can be prohibited from using oil or gas. FUA §§ 301-303, 42 U.S.C.A. §§ 8341-8343 (Supp. 1978). DOE is given discretion to define "alternative fuels." While coal undoubtedly will be the major alternative fuel, DOE can foster the use of alternative technologies with its definitions, for instance, increasing the use of fuel mixtures.

[90]An existing powerplant is forbidden to use natural gas after January 1, 1990 and to increase its gas usage above the average level in 1975-76. FUA § 301(a), 42 U.S.C.A. § 8341(a) (Supp. 1978). Therefore, the use of gas to displace oil is generally not allowed. ***But see*** note 98. The use of gas is banned as of January 1, 1990; however, DOE may issue a prohibition order against the use of oil and gas prior to that date. The statute contains no *automatic* cut-off date for oil use by existing powerplants.

[91]A major fuel burning installation (MFBI) is a stationary unit consisting of a boiler, gas turbine unit, combined cycle unit and internal combustion engine which has a design capability of 100 million Btu per hour or greater, or two or more units on the same site which have a design capability of 250 million Btu per hour in the aggregate. FUA § 103(a)(10), 42 U.S.C.A. § 8302(a)(10) (Supp. 1978). New electric powerplants and MFBI's are those for which construction or acquisition began after November 8, 1978 and those for which construction or acquisition began between April 20, 1977 and November 8, 1978, which cannot be cancelled, rescheduled, or modified without imposing substantial financial penalty and for powerplants, adversely affecting electric system reliability, and for MFBI's, incurring significant operational detriment. FUA § 103; 42 U.S.C.A. § 8302 (Supp. 1978). These definitions are employed in the regulations at 10 C.F.R. Parts 503, 505.

[92]FUA § 401, 42 U.S.C.A. § 8371 (Supp. 1978).

[93]FUA §§ 301-303; 42 U.S.C.A. §§ 8341-8343 (Supp. 1978).

[94]These criteria are found at FUA §§ 301(b), 302(a); 42 U.S.C.A. §§ 8341(b), 8342(a) (Supp. 1978). Each of the criteria has been amplified in the regulations. For example, a reduction in the rated capacity of a unit must exceed 10% to be deemed substantial. 10 C.F.R. §§ 504.5(f), 506.2(f). Obviously, if DOE wished to further decrease the amount of oil and gas use, it could increase that figure.

is not economically prohibitive. However, the definition of "economically prohibitive" is left to DOE to promulgate; DOE has defined the use of alternate fuel to be economically prohibitive only if its use would be 1.3 times more expensive than the use of imported oil products.[95] The 1.3 index actually can understate the impact of the formula. Assume that a gas-user purchases gas at a Btu-equivalent price of 70% of imported oil. Alternative fuel use is not prohibitive if its cost is less than 1.3 times as expensive as the cost of imported oil. Therefore, the hypothetical user's costs could increase from 70% to 129% of the cost of imported oil (that is, almost doubling), but the DOE regulations would not consider that to be unduly burdensome. This is just one example; each of the other criteria and the permanent and temporary exemptions can be manipulated so as to increase or decrease the use of alternate fuels which FUA promotes.[96]

FUA contains a list of temporary and permanent exemptions from mandatory fuel-switching for existing covered facilities.[97] However, as with the initial criteria described above, DOE has the authority to apply the exemptions broadly or narrowly. One indication of the potential flexibility contained in FUA is found in DOE's treatment of temporary public interest exemptions.[98] As the situation worsened in Iran and oil prices rose everywhere, studies of the impact of FUA indicated that it would reduce present gas use only by increasing the use of imported oil. Responding to this, DOE and the FERC promulgated and adopted a set of rules which allow industrial users of imported oil to use non-dedicated gas to displace that oil. This reversal in policy was occasioned by the perception of a "gas bubble," although the FERC faith in its existence was never as great as that of DOE. This use of FUA to promote the use of gas indicates just how flexible a tool FUA, with all its exemptions, can be.

Thorough regulations governing all these areas have been adopted by the ERA.[99] Although they are complicated to the nth-degree, they are the Bible for future gas and oil use. An end-user must understand the regulations, for their prescriptions now take the place of the economic analysis most end-users previously followed in determining their primary fuel.

Therefore, the end-user is faced with a government determination of which fuels it can use. Furthermore, the government can change the rules

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[95]10 C.F.R. §§ 504.12, 506.2(g).

[96]*E.g.*, 10 C.F.R. §§ 506.2(e), (f).

[97]The temporary exemptions include lack of alternate fuel supply, site limitation, environmental considerations, future use of synthetic fuels, public interest, and the future use of coal. Permanent exemptions include lack of alternate fuel supply, site limitations, environmental considerations, certain state and local requirements, cogeneration, certain fuel mixtures, emergency purposes, powerplants necessary to maintain reliability of service, peakload powerplants, certain intermediate load requirements, product or process requirements, certain LNG and Canadian-gas use, and installations necessary to meet scheduled equipment outages.

[98]Section 311(e) of FUA (42 U.S.C.A. § 8351(e) (Supp. 1978)) authorizes DOE to exempt temporarily an electric powerplant from the provisions of the Act, including the ban on increased gas use, if the exemption is demonstrated to be in the public interest. DOE used this section as the basis for a general rule which allowed increased gas use by powerplants if the gas went to displace fuel oil. 10 C.F.R. Part 508. The FERC somewhat reluctantly agreed to allow gas certified to displace fuel oil to be transported by interstate pipelines under some circumstances without prior FERC approval. 18 C.F.R. Part 284, Subpart F. On February 27, 1980, ERA also granted temporary public interest exemptions to FUA restrictions to 128 powerplants in 11 states, thereby enabling them to burn gas in the place of oil and despite FUA restrictions.

[99]The regulations are found at 10 C.F.R. Parts 500-508, 515-516, 580, 595.

as it goes. An end-user which comfortably qualifies for an exemption from fuel-switching today may find itself the target of a prohibition order tomorrow.[100] End-users find themselves at the mercy of the vagaries of national energy priorities.

Both PURPA and FUA contain some sweeteners to make the transition from gas easier for the end-user by helping to pare some of the conversion costs. Under section 606 of PURPA, a user of intrastate or self-help gas contracted for prior to September 1, 1977, may sell its right to that gas if it voluntarily switches to the use of Nos. 4, 5 or 6 fuel oil or is prohibited from using gas after the President declares a natural gas supply emergency. The consideration received for the sale of those rights is limited to the excess cost over contract price of the gas incurred by the use of heavy petroleum fuel oil (not including capital costs) for the remainder of the contract life plus an allowance for the amortization of the undepreciated value of depreciable assets which are directly associated with the use of natural gas and cannot be used with heavy fuel oil. The rights can be sold only to an interstate pipeline, or a distributor, or a high-priority user served by an interstate pipeline. If the person to whom the rights are transferred will in turn resell the gas, the transfer must be certificated. While FERC approval of the transfer must be obtained as well as certificates for resale or transportation in interstate commerce, the sale or transportation of gas transferred under this section will not otherwise make a transporting intrastate pipeline or an end-user subject to Commission jurisdiction as a natural gas company or render it a common carrier.[101]

Section 731 of FUA contains a nearly identical provision with respect to gas contract rights owned by new or existing power plants or MFBI's which receive a prohibition order. No end-user can make a profit under either of these sections, but it can offset some of the operating losses that would otherwise occur.[102]

Both Sections 606 of PURPA and Section 731 of FUA leave unanswered a wide range of questions involving distributors and the traditional scope of state regulation. Assuming that an end-user transfers his contractual right to another higher priority end-user located in another state, the results could jeopardize the exempt status under the Natural Gas Act of the distributor serving the transferring end-user. Moreover, such an assignment may violate a distributor's service agreement with the end-user and result in an allocation contrary to state curtailment and allocation regulations.

A wide-range of end-users are potentially subject to FUA. Section 402 of FUA, prohibiting the use of natural gas for decorative outdoor lighting, reveals the trivialities FUA reaches. Titles II and II of FUA deal with major gas users, those whose design capability equals or exceeds 100 mil-

[100]Nothing in FUA prohibits DOE from amending the regulations so as to make it more difficult for any powerplant or MFBI to justify an exemption from an prohibition order.

[101]PURPA § 606, 15 U.S.C.A. § 717y (Supp. 1978).

[102]FUA § 731, 42 U.S.C.A. § 8441 (Supp. 1978). The provisions of PURPA § 606 and FUA § 731 are carefully designed to limit the consideration the transferor receives to the additional costs incurred by use of an alternative fuel.

lion Btus (approximately 100 Mcf of pipeline quality gas) *per hour*. Section 401 significantly lowers this threshold test figure. Under section 401, DOE may, by generic or individual prohibition order, forbid the use of gas in boilers used to produce steam for space heating which have a design capacity as low as 300 Mcf per day.[103] All new boilers can be brought within the scope of any such rule while a great number of existing boilers also can be brought within the rule under criteria similar to those that apply to existing MFBI's. A boiler with a design capacity of 300 Mcf a day is not a particularly large boiler; by applying the criteria stringently, DOE could prohibit a quite significant proportion of total national gas use—a recent EIA determination estimated that industrial boilers with a capacity more than 300 Mcf a day use more than 95% of all the interstate gas used for industrial boiler fuel.[104] That would drive the boilers to the use of petroleum. In today's petroleum market, such a move seems unlikely—but the power is there, and could be hastily disinterred if natural gas shortages seem imminent. In any case, the combined effect of low curtailment priorities, high prices under incremental pricing, and the potential for prohibition orders must make natural gas seem an unreliable fuel to many end-users, even when compared to oil.

C. Incremental Pricing

Title II of the NGPA[105] created the most direct and immediate intervention of federal regulatory authority into an area previously reserved to the states.[106] In establishing mandatory incremental pricing, Congress effectively decreed that certain classes of gas users would be faced with a price floor on all of their natural gas purchases.[107] The effect on the distributor of rate structures applied to end-users has been profound and perhaps irreversible.

Incremental pricing is a theoretically simple idea whose implementation can be difficult and problematic. In its simplest form, incremental pricing requires charging the users of an additional unit of gas the higher cost of producing that unit of gas. This contrasts with rolled-in pricing, which charges the user of that additional unit of gas the average price of all gas. In an era of rising gas prices and the previous commitment of most low

[103]The rules governing this prohibition are similar to those used in Title II and III of the FUA.

[104]Energy Information Administration, U.S. Department of Energy, *Report to Determine 5 Percent Exemption to Incremental Pricing* (February 26, 1980).

[105]NGPA §§ 201-208, 15 U.S.C.A. §§ 3341-3348 (Supp. 1978).

[106]Section 205(a) of the NGPA (15 U.S.C.A. § 3345(a) (Supp. 1978)) provides that "[a]ny surcharge under this title, paid by any local distribution company with respect to natural gas which is indirectly delivered by any interstate pipeline to incrementally priced industrial facilities which are served by such local distribution company, shall be directly passed through to such industrial facilities." The Joint Explanatory Statement of the Committee on Conference accompanying the NGPA states that the provisions of Title II "preempt and supersede any provision of State or local law to the extent that such a provision would preclude the passthrough of any surcharge under this Title or prevent the application of the requirements of this section." S. Rep. No. 95-1126, 95th Cong. 2nd Sess. 100 (1978).

[107]Title II of the NGPA requires the FERC to implement incremental pricing in two phases. The first phase must apply to non-exempt industrial boiler fuel facilities. Section 206 of the NGPA (15 U.S.C.A. § 3346 (Supp. 1978)) exempts agricultural and certain industrial boiler fuel facilities from the scope of this requirement. *See* text at notes 115-119, *infra*. The second phase of the incremental pricing program required by the NGPA permits the Commission to expand the program beyond industrial boiler fuel facilities. NGPA § 202, 15 U.S.C.A. § 3342 (Supp. 1978).

priced gas to interstate systems, incremental pricing means that the user subject to incremental pricing must pay a significant premium for gas.

Prior to the early 1970's the FPC had a well established policy of rolling in the price of new increments of gas supply.[108] The advantages of rolled in pricing were summarized by the D.C. Circuit in *Battle Creek Gas Co.* v. *FPC*.[109]

> "This method has many apparent advantages and the Commission has repeatedly stated a general preference for it wherever it may equitably be used. It avoids the onerous administrative burden of having to assign a different portion of the cost to each of a large number of customers. It results, if all other factors be equal, in all customers paying the same price for gas taken from the pipeline at the same point, and recognizes that all customers enjoy the benefits of having the whole gas gathering and pipeline system
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> * * *
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> "Use of the rolled-in method thus serves the interest of equal treatment for customers receiving equal service."

In the early 1970's the FPC began to examine the question of whether incremental pricing should be required for new, more expensive supplies such as imported liquefied natural gas. Although it initially decided that such incremental pricing should be imposed both at the pipeline and distributor level,[110] on rehearing the Commission eliminated the condition requiring distributors purchasing LNG to sell the LNG at the burner-tip under separate incremental rate schedules because of a finding that such a condition was "not sound regulatory policy."[111] Subsequently in 1977, as a result of a remand of its original decision,[112] the Commission rejected the concept of incremental pricing at the pipeline level because of concerns with increasing shortfalls in gas supply availability.[113] This experience led FPC Judge Southworth to summarize the FPC experience with incremental pricing as follows:

> "The incremental pricing signal to the burner-tip users is a theoretical exercise of no demonstrated practical value . . . and would certainly be an administrative nightmare. Except for one or two aberrations which it eventually corrected, the

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[108] *See Trunkline Gas Supply Co.*, 8 F.P.C. 250 (1949); *Panhandle Eastern Pipe Line Co.*, 10 F.P.C. 185 (1951); *American Louisiana Pipeline Co.*, 13 F.P.C. 380 (1954); *Truckline Gas Co.*, 21 F.P.C. 704 (1959); *El Paso Natural Gas Co.*, 22 F.P.C. 260 (1959); *Kansas-Nebraska Natural Gas Co.*, 25 F.P.C. 448 (1961); and *Neueces Industrial Gas Co.*, 45 F.P.C. 1224 (1971).

[109] 281 F.2d 42, 46 (D.C. Cir. 1960).

[110] *Columbia LNG Corp.*, Opinion No. 622, 47 F.P.C. 1624, 1639-1641 (1972), where the Commission conditioned the issuance of certificates by requiring the pipeline applicants to sell LNG on an incrementally priced basis and by prohibiting any distributor customer of the pipeline from purchasing LNG supplies unless it first agreed to sell the LNG to its end-user customers under a separate incrementally priced rate schedule.

[111] *Columbia LNG Corp.*, Opinion No. 622-A, 48 F.P.C. 723 (1972).

> "[W]e are convinced that it is not sound regulatory policy to require the distributors to develop separate LNG incremental pricing schedules. We are impressed with the argument that such schedules would be administratively impracticable to implement at this time and, moreover, that the appropriate state or local regulatory commissions should analyze the particular needs of their consumers and distributors and determine appropriate rate designs on the basis of their evaluation." *Id.* at 729-730.

[112] *Columbia LNG Corp. v. F.P.C.*, 491 F.2d 651 (5th Cir. 1974) (remanding the Commission's Opinion No. 622-A for further consideration of the incremental pricing issue at the pipeline and wholesale level).

[113] *Columbia LNG Corp.*, Opinion No. 786, *mimeo.* 12-18 (January 21, 1977). *See also Trunkline LNG Co.*, Opinion No. 796-A, *mimeo.* (June 30, 1977); *Tenneco Atlantic Pipeline Co.*, Initial Decision, *mimeo.* (November 2, 1977); *cf. Pac Indonesia LNG Co.*, DOE/ERA Opinion No. 1, *mimeo.* (December 30, 1977).

Commission has never departed from its basic, practical premise that the costs of all base-load supplies of gas must be rolled in."[114]

Despite this FPC experience, Title II of the NGPA requires the FERC to establish a variant form of incremental pricing, under which certain classes of end-users are required to bear a disproportionate share of acquisition costs of higher priced gas supplies.

Sections 201 and 205 of the NGPA require the FERC to adopt a rule passing through specified costs to non-exempt industrial boiler fuel facilities, served either directly or indirectly by an interstate pipeline.[115] Except for the generation of electricity by electric utilities, and use by schools, hospitals and similar institutions, agricultural uses and qualifying cogenerators, the only boiler fuel facilities exempt from section 201 incremental pricing are those deemed to use less than 300 Mcf of gas per day.[116] By May, 1980, the FERC is required to submit to Congress a second rule which may, but need not, extend incremental pricing far beyond existing non-exempt industrial boiler fuel facilities.[117] While agricultural users initially are exempt from incremental pricing, by May, 1980, the FERC must promulgate a rule which exempts only those agricultural uses for which an alternative fuel or feedstock is neither economically practicable nor reasonably available.[118] The

[114]*El Paso Eastern Co.*, Initial Decision, (October 25, 1977).

[115]On September 28, 1979, the FERC issued Order Nos. 49, 50 and 51 which implement Phase I of the NGPA mandated incremental pricing program. Order No. 49 (*Regulations Implementing the Incremental Pricing Provisions of the Natural Gas Policy Act of 1978*, Docket No. RM79-14, *mimeo.* (September 28, 1979)) established the FERC's regulations requiring interstate pipelines and local distribution companies to pass through certain portions of their natural gas acquisition costs to non-exempt large volume industrial boiler fuel users. In addition, Order No. 49 established a procedure for obtaining exemptions under § 206 of the NGPA and the basic mechanism for implementing incremental pricing charges at the pipeline level. Order No. 50 (*Regulations Implementing Alternative Fuel Price Ceilings on Incremental Pricing Under the Natural Gas Policy Act of 1978*, Docket No. RM79-21, *mimeo.* (September 28, 1979)) established a three-tier system for determining the alternative fuel price ceiling for non-exempt industrial boiler fuel users subject to incremental pricing. *See* text accompanying note 124, *infra*. Order No. 51 was transmitted to Congress for its review pursuant to subsection 206(d) of the NGPA (15 U.S.C.A. § 3346 (Supp. 1978)) and became effective on December 1, 1979. It held 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 No. 51 defined incremental pricing regions to account for varying prices of No. 6 oil throughout the country and set forth the procedure of which non-exempt users file alternate fuel affidavits. The Orders are codified at 18 C.F.R. Part 282.

[116]NGPA § 206, 15 U.S.C.A. § 3346 (Supp. 1978).

[117]NGPA § 202, 15 U.S.C.A. § 3342 (Supp. 1978). Pursuant to a Notice of Proposed Rulemaking issued November 15, 1979 in Docket No. RM80-10, the FERC has proposed "a Phase II rule that would broaden the scope of incremental pricing to include all industrial users other than those specifically exempted by Title II." In addition, the Commission has proposed the retention of the three-tier alternative fuel ceiling approach and the mechanism for calculating and billing incremental pricing surcharges developed under the Phase I program. Notice of Proposed Rulemaking, *Rule Required Under* § 202 of the Natural Gas Policy Act of 1978, Docket No. RM80-10, 44 Fed. Reg. 67170 (1979).

In a news release dated March 20, 1980, the FERC announced that it had requested its Staff to prepare a draft order embodying a Phase II rule. The draft order would continue to use the price of high-sulfur No. 6 fuel oil as the sole alternative fuel ceiling price (*infra*, note 123), would extend incremental pricing to all industrial users except those expressly exempted by the NGPA from incremental pricing, but would exempt from incremental pricing the first 300 Mcf of gas per day used by an industrial user covered by the Phase II rule. News Release, "FERC Considers Phase II Incremental Pricing" (March 20, 1980).

[118]NGPA § 206(b)(2), 15 U.S.C.A. §3346(b)(2) (Supp. 1978). On March 6, 1980 the FERC issued a Notice of Proposed Rulemaking to conform with this statutory provision in two dockets. In Docket No. RM80-28 (Notice Of Proposed Rulemaking, *Permanent Rule Defining Agricultural Uses Exempt from Incremental Pricing Under the Natural Gas Policy Act of 1978*, 45 Fed. Reg. 15562 (1980)), the FERC proposed a rule which "would exempt an agricultural use from being incrementally priced only if the Commission should determine there is no economically practicable or reasonably available alternate fuel for the agricultural use." In Docket No. RM80-29 (Notice of Proposed Rulemaking, *Rule Exempting Agricultural Uses from Incremental Pricing Surcharges*, 45 Fed. Reg. 15563 (1980)), the FERC proposed a second rule which "would exempt all agricultural uses from application of the alternative fuel test until May 1, 1981." The combined effect of these two proposed rules would be to exempt all agricultural users from incremental pricing until May 1, 1981.

use of gas by residential and commercial users, by hospitals and schools, by qualifying cogenerators,[119] and for the generation of electricity by an electric utility are exempt from any incremental pricing. In addition, the FERC may exempt industrial facilities or classes of facilities from incremental pricing, subject to Congressional disapproval, or it may issue an adjustment to protect a user from any special hardships imposed by incremental pricing.[120]

Interstate pipelines are required to isolate specified costs for pass-through to the incrementally-priced users,[121] subject to a ceiling of the "alternate fuel price."[122] The alternate fuel price is based upon the price of one of three types of fuel oil in the area in which the user is located; however, in an attempt to minimize the problems of load loss, the Commission has adopted the lower price of No. 6 fuel oil as the alternative fuel price through October 1, 1980.[123] After that date, an incrementally-priced user's alternative fuel price ceiling will be the area price of No. 2 fuel oil, unless the user certifies that it has the capacity to use either No. 5, high sulfur No. 6, or low sulfur No. 6 fuel oil. If a user certifies that he can use No. 5 or low sulfur No. 6 fuel oil, his alternative price ceiling will be that of No. 6 low sulfur.[124] If he certifies that he can use No. 6 high sulfur fuel oil, then his alternative fuel price ceiling will be the price of No. 6, high sulfur fuel oil.[125]

Under a complicated accounting procedure, which itself was a source of great controversy when under consideration by the FERC, interstate pipelines are required to allocate their incremental accounts to their distributor and end-use customers.[126] The distributor, in turn, is required to pass

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[119]NGPA § 206, 15 U.S.C.A. § 3346 (Supp. 1978); 18 C.F.R. Part 282, Subpart B, §§ 282.201-282.203. With the exception of qualifying cogeneration facilities, the regulations establishing these exemptions were issued in Order No. 49, *supra*. The final rule with regard to cogeneration facilities is set forth in FERC Order No. 69. *Small Power Production and Congeneration Facilities: Regulations Implementating § 210 of the Public Utility Regulatory Policies Act of 1978, Rates and Exemptions*, Order No. 69, 45 Fed. Reg. 12214 (1980). *See also, Interim Rule for Qualification of Gas-Fired Cogeneration Facilities for Purposes of the Incremental Pricing Program*, Docket No. RM79-54, 44 Fed. Reg. 65744 (1979), and *Final Rule Establishing Requirements and Procedures for a Determination of Qualifying Status for Small Power Production and Cogeneration Facilities*, Order No. 70, *mimeo.* (March 13, 1980).

[120]NGPA §§ 206(d), 402(c), 15 U.S.C.A. §§ 3346, 3392 (Supp. 1978). The Notice of Proposed Rulemaking in Docket No. RM80-29 provides a ready example of the Commission's authority to propose rules for further exemptions pursuant to § 206(d). *See* note 118, *supra*.

[121]NGPA § 203, 15 U.S.C.A. § 3343 (Supp. 1978). Pursuant to the provisions of this section of the NGPA, pipelines are required to isolate their costs in excess of a monthly computed incremental pricing threshold for new natural gas, natural gas sold under intrastate rollover contracts, new onshore production well gas, certain LNG imports, natural gas imports, stripper well natural gas, high cost natural gas and certain other gas for pass through to incrementally priced users. Certain pipeline imports may also be incrementally priced, but subject to a different "threshhold."

[122]18 C.F.R. §§ 282.501-282.506.

[123]18 C.F.R. § 282.402. This section was added as a result of FERC Order No. 51. *See, supra* note 115.

[124]18 C.F.R. § 282.403(a)(1); *supra*, notes 122, 123.

[125]18 C.F.R. § 282.403(a)(2); *supra*, notes 122, 123.

[126]18 C.F.R. §§ 282.501-282.506. These regulations were issued as a result of Order No. 49, *supra*. 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 the pipeline's Account 191, unrecovered purchase gas costs.

these costs through to its non-exempt customers.[127] The distributor is required to pass through the costs up to the user's alternative fuel price ceiling irrespective of any alternative rate design it and its regulator may have adopted. In other words, the FERC directly dictates the minimum price distributors can charge certain classes of customers. State authority to pursue other goals is totally removed.

Incremental pricing has been controversial.[128] As its proponents saw it, incremental pricing was to serve two purposes: easing the transition to a deregulated gas market and protecting high-priority users as much as possible from the price increases brought about by Title I of the NGPA.[129] The first goal was to be achieved as industrial users, unwilling to pay substantially higher prices for gas, placed pressure on the pipelines to keep gas prices low: without this pressure, it was feared that pipelines would bid gas prices up without restraint, for they could simply pass through their increased acquisition costs. Because industrials could switch in the long run to other fuels, the argument went, they would be more sensitive to price increases than would be residential users, who lack alternatives. The second goal was to be achieved because the higher costs of new gas would be placed upon the industrials, rather than rolled-in to the prices paid by the residential users.

An intrinsic conflict exists between the two goals. If the first goal is achieved and industrials do switch to alternative fuels, residential users are forced to bear all of the increased costs of gas. In addition, because a large portion of gas customers' bills consists of the payment for and the return on physical facilities, a loss of customers means that the fixed costs must be shared by fewer customers. Therefore, if industrials actually do switch to other fuels, high-priority users could see their bills radically escalate and the protection goal of Title II would be defeated. On the other hand, DOE issued a study indicating that incremental pricing fails as a market-ordering mechanism.[130] The system, therefore, seems condemned to failure on both fronts.

Moreover, as originally conceived, one of the results of the NGPA's scheme was to be a nationwide sharing of increased gas costs by non-exempt industrials for the benefit of high-priority exempt users throughout the country. This result is being blunted by a perfectly legal countermove by the

[127] 18 C.F.R. § 282.504.

[128] As an example of the continuing controversy involving incremental pricing, the Commission is still in the process of trying to define the small boiler fuel exemption. Notice of Proposed Rulemaking, *Permanent Rule Defining Small Existing Industrial Boiler Fuel Users Exempt From Incremental Pricing Under the Natural Gas Policy Act of 1978*, Docket No. RM80-24, 45 Fed. Reg. 15559 (1980); Further Notice of Proposed Rulemaking and Public Hearings, *Section 206(d) Exemption For Small Industrial Boiler Rule Facilities from the Incremental Pricing Provisions of the Natural Gas Policy Act of 1978: Hearings*, Docket No. RM79-48, 45 Fed. Reg. 15556 (1980).

[129] *E.g., Inside F.E.R.C.*, January 21, 1980, pp. 1-2.

[130] *See, Inside F.E.R.C.*, March 3, 1980, p. 1 and February 18, 1980, pp. 4-5.

states[131] which still, however, leaves the industrial end-user bearing an increasing floor on its energy costs. Under the system of accounting adopted by the FERC, each interstate pipeline collects its incremental surcharges in a special account. Its distributor customers pass through their shares of the charges to their non-exempt customers, but only to the extent that the rates otherwise charged those customers are below the alternate fuel price. The sums thereby collected by each distributor then are, in effect, passed back to the pipeline to reduce the incremental pricing surcharge account; the excess of the account over the collection is then charged *pro rata* to all the distributors as part of the PGA. In other words, the incremental surcharges collected by the pipelines from distributor A serve to reduce the PGA charges which would otherwise be paid by *all* the distributors served by the pipeline.

On the other hand, if distributor A raises its price to non-exempt users to the full alternate fuel price, it keeps all of the benefits of incremental pricing for its own exempt users. An example demonstrates how this works. Interstate pipeline X has as its sole customers two distributors, A and B, each located in a different state. X's latest gas acquisition costs are divided, pursuant to the NGPA, $100 to its PGA and $50 to its incremental pricing surcharge account. Assume that A and B take equal volumes from X and that absent a special state incremental pricing plan their rates to non-exempt industrial users would be the same, but that, because of their different end-use profiles, A can absorb thirty dollars from the surcharge account and B can absorb ten. Prior to the passage of the NGPA, pipeline X would have charged both distributor A and B half of the $100 and half of the $50 for a total of $75 each. Because of the NGPA, however, distributor A's share of the gas costs would increase to $85[132] and B's would decrease to $65.[133] Under these circumstances, charges to both A's and B's non-exempt industrials would be the same, while B's exempt users would obviously benefit from A's assumption of a greater share of X's total gas acquisition costs. Next assume that because of a state incremental pricing plan A has no surcharge absorption capacity rather than the $30 originally assumed. B's $10 are subtracted from X's surcharge account, and A and B each must recoup $70 in PGA charges from X. In other words, B now pays $15 of the $30 A would have paid to X had A not raised its prices to non-exempt industrials to at least the alternate fuel price ceiling. Moreover, A's non-exempt customers have their rates reduced under the state

[131]In reaction to Phase I many state regulatory commissions have enacted orders permitting distributors to increase rates to non-exempt industrial boiler fuel users so that the distributor will be unable to report any surcharge absorption capability to its pipeline suppliers. These orders also require that refunds in the amount of the surcharge be credited to the distributor's customers. Examples of these orders are Order, *Illinois Commerce Commission on its Own Motion, the Central Illinois Light Company, et al.*, Docket No. 79-0590, *mimeo*, (December 12, 1979); *City Gas Company of Antigo, Investigation on Motion of the Commission Relative to Incremental Pricing of Gas Used for Industrial Boiler Fuel by Customers of Wisconsin Gas Utilities as Contained in the Natural Gas Policy Act of 1978*, Docket No. 1140-GR-5 *et al.*, Interim Order (November 27, 1979).

[132]One half of the $100 in the PGA account plus $30 of absorption capability plus one half of the $10 remaining in the surcharge account which could not be absorbed by either A or B's non-exempt customers.

[133]One half of the $100 in the PGA account plus $10 of absorption capacity plus one half of the $10 remaining in the surcharge account which could not be absorbed by either A or B's non-exempt customers.

incremental pricing plan by the full $30 of assessed state surcharges. In all cases, however, the non-exempt industrials bear the brunt of incremental pricing.

State regulatory bodies were quick to realize that by permitting distributors to raise their gas prices to non-exempt users to the alternate fuel price ceiling and requiring equal credits to exempt users, they could retain all of the benefits of incremental pricing for exempt users within their borders. Indeed, it has been reported that approximately 30 states have taken steps to permit distributors to reduce their surcharge capacity to zero.[134]

In a pending rulemaking,[135] the FERC has conceded that states have the legal authority to reduce their maximum surcharge absorption capacity to zero; in such cases of *de facto* exemption, all the FERC can do is relieve states and distributors with zero surcharge absorption capacity of the onerous filing requirements occasioned by the NGPA. In that same rulemaking, the FERC is considering whether exemptions from the federal plan should be granted for state alternatives to incremental pricing, such as variable peak and non-peak rates to non-exempt users that recover surcharge absorption capacity in the aggregate,[136] auction sales of gas to non-exempt users,[137] and other alternatives.[138] The FERC is presently in the process of deciding whether to grant exemptions through a generic or individual rulemaking.

Federally-dictated incremental pricing is a reality; only its scope remains to be determined. Beyond incremental pricing, the specter of things-

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[134]*Foster Natural Gas Report*, 1250, p. 13 (February 28, 1980).

[135]Notice of Proposed Rulemaking, *State-Wide Exemptions From Incremental Pricing*, Docket No. RM79-47, 45 Fed. Reg. 1081 (1980).

[136]In comments filed with the FERC in Docket No. RM79-47 on November 9, 1979, the Public Service Commission of the State of New York advised that "New York is now giving serious consideration to a number of rate design techniques such as seasonal pricing, and various marginal costing techniques . . . For example, we can envision circumstances in which a state commission might wish to provide higher rates for one or more classes of industrial customers during certain hours or seasons than others, but where as a practical matter this could only be accomplished if rates higher than the specified alternate fuel cost level for certain peak seasons were matched by rates below such level during the off-peak periods. As long as the average rate paid by the customer was at the prescribed level to avoid a surcharge, it would appear that such state determinations would be consistent with the intent of Congress in Title II of the NGPA. Guidance to the states would be useful as to the permissible limits of their experimentation if they are to maintain for their distributors and users the exemption from the procedures of Order No. 49 which would otherwise be available." *Comments of the Public Service Commission of the State of New York, State-Wide Exemptions From Incremental Pricing*, Docket No. RM79-47, *mimeo.* at 2-3 (November 9, 1979).

[137]On October 26, 1978, the Wisconsin Public Service Commission required Wisconsin Power & Light Company to institute an annual auction tariff for its interruptible customers. Under this plan the price bid by an interruptible industrial customer for gas service determined its relative curtailment priority among other interruptible customers. *Application of Wisconsin Power & Light Company for Authority to Increase Natural Gas Rate as a Natural Gas Public Utility*, Docket No. 6680-GR-3 (October 26, 1978). On April 4, 1979, this program was significantly cut back so that it applied only to a portion of Wisconsin Power's system and only to up to 20% of an industrial user's load (*Id.* April 24, 1979) and today Wisconsin has a plan which permits distributors to reduce their reported pipeline surcharge absorption capability to zero. *City Gas Company of Antigo, Investigation on Motion of the Commission Relative to Incremental Pricing of Gas Used for Industrial Boiler Fuel by Customers of Wisconsin Gas Utilities as Contained in the Natural Gas Policy Act of 1978, supra.*

[138]One such alternative may be the California incremental pricing program which is broader than the present Federal Phase I plan. It includes *all* industrial priority users in Classifications 3, 4 and 5 with installed alternative fuel capability and uses an alternative fuel price ceiling of No. 2 and No. 6 fuel oil. *See Application of Pacific Gas & Electric Company*, Decision No. 90935, Application Nos. 58892 and 59045, Interim Opinion, *mimeo.* (October 23, 1979). *See also, In the Matter of the Application of Southern California Gas Company*, Decision No. 90822, Application No. 58724, Opinion, *mimeo.* at 12 (September 12, 1979), where the Public Utilities Commission of the State of California states that they view their present incremental pricing policy "as consistent with the National Energy Act and plan to extend it on a state-wide basis."

to-come in the area of federal design of end-user rates is raised most acutely by PURPA.[139] PURPA's practical effects on distributors may be limited in the near future, but PURPA contains an implicit assertion of federal authority which is quite breathtaking in its scope.

PURPA asserts that federal power over the retail rates charged intrastate gas users exists under the Interstate Commerce Clause of the Constitution.[140] Furthermore, Titles I[141] and III[142] of PURPA are based on the premise that Congress can enlarge the power of state agencies over intrastate matters. As noted below, this enlargement of jurisdiction occurs only if it is not inconsistent with state law, but that appears to be a bow to comity and not to constitutional limitations. This suggestion of future extensions of federal authority makes PURPA a much more significant piece of legislation than is widely believed.

Title III of PURPA[143] begins the process of federal regulation of all retail sales of natural gas. The title applies to every gas utility with retail sales of 10 billion cubic feet of gas annually[144] and is designed to further quite general goals,[145] thereby providing the justification for a wide range of activities. Each state regulatory authority is required, within two years of the passage of PURPA, to conduct hearings on the advisability of adopting (i) PURPA's standards on the procedures to be followed in terminating natural gas service[146] and (ii) PURPA's prohibition of the recovery through rates of any utility expenditures for promotional or political advertising.[147]

While the State regulatory agency may determine that it is not appropriate to implement the PURPA standards,[148] Title III is explicitly designed as an extension of the authority any regulatory agency might have under state law alone.[149] State commissions are required to report

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[139]15 U.S.C.A. §§ 3201-3211 (Supp. 1978).

[140]PURPA § 2, 16 U.S.C.A. § 2601 (Supp. 1978) provides that "[t]he Congress finds that . . . the proper exercise of congressional authority under the Constitution to regulate interstate commerce require . . . a program . . . insuring that rates to natural gas consumers are equitable." The Conference Report expressly notes that this section affects certain activities which have traditionally been subject to primary regulation by the States. H.R. Rep. No. 95-1750, 95th Cong., 2nd Sess. 67 (1978).

[141]PURPA §§ 101-143, 16 U.S.C.A. §§ 2611-2644 (Supp. 1978) and 42 U.S.C.A. §§ 6801-6808 (Supp. 1978). Title I establishes federal retail regulatory policies for electric utilities and is beyond the scope of this article.

[142]PURPA §§ 301-311, 15 U.S.C.A. §§ 3201-3211 (Supp. 1978). Title III establishes limited federal retail policies for natural gas utilities.

[143]*Id.*

[144]PURPA § 301(b), 15 U.S.C.A. § 3201(b) (Supp. 1978).

[145]These goals are: "(1) conservation of energy supplied by gas utilities; (2) the optimization of the efficiency of the use of facilities and resources by gas utility systems; and (3) equitable rates to gas consumers of natural gas." PURPA § 301(a), 15 U.S.C.A. § 3201(a) (Supp. 1978).

[146]PURPA § 303(a)(1), 15 U.S.C.A. § 3203(a)(1) (Supp. 1978).

[147]PURPA § 303(a)(2), 15 U.S.C.A. § 3203(a)(2) (Supp. 1978).

[148]PURPA § 303(c), 15 U.S.C.A. § 3203(c) (Supp. 1978).

[149]"The conferees intend that since the provisions of this section are parallel to the provisions of section 113, the explanation contained in this statement with respect to the adoption of standards for electric utilities as provided in section 113 are to apply in the same manner as to the adoption of standards for gas utilities as provided in this section. . . ." H.R. Rep. No. 95-1750, 95th Cong., 2nd. Sess. 101 (1978). "The intent here is that where a State regulatory commission or nonregulated utility finds insufficient authority pursuant to otherwise applicable State law, under which it may adopt a standard established in section 113, then these three purposes of the title provide such authority. In effect the three purposes expand the discretion of the State regulatory commission or nonregulated utility to adopt the standards of section 113. However, the conferees also intend that [these] three purposes do not override State law." *Id.* at 101.

to the FERC annually as to the standards that were or were not adopted for each utility and the actions taken with respect to each standard by each utility.[150] While the particular standards PURPA outlines are not earthshaking, the notion that there can be federal standards is quite new.

PURPA also injects DOE into the ratemaking process. First, DOE is given the statutory right to intervene in any proceeding involving utility rates or rate design.[151] While such intervention can only take place in order to advocate the policies of the title, the limitation is meaningless for the policies of the title are broad enough to cover any eventuality.[152]

DOE, with the assistance of the FERC and all other interested parties, is also called upon to conduct a comprehensive study of gas utility rate design proposals.[153] The goal is first to determine how different rate designs affect the consumption and conservation of gas[154] and whether they can be simultaneously and consistently pursued, and second to develop proposals for transmission to Congress.[155]

Thus, PURPA asserts federal jurisdiction over intrastate retail sales of gas, calls upon DOE to provide Congress with the information necessary to formulate a national rate design proposal, provides incentives to utilities to promote conservation by high-priority users, helps industrial direct users to defray the costs of a voluntary conversion from gas to heavy oil use and grants the President the right to prohibit gas-use by MFBI's in an emergency. The effects of this Act on distributors and end-users will not manifest themselves fully for years to come.

D. The Federal Government as Consumer Advocate

The NEA also took major steps toward furthering "consumer" interests through some of the rate matters already discussed and the creation of federal conservation and product standards. These actions will have a direct impact on distributors and the end-users they serve.

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[150]PURPA § 309, 15 U.S.C.A. § 3209 (Supp. 1978).

[151]PURPA § 305, 15 U.S.C.A. § 3205 (Supp. 1978).

[152]*See* text at note 146.

[153]PURPA § 306, 15 U.S.C.A. § 3206 (Supp. 1978). Pursuant to this section, the Secretary of Energy is required by May 9, 1981 to report to Congress on the impact of incremental pricing, marginal cost pricing, end-user gas consumption taxes, wellhead natural gas prices, demand-commodity rate design, declining block rates, interruptible service, seasonal rate differentials and end-user rate schedules on

(i) pipeline and distributor load factors,
(ii) rates to classes of users (industrial, commercial and residential),
(iii) change in costs for each class,
(iv) demand and consumption,
(v) end-user profiles, and
(vi) competition with alternate fuel.

[154]The Secretary has delegated the responsibility of developing the PURPA gas utility rate design study to the ERA which has held a number of public conferences and issued a series of interim reports. *See* Notice, *Public Conference to Discuss the Gas Utility Rate Design Study Required by the Public Utility Regulatory Policies Act of 1978*, Docket No. ERA-R-79-22A, 44 Fed. Reg. 70863 (1979). The fifth interim rate design report which was issued on January 10, 1980 dealt with the effect upon distributors of the following three groups of rate forms:

"• commonly used forms (declining block rates, flat rates with a customer charge, and flat rates without a customer charge);
• three less traditional rates (seasonal, inverted block and volumetric rates); and finally
• Phase I of incremental pricing (as defined in the Natural Gas Policy Act (NGPA))."

ICF INCORPORATED, *Natural Gas Rate Design Study: Interim Report on Simulation of Seven Rate Forms, mimeo.* at I-1 (January 10, 1980).

[155]PURPA § 306(b), (c), 15 U.S.C.A. § 3206(b), (c) (Supp. 1978).

As noted above, section 305 of PURPA grants DOE the right to intervene in any state proceeding concerning gas utility rates or rate design.[156] While this is a yet-unexercised power, it could be a potent force in the future. Similarly, section 306 of PURPA calls for a comprehensive study of rate designs—even should Congress not take formal action on DOE's recommendations, the states can be expected to rely heavily on this study.[157]

In addition, the National Energy Conservation Policy Act ("NECPA")[158] creates a federally-authorized national conservation program.[159] Several new responsibilities are created and passed on to the states and utilities.[160]

Utilities are required by section 215 of NECPA to inspect each residential building within their service areas and report to the occupant on the conservation measures that could be taken to reduce energy consumption.[161] The report must list recommended conservation steps, estimate the savings of energy costs that will result, and inform the consumer of the sources of loans and installers.[162] The cost of each inspection is to be charged directly to the customer as a separate item on its utility bill, unless the State regulatory body determines after hearings that rates will be lower and more equitable if the costs of the surveys are charged to all of the utility's consumers as an operating expense.[163]

Subject to certain exemptions, the utility itself can install only furnace efficiency modifications, clock thermostats and loan management equipment; any other conservation measure, such as insulation, must be installed by others.[164] Utilities are also prohibited from making loans of more than $300 for these measures; these loans are to be repaid through a separate charge on the customer's utility bill, and utility service cannot be terminated for failure to repay the charge.[165]

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[156]*See* text at notes 144-156.

[157]*Supra*, note 155.

[158]*Supra*, note 4. NECPA builds on programs started by the Energy Conservation and Production Act. P.L. 94-385, 90 Stat. 1125 (1976). In addition to the programs discussed *infra*, NECPA provides grants for low-income families (Title III, Part 1), secondary financing and loan insurance for energy conserving improvements and solar energy systems (Title II, Part 2), standards and help for federally-assisted housing (Title II, Part 4), grants to state and local governments for energy conservation (Title III), funds for solar heating and cooling demonstration projects in federal buildings (Title V, Part 2), energy performance standards for federal buildings (Title V, Part 3), a federal photovoltaic utilization program (Title V, Part 3) and for state energy conservation plans (Title VI, Part 2).

[159]Pursuant to the requirements of section 212 of PURPA (16 U.S.C.A. § 825q-1 (Supp. 1978)), the Department of Energy issued its Final Rule on October 30, 1979, implementing the Residential Conservation Service (RCS) Program. Final Rule, *Residential Conservation Service Program*, Docket No. CAS-RM-79-101, 44 Fed. Reg. 64602 (1979). This Final Rule represents the effort by the federal government to bring 90% of the existing residential housing stock to minimum federal construction standards by 1985 and establishes the requirements for state RCS programs.

[160]Pursuant to the provisions of section 212(c) of PURPA, States may submit RCS programs to the DOE for approval under the guidelines of the Final Rule in Docket No. CAS-RM-79-101. For example, in Illinois such an RCS plan is being prepared by the Illinois Institute of Natural Resources. The first draft of the plan requires the larger regulated gas and electric utilities (i.e., utilities having annual sales, for purposes other than resale, which exceed 750 million kilowatt hours of electricity or 10 Bcf of natural gas) to perform on site energy audits of residences and recommend energy conservation practices which can be adopted to increase the efficient use of energy. It is also suggested that in order to avoid duplication that a utility association may be formed to undertake the purposes of the Illinois RCS program. BOOZ, ALLEN & HAMILTON, INC., *Draft Illinois Residential Conservation Service Plan* (January 28, 1980). The Illinois RCS plan has not yet been submitted to DOE for approval.

[161]NECPA § 215(a), 42 U.S.C.A. § 8216(a) (Supp. 1978); 10 C.F.R. § 456.307.

[162]10 C.F.R. § 456.307(c), (d).

[163]NECPA § 215(c), 42 U.S.C.A. § 8216(c) (Supp. 1978); 10 C.F.R. § 456.310.

[164]NECPA § 216(a), (b), 42 U.S.C.A. § 8217(a), (b) (Supp. 1978); 10 C.F.R. § 456.501-456.508.

[165]NECPA §§ 216(c), § 215(e), 42 U.S.C.A. §§ 8217(c), 8216(e) (Supp. 1978); 10 C.F.R. §§ 456.503, 456.311(c).

The utility's audits and recommendations are to take place under the terms of a state residential energy conservation plan which both establishes the appropriate conservation measures for the locale and insures that fair rates are charged by the utility for its services and that the list of approved suppliers and lenders is approved and monitored.[166] The state plans must be submitted to DOE for approval,[167] based upon a comparison of a state plan with the standards and procedures established by DOE after hearings.[168] If DOE disallows a state plan, it may put in place one of its own devising.[169]

In addition, federal legislation now requires manufacturers to test for, improve and provide information on the energy efficiency of a wide range of consumer products.[170] This eventual energy efficiency program will be similar to the existing one for automobiles—manufacturers will be required to test their products for energy-efficiency, to label the products with the test results, and to meet energy efficiency standards.[171] The list

[166]The requirements for a qualifying State RCS Plan are set forth in Subpart C of Part 456 of the regulations comprising the Final Rule in Docket No. CAS-RM-79-101. 10 C.F.R. §§ 456.301-456.319.

[167]NECPA § 212(c); 42 U.S.C.A. § 8213(c) (Supp. 1978); 10 C.F.R. Part 456, Subpart B.

[168]Section 213 of NECPA provides that

> "No proposed residential energy conservation plan submitted for regulated utilities shall be approved by the Secretary unless such plan—
>
> (1) requires each regulated utility to implement a utility program which meets the requirements of section 215 (except such requirements of section 215 as do not apply by reason of section 216(f)) and contains adequate State enforcement procedures in connection with such implementation;
>
> (2) provides a procedure for permitting any supplier or contractor—
>
> (A) who sells or installs residential energy conservation measures in the area served by such utility, and
>
> (B) who meets such minimum requirements as may be contained in rules promulgated by the Secretary under section 212(b)(2)(E)
>
> to be included on a list made public by such utility as provided under section 215(a)(3).
>
> (3) provides a procedure for permitting any bank, savings and loan association, credit union, or other public or private lending institution which—
>
> (A) offers loans for the purchase and installation of residential energy conservation measures in the areas served by such utility and
>
> (B) which meets such minimum requirements as may be promulgated by the Secretary under section 212(b)(2)(E)
>
> to be included on a list made public by such utility as provided under section 215(a)(3);
>
> (4) provides adequate procedures to assure that each regulated utility will charge fair and reasonable prices and rates of interest to its residential customers under such utility program in connection with the purchase and installation of residential energy conservation measures;
>
> (5) provides procedures for resolving complaints against persons who sell or install residential energy conservation measures under such program;
>
> (6) provides procedures for insuring that effective coordination exists among various local, State, and Federal energy conservation programs within and affecting such State, including any energy extension service program administered by the Secretary of Energy;
>
> (7) is adopted after notice and public hearings; and
>
> (8) meets such other requirements as may be contained in the rules promulgated under section 212."
>
> (42 U.S.C. § 8214 (Supp. 1978)).

[169]NECPA § 219; 42 U.S.C.A. § 8220 (Supp. 1978). In accordance with the provisions of § 219, the Final Rule provides that if a State fails to submit a qualifying RCS Plan by September 2, 1980, then the Department of Energy may impose a plan of its own. 10 C.F.R. § 456.602.

[170]Part 2 of Title IV of NECPA establishes test procedures and energy efficiency standards for thirteen types of appliances with priority given to refrigerators and refrigerator-freezers, freezers, water heaters, room air conditioners, kitchen ranges and ovens, central air conditioners, furnaces, clothes dryers and home heating equipment other than furnaces. Part 3 of the same Title authorizes DOE to prescribe test procedures and labeling requirements with respect to electric motors, pumps and a variety of industrial equipment. Likewise, Part 4 of Title IV requires the DOE to establish targets for the utilization of certain recycleable materials (aluminum, coopper, lead, zinc, iron, steel, paper, textiles and rubber recovered from solid waste) by the metals and metals products industries, the paper and allied products industries, the textile mill products industry and the rubber industry.

[171]NECPA §§ 421, 422, 441, 461; 42 U.S.C.A. §§ 6293, 6295, 6311-6317, 6346 (Supp. 1978); 10 C.F.R. Part 430, 15 C.F.R. Part 9.

of covered production will grow with time and the standards can become more rigid. The labeling requirements may well decrease the differences between competing products and place severe limitations on product designs. Similar provisions cover industrial equipment, primarily electric motors and pumps.[172]

In the industrial sector, DOE has recently established a voluntary energy efficiency standards program.[173] Certain industrial sectors are targeted for improvements in energy efficiency in their own operations as well as in their products.[174] The Secretary of Energy has promulgated voluntary energy improvement targets for the ten major energy-consuming industries in the country.[175] These industries are required to report to DOE upon the progress they have achieved in meeting these goals.[176] DOE, in turn, is required to report the results to Congress.[177] The threat here is explicit—if industry fails to voluntarily make efficiency improvements, Congress will mandate them. The fear here for any end-user is that Congress will mandate precisely how and where improvements are to be made—removing from the end-user the ability to plan for itself and control its ever-rising fuel costs. In other words, should the industrial sector fail to curb its energy appetite, it could find itself manufacturing specified products, using specified processes, and burning specified fuels. The intelligent self-allocation of resources by end-users and the design of products to meet consumer demands could become a theory of the past.

In sum, NECPA mandates that gas utilities take an active role, under their states' supervisions, in promoting energy conservation by residential users. If DOE is dissatisfied with state plans, it can take over the supervisory role for itself. Industrials also are assigned a more active role in promoting conservation. More and more products will be required to meet specific energy standards. Furthermore, industrials will be forced to assure an ever-larger role in supplying information to consumers. In other words, DOE has the authority to promote the insulation of every home in the country—and to set the efficiency standards for the appliance that are used in those homes. Distributors and state regulators, given jurisdictional jealousies, may chafe at this new federal role. Individual consumers, too, may find their lives subject to a new measure of federal interference with their choice of goods.

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[172]NECPA § 427, 42 U.S.C.A. § 6306 (Supp. 1978).

[173]10 C.F.R. Part 445.

[174]These industries are identified by Standard Industrial Classification Code at 10 C.F.R. § 445.5.

[175]The DOE efficiency standards reflect a determination that energy consumption for the ten major energy industries (food and kindred products, textile mill products, paper and allied products, chemicals and allied products, petroleum and coal products, stone, clay, and glass products, primary metal industries, fabricated metal products, machinery except electrical and transportation equipment) can be reduced by between 9% and 24% depending upon the particular industry. 10 C.F.R. § 445.42.

[176]10 C.F.R. Part 445, Subpart C.

[177]NECPA § 601, 42 U.S.C.A. §§ 6341-45 (Supp. 1978).

CONCLUSION

The passage of the National Energy Act fundamentally altered the division of authority between federal and local energy authorities and limited the ability of end-users to make their own energy decisions based on traditional criteria such as economic efficiency. Traditionally, the regulation of gas distributors and end-users had been left to state regulatory authorities, for reasons both of jurisdiction and comity. The National Energy Act extended federal jurisdiction, and the general energy crisis, as well as the specific gas crisis of the 1970's, raised national concerns that overrode comity.

This trend will in all likelihood increase. The only real prospect of its arrest or reversal lies in the appearance of a long-term and abundant supply of gas. Even then the pressures created by the United States' dependence on foreign oil are likely to continue the move toward a national energy policy.